

Philip Morris International Inc.
Form 10-Q
July 30, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
(Mark One)

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

For the quarterly period ended June 30, 2015
OR

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

For the transition period from _____ to _____
Commission File Number 001-33708
Philip Morris International Inc.

(Exact name of registrant as specified in its charter)

Virginia	13-3435103
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

120 Park Avenue	10017
New York, New York	
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (917) 663-2000

Former name, former address and former fiscal year, if changed since last report

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

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

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

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐
(Do not check if a smaller reporting company)

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

At July 28, 2015, there were 1,549,185,692 shares outstanding of the registrant's common stock, no par value per share.

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In this report, "PMI," "we," "us" and "our" refer to Philip Morris International Inc. and its subsidiaries.	

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

Philip Morris International Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in millions of dollars)

(Unaudited)

	June 30, 2015	December 31, 2014
ASSETS		
Cash and cash equivalents	\$1,838	\$1,682
Receivables (less allowances of \$72 in 2015 and \$50 in 2014)	3,619	4,004
Inventories:		
Leaf tobacco	3,154	3,135
Other raw materials	1,671	1,696
Finished product	2,382	3,761
	7,207	8,592
Deferred income taxes	428	533
Other current assets	680	673
Total current assets	13,772	15,484
Property, plant and equipment, at cost	12,327	12,759
Less: accumulated depreciation	6,512	6,688
	5,815	6,071
Goodwill (Note 5)	7,914	8,388
Other intangible assets, net (Note 5)	2,807	2,985
Investments in unconsolidated subsidiaries (Note 15)	1,020	1,083
Other assets	1,385	1,176
TOTAL ASSETS	\$32,713	\$35,187

See notes to condensed consolidated financial statements.

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Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Balance Sheets (Continued)
(in millions of dollars, except share data)
(Unaudited)

	June 30, 2015	December 31, 2014
LIABILITIES		
Short-term borrowings (Note 11)	\$1,710	\$1,208
Current portion of long-term debt (Note 11)	2,926	1,318
Accounts payable	1,089	1,242
Accrued liabilities:		
Marketing and selling	476	549
Taxes, except income taxes	4,546	5,490
Employment costs	834	1,135
Dividends payable	1,558	1,559
Other	1,366	1,375
Income taxes	651	1,078
Deferred income taxes	230	158
Total current liabilities	15,386	15,112
Long-term debt (Note 11)	24,566	26,929
Deferred income taxes	1,799	1,549
Employment costs	2,124	2,202
Other liabilities	636	598
Total liabilities	44,511	46,390
Contingencies (Note 9)		
STOCKHOLDERS' (DEFICIT) EQUITY		
Common stock, no par value (2,109,316,331 shares issued in 2015 and 2014)	—	—
Additional paid-in capital	757	710
Earnings reinvested in the business	29,822	29,249
Accumulated other comprehensive losses	(8,107)	(6,826)
	22,472	23,133
Less: cost of repurchased stock (560,140,316 and 562,416,635 shares in 2015 and 2014, respectively)	35,623	35,762
Total PMI stockholders' deficit	(13,151)	(12,629)
Noncontrolling interests	1,353	1,426
Total stockholders' deficit	(11,798)	(11,203)
TOTAL LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY	\$32,713	\$35,187

See notes to condensed consolidated financial statements.

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Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Statements of Earnings
(in millions of dollars, except per share data)
(Unaudited)

	For the Six Months Ended June 30,	
	2015	2014
Net revenues	\$36,115	\$38,830
Cost of sales	4,607	5,070
Excise taxes on products	22,640	24,116
Gross profit	8,868	9,644
Marketing, administration and research costs	3,062	3,263
Asset impairment and exit costs (Note 2)	—	512
Amortization of intangibles	43	44
Operating income	5,763	5,825
Interest expense, net	534	522
Earnings before income taxes	5,229	5,303
Provision for income taxes	1,528	1,528
Equity (income)/loss in unconsolidated subsidiaries, net	(49)	(36)
Net earnings	3,750	3,811
Net earnings attributable to noncontrolling interests	68	85
Net earnings attributable to PMI	\$3,682	\$3,726
Per share data (Note 7):		
Basic earnings per share	\$2.37	\$2.35
Diluted earnings per share	\$2.37	\$2.35
Dividends declared	\$2.00	\$1.88

See notes to condensed consolidated financial statements.

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Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Statements of Earnings
(in millions of dollars, except per share data)
(Unaudited)

	For the Three Months Ended June 30,	
	2015	2014
Net revenues	\$18,763	\$21,051
Cost of sales	2,378	2,696
Excise taxes on products	11,904	13,254
Gross profit	4,481	5,101
Marketing, administration and research costs	1,568	1,716
Asset impairment and exit costs (Note 2)	—	489
Amortization of intangibles	21	22
Operating income	2,892	2,874
Interest expense, net	259	254
Earnings before income taxes	2,633	2,620
Provision for income taxes	743	752
Equity (income)/loss in unconsolidated subsidiaries, net	(26	) (27
Net earnings	1,916	1,895
Net earnings attributable to noncontrolling interests	29	44
Net earnings attributable to PMI	\$1,887	\$1,851
Per share data (Note 7):		
Basic earnings per share	\$1.21	\$1.17
Diluted earnings per share	\$1.21	\$1.17
Dividends declared	\$1.00	\$0.94

See notes to condensed consolidated financial statements.

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Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Statements of Comprehensive Earnings
(in millions of dollars)
(Unaudited)

	For the Six Months Ended June 30,		
	2015	2014	
Net earnings	\$3,750	\$3,811	
Other comprehensive earnings (losses), net of income taxes:			
Change in currency translation adjustment:			
Unrealized losses, net of income taxes of (\$330) in 2015 and (\$59) in 2014	(1,417	) (114	)
Change in net loss and prior service cost:			
Net losses and prior service costs, net of income taxes of \$3 in 2014	—	(41	)
Amortization of net losses, prior service costs and net transition costs, net of income taxes of (\$24) in 2015 and (\$26) in 2014	110	81	
Change in fair value of derivatives accounted for as hedges:			
Gains (losses) recognized, net of income taxes of (\$6) in 2015 and \$5 in 2014	66	(35	)
Gains transferred to earnings, net of income taxes of \$8 in 2015 and \$2 in 2014	(66	) (13	)
Total other comprehensive losses	(1,307	) (122	)
Total comprehensive earnings	2,443	3,689	
Less comprehensive earnings attributable to:			
Noncontrolling interests	42	87	
Comprehensive earnings attributable to PMI	\$2,401	\$3,602	

See notes to condensed consolidated financial statements

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Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Statements of Comprehensive Earnings
(in millions of dollars)
(Unaudited)

	For the Three Months Ended June 30,	
	2015	2014
Net earnings	\$1,916	\$1,895
Other comprehensive earnings (losses), net of income taxes:		
Change in currency translation adjustments:		
Unrealized losses, net of income taxes of \$104 in 2015 and (\$55) in 2014	(74	) (77
Change in net loss and prior service cost:		
Net losses and prior service costs, net of income taxes of \$3 in 2014	—	(41
Amortization of net losses, prior service costs and net transition costs, net of income taxes of (\$12) in 2015 and (\$14) in 2014	54	43
Change in fair value of derivatives accounted for as hedges:		
Gains (losses) recognized, net of income taxes of (\$4) in 2015 and \$2 in 2014	41	(11
Gains transferred to earnings, net of income taxes of \$5 in 2015 and \$1 in 2014	(39	) (6
Total other comprehensive losses	(18	) (92
Total comprehensive earnings	1,898	1,803
Less comprehensive earnings attributable to:		
Noncontrolling interests	28	53
Comprehensive earnings attributable to PMI	\$1,870	\$1,750

See notes to condensed consolidated financial statements

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Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Statements of Stockholders' (Deficit) Equity
For the Six Months Ended June 30, 2015 and 2014
(in millions of dollars, except per share amounts)
(Unaudited)

	PMI Stockholders' (Deficit) Equity						
	Common Stock	Additional Paid-in Capital	Earnings Reinvested in the Business	Accumulated Other Comprehensive Loss	Cost of Repurchased Stock	Noncontrolling Interests	Total
Balances, January 1, 2014	\$—	\$ 723	\$ 27,843	\$ (4,190)	\$ (32,142)	\$ 1,492	\$(6,274)
Net earnings			3,726			85	3,811
Other comprehensive earnings (losses), net of income taxes				(124)		2	(122)
Issuance of stock awards and exercise of stock options		(74)			164		90
Dividends declared (\$1.88 per share)			(2,968)				(2,968)
Payments to noncontrolling interests						(134)	(134)
Common stock repurchased					(2,250)		(2,250)
Balances, June 30, 2014	\$—	\$ 649	\$ 28,601	\$ (4,314)	\$ (34,228)	\$ 1,445	\$(7,847)
Balances, January 1, 2015	\$—	\$ 710	\$ 29,249	\$ (6,826)	\$ (35,762)	\$ 1,426	\$(11,203)
Net earnings			3,682			68	3,750
Other comprehensive earnings (losses), net of income taxes				(1,281)		(26)	(1,307)
Issuance of stock awards		(66)			139		73
Dividends declared (\$2.00 per share)			(3,109)				(3,109)
Payments to noncontrolling interests						(115)	(115)
Purchase price activity for subsidiary shares from noncontrolling interests (Note 16)		113					113
Balances, June 30, 2015	\$—	\$ 757	\$ 29,822	\$ (8,107)	\$ (35,623)	\$ 1,353	\$(11,798)

See notes to condensed consolidated financial statements.

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Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(in millions of dollars)
(Unaudited)

	For the Six Months Ended June 30,	
	2015	2014
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES		
Net earnings	\$3,750	\$3,811
Adjustments to reconcile net earnings to operating cash flows:		
Depreciation and amortization	377	427
Deferred income tax provision	146	81
Asset impairment and exit costs, net of cash paid	(204)	) 282
Cash effects of changes, net of the effects from acquired companies:		
Receivables, net	62	(245)
Inventories	809	1,484
Accounts payable	38	2
Income taxes	(379)	) (675)
Accrued liabilities and other current assets	(1,461)	) (1,666)
Pension plan contributions	(20)	) (82)
Other	182	1
Net cash provided by operating activities	3,300	3,420
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES		
Capital expenditures	(413)	) (508)
Purchase of businesses, net of acquired cash	—	(103)
Investments in unconsolidated subsidiaries	(11)	) (16)
Other	200	83
Net cash used in investing activities	(224)	) (544)

See notes to condensed consolidated financial statements.

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Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows (Continued)
(in millions of dollars)
(Unaudited)

	For the Six Months Ended June 30,	
	2015	2014
CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES		
Short-term borrowing activity by original maturity:		
Net issuances (repayments) - maturities of 90 days or less	\$513	\$(255)
Issuances - maturities longer than 90 days	73	921
Repayments - maturities longer than 90 days	(13)	(1,094)
Long-term debt proceeds	302	3,632
Long-term debt repaid	(400)	(1,240)
Repurchases of common stock	(48)	(2,281)
Dividends paid	(3,110)	(2,993)
Purchase price activity for subsidiary shares from noncontrolling interests (Note 16)	113	—
Other	(70)	(177)
Net cash used in financing activities	(2,640)	(3,487)
Effect of exchange rate changes on cash and cash equivalents	(280)	(2)
Cash and cash equivalents:		
Increase (Decrease)	156	(613)
Balance at beginning of period	1,682	2,154
Balance at end of period	\$1,838	\$1,541

See notes to condensed consolidated financial statements.

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Philip Morris International Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

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, other tobacco products and other nicotine-containing 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 interim condensed consolidated financial statements of PMI are unaudited. These interim condensed consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles and such principles are applied on a consistent basis. It is the opinion of PMI’s management that all adjustments necessary for a fair statement of the interim results presented have been reflected therein. All such adjustments were of a normal recurring nature. Net revenues and net earnings attributable to PMI for any interim period are not necessarily indicative of results that may be expected for the entire year.

These statements should be read in conjunction with the audited consolidated financial statements and related notes, which appear in PMI’s Annual Report on Form 10-K for the year ended December 31, 2014.

Note 2. Asset Impairment and Exit Costs:

Pre-tax asset impairment and exit costs consisted of the following:

(in millions)	For the Six Months Ended June 30,		For the Three Months Ended June 30,	
	2015	2014	2015	2014
Separation programs:				
European Union	\$—	\$359	\$—	\$359
Asia	—	24	—	1
Total separation programs	—	383	—	360
Asset impairment charges:				
European Union	—	129	—	129
Total asset impairment charges	—	129	—	129
Asset impairment and exit costs	\$—	\$512	\$—	\$489

Movement in Exit Cost Liabilities

The movement in exit cost liabilities for the six months ended June 30, 2015 was as follows:

(in millions)	
Liability balance, January 1, 2015	\$270
Charges, net	—
Cash spent	(204)
Currency/other	(14)
Liability balance, June 30, 2015	\$52

Cash payments related to exit costs at PMI were \$204 million and \$44 million for the six months and three months ended June 30, 2015, respectively, and \$230 million and \$30 million for the six months and three months ended June 30, 2014, respectively. Future cash payments for exit costs incurred to date are expected to be approximately \$52 million, and will be substantially paid by the end of 2015.

The pre-tax asset impairment and exit costs shown above are primarily a result of the following:

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Philip Morris International Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

The Netherlands

On April 4, 2014, PMI announced the initiation by its affiliate, Philip Morris Holland B.V. (“PMH”), of consultations with employee representatives on a proposal to discontinue cigarette production at its factory located in Bergen op Zoom, the Netherlands. PMH reached an agreement with the trade unions and their members on a social plan and ceased cigarette production on September 1, 2014. For the six months and three months ended June 30, 2014, total pre-tax asset impairment and exit costs of \$488 million were recorded for this program in the European Union segment. This amount includes employee separation costs of \$359 million and asset impairment costs of \$129 million.

Other

Separation Program Charges

PMI recorded other pre-tax separation program charges of \$24 million and \$1 million for the six months and three months ended June 30, 2014, respectively, related to severance costs for a factory closure in Australia.

Note 3. Stock Plans:

In May 2012, PMI’s shareholders 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. Up to 30 million shares of PMI’s common stock may be issued under the 2012 Plan. At June 30, 2015, shares available for grant under the 2012 Plan were 23,252,170.

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. At June 30, 2015, shares available for grant under the plan were 691,432.

During the six months ended June 30, 2015, PMI granted 1.5 million shares of deferred stock awards to eligible employees at a grant date fair value of \$82.28 per share. During the six months ended June 30, 2014, PMI granted 2.4 million shares of deferred stock awards to eligible employees at a weighted-average grant date fair value of \$77.74 per share. PMI recorded compensation expense related to stock awards of \$94 million and \$113 million during the six months ended June 30, 2015 and 2014, respectively, and \$36 million and \$47 million during the three months ended June 30, 2015 and 2014, respectively. As of June 30, 2015, PMI had \$212 million of total unrecognized compensation cost related to non-vested deferred stock awards. The cost is recognized over the original restriction period of the awards, which is typically three or more years after the date of the award, subject to earlier vesting on death or disability or normal retirement, or separation from employment by mutual agreement after reaching age 58.

During the six months ended June 30, 2015, 2.5 million shares of PMI deferred stock awards vested. The grant date fair value of all the vested shares was approximately \$202 million. The total fair value of deferred stock awards that vested during the six months ended June 30, 2015 was approximately \$209 million.

Note 4. 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.

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Philip Morris International Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Pension Plans

Components of Net Periodic Benefit Cost

Net periodic pension cost consisted of the following:

	U.S. Plans		Non-U.S. Plans	
	For the Six Months Ended		For the Six Months Ended	
(in millions)	June 30,		June 30,	
	2015	2014	2015	2014
Service cost	\$3	\$3	\$101	\$104
Interest cost	9	8	72	103
Expected return on plan assets	(7	) (8	) (164	) (177
Amortization:				
Net loss	5	3	90	57
Prior service cost	—	—	2	4
Net periodic pension cost	\$10	\$6	\$101	\$91
	U.S. Plans		Non-U.S. Plans	
	For the Three Months Ended		For the Three Months Ended	
(in millions)	June 30,		June 30,	
	2015	2014	2015	2014
Service cost	\$2	\$2	\$50	\$52
Interest cost	4	4	36	52
Expected return on plan assets	(3	) (4	) (81	) (89
Amortization:				
Net loss	2	1	44	29
Prior service cost	—	—	1	2
Net periodic pension cost	\$5	\$3	\$50	\$46

Employer Contributions

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. Employer contributions of \$20 million were made to the pension plans during the six months ended June 30, 2015. Currently, PMI anticipates making additional contributions during the remainder of 2015 of approximately \$138 million 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.

Note 5. Goodwill and Other Intangible Assets, net:

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

	Goodwill		Other Intangible Assets, net	
(in millions)	June 30,	December 31,	June 30,	December 31,
	2015	2014	2015	2014
European Union	\$1,311	\$1,398	\$551	\$582
Eastern Europe, Middle East & Africa	486	517	210	215
Asia	3,701	3,904	1,131	1,207
Latin America & Canada	2,416	2,569	915	981

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Total	\$7,914	\$8,388	\$2,807	\$2,985
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Philip Morris International Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Goodwill primarily reflects PMI's acquisitions in Canada, Colombia, Greece, Indonesia, Mexico, Pakistan and Serbia, as well as the business combination in the Philippines. The movements in goodwill from December 31, 2014, were as follows:

(in millions)	European Union	Eastern Europe, Middle East & Africa	Asia	Latin America & Canada	Total
Balances, December 31, 2014	\$1,398	\$517	\$3,904	\$2,569	\$8,388
Changes due to:					
Currency	(87)	(31)	(203)	(153)	(474)
Balances, June 30, 2015	\$1,311	\$486	\$3,701	\$2,416	\$7,914

Additional details of other intangible assets were as follows:

(in millions)	June 30, 2015	December 31, 2014
	Gross Carrying Amount	Gross Carrying Amount
	Accumulated Amortization	Accumulated Amortization
Non-amortizable intangible assets	\$1,608	\$1,704
Amortizable intangible assets	1,704	1,877
Total other intangible assets	\$3,312	\$3,581

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 and distribution networks associated with business combinations. The gross carrying amount, the range of useful lives as well as the weighted-average remaining useful life of amortizable intangible assets at June 30, 2015, were as follows:

(dollars in millions)	Gross Carrying Amount	Initial Estimated Useful Lives	Weighted-Average Remaining Useful Life
Trademarks	\$1,452	2 - 40 years	23 years
Distribution networks	161	5 - 30 years	12 years
Other (including farmer contracts and intellectual property rights)	91	4 - 17 years	11 years
	\$1,704		

Pre-tax amortization expense for intangible assets during the six months ended June 30, 2015 and 2014 was \$43 million and \$44 million, respectively, and \$21 million and \$22 million for the three months ended June 30, 2015 and 2014, respectively. Amortization expense for each of the next five years is estimated to be \$72 million or less, 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, 2014, was due to currency movements and the retirement of fully amortized intangible assets.

During the first quarter of 2015, PMI completed its annual review of goodwill and non-amortizable intangible assets for potential impairment, and no impairment charges were required as a result of this review.

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Philip Morris International Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Note 6. Financial Instruments:

Overview

PMI operates in markets outside of the United States of America, with manufacturing and sales facilities in various locations around the world. PMI utilizes certain financial instruments to manage foreign currency and interest rate exposure. Derivative financial instruments are used by PMI principally to reduce exposures to market risks resulting from fluctuations in foreign currency exchange and interest rates by creating offsetting exposures. PMI is not a party to leveraged derivatives and, by policy, does not use derivative financial instruments for speculative purposes. Financial instruments qualifying for hedge accounting must maintain a specified level of effectiveness between the hedging instrument and the item being hedged, both at inception and throughout the hedged period. PMI formally documents the nature and relationships between the hedging instruments and hedged items, as well as its risk-management objectives, strategies for undertaking the various hedge transactions and method of assessing hedge effectiveness. Additionally, for hedges of forecasted transactions, the significant characteristics and expected terms of the forecasted transaction must be specifically identified, and it must be probable that each forecasted transaction will occur. If it were deemed probable that the forecasted transaction would not occur, the gain or loss would be recognized in earnings. PMI reports its net transaction gains or losses in marketing, administration and research costs on the condensed 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 ("foreign exchange contracts"), and interest rate contracts to mitigate its exposure to changes in exchange and interest rates from third-party and intercompany actual and forecasted transactions. The primary currencies to which PMI is exposed include the Australian dollar, Euro, Indonesian rupiah, Japanese yen, Mexican peso, Russian ruble, Swiss franc and Turkish lira. At June 30, 2015, PMI had contracts with aggregate notional amounts of \$22.6 billion of which \$2.6 billion related to cash flow hedges, \$4.9 billion related to hedges of net investments in foreign operations and \$15.1 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 condensed consolidated balance sheets as of June 30, 2015 and December 31, 2014, were as follows:

(in millions)	Asset Derivatives			Liability Derivatives		
	Balance Sheet Classification	Fair Value At June 30, 2015	At December 31, 2014	Balance Sheet Classification	Fair Value At June 30, 2015	At December 31, 2014
Foreign exchange contracts designated as hedging instruments	Other current assets	\$318	\$248	Other accrued liabilities	\$2	\$—
	Other assets	173	122	Other liabilities	\$61	\$25
Foreign exchange contracts not designated as hedging instruments	Other current assets	21	34	Other accrued liabilities	78	126
	Other assets	47	2			
Total derivatives		\$559	\$406		\$141	\$151

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For the six months and three months ended June 30, 2015 and 2014, PMI's cash flow and net investment hedging instruments impacted the condensed consolidated statements of earnings and comprehensive earnings as follows:

(pre-tax, millions)	For the Six Months Ended June 30,		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	
	2015	2014		2015	2014
Derivatives in Cash Flow Hedging Relationship					
Foreign exchange contracts	\$72	\$(40)	Net revenues	\$75	\$32
			Marketing, administration and research costs	16	(1)
			Interest expense, net	(17)	(16)
Derivatives in Net Investment Hedging Relationship					
Foreign exchange contracts	209	36			
Total	\$281	\$(4)		\$74	\$15
(pre-tax, millions)	For the Three Months Ended June 30,		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	
	2015	2014		2015	2014
Derivatives in Cash Flow Hedging Relationship					
Foreign exchange contracts	\$45	\$(13)	Net revenues	\$45	\$17
			Marketing, administration and research costs	9	(1)
			Interest expense, net	(10)	(9)
Derivatives in Net Investment Hedging Relationship					
Foreign exchange contracts	(77)	11			
Total	\$(32)	\$(2)		\$44	\$7

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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 condensed consolidated statements of earnings. During the six months and three months ended June 30, 2015 and 2014, ineffectiveness related to cash flow hedges was not material. As of June 30, 2015, PMI has hedged forecasted transactions for periods not exceeding the next eighteen months with the exception of one foreign exchange contract that expires in May 2024. The impact of these hedges is primarily included in operating cash flows on PMI's condensed consolidated statement of cash flows.

Hedges of Net Investments in Foreign Operations

PMI designates certain foreign currency denominated debt and foreign exchange contracts as net investment hedges of its foreign operations. For the six months ended June 30, 2015 and 2014, these hedges of net investments resulted in gains, net of income taxes, of \$642 million and \$93 million, respectively. For the three months ended June 30, 2015 and 2014, these hedges of net investments resulted in gains (losses), net of income taxes, of \$(193) million and \$76 million, respectively. These gains (losses) were reported as a component of accumulated other comprehensive losses within currency translation adjustments. For the six months and three months ended June 30, 2015 and 2014, ineffectiveness related to net investment hedges was not material. Other investing cash flows on PMI's condensed consolidated statements of cash flows include the premiums paid for, and settlements of, net investment hedges.

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 condensed consolidated statement of earnings. For the six months ended June 30, 2015 and 2014, the gains (losses) from contracts for which PMI did not apply hedge accounting were \$(735) million and \$94 million, respectively. For the three months ended June 30, 2015 and 2014, the gains from contracts for which PMI did not apply hedge accounting were \$16 million and \$142 million, respectively. The gains (losses) from these contracts substantially offset the gains (losses) generated by the underlying intercompany and third-party loans being hedged.

For the six months and three months ended June 30, 2015 and 2014, the net impact of these contracts on the condensed consolidated statements of earnings was not material.

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 Six Months Ended		For the Three Months Ended	
	June 30, 2015	2014	June 30, 2015	2014
Gain at beginning of period	\$123	\$63	\$121	\$32
Derivative gains transferred to earnings	(66	) (13	) (39	) (6
Change in fair value	66	(35	) 41	(11
Gain as of June 30,	\$123	\$15	\$123	\$15

At June 30, 2015, PMI expects \$81 million of derivative gains that are included in accumulated other comprehensive losses to be reclassified to the condensed 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.

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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 12. Fair Value Measurements and Note 14. Balance Sheet Offsetting for additional discussion of derivative financial instruments.

Note 7. Earnings Per Share:

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

(in millions)	For the Six Months Ended June 30,		For the Three Months Ended June 30,	
	2015	2014	2015	2014
Net earnings attributable to PMI	\$3,682	\$3,726	\$1,887	\$1,851
Less distributed and undistributed earnings attributable to share-based payment awards	13	17	6	9
Net earnings for basic and diluted EPS	\$3,669	\$3,709	\$1,881	\$1,842
Weighted-average shares for basic and diluted EPS	1,549	1,577	1,549	1,571

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.

For the 2015 and 2014 computations, there were no antidilutive stock options.

Note 8. Segment Reporting:

PMI's subsidiaries and affiliates are engaged in the manufacture and sale of cigarettes, other tobacco products and other nicotine-containing 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 and, accordingly, such items are not presented by segment since they are excluded from the measure of segment profitability reviewed by management.

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Segment data were as follows:

(in millions)	For the Six Months Ended June 30,		For the Three Months Ended June 30,	
	2015	2014	2015	2014
Net revenues:				
European Union	\$12,276	\$14,448	\$6,336	\$7,829
Eastern Europe, Middle East & Africa	9,423	10,236	4,994	5,674
Asia	9,803	9,572	5,039	5,097
Latin America & Canada	4,613	4,574	2,394	2,451
Net revenues	\$36,115	\$38,830	\$18,763	\$21,051
Earnings before income taxes:				
Operating companies income:				
European Union	\$1,890	\$1,689	\$977	\$711
Eastern Europe, Middle East & Africa	1,761	2,014	881	1,087
Asia	1,731	1,815	797	900
Latin America & Canada	555	467	325	265
Amortization of intangibles	(43)	(44)	(21)	(22)
General corporate expenses	(82)	(80)	(41)	(40)
Less:				
Equity (income)/loss in unconsolidated subsidiaries, net	(49)	(36)	(26)	(27)
Operating income	5,763	5,825	2,892	2,874
Interest expense, net	(534)	(522)	(259)	(254)
Earnings before income taxes	\$5,229	\$5,303	\$2,633	\$2,620

Items affecting the comparability of results from operations are asset impairment and exit costs. See Note 2. Asset Impairment and Exit Costs for a breakdown of these costs by segment.

Note 9. Contingencies:

Tobacco-Related Litigation

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

Damages claimed in some of the tobacco-related litigation are significant and, in certain cases in Brazil, Canada 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

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unable to estimate the possible loss or range of loss for any of the pending tobacco-related cases; and (iii) accordingly, no estimated loss has been accrued in the consolidated financial statements for unfavorable outcomes in these cases, if any. Legal defense costs are expensed as incurred.

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

To date, we have paid one judgment in a tobacco-related case. That judgment, including costs, was approximately €1,400 (approximately \$1,500), 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 July 29, 2015, July 30, 2014 and August 1, 2013:

Type of Case	Number of Cases Pending as of July 29, 2015	Number of Cases Pending as of July 30, 2014	Number of Cases Pending as of August 1, 2013
Individual Smoking and Health Cases	65	63	63
Smoking and Health Class Actions	11	11	11
Health Care Cost Recovery Actions	16	15	15
Lights Class Actions	—	1	1
Individual Lights Cases	2	2	1
Public Civil Actions	2	2	4

Since 1995, when the first tobacco-related litigation was filed against a PMI entity, 436 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. Twelve cases have had decisions in favor of plaintiffs. Nine of these cases have subsequently reached final resolution in our favor and three remain on appeal.

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

Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
February 2004	Brazil/The Smoker Health Defense Association	Class Action	The Civil Court of São Paulo found defendants liable without hearing evidence. The court did not assess actual damages, which were to be assessed in a second phase of the case. The size of the class was not defined in the ruling.	In April 2004, the court clarified its ruling, awarding “moral damages” of R\$1,000 (approximately \$340) 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 appealed the decision. In February 2015, the appellate court unanimously dismissed plaintiff’s appeal. Plaintiff may further appeal. 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.

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Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
May 27, 2015	Canada/Cecilia Letourneau	Class Action	On May 27, 2015, the Superior Court of the District of Montreal, Province of Quebec ruled in favor of the Letourneau class on liability and awarded a total of CAD 131 million (approximately \$100.5 million) in punitive damages, allocating CAD 46 million (approximately \$35.3 million) to our subsidiary. The trial court ordered defendants to pay the full punitive damage award into a trust within 60 days. The trial court found that a claims process to allocate the awarded damages to individual class members would be too expensive and difficult to administer. The trial court ordered a briefing on the proposed process for the distribution of sums remaining from the punitive damage award after payment of attorneys' fees and legal costs.	On June 26, 2015, our subsidiary commenced the appellate process by filing its inscription in appeal of the trial court's judgment with the Court of Appeal of Quebec. Our subsidiary also filed a motion to cancel the trial court's order for payment of CAD 46 million (approximately \$35.3 million) into a trust within 60 days notwithstanding appeal. On July 23, the Court of Appeal granted the motion to cancel and overturned the trial court's ruling that our subsidiary make an initial payment within 60 days.

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Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
May 27, 2015	Canada/Conseil Québécois Sur Le Tabac Et La Santé and Jean-Yves Blais	Class Action	On May 27, 2015, the Superior Court of the District of Montreal, Province of Quebec ruled in favor of the Blais class on liability and found the class members' compensatory damages totaled approximately CAD 15.5 billion (approximately \$11.9 billion), including pre-judgment interest. The trial court awarded compensatory damages on a joint and several liability basis, allocating 20% to our subsidiary (approximately CAD 3.1 billion including pre-judgment interest (approximately \$2.38 billion)). The trial court awarded CAD 90,000 (approximately \$69,000) in punitive damages, allocating CAD 30,000 (approximately \$23,000) to our subsidiary. The trial court ordered defendants to pay CAD 1 billion (approximately \$770 million) of the compensatory damage award into a trust within 60 days, CAD \$200 million (approximately \$154 million) of which is our subsidiary's portion, and the full punitive damage award into a trust within 60 days, CAD 30,000 (approximately	On June 26, 2015, our subsidiary commenced the appellate process by filing its inscription in appeal of the trial court's judgment with the Court of Appeal of Quebec. Our subsidiary also filed a motion to cancel the trial court's order for payment of approximately CAD 200 million (approximately \$154 million) into a trust within 60 days notwithstanding appeal. On July 23, the Court of Appeal granted the motion to cancel and overturned the trial court's ruling that our subsidiary make an initial payment within 60 days.

\$23,000) of which is our subsidiary's portion. The trial court ordered a briefing on a proposed claims process for the distribution of damages to individual class members and for payment of attorneys' fees and legal costs.

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

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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 July 29, 2015, there were a number of smoking and health cases pending against us, our subsidiaries or indemnitees, as follows:

65 cases brought by individual plaintiffs in Argentina (26), Brazil (22), Canada (2), Chile (7), Costa Rica (2), Greece (1), Italy (2), Morocco (1), the Philippines (1) and Scotland (1), compared with 63 such cases on July 30, 2014, and 63 cases on August 1, 2013; and

11 cases brought on behalf of classes of individual plaintiffs in Brazil (2) and Canada (9), compared with 11 such cases on July 30, 2014 and 11 such cases on August 1, 2013.

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 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 July 2014, plaintiff appealed to the Superior Court of Justice.

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, sought compensatory and punitive damages for each member of the class who is deemed addicted to smoking. The class was certified in 2005. Trial began in March 2012 and concluded in December 2014. The trial court issued its judgment on May 27, 2015. The trial court found our subsidiary and two other Canadian manufacturers liable and awarded a total of CAD 131 million (approximately \$100.5 million) in punitive damages, allocating CAD 46 million (approximately \$35.3 million) to our subsidiary. The trial court found that defendants violated the Civil Code of Quebec, the Quebec Charter of Human Rights and Freedoms, and the Quebec Consumer Protection Act by failing to warn adequately of the dangers of smoking. The trial court also found that defendants conspired to prevent consumers from learning the dangers of smoking. The trial court further held that these civil faults were a cause of the class members' addiction. The trial court rejected other grounds of fault advanced by the class, holding that: (i) the evidence was insufficient to show that

defendants marketed to youth, (ii) defendants' advertising did not convey false information about the characteristics of cigarettes, and (iii) defendants did not commit a fault by using the descriptors light or mild for cigarettes with a lower tar delivery. The trial court estimated the size of the addiction class at 918,000 members but declined to award compensatory damages to the addiction class because the evidence did not establish the claims with sufficient accuracy. The trial court ordered defendants to pay the full punitive damage award into a trust within 60 days and found that a claims process to allocate the awarded damages to individual class members would be too expensive and difficult to administer. The trial court ordered briefing on the proposed process for the distribution of sums remaining from the punitive damage award after payment of attorneys' fees and legal costs. On June 26, 2015, our subsidiary commenced the appellate process by filing its inscription of appeal of the trial court's judgment with the Court of Appeal of Quebec. Our subsidiary also filed a motion to cancel the trial court's order for payment into a trust within 60 days notwithstanding appeal. On July 23, 2015, the Court of Appeal granted the motion to cancel and overturned the trial court's ruling that our subsidiary make an initial payment within 60 days. A case management conference is scheduled for September 3, 2015, to establish a briefing schedule before the Court of Appeal on our subsidiary's merits appeal. Our subsidiary and PMI believe that the findings of liability

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

In the second class action pending in Canada, Conseil Québécois Sur Le Tabac Et La Santé and Jean-Yves Blais v. Imperial Tobacco Ltd., Rothmans, Benson & Hedges Inc. and JTI Macdonald Corp., Quebec Superior Court, Canada, filed in November 1998, our subsidiary and other Canadian manufacturers are defendants. The plaintiffs, an anti-smoking organization and an individual smoker, sought compensatory and punitive damages for each member of the class who allegedly suffers from certain smoking-related diseases. The class was certified in 2005. Trial began in March 2012 and concluded in December 2014. The trial court issued its judgment on May 27, 2015. The trial court found our subsidiary and two other Canadian manufacturers liable and found that the class members' compensatory damages totaled approximately CAD 15.5 billion (approximately \$11.9 billion), including pre-judgment interest. The trial court awarded compensatory damages on a joint and several liability basis, allocating 20% to our subsidiary (approximately CAD 3.1 billion, including pre-judgment interest (approximately \$2.38 billion). In addition, the trial court awarded CAD 90,000 (approximately \$69,000) in punitive damages, allocating CAD 30,000 (approximately \$23,000) to our subsidiary and found that defendants violated the Civil Code of Quebec, the Quebec Charter of Human Rights and Freedoms, and the Quebec Consumer Protection Act by failing to warn adequately of the dangers of smoking. The trial court also found that defendants conspired to prevent consumers from learning the dangers of smoking. The trial court further held that these civil faults were a cause of the class members' diseases. The trial court rejected other grounds of fault advanced by the class, holding that: (i) the evidence was insufficient to show that defendants marketed to youth, (ii) defendants' advertising did not convey false information about the characteristics of cigarettes, and (iii) defendants did not commit a fault by using the descriptors light or mild for cigarettes with a lower tar delivery. The trial court estimated the disease class at 99,957 members. The trial court ordered defendants to pay CAD 1 billion (approximately \$770 million) of the compensatory damage award into a trust within 60 days, CAD \$200 million (approximately \$154 million) of which is our subsidiary's portion, and the full punitive damage award into a trust within 60 days, CAD 30,000 (approximately \$23,000) of which is our subsidiary's portion and ordered briefing on a proposed claims process for the distribution of damages to individual class members and for payment of attorneys' fees and legal costs. On June 26, 2015, our subsidiary commenced the appellate process by filing its inscription of appeal of the trial court's judgment with the Court of Appeal of Quebec. Our subsidiary also filed a motion to cancel the trial court's order for payment into a trust within 60 days notwithstanding appeal. On July 23, 2015, the Court of Appeal granted the motion to cancel and overturned the trial court's ruling that our subsidiary make an initial payment within 60 days. A case management conference is scheduled for September 3, 2015, to establish a briefing schedule before the Court of Appeal on our subsidiary's merits appeal. Our subsidiary and PMI believe that the findings of liability and damages were incorrect and should ultimately be set aside on any one of many grounds, including the following: (i) holding that defendants violated Quebec law by failing to warn class members of the risks of smoking even after the court found that class members knew, or should have known, of the risks, (ii) finding that plaintiffs were not required to prove that defendants' alleged misconduct caused injury to each class member in direct contravention of binding precedent, (iii) creating a factual presumption, without any evidence from class members or otherwise, that defendants' alleged misconduct caused all smoking by all class members, (iv) relying on epidemiological evidence that did not meet recognized scientific standards, and (v) awarding punitive damages to punish defendants without proper consideration as to whether punitive damages were necessary to deter future

misconduct.

In the third class action pending in Canada, *Kunta v. Canadian Tobacco Manufacturers' Council, et al.*, The Queen's Bench, Winnipeg, Canada, filed June 12, 2009, we, our subsidiaries, and our indemnitees (PM USA and Altria), and other members of the industry are defendants. The plaintiff, an individual smoker, alleges her own addiction to tobacco products and chronic obstructive pulmonary disease ("COPD"), severe asthma, and mild reversible lung disease resulting from the use of tobacco products. She is seeking compensatory and punitive damages on behalf of a proposed class comprised of all smokers, their estates, dependents and family members, as well as restitution of profits, and reimbursement of government health care costs allegedly caused by tobacco products. In September 2009, plaintiff's counsel informed defendants that he did not anticipate taking any action in this case while he pursues the class action filed in Saskatchewan (see description of Adams, below).

In the fourth class action pending in Canada, *Adams v. Canadian Tobacco Manufacturers' Council, et al.*, The Queen's Bench, Saskatchewan, Canada, filed July 10, 2009, we, our subsidiaries, and our indemnitees (PM USA and Altria), and other members of the industry are defendants. The plaintiff, an individual smoker, alleges her own addiction to tobacco products and COPD resulting from the use of tobacco products. She is seeking compensatory and punitive damages on behalf of a proposed class

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comprised of all smokers who have smoked a minimum of 25,000 cigarettes and have allegedly suffered, or suffer, from COPD, emphysema, heart disease, or cancer, as well as restitution of profits. Preliminary motions are pending. In the fifth class action pending in Canada, *Semple v. Canadian Tobacco Manufacturers' Council, et al.*, The Supreme Court (trial court), Nova Scotia, Canada, filed June 18, 2009, we, our subsidiaries, and our indemnitees (PM USA and Altria), and other members of the industry are defendants. The plaintiff, an individual smoker, alleges his own addiction to tobacco products and COPD resulting from the use of tobacco products. He is seeking compensatory and punitive damages on behalf of a proposed class comprised of all smokers, their estates, dependents and family members, as well as restitution of profits, and reimbursement of government health care costs allegedly caused by tobacco products. No activity in this case is anticipated while plaintiff's counsel pursues the class action filed in Saskatchewan (see description of Adams, above).

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

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

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

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

Health Care Cost Recovery Litigation: These cases, brought by governmental and non-governmental plaintiffs, seek reimbursement of health care cost expenditures allegedly caused by tobacco products. Plaintiffs' allegations of liability

in these cases are based on various theories of recovery including unjust enrichment, negligence, negligent design, strict liability, breach of express and implied warranties, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, defective product, failure to warn, sale of cigarettes to minors, and claims under statutes governing competition and deceptive trade practices. Plaintiffs in these cases seek various forms of relief including compensatory and other damages, and injunctive and equitable relief. Defenses raised in these cases include lack of proximate cause, remoteness of injury, failure to state a claim, adequate remedy at law, “unclean hands” (namely, that plaintiffs cannot obtain equitable relief because they participated in, and benefited from, the sale of cigarettes), and statute of limitations.

As of July 29, 2015, there were 16 health care cost recovery cases pending against us, our subsidiaries or indemnitees in Canada (10), Korea (1) and Nigeria (5), compared with 15 such cases on July 30, 2014 and 15 such cases on August 1, 2013.

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

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

In the third health care cost recovery case filed in Canada, *Her Majesty the Queen in Right of Ontario v. Rothmans Inc., et al.*, Ontario Superior Court of Justice, Toronto, Canada, filed September 29, 2009, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Ontario based on legislation enacted in the province. This legislation is similar to the laws introduced in British Columbia and New Brunswick that authorize the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a “tobacco related wrong.” 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), 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.” Defendants filed their defenses in December 2014 and July 2015. Pre-trial discovery is ongoing.

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

In the seventh health care cost recovery case filed in Canada, *Her Majesty the Queen in Right of the Province of Manitoba v. Rothmans, Benson & Hedges, Inc., et al.*, The Queen's Bench, Winnipeg Judicial Centre, Canada, filed May 31, 2012, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are

defendants. The claim was filed by the government of the province of Manitoba based on legislation enacted in the province that is similar to the laws enacted in several other Canadian provinces. The legislation authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a “tobacco related wrong.” Defendants filed their defenses in September 2014. Discovery is scheduled to begin in 2017.

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

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has incurred, and will incur, as a result of a “tobacco related wrong.” Defendants filed their defenses in February 2015. Discovery is scheduled to begin in 2017.

In the ninth health care cost recovery case filed in Canada, Her Majesty the Queen in Right of the Province of Prince Edward Island v. Rothmans, Benson & Hedges Inc., et al., Supreme Court of Prince Edward Island (General Section), Canada, filed September 10, 2012, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Prince Edward Island based on legislation enacted in the province that is similar to the laws enacted in several other Canadian provinces. The legislation authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a “tobacco related wrong.” Defendants filed their defenses in February 2015. Discovery is scheduled to begin in 2017.

In the tenth health care cost recovery case filed in Canada, Her Majesty the Queen in Right of the Province of Nova Scotia v. Rothmans, Benson & Hedges Inc., et al., Supreme Court of Nova Scotia, Canada, filed January 2, 2015, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Nova Scotia based on legislation enacted in the province that is similar to the laws enacted in several other Canadian provinces. The legislation authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a “tobacco related wrong.” In January 2015, we, our subsidiaries, and our indemnitees were served with the statement of claim. Defendants filed their defenses in July 2015. Discovery is scheduled to begin in 2017.

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

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

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

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

re-serve the writ. We have not yet been re-served.

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

In the health care cost recovery case in Korea, *the National Health Insurance Service v. KT&G, et. al.*, filed April 14, 2014, our subsidiary and other Korean manufacturers are defendants. Plaintiff alleges that defendants concealed the health hazards of smoking, marketed to youth, added ingredients to make their products more harmful and addictive, and misled consumers into believing that Lights cigarettes are safer than regular cigarettes. The National Health Insurance Service seeks to recover

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approximately \$53.7 million allegedly incurred in treating 3,484 patients with small cell lung cancer, squamous cell lung cancer, and squamous cell laryngeal cancer from 2003 to 2012. The case is now in the evidentiary phase.

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 July 29, 2015, there were 2 lights cases brought by individual plaintiffs pending against our subsidiaries or indemnitees in Chile (1) and Italy (1), compared with 2 such cases on July 30, 2014, and 1 such case on August 1, 2013.

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 July 29, 2015, there were 2 public civil actions pending against our subsidiaries in Argentina (1) and Venezuela (1), compared with 2 such cases on July 30, 2014, and 4 such cases on August 1, 2013.

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 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 10. Income Taxes:

Income tax provisions for jurisdictions outside the United States of America, as well as state and local income tax provisions, were determined on a separate company basis and the related assets and liabilities were recorded in PMI's condensed consolidated balance sheets.

PMI's effective tax rates for the six months and three months ended June 30, 2015 were 29.2% and 28.2%, respectively. PMI's effective tax rates for the six months and three months ended June 30, 2014 were 28.8% and 28.7%, respectively. PMI estimates that its full-year 2015 effective tax rate will be approximately 29%. The effective tax rate for the six months ended June 30, 2015

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was unfavorably impacted by changes to repatriation assertions on certain foreign subsidiary historical earnings (\$58 million). Excluding the effect of the 2015 repatriation assertion changes, the change in the effective tax rate for the six months ended June 30, 2015, as compared to the six months ended June 30, 2014, was primarily due to earnings mix by taxing jurisdiction and repatriation cost differences.

The effective tax rates are based on PMI's full-year earnings mix projections by taxing jurisdiction and cash repatriation plans. Changes in earnings mix by taxing jurisdiction or in cash repatriation plans could have an impact on the effective tax rates, which PMI monitors each quarter. Significant judgment is required in determining income tax provisions and in evaluating tax positions.

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.

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

Note 11. Indebtedness:

Short-term Borrowings:

At June 30, 2015 and December 31, 2014, PMI's short-term borrowings, consisting of commercial paper and bank loans to certain PMI subsidiaries, had a carrying value of \$1,710 million and \$1,208 million, respectively. The fair value of PMI's short-term borrowings, based on current market interest rates, approximates carrying value.

Long-term Debt:

At June 30, 2015 and December 31, 2014, PMI's long-term debt consisted of the following:

(in millions)	June 30, 2015	December 31, 2014
U.S. dollar notes, 1.125% to 6.375% (average interest rate 3.874%), due through 2044	\$16,841	\$17,229
Foreign currency obligations:		
Euro notes, 1.750% to 5.875% (average interest rate 3.104%), due through 2033	8,389	9,161
Swiss franc notes, 0.750% to 2.000% (average interest rate 1.217%), due through 2024	1,792	1,690
Other (average interest rate 3.111%), due through 2024	470	167
	27,492	28,247
Less current portion of long-term debt	2,926	1,318
	\$24,566	\$26,929

Other foreign currency debt above includes mortgage debt in Switzerland and capital lease obligations at June 30, 2015 and December 31, 2014.

Credit Facilities:

On January 23, 2015, PMI entered into an agreement to extend the term of its existing \$2.0 billion 364-day revolving credit facility, effective February 10, 2015, from February 10, 2015 to February 9, 2016. On January 23, 2015, PMI also entered into an agreement to extend the term of its existing \$2.5 billion multi-year revolving credit facility, effective February 28, 2015, from February 28, 2019 to February 28, 2020.

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At June 30, 2015, PMI's total committed credit facilities were as follows:

(in billions)

Type	Committed Credit Facilities
364-day revolving credit, expiring February 9, 2016	\$2.0
Multi-year revolving credit, expiring February 28, 2020	2.5
Multi-year revolving credit, expiring October 25, 2016	3.5
Total facilities	\$8.0

At June 30, 2015, there were no borrowings under these committed credit facilities, and the entire committed amounts were available for borrowing.

Note 12. 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

PMI assesses the fair value of its foreign exchange contracts and interest rate contracts using standard valuation models that use, as their basis, readily observable market inputs. The fair value of PMI's foreign exchange forward contracts is determined by using the prevailing foreign exchange spot rates and interest rate differentials, and the respective maturity dates of the instruments. The fair value of PMI's currency options is determined by using a Black-Scholes methodology based on foreign exchange spot rates and interest rate differentials, currency volatilities and maturity dates. PMI's derivative financial instruments have been classified within Level 2 in the table shown below. See Note 6. Financial Instruments for an additional discussion of derivative financial instruments.

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 \$13 million of capital lease obligations, was \$27,479 million at June 30, 2015. 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 in the table shown below.

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Contingent Consideration

The fair value of PMI's contingent consideration relating to acquisitions is determined utilizing a discounted cash flow approach using various probability weighted scenarios. The significant unobservable inputs used in calculating the fair value of the contingent consideration includes financial performance scenarios, the probability of achieving those scenarios, and the discount rate. PMI's contingent consideration has been classified within Level 3 in the table shown below. For additional information, see Note 16. Acquisitions and Other Business Arrangements.

The aggregate fair values of PMI's derivative financial instruments, debt and contingent consideration as of June 30, 2015, were as follows:

(in millions)	Fair Value at June 30, 2015	Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Foreign exchange contracts	\$559	\$—	\$559	\$—
Total assets	\$559	\$—	\$559	\$—
Liabilities:				
Debt	\$28,847	\$28,362	\$485	\$—
Foreign exchange contracts	141	—	141	—
Contingent consideration	23	—	—	23
Total liabilities	\$29,011	\$28,362	\$626	\$23

Note 13. Accumulated Other Comprehensive Losses:

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

(in millions)	At June 30, 2015	At December 31, 2014	At June 30, 2014
Currency translation adjustments	\$(5,320)	) \$(3,929)	) \$(2,323)
Pension and other benefits	(2,910)	) (3,020)	) (2,006)
Derivatives accounted for as hedges	123	123	15
Total accumulated other comprehensive losses	\$(8,107)	) \$(6,826)	) \$(4,314)

Reclassifications from Other Comprehensive Earnings

The movements in accumulated other comprehensive losses and the related tax impact, for each of the components above, that are due to current period activity and reclassifications to the income statement are shown on the condensed consolidated statements of comprehensive earnings for the six months and three months ended June 30, 2015 and 2014. For additional information, see Note 4. Benefit Plans and Note 6. Financial Instruments for disclosures related to PMI's pension and other benefits, and derivative financial instruments, respectively.

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Note 14. Balance Sheet Offsetting:

Derivative Financial Instruments

PMI uses foreign exchange contracts and interest rate contracts to mitigate its exposure to changes in exchange and interest rates from third-party and intercompany actual and forecasted transactions. Substantially all of PMI's derivative financial instruments are subject to master netting arrangements, whereby the right to offset occurs in the event of default by a participating party. While these contracts contain the enforceable right to offset through close-out netting rights, PMI elects to present them on a gross basis in the condensed consolidated balance sheets. Collateral associated with these arrangements is in the form of cash and is unrestricted. See Note 6. Financial Instruments for disclosures related to PMI's derivative financial instruments.

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

(in millions)	Gross Amounts Recognized	Gross Amount Offset in the Condensed Balance Sheet	Net Amounts Presented in the Condensed Balance Sheet	Gross Amounts Not Offset in the Condensed Consolidated Balance Sheet		
				Financial Instruments	Cash Collateral Received/Pledged	Net Amount
At June 30, 2015						
Assets						
Foreign exchange contracts	\$ 559	\$—	\$ 559	\$(114	)\$ (403	) \$42
Liabilities						
Foreign exchange contracts	\$ 141	\$—	\$ 141	\$(114	)\$ (10	) \$17
At December 31, 2014						
Assets						
Foreign exchange contracts	\$ 406	\$—	\$ 406	\$(77	)\$ (306	) \$23
Liabilities						
Foreign exchange contracts	\$ 151	\$—	\$ 151	\$(77	)\$ (63	) \$11

Note 15. Investments in Unconsolidated Subsidiaries:

At June 30, 2015 and December 31, 2014, PMI had total investments in unconsolidated subsidiaries of \$1,020 million and \$1,083 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 and movements in currency translation adjustments. The carrying value of our equity method investments at the acquisition date exceeded our share of the unconsolidated subsidiaries' book value by \$1,417 million, including \$1,264 million attributable to goodwill. The difference between the investment carrying value and the amount of underlying equity in net assets, excluding the \$1,264 million attributable to goodwill, is being amortized on a straight-line basis over the underlying assets' estimated useful lives of 3 to 20 years.

At June 30, 2015 and December 31, 2014, PMI received year-to-date dividends from unconsolidated subsidiaries of \$86 million and \$107 million, respectively.

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

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 \$760 million. An

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additional payment of up to \$100 million, which is contingent on Megapolis's operational performance over the four fiscal years following the closing of the transaction, will also be made by 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 had 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 condensed consolidated balance sheets.

At June 30, 2015 and December 31, 2014, PMI's investments in other unconsolidated subsidiaries were \$39 million and \$38 million, respectively, with ownership percentages ranging from 40% to 50%.

PMI's earnings activity from unconsolidated subsidiaries was as follows:

	For the Six Months Ended June 30,		For the Three Months Ended June 30,	
(in millions)	2015	2014	2015	2014
Net revenues	\$2,218	\$2,606	\$1,322	\$1,420

PMI's balance sheet activity related to unconsolidated subsidiaries was as follows:

(in millions)	At June 30, 2015	At December 31, 2014
Receivables	\$488	\$407
Notes receivable	\$104	\$100
Other liabilities	\$97	\$93

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

Note 16. Acquisitions and Other Business Arrangements:

In June 2014, PMI acquired 100% of Nicocigs Limited, a leading U.K.-based e-vapor company, for the final purchase price of \$103 million, net of cash acquired, with additional contingent payments of up to \$77 million, primarily relating to performance targets over a three-year period. At June 30, 2015, the additional contingent payments were up to \$63 million over the remaining two-year period. For additional information regarding this contingent consideration, see Note 12. Fair Value Measurements.

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, for \$703 million. As a result, PMI now owns 100% of its Mexican tobacco business. A former director of PMI, whose term expired at the Annual Meeting of Shareholders in May 2015, had an affiliation with Grupo Carso. The final purchase price was subject to an 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 May 2015, PMI received a payment of \$113 million from Grupo Carso as the final purchase price adjustment. This resulted in a total net purchase price of \$590 million. In addition, PMI agreed to pay a dividend of approximately \$38 million to Grupo Carso related to the earnings of the

Mexican tobacco business for the nine months ended September 30, 2013. In March 2014, the dividend was declared and paid. The purchase of the remaining 20% interest resulted in a net decrease to PMI's additional paid-in capital of \$559 million.

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

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Philip Morris International Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Note 17. New Accounting Standards:

On May 28, 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ASU 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09"). ASU 2014-09 contains principles that an entity will need to apply to determine the measurement of revenue and timing of when it is recognized. The underlying principle is that an entity will recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services.

Entities can apply the final standard using one of the following two methods:

1. retrospectively to each prior period presented; or
2. retrospectively, with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial application, with additional disclosures in reporting periods that include the date of initial application.

ASU 2014-09 is effective for interim and annual reporting periods beginning on or after January 1, 2017. In July 2015, the FASB approved a proposal which allows for a deferral of the implementation until January 1, 2018 and permits early application, but not before the original effective date of January 1, 2017. PMI is currently assessing the impact that the adoption of ASU 2014-09 will have on its financial position or results of operations.

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Item 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Description of Our Company

We are a holding company whose subsidiaries and affiliates, and their licensees, are engaged in the manufacture and sale of cigarettes, other tobacco products and other nicotine-containing products in markets outside the United States of America. We manage our business in four segments:

European Union;

Eastern Europe, Middle East & Africa ("EEMA");

Asia; and

Latin America & Canada.

Our products are sold in more than 180 markets and, in many of these markets, we hold the number one or number two market share position. We have a wide range of premium, mid-price and low-price brands. Our portfolio comprises both international and local brands.

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

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

Philip Morris International Inc. is a legal entity separate and distinct from its direct and indirect subsidiaries.

Accordingly, our right, and thus the right of our creditors and stockholders, to participate in any distribution of the assets or earnings of any subsidiary is subject to the prior rights of creditors of such subsidiary, except to the extent that claims of our company itself as a creditor may be recognized. As a holding company, our principal sources of funds, including funds to make payment on our debt securities, are from the receipt of dividends and repayment of debt from our subsidiaries. Our principal wholly owned and majority-owned subsidiaries currently are not limited by long-term debt or other agreements in their ability to pay cash dividends or to make other distributions with respect to their common stock.

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Executive Summary

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

Consolidated Operating Results for the Six Months Ended June 30, 2015 – The changes in our reported diluted earnings per share ("diluted EPS") for the six months ended June 30, 2015, from the comparable 2014 amounts, were as follows:

	Diluted EPS	% Growth
For the six months ended June 30, 2014	\$2.35	
2014 Asset impairment and exit costs	0.25	
2014 Tax items	—	
Subtotal of 2014 items	0.25	
2015 Asset impairment and exit costs	—	
2015 Tax items	—	
Subtotal of 2015 items	—	
Currency	(0.64	)
Interest	(0.03	)
Change in tax rate	(0.04	)
Impact of lower shares outstanding and share-based payments	0.05	
Operations	0.43	
For the six months ended June 30, 2015	\$2.37	0.9 %

Asset Impairment and Exit Costs – During the six months ended June 30, 2014, we recorded pre-tax asset impairment and exit costs of \$512 million (\$400 million after tax or \$0.25 per share) related to the factory closures in the Netherlands and Australia.

On April 4, 2014, we announced the initiation by our affiliate, Philip Morris Holland B.V. ("PMH"), of consultations with employee representatives on a proposal to discontinue cigarette production at its factory located in Bergen op Zoom, the Netherlands. PMH reached an agreement with the trade unions and their members on a social plan, and ceased cigarette production on September 1, 2014. For the six months ended June 30, 2014, we recorded pre-tax asset impairment and exist costs of \$488 million. For further details, see the "Asset Impairment and Exit Costs" section of the following "Discussion and Analysis."

Income Taxes – Our effective income tax rate for the six months ended June 30, 2015 increased by 0.4 percentage points to 29.2%. The change in tax rate that decreased our diluted EPS by \$0.04 per share in 2015 was primarily due to changes to repatriation assertions on certain foreign subsidiary historical earnings (\$58 million), as well as earnings mix by taxing jurisdiction and repatriation cost differences. We estimate that our full-year 2015 effective tax rate will be approximately 29%.

Currency – The unfavorable currency impact during the reporting period results from the strengthening of the U.S. dollar, especially against the Euro, Indonesian rupiah, Japanese yen, Russian ruble and the Ukraine hryvnia. This unfavorable currency movement has impacted our profitability across our primary revenue markets and local currency cost bases.

Interest – The unfavorable impact of interest was due primarily to higher average debt levels, partially offset by lower average interest rates on debt.

Lower Shares Outstanding and Share-Based Payments – The favorable diluted EPS impact was due to the repurchase of our common stock in 2014 pursuant to our share repurchase program.

Operations – The increase in diluted EPS of \$0.43 from our operations in the table above was due to the following segments:

-

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

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

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

Asia: Higher pricing, partially offset by unfavorable volume/mix, higher manufacturing costs and higher marketing, administration and research costs.

Consolidated Operating Results for the Three Months Ended June 30, 2015 – The changes in our reported diluted EPS for the three months ended June 30, 2015, from the comparable 2014 amounts, were as follows:

	Diluted EPS	% Growth
For the three months ended June 30, 2014	\$1.17	
2014 Asset impairment and exit costs	0.24	
2014 Tax items	—	
Subtotal of 2014 items	0.24	
2015 Asset impairment and exit costs	—	
2015 Tax items	—	
Subtotal of 2015 items	—	
Currency	(0.33)	)
Interest	(0.02)	)
Change in tax rate	(0.01)	)
Impact of lower shares outstanding and share-based payments	0.02	
Operations	0.14	
For the three months ended June 30, 2015	\$1.21	3.4 %

Asset Impairment and Exit Costs – During the second quarter of 2014, we recorded pre-tax asset impairment and exit costs of \$489 million (\$384 million after tax or \$0.24 per share) related to the factory closures in the Netherlands and Australia.

As previously discussed, on April 4, 2014, we announced the initiation by our affiliate, PMH, of consultations with employee representatives on a proposal to discontinue cigarette production at its factory located in Bergen op Zoom, the Netherlands. PMH reached an agreement with the trade unions and their members on a social plan, and ceased cigarette production on September 1, 2014. For the three months ended June 30, 2014, we recorded pre-tax asset impairment and exist costs of \$488 million. For further details, see the "Asset Impairment and Exit Costs" section of the following "Discussion and Analysis."

Income Taxes – Our effective income tax rate for the three months ended June 30, 2015 decreased by 0.5 percentage points to 28.2%. The effective tax rate for the three months ended June 30, 2014 was unfavorably impacted by the asset impairment and exit costs related to the factory closures. Excluding the impact of this item, the change in tax rate that decreased our diluted EPS by \$0.01 per share in 2015, was primarily due to earnings mix by taxing jurisdiction and repatriation cost differences.

Currency – The unfavorable currency impact during the reporting period results from the strengthening of the U.S. dollar, especially against the Euro, Indonesian rupiah, Japanese yen, Russian ruble and the Ukraine hryvnia. This unfavorable currency movement has impacted our profitability across our primary revenue markets and local currency cost bases.

Interest – The unfavorable impact of interest was due primarily to higher average debt levels, partially offset by lower average interest rates on debt.

Lower Shares Outstanding and Share-Based Payments – The favorable diluted EPS impact was due to the repurchase of our common stock in 2014 pursuant to our share repurchase program.

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Operations – The increase in diluted EPS of \$0.14 from our operations in the table above was due primarily to the following segments:

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

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

2015 Forecasted Results - On July 16, 2015, we reaffirmed our 2015 full-year reported diluted EPS forecast to be in a range of \$4.32 to \$4.42, at prevailing exchange rates at that time, versus \$4.76 in 2014. Excluding an unfavorable currency impact, at then-prevailing exchange rates, of approximately \$1.15 per share for the full-year 2015, the reported diluted earnings per share range represents a projected increase of 9% to 11% versus adjusted diluted earnings per share of \$5.02 in 2014. We also announced that we anticipate our currency-neutral 2015 full-year adjusted diluted EPS growth rate to be toward the upper end of our projected increase of 9% to 11%. This forecast includes incremental investment during the second half of the year to support the deployment of iQOS in Japan, Italy and additional 2015 launch markets. Our guidance now also includes accelerated spending in the fourth quarter behind planned iQOS launches in 2016, as well as incremental marketing investments in the second half to further reinforce the favorable momentum of our combustible business. This forecast does not include any share repurchases in 2015.

We calculated 2014 adjusted diluted EPS as reported diluted EPS of \$4.76, plus the \$0.26 per share charge related to asset impairment and exit costs.

Adjusted diluted EPS is not a measure under accounting principles generally accepted in the United States of America ("U.S. GAAP"). We define adjusted diluted EPS as reported diluted EPS adjusted for asset impairment and exit costs, discrete tax items and unusual items. We believe it is appropriate to disclose this measure as it represents core earnings, improves comparability and helps investors analyze business performance and trends. Adjusted diluted EPS should be considered neither in isolation nor as a substitute for reported diluted EPS prepared in accordance with U.S. GAAP.

This 2015 guidance excludes the impact of any future acquisitions, unanticipated asset impairment and exit cost charges, future changes in currency exchange rates and any unusual events. The factors described in the "Cautionary Factors That May Affect Future Results" section of the following "Discussion and Analysis" represent continuing risks to this forecast.

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Discussion and Analysis

Consolidated Operating Results

See pages 73-77 for a discussion of our "Cautionary Factors That May Affect Future Results." Our cigarette volume, net revenues, excise taxes on products and operating companies income by segment were as follows:

	For the Six Months Ended		For the Three Months Ended	
	June 30,		June 30,	
(in millions)	2015	2014	2015	2014
Cigarette volume:				
European Union	90,880	91,618	48,159	49,913
Eastern Europe, Middle East & Africa	138,550	136,176	73,829	74,170
Asia	145,381	146,454	75,256	75,653
Latin America & Canada	43,779	44,514	22,589	23,065
Total cigarette volume	418,590	418,762	219,833	222,801
Net revenues:				
European Union	\$12,276	\$14,448	\$6,336	\$7,829
Eastern Europe, Middle East & Africa	9,423	10,236	4,994	5,674
Asia	9,803	9,572	5,039	5,097
Latin America & Canada	4,613	4,574	2,394	2,451
Net revenues	\$36,115	\$38,830	\$18,763	\$21,051
Excise taxes on products:				
European Union	\$8,396	\$10,042	\$4,348	\$5,436
Eastern Europe, Middle East & Africa	5,661	5,944	3,075	3,391
Asia	5,503	5,079	2,894	2,786
Latin America & Canada	3,080	3,051	1,587	1,641
Excise taxes on products	\$22,640	\$24,116	\$11,904	\$13,254
Operating income:				
Operating companies income:				
European Union	\$1,890	\$1,689	\$977	\$711
Eastern Europe, Middle East & Africa	1,761	2,014	881	1,087
Asia	1,731	1,815	797	900
Latin America & Canada	555	467	325	265
Amortization of intangibles	(43)	(44)	(21)	(22)
General corporate expenses	(82)	(80)	(41)	(40)
Less:				
Equity (income)/loss in unconsolidated subsidiaries, net	(49)	(36)	(26)	(27)
Operating income	\$5,763	\$5,825	\$2,892	\$2,874

As discussed in Note 8. Segment Reporting to our condensed consolidated financial statements, we evaluate segment performance and allocate resources based on operating companies income, which we define as operating income, excluding general corporate expenses and amortization of intangibles, plus equity (income)/loss in unconsolidated subsidiaries, net. We believe it is appropriate to disclose this measure to help investors analyze the business performance and trends of our various business segments.

References to total international cigarette market, total cigarette market, total market and market shares throughout this "Discussion and Analysis" reflect our best estimates of tax-paid volumes based on a number of internal and external sources.

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Consolidated Operating Results for the Six Months Ended June 30, 2015

The following discussion compares our consolidated operating results for the six months ended June 30, 2015, with the six months ended June 30, 2014.

Our cigarette shipment volume of 418.6 billion units was essentially flat as growth in:

• EMEA, driven principally by Russia and Saudi Arabia, was offset by declines in the:

• European Union, mainly Italy;

• Asia, largely due to Korea and the Philippines, partially offset by Indonesia; and

• Latin America & Canada, mainly due to Argentina.

Excluding acquisitions, our cigarette shipment volume was down by 0.1%. Estimated net inventory movements for the six months ended June 30, 2015 were favorable, driven mainly by Japan. Excluding these inventory movements, our total cigarette shipment volume decreased by 1.0%.

Our cigarette market share increased in a number of key markets, including Algeria, Argentina, Austria, Belgium, Brazil, Egypt, France, Germany, Hong Kong, Indonesia, Korea, Poland, Russia, Saudi Arabia, Singapore, Spain and Switzerland.

Our cigarette shipment volume by brand is shown in the table below:

PMI Cigarette Shipment Volume by Brand (Million Units)

	Six Months Year-to-Date		Change	
	2015	2014		
Marlboro	139,569	139,032	0.4	%
L&M	47,224	45,154	4.6	%
Parliament	21,084	22,307	(5.5)	)%
Bond Street	20,957	20,415	2.7	%
Chesterfield	20,151	20,583	(2.1)	)%
Philip Morris	16,593	15,808	5.0	%
Lark	14,714	13,706	7.4	%
Others	138,298	141,757	(2.4)	)%
Total PMI	418,590	418,762	—	%

For the six months ended June 30, 2015, the increase in cigarette shipment volume of Marlboro reflected growth in: the European Union, notably France and Spain, partly offset by Italy; and EMEA, notably Turkey and Saudi Arabia, partly offset by Egypt and Ukraine. Cigarette shipment volume of Marlboro decreased in: Asia, mainly due to Japan and Korea, partly offset by the Philippines; and Latin America & Canada, mainly due to Argentina.

The increase in cigarette shipment volume of L&M was driven by growth in EMEA, notably Egypt, Turkey and Ukraine, partly offset by a decline in the European Union, mainly Spain. The decrease in cigarette shipment volume of Parliament was primarily due to Japan, Korea and Ukraine, partly offset by Turkey. The increase in cigarette shipment volume of Bond Street was predominantly driven by Australia and Russia, partly offset by Kazakhstan and Ukraine. The decrease in cigarette shipment volume of Chesterfield was primarily due to EMEA, mainly Russia, Turkey and Ukraine, partly offset by the European Union, mainly Italy. The increase in cigarette shipment volume of Philip Morris primarily reflects the morphing from Diana in Italy, partly offset by the morphing to Lark in Japan. The increase in cigarette shipment volume of Lark was predominantly driven by Japan, benefiting from trade inventory movements, partly offset by Korea and Turkey.

Our other tobacco products ("OTP") primarily include tobacco for roll-your-own and make-your-own cigarettes, pipe tobacco, cigars and cigarillos. Total shipment volume of OTP, in cigarette equivalent units, increased by 2.7% to 16.9 billion cigarette equivalent units.

Total shipment volume for cigarettes and OTP, in cigarette equivalent units, was flat, excluding acquisitions.

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

	For the Six Months Ended June 30,				
(in millions)	2015	2014	Variance	%	
Net revenues	\$36,115	\$38,830	\$(2,715)	(7.0)	)%
Excise taxes on products	22,640	24,116	(1,476)	(6.1)	)%
Net revenues, excluding excise taxes on products	\$13,475	\$14,714	\$(1,239)	(8.4)	)%

Net revenues, which include excise taxes billed to customers, decreased by \$2.7 billion (7.0%). Excluding excise taxes, net revenues decreased by \$1.2 billion (8.4%) to \$13.5 billion. This decrease was due to:

- unfavorable currency (\$2.2 billion) and
- unfavorable volume/mix (\$89 million), partly offset by
- price increases (\$1.1 billion) and
- the impact of acquisitions (\$16 million).

Currency movements decreased net revenues by \$6.1 billion and net revenues, excluding excise taxes on products by \$2.2 billion. The \$2.2 billion decrease was due primarily to the Argentine peso, Australian dollar, Canadian dollar, Euro, Indonesian rupiah, Japanese yen, Mexican peso, Polish zloty, Russian ruble, Turkish lira and the Ukraine hryvnia.

Net revenues include \$898 million in 2015 and \$991 million in 2014 related to sales of OTP. These net revenue amounts include excise taxes billed to customers. Excluding excise taxes, net revenues for OTP were \$332 million in 2015 and \$368 million in 2014.

Excise taxes on products decreased by \$1.5 billion (6.1%), due primarily to:

- favorable currency (\$3.9 billion) and
- lower excise taxes resulting from unfavorable volume/mix (\$175 million), partly offset by
- higher excise taxes resulting from changes in retail prices and tax rates (\$2.6 billion).

Governments have consistently increased excise taxes in most of the markets in which we operate. As discussed under the caption “Business Environment,” we expect excise taxes to continue to increase.

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

	For the Six Months Ended June 30,				
(in millions)	2015	2014	Variance	%	
Cost of sales	\$4,607	\$5,070	\$(463)	(9.1)	)%
Marketing, administration and research costs	3,062	3,263	(201)	(6.2)	)%
Operating income	5,763	5,825	(62)	(1.1)	)%

Cost of sales decreased \$463 million (9.1%), due primarily to:

- favorable currency (\$635 million), partly offset by
- higher manufacturing costs (\$114 million, principally in our EEMA and Asia segments) and
- higher cost of sales resulting from volume/mix (\$49 million).

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Marketing, administration and research costs decreased by \$201 million (6.2%), due primarily to:

• favorable currency (\$351 million), partly offset by
• higher expenses (\$143 million, primarily higher marketing and selling expenses).

Operating income decreased by \$62 million (1.1%). This decrease was due primarily to:

• unfavorable currency (\$1.2 billion),
• higher marketing, administration and research costs (\$143 million),
• unfavorable volume/mix (\$138 million) and
• higher manufacturing costs (\$114 million), partly offset by
• price increases (\$1.1 billion) and
• the non-recurrence of the 2014 pre-tax charges for asset impairment and exit costs (\$512 million, primarily related to the decision to discontinue cigarette production in the Netherlands).

Interest expense, net, of \$534 million increased by \$12 million, due primarily to higher average debt levels, partially offset by lower average interest rates on debt.

Our effective tax rate increased by 0.4 percentage points to 29.2%. We estimate that our full-year 2015 effective tax rate will be approximately 29%. The effective tax rate for the six months ended June 30, 2015 was unfavorably impacted by changes to repatriation assertions on certain foreign subsidiary historical earnings (\$58 million). The effective tax rate is based on our full-year earnings mix by taxing jurisdiction and cash repatriation plans. Changes in our cash repatriation plans could have an impact on the effective tax rate, which we monitor each quarter. Significant judgment is required in determining income tax provisions and in evaluating tax positions.

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

Equity (income)/loss in unconsolidated subsidiaries, net, of \$(49) million increased by \$13 million, due primarily to higher earnings from our investments in North Africa and Russia, which are reflected in the EEMA segment.

Net earnings attributable to PMI of \$3.7 billion decreased by \$44 million (1.2%). This decrease was due primarily to lower operating income as discussed above. Diluted and basic EPS of \$2.37 increased by 0.9%. Excluding an unfavorable currency impact of \$0.64, diluted EPS increased by 28.1%.

Consolidated Operating Results for the Three Months Ended June 30, 2015

The following discussion compares our consolidated operating results for the three months ended June 30, 2015, with the three months ended June 30, 2014.

Our cigarette shipment volume of 219.8 billion units decreased by 1.3%. This decrease was due principally to the:

• European Union, mainly Italy, Poland and Spain, partly offset by France;
• EEMA, principally due to Kazakhstan and Ukraine, partly offset by Russia and Saudi Arabia;
• Asia, largely due to Australia, Indonesia, Korea and the Philippines, partly offset by Japan; and
• Latin America & Canada, mainly Argentina and Mexico.

Excluding acquisitions, our cigarette shipment volume decreased by 1.4%. Estimated net inventory movements for the three months ended June 30, 2015 were favorable, driven mainly by Japan, reflecting a positive comparison with the same period in 2014, which was impacted by retail trade inventory reductions following the consumption tax-driven retail price increases of April 1, 2014. Excluding these inventory movements, our total cigarette shipment volume

decreased by 1.6%.

Our cigarette market share increased in a number of key markets, including Algeria, Argentina, Austria, Belgium, Brazil, Egypt, France, Germany, Hong Kong, Indonesia, Korea, Russia, Saudi Arabia, Singapore, Spain and Switzerland.

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Our cigarette shipment volume by brand is shown in the table below:

PMI Cigarette Shipment Volume by Brand (Million Units)

	Second-Quarter			
	2015	2014	Change	
Marlboro	72,322	73,151	(1.1	)%
L&M	24,546	24,201	1.4	%
Parliament	11,514	12,394	(7.1	)%
Bond Street	11,777	11,137	5.8	%
Chesterfield	10,611	11,797	(10.1	)%
Philip Morris	8,831	7,779	13.5	%
Lark	8,270	6,879	20.2	%
Others	71,962	75,463	(4.6	)%
Total PMI	219,833	222,801	(1.3	)%

For the three months ended June 30, 2015, the decrease in cigarette shipment volume of Marlboro reflected declines in: the European Union, notably Italy and the United Kingdom, partly offset by France and Spain; EEMA, notably North Africa and Ukraine, partly offset by Saudi Arabia and Turkey; and Latin America & Canada, mainly Argentina, Brazil and Mexico. Cigarette shipment volume of Marlboro increased in Asia, driven by the Philippines and Vietnam, partly offset by Indonesia and Japan.

The increase in cigarette shipment volume of L&M was driven by growth in EEMA, notably Egypt, Turkey and Ukraine, partly offset by a decline in the European Union, mainly Spain, and in Asia, mainly Thailand. The decrease in cigarette shipment volume of Parliament was primarily due to Japan, Korea and Ukraine. The increase in cigarette shipment volume of Bond Street was predominantly driven by Australia and Russia, partly offset by Kazakhstan and Ukraine. The decrease in cigarette shipment volume of Chesterfield was primarily due to the European Union, mainly Italy and Spain, and EEMA, mainly Russia, Turkey and Ukraine. The increase in cigarette shipment volume of Philip Morris primarily reflects the morphing from Diana in Italy. The increase in cigarette shipment volume of Lark was predominantly driven by Japan, benefiting from trade inventory movements, partly offset by Korea and Turkey. Total shipment volume of OTP, in cigarette equivalent units, increased by 3.3% to 8.7 billion cigarette equivalent units.

Total shipment volume for cigarettes and OTP, in cigarette equivalent units, decreased by 1.2%, excluding acquisitions.

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

	For the Three Months Ended				
	June 30,				
(in millions)	2015	2014	Variance	%	
Net revenues	\$18,763	\$21,051	\$(2,288	) (10.9	)%
Excise taxes on products	11,904	13,254	(1,350	) (10.2	)%
Net revenues, excluding excise taxes on products	\$6,859	\$7,797	\$(938	) (12.0	)%

Net revenues, which include excise taxes billed to customers, decreased by \$2.3 billion (10.9)%. Excluding excise taxes, net revenues decreased by \$938 million (12.0)% to \$6.9 billion. This decrease was due primarily to:

- unfavorable currency (\$1.3 billion) and
- unfavorable volume/mix (\$167 million), partly offset by
- price increases (\$514 million).

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Currency movements decreased net revenues by \$3.7 billion and net revenues, excluding excise taxes on products, by \$1.3 billion. The \$1.3 billion decrease was due primarily to the Argentine peso, Australian dollar, Brazilian real, Canadian dollar, Euro, Indonesian rupiah, Japanese yen, Mexican peso, Polish zloty, Russian ruble, Turkish lira and the Ukraine hryvnia.

Net revenues include \$455 million in 2015 and \$521 million in 2014 related to sales of OTP. These net revenue amounts include excise taxes billed to customers. Excluding excise taxes, net revenues for OTP were \$168 million in 2015 and \$191 million in 2014.

Excise taxes on products decreased by \$1.4 billion (10.2)%, due primarily to:

• favorable currency (\$2.4 billion) and
 • lower excise taxes resulting from unfavorable volume/mix (\$318 million), partly offset by
 • higher excise taxes resulting from changes in retail prices and tax rates (\$1.4 billion).

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

	For the Three Months Ended				
	June 30,				
(in millions)	2015	2014	Variance	%	
Cost of sales	\$2,378	\$2,696	\$(318)	(11.8)	%
Marketing, administration and research costs	1,568	1,716	(148)	(8.6)	%
Operating income	2,892	2,874	18	0.6	%

Cost of sales decreased by \$318 million (11.8%), due primarily to:

• favorable currency (\$378 million), partly offset by
 • higher manufacturing costs (\$51 million, principally in our EEMA and Asia segments).

Marketing, administration and research costs decreased by \$148 million (8.6%), due primarily to:

• favorable currency (\$240 million), partly offset by
 • higher expenses (\$88 million, primarily higher marketing and selling expenses).

Operating income increased by \$18 million (0.6%), due primarily to:

• price increases (\$514 million) and
 • the non-recurrence of the 2014 pre-tax charges for asset impairment and exit costs (\$489 million, primarily related to the decision to discontinue cigarette production in the Netherlands), partly offset by
 • unfavorable currency (\$673 million),
 • unfavorable volume/mix (\$171 million),
 • higher marketing, administration and research costs (\$88 million) and
 • higher manufacturing costs (\$51 million).

Interest expense, net, of \$259 million increased by \$5 million, due primarily to higher average debt levels, partially offset by lower average interest rates on debt.

Our effective tax rate decreased by 0.5 percentage points to 28.2%. The effective tax rate is based on our full-year earnings mix by taxing jurisdiction and cash repatriation plans. Changes in our cash repatriation plans could have an impact on the effective tax rate, which we monitor each quarter. Significant judgment is required in determining

income tax provisions and in evaluating tax positions.

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Net earnings attributable to PMI of \$1.9 billion increased by \$36 million (1.9%). This increase was due primarily to higher operating income as discussed above. Diluted and basic EPS of \$1.21 increased by 3.4%. Excluding an unfavorable currency impact of \$0.33, diluted EPS increased by 31.6%.

Operating Results by Business Segment

Business Environment

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

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

- fiscal challenges, such as excise tax increases and discriminatory tax structures;
- actual and proposed extreme regulatory requirements, including regulation of the packaging, marketing and sale of tobacco products, as well as the products themselves, that may reduce our competitiveness, eliminate our ability to communicate with adult smokers, ban certain of our products, limit our ability to differentiate our products from those of our competitors, and interfere with our intellectual property rights;
- illicit trade in cigarettes and other tobacco products, including counterfeit, contraband and so-called “illicit whites”;
- intense competition, including from non-tax paid volume by certain local manufacturers;
- pending and threatened litigation as discussed in Note 9. Contingencies; and
- governmental investigations.

FCTC: The World Health Organization's (“WHO”) Framework Convention on Tobacco Control (“FCTC”), an international public health treaty with the objective of reducing tobacco use, drives much of the regulation that shapes the business environment in which we operate. The treaty, to which 179 countries and the European Union are Parties, requires Parties to have in place various tobacco control measures and recommends others.

We support many of the regulatory policies required by the FCTC, including measures that strictly prohibit the sale of tobacco products to minors, limit public smoking, require health warnings on tobacco packaging, and regulate product content to prevent increased adverse health effects of smoking. We advocate measures that establish a regulatory framework for Reduced-Risk Products. We also support the use of tax and price policies to achieve public health objectives, as long as such policies are not discriminatory or excessive, and do not result in increased illicit trade.

However, the FCTC governing body, the Conference of the Parties (“CoP”), has adopted non-binding guidelines and policy recommendations related to certain articles of the FCTC, some of which we strongly oppose, including extreme measures such as point-of-sale display bans, plain packaging, bans on all forms of communications with adult smokers, ingredient restrictions or bans based on the concepts of palatability or attractiveness, and excessive taxation. Among other things, these measures would limit our ability to differentiate our products and disrupt competition, are not based on sound evidence of a public health benefit, are likely to lead to adverse consequences such as increased illicit trade and, in some cases, result in the expropriation of our trademarks and violate international treaties.

It is not possible to predict whether or to what extent measures recommended in the FCTC guidelines will be implemented. In some instances where these extreme measures have been adopted by national governments, we have commenced legal proceedings challenging them.

Excise, Sales and Other Taxes: Excessive and disruptive tax increases and discriminatory tax structures are expected to continue to have an adverse impact on our profitability, due to lower consumption and consumer down-trading

from premium to non-premium, discount, other low-price or low-taxed tobacco products, such as fine cut tobacco and illicit products. In addition, in certain jurisdictions, our products are subject to tax structures that discriminate against premium-price products and manufactured cigarettes. We believe that such tax structures undermine public health by encouraging consumers to turn to the illicit trade for cheaper tobacco products and ultimately undercut government revenue objectives, disrupt the competitive environment, and

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encourage criminal activity. Other jurisdictions have imposed, or are seeking to impose, levies or other taxes on tobacco companies. We oppose such extreme and discriminatory tax measures.

EU Tobacco Products Directive: In April 2014, the EU adopted the text of a significantly revised EU Tobacco Products Directive that, among other things, provides for:

health warnings covering 65% of the front and back panels of packs with specific health warning dimensions that will in effect prohibit various pack formats, such as certain packs for slim cigarettes, even though the agreed text does not ban slim cigarettes. Member States would also have the option to further standardize tobacco packaging, including, under certain conditions, by introducing plain packaging;

a ban on packs of fewer than 20 cigarettes;

a ban on characterizing flavors in some tobacco products, with a transition period for menthol expiring in May 2020; tracking and tracing measures requiring tracking at pack level down to retail, which we believe will provide no incremental benefit in the fight against illicit trade; and

a framework for the regulation of novel tobacco products and e-cigarettes (except for those found to be medicines or medical devices), including requirements for health warnings and information leaflets, prohibiting product packaging text related to reduced risk, and introducing notification requirements in advance of commercialization.

The revised Directive entered into force in May 2014. Member States are required to implement the Directive by May 2016.

In June 2014, two of our subsidiaries filed papers in the English High Court seeking judicial review of whether the Directive complies with existing EU Treaties. In November 2014, the English High Court referred the case to the Court of Justice of the European Union ("CJEU") and requested that the CJEU issue a judgment in advance of May 2016. In July 2014, the government of Poland filed a complaint with the CJEU challenging the validity of various provisions in the Directive that ban menthol cigarettes. It is not possible to predict the outcome of these legal proceedings.

Plain Packaging: To date, only Australia has implemented plain packaging. Its regulation, which came into force in December 2012, bans the use of branding, logos and colors on packaging of all tobacco products other than the brand name and variant, which may be printed only in specified locations and in a uniform font. The remainder of the pack is reserved for health warnings and government messages about cessation. The branding of individual cigarettes is also prohibited under this regulation.

Ireland and the U.K. have adopted plain packaging legislation, with implementation scheduled to begin no later than May 2016 and full compliance at retail required as of May 2017. In Ireland, implementation is subject to a Ministerial Commencement Order, which has yet to be issued.

In May 2015, three of our subsidiaries filed papers in the English High Court seeking judicial review of the U.K.'s plain packaging legislation. It is not possible to predict the outcome of these legal proceedings.

In other countries, including France and New Zealand, proposals to implement plain packaging are in various stages of the legislative process. Additionally, several countries, including Finland, Hungary, Norway and Turkey are considering plain packaging, but no legislative proposals have been published. It is not possible to predict whether any of these countries will implement plain packaging.

Australia's plain packaging legislation triggered three legal challenges. First, major tobacco manufacturers, including our Australian subsidiary, challenged the legislation's constitutionality in the High Court of Australia. Although the

High Court found the legislation constitutional, a majority of the Justices concluded that plain packaging deprives tobacco manufacturers of their property, raising serious questions about the legality of similar proposals in other jurisdictions. Second, our Hong Kong subsidiary initiated arbitration proceedings against the Australian government pursuant to the Hong Kong-Australia Bilateral Investment Treaty and is seeking substantial compensation for the deprivation of its investments in Australia. Third, several countries have initiated World Trade Organization ("WTO") dispute settlement proceedings against Australia. The ongoing legal challenges may take several years to complete, and it is not possible to predict their outcomes.

We oppose plain packaging because it expropriates our valuable intellectual property by taking away our trademarks and moves the industry much closer to a commodity business where there is no distinction among brands and, therefore, the ability to compete for adult smoker market share is greatly reduced. Several studies, including industry-commissioned studies as well as data released by Australian state governments, show that there is no sound basis to conclude that the implementation of plain packaging in Australia has had any impact on smoking prevalence among adults or youth. Data from Australia also appear to confirm that,

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since the implementation of plain packaging, down-trading to lower price and lower margin brands has accelerated and the illicit trade has increased.

In the event any particular jurisdiction adopts plain packaging regulation, we will consider all available options, including litigation, to ensure the protection of our intellectual property.

Restrictions and Bans on the Use of Ingredients: Currently, the WHO and others in the public health community recommend restrictions or total bans on the use of some or all ingredients in tobacco products, including menthol. Some regulators have considered and rejected such proposals, while others have proposed and, in a few cases, adopted restrictions or bans. In particular, as mentioned above, the European Union has adopted a ban of characterizing flavors in tobacco products, subject to an exemption until May 2020 for menthol. Furthermore, Turkey has adopted a ban of menthol as of May 2020. Sweeping ingredient bans have been adopted only by Canada and Brazil.

While the Canadian ingredient ban exempts menthol on the national level, some Canadian provinces have adopted or are in the process of adopting provincial menthol bans.

The Brazil ingredients ban, which, as originally drafted, would prohibit the use of virtually all ingredients with flavoring or aromatic properties, is not in force due to a legal challenge by a tobacco industry union, of which our Brazilian subsidiary is a member. It is not possible to predict the outcome of this legal proceeding.

Broad restrictions and bans on the use of ingredients would require us to reformulate our American Blend tobacco products and could reduce our ability to differentiate these products in the market in the long term. Menthol bans would eliminate the entire category of mentholated tobacco products. We oppose broad bans or sweeping restrictions on the use of ingredients, as they are often based on the subjective and scientifically unsupported notion that ingredients make tobacco products more “attractive” or “palatable” and therefore could encourage tobacco consumption, and also because prohibiting entire categories of cigarettes, such as menthol, is likely to lead to a massive increase in illicit trade.

Many countries have enacted or proposed legislation or regulations that require cigarette manufacturers to disclose to governments and to the public the ingredients used in the manufacture of tobacco products and, in certain cases, to provide toxicological information about those ingredients. We have made, and will continue to make, full disclosures where adequate assurances of trade secret protection are provided.

Bans on Display of Tobacco Products at Retail: In a few of our markets, governments have banned or propose to ban the display of tobacco products at the point of retail sale. Other countries have rejected display ban proposals. We oppose display bans because they restrict competition by favoring established brands and encourage illicit trade, while not reducing smoking or otherwise benefiting public health. In some markets, our subsidiaries and, in some cases, individual retailers have commenced legal proceedings to overturn display bans.

Health Warning Requirements: In most countries, governments require large and often graphic health warnings covering at least 30% of the front and back of cigarette packs (the size mandated by the FCTC). A growing number of countries require warnings covering 50% of the front and back of the pack, and a small number of countries require larger warnings, such as Australia (75% front and 90% back), Mexico (30% front and 100% back), Uruguay (80% front and back) and Canada (75% front and back).

In March 2013, the Ministry of Public Health in Thailand issued a regulation mandating health warnings covering 85% of the front and back of cigarette packs. While a lower court suspended this requirement pending the outcome of legal challenges by two of our affiliates, Thailand’s Supreme Administrative Court recently overturned this order and

allowed the regulation to be implemented during the pendency of our affiliates' claims. The legal challenges by our affiliates are still pending. It is not possible to predict the outcome of these proceedings.

We support health warning requirements designed to inform consumers of the risks of smoking. In fact, where health warnings are not required, we place them on packaging voluntarily in the official language or languages of the country. We defer to governments on the content of warnings except for content that vilifies tobacco companies or does not fairly represent the actual effects of smoking. However, we oppose excessively large health warnings, i.e., larger than 50%. The data show that disproportionately increasing the size of health warnings does not effectively reduce tobacco consumption. Yet, such health warnings impede our ability to compete in the market by leaving insufficient space for our distinctive trademarks and pack designs.

Other Packaging Restrictions: Some governments have passed, or are seeking to pass, restrictions on packaging and labeling, including standardizing the shape, format and lay-out of packaging, as well as imposing broad restrictions on how the space left for branding and product descriptions can be used. Examples include prohibitions on (1) the use of colors that are alleged to

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suggest that one brand is less harmful than others, (2) specific descriptive phrases deemed to be misleading, including, for example, “premium,” “full flavor,” “international,” “gold,” “silver,” and “menthol,” and (3), in one country, all but one variant per brand. We oppose broad packaging restrictions because they unnecessarily limit brand and product differentiation, are anticompetitive, prevent us from providing consumers with information about our products, unduly restrict our intellectual property rights, and violate international trade agreements. In some instances, we have commenced litigation challenging such regulations. It is not possible to predict the outcome of these proceedings.

Bans and Restrictions on Advertising, Marketing, Promotions and Sponsorships: For many years, the FCTC has called for, and countries have imposed, partial or total bans on tobacco advertising, marketing, promotions and sponsorships, including bans and restrictions on advertising on radio and television, in print and on the Internet. The FCTC also requires disclosure of expenditures on advertising, promotion and sponsorship where such activities are not prohibited. The FCTC guidelines recommend that governments adopt extreme and sweeping prohibitions, including all forms of communication to adult smokers. Where restrictions on advertising prevent us from communicating directly and effectively with adult smokers, they impede our ability to compete in the market. For this reason, and because we believe that the available evidence does not show that marketing restrictions effectively reduce smoking, we oppose complete bans on advertising and communication that do not allow manufacturers to communicate directly and effectively with adult smokers.

Restrictions on Product Design: Anti-tobacco organizations and some regulators are calling for the further standardization of tobacco products by requiring, for example, that cigarettes have a certain minimum diameter, which amounts to a ban on slim cigarettes, or requiring the use of standardized filter and cigarette paper designs. We oppose such restrictions because they limit our ability to differentiate our products and because we believe that there is no correlation, let alone a causal link, between product design variations and smoking rates, nor is there any scientific evidence that these restrictions would improve public health.

Reduced cigarette ignition propensity (“RCIP”) standards are recommended by the FCTC guidelines, have been adopted in several of our markets (e.g., Australia, Canada, South Africa, South Korea, and the EU), and are being considered in several others. While the available evidence (namely, from two provinces in Canada and the State of New York) so far suggests that the implementation of RCIP standards did not result in the predicted reduction of smoking related fires, RCIP standards do increase production costs.

Restrictions on Public Smoking: The pace and scope of public smoking restrictions have increased significantly in most of our markets. Many countries around the world have adopted, or are likely to adopt, regulations that restrict or ban smoking in public and/or work places, restaurants, bars and nightclubs. Some public health groups have called for, and some regional governments and municipalities have adopted or proposed, bans on smoking in outdoor places, as well as bans on smoking in cars (typically when minors are present) and private homes. The FCTC requires Parties to adopt restrictions on public smoking, and the guidelines call for broad bans in all indoor public places but limit their recommendations on private place smoking, such as in cars and private homes, to increased education on the risk of exposure to environmental tobacco smoke.

While we believe outright bans are appropriate in many public places, such as schools, playgrounds, youth facilities, and many indoor public places, governments can and should seek a balance between the desire to protect non-smokers from environmental tobacco smoke and allowing adults who choose to smoke to do so. Owners of restaurants, bars, cafes, and other entertainment establishments should have the flexibility to permit, restrict, or prohibit smoking, and workplaces should be permitted to provide designated smoking rooms for adult smokers. Finally, we oppose bans on smoking outdoors (beyond places and facilities for children) and in private places.

Restrictions on the sale of innovative tobacco products: In Singapore, the Ministry of Health issued a ban on the sale of “emerging” tobacco products, including novel tobacco or nicotine products, such as smokeless tobacco -- where no combustion takes place and no smoke is produced -- dissolvable tobacco products or nicotine, and nicotine delivery systems (i.e., e-cigarettes) as of December 2015. According to the Ministry of Health, the ban is a pre-emptive measure to protect public health against the known and potential harms of such products. As written, the preemptive ban appears to foreclose consumer access even to products that might be shown to present significantly less risk of harm than existing products. By contrast, we support regulation that sets strict standards and propels innovation to benefit consumer and public health.

Other Regulatory Issues: Some regulators are considering, or in some cases have adopted, regulatory measures designed to reduce the supply of tobacco products. These include regulations intended to reduce the number of retailers selling tobacco products by, for example, reducing the overall number of tobacco retail licenses available or banning the sale of tobacco within arbitrary distances of certain public facilities. We oppose such measures because they stimulate illicit trade and could arbitrarily deprive business owners and their employees of their livelihood with no indication that such restrictions would improve public health.

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Regulators in some countries have also called for the exclusion of tobacco from certain basic provisions of trade and investment agreements, such as the Trans-Pacific Partnership Agreement, which is under negotiation. This could limit our ability to protect investments and intellectual property, would constitute unfair discrimination against a legal industry, and would be at odds with fundamental principles of international trade.

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

Illicit Trade: The illicit tobacco trade creates a cheap and unregulated supply of tobacco products, undermines efforts to reduce smoking, especially among youth, damages legitimate businesses, stimulates organized crime, increases corruption and reduces government tax revenue. Illicit trade may account for as much as 10% of global cigarette consumption; this includes counterfeit, contraband and the growing problem of "illicit whites," which are unique cigarette brands manufactured predominantly for smuggling. We estimate that illicit trade in the European Union accounted for more than 10% of total cigarette consumption in 2014.

A number of jurisdictions are considering regulatory measures and government action to prevent illicit trade. In November 2012, the FCTC adopted the Protocol to Eliminate Illicit Trade in Tobacco Products (the "Protocol"), which includes supply chain control measures, such as licensing of manufacturers and distributors, enforcement in free trade zones, controls on duty free and Internet sales and the implementation of tracking and tracing technologies. The Protocol, which we support, will come into force once the fortieth country ratifies it, after which countries must implement its measures via national legislation. To date, eight countries have ratified the Protocol. It is not possible to predict whether other countries will do so.

Additionally, we and our subsidiaries have entered into cooperation agreements with governments and authorities to support their anti-illicit trade efforts. For example, in 2004, we entered into a 12-year cooperation agreement with the EU and its member states that provides for cooperation with European law enforcement agencies on anti-contraband and on anti-counterfeit efforts. Under the terms of this agreement we make financial contributions of approximately \$75 million per year (recorded as an expense in cost of sales when product is shipped) to support these efforts. We are also required to pay the excise taxes, VAT and customs duties on qualifying seizures of up to 450 million genuine PMI products in the EU in a given year, and five times the applicable taxes and duties if seizures exceed this threshold in a given year. To date, our payments for product seizures have been immaterial.

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

Reduced-Risk Products: We use the term Reduced-Risk Products ("RRPs") to refer to products with the potential to reduce individual risk and population harm in comparison to smoking combustible tobacco products such as cigarettes. One of our strategic priorities is to develop, assess and commercialize a portfolio of innovative RRP's. Our RRP's are in various stages of development and commercialization, and we are conducting extensive and rigorous scientific studies to determine whether they reduce exposure to harmful and potentially harmful constituents and ultimately reduce disease risk, compared to cigarettes. Any claims we make are based on a full set of data from the relevant scientific studies and may also be subject to government review and approval, as is the case in the U.S. today. We draw upon a team of world-class scientists from a broad spectrum of scientific disciplines, and our efforts are guided by the following three key objectives:

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to develop RRP's that provide adult smokers the taste, sensory experience, nicotine delivery profile and ritual characteristics that are similar to those currently provided by cigarettes;

to substantiate the reduction of risk for the individual adult smoker and the reduction of harm to the population as a whole, based on robust scientific evidence derived from well-established assessment processes; and

to advocate for the development of science-based regulatory frameworks for the development and commercialization of RRP's, including the communication to adult smokers of scientifically substantiated reduced exposure or reduced risk claims.

Our product development is based on the elimination of combustion via tobacco heating and other innovative systems for aerosol generation, which we believe is the most promising path to reduce risk.

Our approach to individual risk assessment is to use cessation as the benchmark because the short-term and long-term effects of smoking cessation on risk reduction are well known.

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

Platform 1, as discussed below, uses a precisely controlled heating device that we are commercializing under the iQOS brand name, into which a specially designed tobacco product under the Marlboro and HeatSticks brand names is inserted to generate an aerosol. Six short-term clinical studies have been completed. The study results show a substantial reduction in relevant biomarkers of exposure in adult consumers who switched to iQOS compared to adult consumers who continued to smoke cigarettes over a five-day period. The conduct phase of two three-month clinical studies for Platform 1 has been completed. The final report of the two three-month clinical studies will be completed in the second half of 2015. We also initiated a longer term clinical study in December 2014, with the final results anticipated in the second half of 2016.

Platform 2 uses a pressed carbon heat source to generate an aerosol by heating tobacco. Clinical testing of Platform 2 started in the second quarter of 2015.

Platform 3 is based on technology we acquired from Professor Jed Rose of Duke University and his co-inventors in May 2011. This product creates an aerosol of nicotine salt formed by the chemical reaction of nicotine with a weak organic acid. We are exploring two routes for this platform, one with electronics and one without. The product replicates the feel and ritual of smoking without tobacco and without burning. We have begun pre-clinical testing of this product and plan to begin clinical trials as of the second half of 2015.

Platform 4 covers e-vapor products, which are battery powered devices that produce an aerosol by vaporizing a liquid nicotine solution. Our e-vapor products comprise devices using current generation technology, and we are working on developing the next generation of e-vapor technologies to address the challenges presented by the e-vapor products currently on the market, ranging from consumer satisfaction to manufacturing processes and product consistency.

We are also developing other potential product platforms.

We are proceeding with the commercialization of RRP. In January 2014, we announced an investment of up to €500 million over three years in our first manufacturing facility in the European Union and an associated pilot plant near Bologna, Italy, to produce our RRP. We plan for the factory to initially manufacture Platform 1 tobacco sticks (HeatSticks). When fully operational by 2016, and together with the pilot plant that was opened for production in October 2014, we expect to reach an annual production capacity of up to 30 billion units.

In the United States of America, an established regulatory framework for assessing “Modified Risk Tobacco Products” (“MRTPs”) exists under the jurisdiction of the Food and Drug Administration (“FDA”). We expect that future FDA actions are likely to influence the regulatory approach of other interested governments. Our assessment approach and the studies conducted to date reflect the rigorous evidentiary package contemplated in the FDA’s Draft Guidance for Modified Risk Tobacco Product Applications (2012). We have shared our approach and studies with the FDA’s Center for Tobacco Products. In parallel, we are engaging with regulators in several EU member states, as well as in a number of other countries. We plan to submit a Modified Risk Tobacco Product application for Platform 1 when we believe we have the evidentiary package contemplated in the Draft Guidance.

As we work to develop evidence to substantiate the risk reduction potential of our products, we will review our ability to make claims of reduced exposure or risk based on applicable laws and regulations and, as we are already doing, engage with regulators and share the evidence with them. We are also engaging with the scientific community, sharing our assessment approach and the results we have generated. There can be no assurance that we will succeed in our efforts or that regulators will permit the marketing of our RRP with substantiated claims of reduced formation,

exposure, individual risk or population harm.

In 2014, we introduced the iQOS system in pilot city launches in Nagoya, Japan, and in Milan, Italy, and plan to commence national expansion in those two countries in 2015. We will launch iQOS in Switzerland in August 2015 and plan to launch the product in several other markets thereafter. To date, the product has not been marketed with claims of reduced risk.

In December 2013, we established a strategic framework with Altria Group, Inc. ("Altria") under which Altria will make available its e-vapor products exclusively to us for commercialization outside the United States of America, and we will make available two of our RRP's exclusively to Altria for commercialization in the United States of America. In March 2015, we launched Solaris, a Platform 4 e-vapor product licensed from Altria, in Spain. In July 2015, we extended the strategic framework with Altria to include a Joint Research, Development and Technology Sharing Agreement. The additional agreement provides the framework under which PMI and Altria will collaborate to develop the next generation of e-vapor products for commercialization in the United States of America by Altria and in markets outside the United States of America by PMI. The collaboration between PMI and Altria in this endeavor is enabled by exclusive technology cross licenses and technical information sharing. The agreements

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also provide for cooperation on the scientific assessment of, and for the sharing of improvements to, the existing generation of licensed products.

In June 2014, we acquired 100% of Nicocigs Limited, a leading U.K.-based e-vapor company whose principal brand is Nicolites. This acquisition provided PMI with immediate access to, and a significant presence in, the U.K. e-vapor market.

Other Legislation, Regulation or Governmental Action: In Argentina, the National Commission for the Defense of Competition issued a resolution in May 2010 in which it found that our affiliate's establishment in 1997 of a system of exclusive zonified distributors ("EZDs") in Buenos Aires city and region was anticompetitive, despite having issued two prior decisions (in 1997 and 2000) in which it had found the establishment of the EZD system was not anticompetitive. The resolution is not a final decision, and our Argentinean affiliate has opposed the resolution and submitted additional evidence.

In Germany, in October 2013, the Administrative District Office Munich, acting under the policy supervision of the Bavarian Ministry of Health and Environment, sent our German affiliate an order alleging that certain components of its Marlboro advertising campaign do not comply with the applicable tobacco advertising law, and requiring our affiliate to stop this particular campaign throughout Germany and to remove all outdoor advertisements within one month from the effective date of the order and point-of-sale materials within three months. Our affiliate did not believe the allegations properly reflected the facts and the law and filed a challenge in the Munich Administrative Court, which was granted in part and denied in part. At an appeals hearing in April 2014, before the Bavarian Higher Administrative Court, the parties agreed that our affiliate could continue the campaign with certain limitations on image visuals and text slogans for the duration of the court proceedings. In April 2015, the Administrative District Office Munich issued a revised order, which again requires our affiliate to stop using core elements of this particular campaign within one to three months from the effective date of the order. Our affiliate has challenged the revised order in the Munich Administrative Court.

It is not possible to predict what, if any, additional legislation, regulation or other governmental action will be enacted or implemented relating to the manufacturing, advertising, sale or use of tobacco products, or the tobacco industry generally. It is possible, however, that legislation, regulation or other governmental action could be enacted or implemented that might materially affect our business, volume, results of operations, cash flows and financial position.

Governmental Investigations

From time to time, we are subject to governmental investigations on a range of matters. As part of an investigation by the Department of Special Investigations ("DSI") of the government of Thailand into alleged under declaration of import prices by Thai cigarette importers, the DSI proposed to bring charges against our subsidiary, Philip Morris (Thailand) Limited, Thailand Branch ("PM Thailand") for alleged underpayment of customs duties and excise taxes of approximately \$2 billion covering the period from July 28, 2003, to February 20, 2007 ("2003-2007 Investigation"). In September 2009, the DSI submitted the case file to the Public Prosecutor for review. The DSI also commenced an informal inquiry alleging underpayment by PM Thailand of customs duties and excise taxes of approximately \$1.8 billion, covering the period 2000-2003. In early 2011, the Public Prosecutor's office issued a non-prosecution order in the 2003-2007 Investigation. In August 2011, the Director-General of DSI publicly announced that he disagreed with the non-prosecution order. Thus, the matter was referred for resolution to the Attorney General, whose deputy subsequently stated that the Attorney General has made a ruling to proceed with a prosecution order. Based on available information, it is probable that criminal charges will be filed. PM Thailand has been cooperating with the Thai authorities and believes that its declared import prices are in compliance with the Customs Valuation Agreement

of the WTO and Thai law.

Additionally, in November 2010, a WTO panel issued its decision in a dispute relating to facts that arose from August 2006 between the Philippines and Thailand concerning a series of Thai customs and tax measures affecting cigarettes imported by PM Thailand into Thailand from the Philippines. The WTO panel decision, which was upheld by the WTO Appellate Body, concluded that Thailand had no basis to find that PM Thailand's declared customs values and taxes paid were too low, as alleged by the DSI in 2009. The decision also created obligations for Thailand to revise its laws, regulations, or practices affecting the customs valuation and tax treatment of future cigarette imports. Thailand agreed in September 2011 to comply with the decision by October 2012. The Philippines contends that to date Thailand has not fully complied and is pursuing bilateral discussions with Thailand to address the outstanding issues. At WTO meetings, the Philippines has repeatedly expressed concerns with ongoing investigations by Thailand of PM Thailand, noting that these investigations appear to be based on grounds not supported by WTO customs valuation rules and inconsistent with several decisions already taken by Thai Customs and other Thai governmental agencies.

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Acquisitions and Other Business Arrangements

In July 2015, we dissolved our exclusive joint venture agreement with Swedish Match AB ("SWMA") to commercialize Swedish snus and other smoke-free tobacco products worldwide, outside of Scandinavia and the United States. The dissolution, mutually agreed with SWMA, means that both companies will now focus on independent strategies for the commercialization of these products and the trademarks and intellectual property licensed to the joint venture by the companies will revert to their original owners. The two companies have concurrently entered into transitional agreements under which SWMA will contract manufacture snus products for us in certain markets, including Canada and Russia, and we will distribute Swedish Match's brand General in Canada and Russia. The dissolution of this agreement was not material to our consolidated financial position, results of operations or cash flows in any of the periods presented.

In June 2015, we announced that our subsidiary, PT HM Sampoerna ("Sampoerna"), of which we hold a 98.18% interest, will explore options to comply with the January 30, 2014 Indonesian Stock Exchange regulation requiring all listed public companies to have at least a 7.5% public shareholding by January 30, 2016. Sampoerna has engaged investment banks to assist with the evaluation of various strategic options, including potential capital market transactions, to fulfill this requirement.

In June 2014, we acquired 100% of Nicocigs Limited, a leading U.K.-based e-vapor company, for the final purchase price of \$103 million, net of cash acquired, with additional contingent payments of up to \$77 million, primarily relating to performance targets over a three-year period. As of June 30, 2015, the additional contingent payments were up to \$63 million over the remaining two-year period. For additional information, see Note 12. Fair Value Measurements to our condensed consolidated financial statements. The effect of this acquisition was not material to our consolidated financial position, results of operations or cash flows in any of the periods presented.

In September 2013, Grupo Carso, S.A.B. de C.V. ("Grupo Carso") sold to us its remaining 20% interest in our Mexican tobacco business for \$703 million. As a result, we own 100% of the Mexican tobacco business. A former director of PMI, whose term expired at the Annual Meeting of Shareholders in May 2015, had an affiliation with Grupo Carso. The final purchase price was subject to an 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 May 2015, we received a payment of \$113 million from Grupo Carso as the final purchase price adjustment. This resulted in a total net purchase price of \$590 million. In addition, we agreed to pay a dividend of approximately \$38 million to Grupo Carso related to the earnings of the Mexican tobacco business for the nine months ended September 30, 2013. In March 2014, the dividend was declared and paid. The purchase of the remaining 20% interest resulted in a net decrease to our additional paid-in capital of \$559 million.

Investments in Unconsolidated Subsidiaries

On September 30, 2013, we acquired a 49% equity interest in United Arab Emirates-based Emirati Investors-TA (FZC) ("EITA"), formerly Arab Investors-TA (FZC), for approximately \$625 million. As a result of this transaction, we hold an approximate 25% economic interest in Société des Tabacs Algéro-Emiratie ("STAEM"), an Algerian joint venture which is 51% owned by EITA and 49% by the Algerian state-owned enterprise Société Nationale des Tabacs et Allumettes SpA. STAEM manufactures and distributes under license some of our brands. The initial investment in EITA was recorded at cost and is included in investments in unconsolidated subsidiaries on the condensed consolidated balance sheets.

On December 12, 2013, we acquired from Megapolis Investment BV a 20% equity interest in Megapolis Distribution BV, the holding company of CJSC TK Megapolis ("Megapolis"), our distributor in Russia, for a purchase price of

\$760 million. An additional payment of up to \$100 million, which is contingent on Megapolis's operational performance over the four fiscal years following the closing of the transaction, will also be made by us if the performance criteria are satisfied. We have also agreed to provide Megapolis Investment BV with a \$100 million interest-bearing loan. We and Megapolis Investment BV have agreed to set off any future contingent payments owed by us against the future repayments due under the loan agreement. Any loan repayments in excess of the contingent consideration earned by the performance of Megapolis are due to be repaid, in cash, to us on March 31, 2017. At December 31, 2013, we recorded a \$100 million asset related to the loan receivable and a discounted liability of \$86 million related to the contingent consideration. The initial investment in Megapolis was recorded at cost and is included in investments in unconsolidated subsidiaries on the condensed consolidated balance sheets.

Asset Impairment and Exit Costs

On April 4, 2014, we announced the initiation by our affiliate, Philip Morris Holland B.V. ("PMH"), of consultations with employee representatives on a proposal to discontinue cigarette production at its factory located in Bergen op Zoom, the Netherlands. PMH reached an agreement with the trade unions and their members on a social plan, and ceased cigarette production on September 1,

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2014. In total, we expect to incur a total pre-tax charge of approximately \$547 million for the program. During 2014, we recorded pre-tax asset impairment and exit costs of \$489 million. This amount included employee separation costs of \$343 million, asset impairment costs of \$139 million and other separation costs of \$7 million. In addition, as part of the total program, up to \$58 million of pre-tax implementation costs, primarily related to notice period payments, will be reflected in cost of sales and marketing, administration and research costs in our consolidated statement of earnings. During 2014, \$50 million of these pre-tax implementations costs were reflected in our consolidated statements of earnings. Excluding asset impairment costs, substantially all of these charges will result in cash expenditures expected to be paid by the end of 2015.

Trade Policy

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

Tobacco products are agricultural products under U.S. law and are not technological or strategic in nature. From time to time we make sales in countries subject to Trade Sanctions, pursuant to either exemptions or licenses granted under the applicable Trade Sanctions.

A subsidiary sells products to distributors that in turn sell those products to duty free customers that supply U.N. peacekeeping forces around the world, including those in the Republic of the Sudan. We do not believe that these exempt sales of our products for ultimate resale in the Republic of the Sudan, which are de minimis in volume and value, present a material risk to our shareholders, our reputation or the value of our shares. We have no employees, operations or assets in the Republic of the Sudan.

To our knowledge, none of our commercial arrangements result in the governments of any country identified by the U.S. government as a state sponsor of terrorism, nor entities controlled by those governments, receiving cash or acting as intermediaries in violation of U.S. laws. We do not sell products in Iran and Syria.

Certain states within the U.S. have enacted legislation permitting state pension funds to divest or abstain from future investment in stocks of companies that do business with certain countries that are sanctioned by the U.S. We do not believe such legislation has had a material effect on the price of our shares.

Operating Results – Six Months and Three Months Ended June 30, 2015

The following discussion compares operating results within each of our reportable segments for the six months and three months ended June 30, 2015, with the six months and three months ended June 30, 2014.

European Union:

European Union (in millions)	For the Six Months Ended June 30,				
	2015	2014	Variance	%	
Net revenues	\$12,276	\$14,448	\$(2,172)	) (15.0	)%
Excise taxes on products	8,396	10,042	(1,646)	) (16.4	)%
Net revenues, excluding excise taxes on products	3,880	4,406	(526)	) (11.9	)%
Operating companies income	1,890	1,689	201	11.9	%

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For the six months ended June 30, 2015, net revenues, which include excise taxes billed to customers, decreased by \$2.2 billion. Excluding excise taxes, net revenues decreased by \$526 million due to:

• unfavorable currency (\$766 million) and
• unfavorable volume/mix (\$18 million), partly offset by
• price increases (\$247 million).

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The net revenues of the European Union segment include \$713 million in 2015 and \$819 million in 2014 related to sales of OTP. Excluding excise taxes, OTP net revenues for the European Union segment were \$251 million in 2015 and \$282 million in 2014.

Operating companies income increased by \$201 million during the six months ended June 30, 2015. This increase was due primarily to:

- the non-recurrence of the 2014 pre-tax charge for asset impairment and exit costs (\$488 million) related to the decision to discontinue cigarette production in the Netherlands,
- price increases (\$247 million) and
- lower manufacturing costs (\$17 million), partly offset by
- unfavorable currency (\$470 million),
- higher marketing, administration and research costs (\$53 million) and
- unfavorable volume/mix (\$24 million).

European Union (in millions)	For the Three Months Ended June 30,				
	2015	2014	Variance	%	
Net revenues	\$6,336	\$7,829	\$(1,493)	(19.1)	%
Excise taxes on products	4,348	5,436	(1,088)	(20.0)	%
Net revenues, excluding excise taxes on products	1,988	2,393	(405)	(16.9)	%
Operating companies income	977	\$711	266	37.4	%

For the three months ended June 30, 2015, net revenues decreased by \$1.5 billion. Excluding excise taxes, net revenues decreased by \$405 million due primarily to:

- unfavorable currency (\$488 million) and
- unfavorable volume/mix (\$60 million), partly offset by
- price increases (\$139 million).

The net revenues of the European Union segment include \$363 million in 2015 and \$432 million in 2014 related to sales of OTP. Excluding excise taxes, OTP net revenues for the European Union segment were \$127 million in 2015 and \$148 million in 2014.

Operating companies income increased by \$266 million during the three months ended June 30, 2015. This increase was due primarily to:

- the non-recurrence of the 2014 pre-tax charge for asset impairment and exit costs (\$488 million) related to the decision to discontinue cigarette production in the Netherlands,
- price increases (\$139 million), partly offset by
- unfavorable currency (\$279 million),
- unfavorable volume/mix (\$53 million) and
- higher marketing, administration and research costs (\$33 million).

European Union - Industry Volume

The total cigarette market in the European Union of 117.1 billion units decreased by 3.0% in the second quarter and by 2.3% to 221.8 billion units for the six months year-to-date. Excluding the impact of estimated trade inventory movements, the total cigarette market declined by 2.3% in the second quarter and by 2.5% for the six months year-to-date, reflecting, in certain key geographies, improving economies, a moderation in the level of illicit trade,

lower out-switching to the fine cut category and a lower prevalence of e-vapor products. In 2015, the total cigarette market in the European Union is now forecast to decrease by approximately 3.0% to 3.5%.

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The total OTP market in the European Union in the second quarter of 41.5 billion cigarette equivalent units decreased by 0.5%, reflecting a lower total fine cut market, down by 0.1% to 36.2 billion cigarette equivalent units. For the six months year-to-date, the total OTP market in the European Union of 79.2 billion cigarette equivalent units decreased by 1.1%, reflecting a lower total fine cut market, down by 1.0% to 69.2 billion cigarette equivalent units.

European Union - Shipment Volume and Market Share

Our cigarette shipment volume and market share performance by brand are shown in the tables below:

European Union Cigarette Shipment Volume by Brand (Million Units)

	Second-Quarter				Six Months Year-to-Date			
	2015	2014	Change		2015	2014	Change	
Marlboro	23,554	23,913	(1.5)%		44,346	44,144	0.5	%
L&M	8,528	8,717	(2.2)%		15,926	16,122	(1.2)%	
Chesterfield	6,905	7,501	(7.9)%		13,210	12,908	2.3	%
Philip Morris	3,634	2,590	40.3 %		6,016	4,941	21.8	%
Others	5,538	7,192	(23.0)%		11,382	13,503	(15.7)%	
Total EU	48,159	49,913	(3.5)%		90,880	91,618	(0.8)%	

European Union Cigarette Market Shares by Brand

	Second-Quarter				Six Months Year-to-Date			
	2015	2014	Change p.p.		2015	2014	Change p.p.	
Marlboro	19.6	% 19.4	% 0.2		19.4	% 19.3	% 0.1	
L&M	7.3	% 7.2	% 0.1		7.2	% 7.1	% 0.1	
Chesterfield	5.8	% 5.7	% 0.1		5.8	% 5.4	% 0.4	
Philip Morris	2.5	% 2.2	% 0.3		2.4	% 2.1	% 0.3	
Others	5.2	% 5.9	% (0.7)		5.2	% 5.9	% (0.7)	
Total EU	40.4	% 40.4	% —		40.0	% 39.8	% 0.2	

In the second quarter, our cigarette shipment volume of 48.2 billion units decreased by 3.5%, or by 2.9% excluding inventory movements, mainly due to Italy and Spain, partly offset by France. Market share was flat at 40.4%, with gains, mainly in France, Germany and Spain, mainly offset by Italy.

In the second quarter, our shipments of OTP of 6.1 billion cigarette equivalent units increased by 3.6%, driven principally by higher market share. Our total OTP market share increased by 0.2 points to 14.5%, reflecting a gain in the fine cut category.

For the six months year-to-date, our cigarette shipment volume of 90.9 billion units decreased by 0.8%, or by 1.4% excluding inventory movements, notably due to Italy, partly offset by France and Spain. Market share increased by 0.2 points to 40.0%, driven notably by France, Germany and Spain, partly offset by the United Kingdom.

For the six months year-to-date, our shipments of OTP of 11.6 billion cigarette equivalent units increased by 3.7%, driven principally by higher market share. Our total OTP market share increased by 0.2 points to 14.4%, reflecting a slight gain in the fine cut category.

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European Union - Market Discussions

In France, industry size, PMI cigarette shipment volume and market share performance are shown in the table below.

	France Key Market Data							
	Second-Quarter					Six Months Year-to-Date		
	2015	2014	Change % / p.p.			2015	2014	Change % / p.p.
Total Cigarette Market (billion units)	11.8	11.8	0.1		%	22.4	22.3	0.3
PMI Shipments (million units)	5,126	4,816	6.4		%	9,704	9,378	3.5
PMI Cigarette Market Share								
Marlboro	25.9	% 25.5	% 0.4			25.7	% 25.3	% 0.4
Philip Morris	9.6	% 9.4	% 0.2			9.6	% 9.4	% 0.2
Chesterfield	3.3	% 3.4	% (0.1)	)		3.3	% 3.4	% (0.1)
Others	3.0	% 3.1	% (0.1)	)		2.9	% 3.1	% (0.2)
Total	41.8	% 41.4	% 0.4			41.5	% 41.2	% 0.3

In the second quarter, the total cigarette market was essentially flat, reflecting its general recovery since the second half of 2014 and a lower prevalence of e-vapor products. Excluding the net impact of inventory movements, our cigarette shipment volume increased by 0.9%, reflecting market share growth, notably of premium brands Marlboro and Philip Morris. The total industry fine cut category of 3.7 billion cigarette equivalent units increased by 7.2%. Our market share of the category decreased by 1.6 points to 25.0%.

For the six months year-to-date, the increase in the total cigarette market reflected the same dynamics as in the quarter. Excluding the net impact of inventory movements, our cigarette shipment volume increased by 1.2%, reflecting market share growth, notably of premium brands Marlboro and Philip Morris. The total industry fine cut category of 7.0 billion cigarette equivalent units increased by 6.2%. Our market share of the category decreased by 1.3 points to 25.0%.

In Germany, industry size, PMI cigarette shipment volume and market share performance are shown in the table below.

	Germany Key Market Data			Six Months Year-to-Date				
	Second-Quarter							
	2015	2014	Change		2015	2014	Change	
			% / p.p.				% / p.p.	
Total Cigarette Market (billion units)	19.9	20.9	(5.0	)%	38.0	39.1	(2.7	)%
PMI Shipments (million units)	7,756	7,732	0.3	%	14,501	14,440	0.4	%
PMI Cigarette Market Share								
Marlboro	23.0	% 21.8	% 1.2		22.5	% 21.9	% 0.6	
L&M	12.7	% 11.9	% 0.8		12.5	% 11.8	% 0.7	
Chesterfield	1.8	% 1.7	% 0.1		1.7	% 1.7	% —	
Others	1.5	% 1.5	% —		1.4	% 1.5	% (0.1	)
Total	39.0	% 36.9	% 2.1		38.1	% 36.9	% 1.2	

In the second quarter, the decline of the total cigarette market was mainly due to unfavorable trade inventory movements. Excluding these inventory movements, the total cigarette market declined by 2.2%, mainly due to the annualized impact of price increases in the third quarter of 2014, partly offset by a lower prevalence of illicit trade. The increase in our market share was driven by Marlboro, mainly reflecting the positive impact of the new 2.0 Architecture, and L&M, benefiting from a rounded retail price

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point of €5.00 per pack. While the total industry fine cut category of 10.2 billion cigarette equivalent units decreased by 2.2%, our market share of the category increased by 0.4 points to 13.4%.

For the six months year-to-date, the decline of the total cigarette market was partly due to unfavorable trade inventory movements. Excluding these inventory movements, the total cigarette market declined by 2.1%, reflecting the same dynamics as in the second quarter. The increase in our market share was driven by the same factors as in the second quarter. While the total industry fine cut category of 19.7 billion cigarette equivalent units decreased by 2.9%, our market share of the category was flat at 13.0%.

In Italy, industry size, PMI cigarette shipment volume and market share performance are shown in the table below.

	Italy Key Market Data Second-Quarter			Six Months Year-to-Date		
	2015	2014	Change % / p.p.	2015	2014	Change % / p.p.
Total Cigarette Market (billion units)	18.9	19.2	(1.6)%	35.4	36.0	(1.7)%
PMI Shipments (million units)	10,564	11,402	(7.3)%	20,214	20,469	(1.2)%
PMI Cigarette Market Share						
Marlboro	24.1	% 25.0	% (0.9)	24.2	% 25.3	% (1.1)
Chesterfield	10.8	% 10.0	% 0.8	10.7	% 7.7	% 3.0
Diana	6.2	% 8.5	% (2.3)	6.9	% 9.2	% (2.3)
Others	12.7	% 11.8	% 0.9	12.1	% 12.0	% 0.1
Total	53.8	% 55.3	% (1.5)	53.9	% 54.2	% (0.3)

In the second quarter and for the six months year-to-date, the decline in the total cigarette market was mainly due to the tax-driven price increases in January 2015 and out-switching to less expensive other tobacco product categories, particularly fine cut, partly offset by a lower prevalence of illicit trade and e-vapor products. Excluding the net impact of inventory movements, our cigarette shipment volume decreased by 4.0% in the second quarter and by 2.2% for the six months year-to-date, reflecting market share loss, notably of Marlboro, largely due to its price increase in the first quarter of 2015 to €5.20 per pack from its round retail price point of €5.00 per pack, and low-price Diana, which is currently being morphed into Philip Morris, and which had been impacted by the growth of the super-low price segment, partly offset by Chesterfield, reflecting the annualized impact of the brand's repositioning into the super-low price segment. In the second quarter, the total industry fine cut category of 1.6 billion cigarette equivalent units increased by 6.2%. Our market share of the category decreased by 0.9 points to 41.3%. For the six months year-to-date, the total industry fine cut category of 3.1 billion cigarette equivalent units increased by 5.2%. Our market share of the category decreased by 0.3 points to 41.4%.

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In Poland, industry size, PMI cigarette shipment volume and market share performance are shown in the table below.

	Poland Key Market Data Second-Quarter			Six Months Year-to-Date		
	2015	2014	Change % / p.p.	2015	2014	Change % / p.p.
Total Cigarette Market (billion units)	10.6	11.1	(4.7)%	20.3	21.6	(5.7)%
PMI Shipments (million units)	4,266	4,489	(5.0)%	8,023	8,159	(1.7)%
PMI Cigarette Market Share						
Marlboro	11.4	% 10.9	% 0.5	11.0	% 10.6	% 0.4
L&M	17.9	% 17.8	% 0.1	17.7	% 17.1	% 0.6
Chesterfield	8.6	% 7.9	% 0.7	8.3	% 7.5	% 0.8
Others	2.4	% 3.8	% (1.4)	2.4	% 3.6	% (1.2)
Total	40.3	% 40.4	% (0.1)	39.4	% 38.8	% 0.6

In the second quarter and for the six months year-to-date, the decline in the total cigarette market was mainly due the prevalence of e-vapor products, illicit trade and non-duty paid OTP products. While our cigarette shipment volume in the quarter and year-to-date decreased, reflecting a lower total market, market share was essentially flat in the second quarter, and up by 0.6 points for the six months year-to-date, with declines from super-low price brands Red & White and RGD offset by Marlboro, partly reflecting the positive impact of the new 2.0 Architecture, L&M, driven by new product launches, and Chesterfield, partly driven by its round corner box super-slims variants. In the second quarter, the total industry fine cut category of 1.0 billion cigarette equivalent units increased by 12.7%. Our market share of the category decreased by 2.2 points to 33.1%. For the six months year-to-date, the total industry fine cut category of 2.0 billion cigarette equivalent units increased by 5.1%. Our market share of the category decreased by 1.7 points to 33.4%.

In Spain, industry size, PMI cigarette shipment volume and market share performance are shown in the table below.

	Spain Key Market Data Second-Quarter			Six Months Year-to-Date		
	2015	2014	Change % / p.p.	2015	2014	Change % / p.p.
Total Cigarette Market (billion units)	11.8	12.3	(4.1)%	22.3	22.8	(2.4)%
PMI Shipments (million units)	4,121	4,337	(5.0)%	7,688	7,524	2.2 %
PMI Cigarette Market Share						
Marlboro	16.8	% 15.8	% 1.0	16.4	% 15.5	% 0.9
Chesterfield	9.1	% 9.2	% (0.1)	9.3	% 9.3	% —
L&M	5.9	% 6.1	% (0.2)	5.9	% 6.2	% (0.3)
Others	1.4	% 0.9	% 0.5	1.4	% 0.7	% 0.7
Total	33.2	% 32.0	% 1.2	33.0	% 31.7	% 1.3

In the second quarter and for the six months year-to-date, the decline of the total cigarette market was mainly due to unfavorable trade inventory movements. Excluding these inventory movements, the total cigarette market declined by 0.5% in the second quarter and by 1.0% for the six months year-to-date, mainly due to the impact of price increases in the second half of 2014 and the first quarter of 2015, partly offset by an improving economy, a lower prevalence of illicit trade and e-vapor products, and in-switching from fine cut. Excluding inventory movements, our cigarette

shipment volume decreased by 0.4% in the second quarter and increased by 1.6% for the six months year-to-date. The increase in our market share in the second quarter and for the six months year-to-date was driven mainly by Marlboro, benefiting from a round price point in the vending channel, the new 2.0 Architecture, and an improving economy. In the second quarter, the total industry fine cut category of 2.5 billion cigarette equivalent

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units decreased by 2.2%. Our market share of the fine cut category decreased by 1.2 points to 13.5%. For the six months year-to-date, the total industry fine cut category of 4.7 billion cigarette equivalent units decreased by 1.5%. Our market share of the fine cut category decreased by 1.3 points to 13.9%.

Eastern Europe, Middle East & Africa:

Eastern Europe, Middle East & Africa (in millions)	For the Six Months Ended June 30,				
	2015	2014	Variance	%	
Net revenues	\$9,423	\$10,236	\$(813)	)	(7.9)%
Excise taxes on products	5,661	5,944	(283)	)	(4.8)%
Net revenues, excluding excise taxes on products	3,762	4,292	(530)	)	(12.3)%
Operating companies income	1,761	2,014	(253)	)	(12.6)%

For the six months ended June 30, 2015, net revenues, which include excise taxes billed to customers, decreased by \$813 million. Excluding excise taxes, net revenues decreased by \$530 million due primarily to:

- unfavorable currency (\$909 million), partly offset by
- price increases (\$311 million) and
- favorable volume/mix (\$67 million).

Operating companies income decreased by \$253 million during the six months ended June 30, 2015. This decrease was due primarily to:

- unfavorable currency (\$524 million),
- higher marketing, administration and research costs (\$67 million) and
- higher manufacturing costs (\$38 million), partially offset by
- price increases (\$311 million),
- favorable volume/mix (\$35 million) and
- higher equity income in unconsolidated subsidiaries (\$31 million).

Eastern Europe, Middle East & Africa (in millions)	For the Three Months Ended June 30,				
	2015	2014	Variance	%	
Net revenues	\$4,994	\$5,674	\$(680)	)	(12.0)%
Excise taxes on products	3,075	3,391	(316)	)	(9.3)%
Net revenues, excluding excise taxes on products	1,919	2,283	(364)	)	(15.9)%
Operating companies income	881	\$1,087	(206)	)	(19.0)%

For the three months ended June 30, 2015, net revenues decreased by \$680 million. Excluding excise taxes, net revenues decreased by \$364 million due primarily to:

- unfavorable currency (\$464 million) and
- unfavorable volume/mix (\$43 million), partly offset by
- price increases (\$142 million).

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Operating companies income decreased by \$206 million during the three months ended June 30, 2015. This decrease was due primarily to:

• unfavorable currency (\$253 million),
 • higher marketing, administration and research costs (\$47 million),
 • unfavorable volume/mix (\$39 million) and
 • higher manufacturing costs (\$14 million), partly offset by
 • price increases (\$142 million).

Eastern Europe Middle East & Africa - PMI Cigarette Shipment Volume

In the second quarter, our cigarette shipment volume of 73.8 billion units decreased by 0.5%, or by 0.6% excluding acquisitions. The decline was principally due to Kazakhstan, reflecting a lower total market and share, and Ukraine, partly offset by Russia and the Middle East, notably Saudi Arabia. Our cigarette shipment volume of premium brands decreased by 2.5%, mainly due to: Marlboro, down by 3.1% to 21.1 billion units, principally due to Egypt and Ukraine, partly offset by Saudi Arabia, and Turkey; and Parliament, down by 2.1% to 8.8 billion units, mainly due to Ukraine. Our cigarette shipment volume of L&M increased by 5.4% to 13.2 billion units, driven by Egypt, Turkey and Ukraine, partially offset by Russia.

For the six months year-to-date, our cigarette shipment volume of 138.6 billion units increased by 1.7%, or by 1.6% excluding acquisitions, mainly driven by Russia and the Middle East, notably Saudi Arabia, partly offset by Kazakhstan and Ukraine. Our cigarette shipment volume of premium brands increased by 1.8%, mainly driven by: Marlboro, up by 2.8% to 41.4 billion units, driven notably by Saudi Arabia and Turkey, partly offset by Egypt and Ukraine; and Parliament, up by 0.2% to 16.2 billion units, driven principally by Turkey, partly offset by Ukraine. Our cigarette shipment volume of L&M increased by 9.6% to 25.5 billion units, driven by Egypt, Turkey and Ukraine.

Eastern Europe Middle East & Africa - Market Discussions

In North Africa (defined as Algeria, Egypt, Libya, Morocco and Tunisia), estimated industry size, PMI cigarette shipment volume and market share performance are shown in the table below.

	North Africa Key Market Data			Six Months Year-to-Date			
	Second-Quarter						
	2015	2014	Change % / p.p.	2015	2014	Change % / p.p.	
Total Cigarette Market (billion units)	34.8	36.1	(3.8)%	67.1	70.6	(4.9)%	
PMI Shipments (million units)	8,806	9,204	(4.3)%	18,008	17,760	1.4 %	
PMI Cigarette Market Share							
Marlboro	13.9	% 14.2	% (0.3)	14.3	% 14.7	% (0.4)	
L&M	10.6	% 8.4	% 2.2	10.7	% 8.2	% 2.5	
Others	1.8	% 1.8	% —	1.9	% 1.8	% 0.1	
Total	26.3	% 24.4	% 1.9	26.9	% 24.7	% 2.2	

In the second quarter, the decline of the estimated total market was due principally to Algeria, Egypt, mainly reflecting the impact of excise tax-driven price increases in July 2014 and February 2015, partly offset by Libya and

Tunisia. For the six months year-to-date, the estimated total market decreased by 4.9%, due to Algeria, Egypt, Libya and Morocco, partly offset by Tunisia. The decline in our cigarette shipment volume in the second quarter mainly reflected the lower total market, notably in Egypt, partly offset by higher market share. Our cigarette shipment volume for the six months year-to-date increased by 1.4%. Our market share growth in the second quarter and for the six months year-to-date was driven mainly by L&M in Egypt, reflecting improved territorial coverage, brand building activities and the growth of round corner box versions, partly offset by Marlboro, mainly in Egypt.

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In Russia, estimated industry size, PMI cigarette shipment volume and market share performance, as measured by Nielsen, are shown in the table below.

	Russia Key Market Data Second-Quarter			Six Months Year-to-Date			
	2015	2014	Change % / p.p.	2015	2014	Change % / p.p.	
Total Cigarette Market (billion units)	77.2	80.6	(4.2)%	138.6	148.3	(6.5)%	
PMI Shipments (million units)	23,075	21,906	5.3 %	42,084	40,495	3.9 %	
PMI Cigarette Market Share							
Marlboro	1.4	% 1.6	% (0.2)	1.4	% 1.6	% (0.2)	
Parliament	3.9	% 3.6	% 0.3	3.9	% 3.6	% 0.3	
Bond Street	8.1	% 7.4	% 0.7	8.0	% 7.2	% 0.8	
Others	14.4	% 14.3	% 0.1	14.4	% 14.5	% (0.1)	
Total	27.8	% 26.9	% 0.9	27.7	% 26.9	% 0.8	

In the quarter and year-to-date, the decline of the estimated total cigarette market was mainly due to the unfavorable impact of tax-driven price increases and lower consumer purchasing power as a result of a weak economy. The increase in our cigarette shipment volume in the second quarter and six months year-to-date largely reflected market share growth. The increase in our market share in the quarter and year-to-date was driven by above premium price Parliament and low price Bond Street.

In Turkey, estimated industry size, PMI cigarette shipment volume and market share performance, as measured by Nielsen, are shown in the table below.

	Turkey Key Market Data Second-Quarter			Six Months Year-to-Date			
	2015	2014	Change % / p.p.	2015	2014	Change % / p.p.	
Total Cigarette Market (billion units)	25.8	24.1	7.2 %	45.8	42.2	8.5 %	
PMI Shipments (million units)	12,012	12,248	(1.9)%	21,283	21,205	0.4 %	
PMI Cigarette Market Share							
Marlboro	9.3	% 8.5	% 0.8	9.1	% 8.5	% 0.6	
Parliament	11.6	% 10.9	% 0.7	11.6	% 10.7	% 0.9	
Lark	7.5	% 9.7	% (2.2)	7.4	% 10.0	% (2.6)	
Others	15.0	% 15.3	% (0.3)	15.2	% 15.2	% —	
Total	43.4	% 44.4	% (1.0)	43.3	% 44.4	% (1.1)	

In the second quarter, the increase in the estimated total cigarette market mainly reflected an increase in the adult population and a lower prevalence of illicit trade. For the six months year-to-date, the increase in the total cigarette market reflected the same dynamics as in the second quarter, as well as the favorable net impact of estimated trade inventory movements. Excluding these inventory movements, the total cigarette market increased by 6.8%. The decrease in our cigarette shipment volume in the second quarter was mainly due to market share loss in the low price segment. Our cigarette shipment volume for the six months year-to-date increased by 0.4%. In the quarter and year-to-date, the decrease in our market share was primarily due to low-price Lark, reflecting the impact of price

repositioning by our principal competitor in May 2014. The decline was partly offset by our premium brands, notably Parliament, reflecting its strengthening brand equity, and by up-trading from the mid-price segment.

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In Ukraine, estimated industry size, PMI cigarette shipment volume and market share performance, as measured by Nielsen, are shown in the table below.

	Ukraine Key Market Data Second-Quarter			Six Months Year-to-Date		
	2015	2014	Change % / p.p.	2015	2014	Change % / p.p.
Total Cigarette Market (billion units)	18.9	20.4	(7.5)%	33.6	34.7	(3.1)%
PMI Shipments (million units)	5,070	6,176	(17.9)%	9,678	11,287	(14.3)%
PMI Cigarette Market Share						
Marlboro	3.8	% 4.8	% (1.0)	4.1	% 5.0	% (0.9)
Parliament	2.7	% 2.9	% (0.2)	2.8	% 3.0	% (0.2)
Bond Street	8.0	% 9.1	% (1.1)	7.9	% 9.2	% (1.3)
Others	15.4	% 15.8	% (0.4)	16.1	% 15.6	% 0.5
Total	29.9	% 32.6	% (2.7)	30.9	% 32.8	% (1.9)

In the quarter and year-to-date, the decline of the estimated total cigarette market was mainly due to lower consumer purchasing power as a result of a weak economy, and continued business disruption due to the political instability in the east of the country, partly offset by a lower prevalence of illicit trade. The decrease in our cigarette shipment volume in the second quarter and six months year-to-date largely reflected a lower total market and market share loss. The decrease in our market share in the quarter and year-to-date was due to Marlboro, reflecting the impact of lower consumer purchasing power, and Bond Street, mainly resulting from competitive price pressure in the low price segment. The year-to-date share growth of "Others" was mainly driven by growth of low-price L&M and super low-price President, partly offset by mid-price Chesterfield and super low-price Optima.

Asia:

Asia (in millions)	For the Six Months Ended June 30,				
	2015	2014	Variance	%	
Net revenues	\$9,803	\$9,572	\$231	2.4	%
Excise taxes on products	5,503	10,527	5,079	424	8.3 %
Net revenues, excluding excise taxes on products	4,300	4,493	(193)	(4.3)	%
Operating companies income	1,731	1,815	(84)	(4.6)	%

For the six months ended June 30, 2015, net revenues, which include excise taxes billed to customers, increased by \$231 million. Excluding excise taxes, net revenues decreased by \$193 million due to:

- unfavorable currency (\$357 million) and
- unfavorable volume/mix (\$92 million), partly offset by
- price increases (\$256 million).

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Operating companies income decreased by \$84 million during the six months ended June 30, 2015. This decrease was due primarily to:

- unfavorable currency (\$176 million),
- unfavorable volume/mix (\$99 million),
- higher manufacturing costs (\$60 million, mainly due to higher costs in Indonesia) and
- higher marketing, administration and research costs (\$27 million), partly offset by
- price increases (\$256 million) and
- the non-recurrence of the 2014 pre-tax charges for asset impairment and exit costs (\$24 million) due to the factory closure in Australia.

Asia (in millions)	For the Three Months Ended June 30,				
	2015	2014	Variance	%	
Net revenues	\$5,039	\$5,097	\$(58)	) (1.1	)%
Excise taxes on products	2,894	2,786	108	3.9	%
Net revenues, excluding excise taxes on products	2,145	2,311	(166)	) (7.2	)%
Operating companies income	797	900	(103)	) (11.4	)%

For the three months ended June 30, 2015, net revenues decreased by \$58 million. Excluding excise taxes, net revenues decreased by \$166 million due to:

- unfavorable currency (\$229 million) and
- unfavorable volume/mix (\$42 million), partly offset by
- price increases (\$105 million).

Operating companies income decreased by \$103 million during the three months ended June 30, 2015. This decrease was due primarily to:

- unfavorable currency (\$97 million),
- unfavorable volume/mix (\$55 million),
- higher marketing, administration and research costs (\$28 million) and
- higher manufacturing costs (\$27 million, mainly due to higher costs in Indonesia), partly offset by
- price increases (\$105 million).

Asia - PMI Cigarette Shipment Volume

In the second quarter, our cigarette shipment volume of 75.3 billion units decreased by 0.5%, largely due to Australia, mainly reflecting the lower total market, Indonesia, Korea and the Philippines. The decrease was partly offset by higher cigarette shipment volume in Japan, mainly driven by a higher total market and favorable net trade inventory movements. Excluding these inventory movements, our cigarette shipment volume decreased by 1.8%. Cigarette shipment volume of Marlboro of 18.9 billion units increased by 2.2%, predominantly driven by the Philippines and Vietnam, partly offset by Indonesia and Japan. Cigarette shipment volume of Parliament of 2.4 billion units decreased by 21.8%, due to Japan and Korea. Cigarette shipment volume of Lark of 5.7 billion units increased by 53.3%, driven by Japan, benefiting from trade inventory movements.

For the six months year-to-date, our cigarette shipment volume of 145.4 billion units decreased by 0.7%, mainly due to Korea and the Philippines, partly offset by Indonesia. Estimated net inventory movements year-to-date were favorable, driven by Japan. Excluding these inventory movements, our cigarette volume decreased by 1.4%. Cigarette shipment volume of Marlboro of 36.9 billion units decreased by 1.6%, predominantly due to Japan and Korea, partly offset by the Philippines. Cigarette shipment volume of Parliament of 4.3 billion units decreased by 22.5%, due to Japan and Korea. Cigarette shipment volume of Lark of 10.2 billion units increased by 23.2%, driven by Japan, benefiting from trade inventory movements.

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Asia - Market Discussions

In Indonesia, estimated industry size, PMI cigarette shipment volume and market share performance are shown in the table below.

	Indonesia Key Market Data				Six Months Year-to-Date			
	Second-Quarter			Change % / p.p.				Change % / p.p.
	2015	2014			2015	2014		
Total Cigarette Market (billion units)	78.6	82.4		(4.6)%	156.9	156.2		0.4 %
PMI Shipments (million units)	27,659	28,598		(3.3)%	55,343	54,133		2.2 %
PMI Cigarette Market Share								
Sampoerna A	15.0	% 14.1	% 0.9		15.0	% 14.2	% 0.8	
Dji Sam Soe	7.0	% 6.2	% 0.8		7.0	% 5.9	% 1.1	
U Mild	4.9	% 5.6	% (0.7)		5.0	% 5.4	% (0.4)	
Others	8.3	% 8.8	% (0.5)		8.3	% 9.1	% (0.8)	
Total	35.2	% 34.7	% 0.5		35.3	% 34.6	% 0.7	

In the second quarter, the decline of the estimated total market was mainly due to a soft economic environment. For the six months year-to-date, the estimated total market increased by 0.4%. The decline in our cigarette shipment volume in the second quarter mainly reflected U Mild's crossing a critical price point ahead of competition earlier in the year, and the impact of the softer macro-economic environment. The increase in our cigarette shipment volume for the six months year-to-date mainly reflected market share growth. Our market share growth in the second quarter and six months year-to-date was driven by a strong performance from our machine-made kretek brands, notably Sampoerna A, Dji Sam Soe Magnum and Dji Sam Soe Magnum Blue, partly offset by U Mild and a decline in our hand-rolled kretek portfolio, notably due to Sampoerna Hijau in "Others," down by 0.5 points to 2.9%, largely reflecting the decline of the total segment. While Marlboro's market share decreased slightly by 0.1 point to 5.1%, its share of the "white" cigarettes segment, which represented 6.2% of the total cigarette market, increased by 2.0 points to 81.3%. The machine-made kretek segment, representing 75.0% of the total cigarette market, increased by 1.6 points and PMI's share of the segment increased by 1.1 points to 30.7%. The hand-rolled kretek segment, representing 18.8% of the total cigarette market, decreased by 1.3 points. Our share of the segment decreased by 1.1 points to 37.9%.

In Japan, industry size, PMI cigarette shipment volume and market share performance are shown in the table below.

	Japan Key Market Data				Six Months Year-to-Date			
	Second-Quarter			Change % / p.p.				Change % / p.p.
	2015	2014			2015	2014		
Total Cigarette Market (billion units)	46.0	41.5		11.0 %	88.5	90.9		(2.5)%
PMI Shipments (million units)	13,552	11,750		15.3 %	25,398	25,237		0.6 %
PMI Cigarette Market Share								
Marlboro	11.3	% 11.5	% (0.2)		11.4	% 11.7	% (0.3)	
Parliament	2.3	% 2.4	% (0.1)		2.3	% 2.2	% 0.1	
Lark	10.0	% 10.4	% (0.4)		10.0	% 9.8	% 0.2	
Others	1.8	% 2.1	% (0.3)		1.8	% 2.2	% (0.4)	

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Total	25.4	%	26.4	%	(1.0	)	25.5	%	25.9	%	(0.4	)
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In the second quarter, the increase of the total cigarette market primarily reflected a favorable comparison with the second quarter of 2014 in which the total market decreased by 14.4%, mainly driven by unfavorable estimated retail trade inventory movements following the consumption tax-driven retail price increases of April, 2014. Excluding the impact of these inventory movements, the total cigarette market declined by 1.7%, mainly reflecting the unfavorable impact of price increases. For the six months year-to-date, the total market declined by 2.5% and 2.6% excluding estimated retail trade inventory movements. The increase of our cigarette shipment volume in the second quarter mainly reflected the higher total market and favorable trade inventory movements. Our cigarette shipment volume for the six months year-to-date increased by 0.6%. Excluding the impact of estimated trade inventory movements, our market share in the second quarter and for the six months year-to-date declined by 0.4 and 0.3 points, respectively.

In Korea, industry size, PMI cigarette shipment volume and market share performance are shown in the table below.

	Korea Key Market Data Second-Quarter			Six Months Year-to-Date		
	2015	2014	Change % / p.p.	2015	2014	Change % / p.p.
Total Cigarette Market (billion units)	18.1	22.4	(19.2)%	30.7	41.8	(26.6)%
PMI Shipments (million units)	3,732	4,404	(15.3)%	6,190	8,230	(24.8)%
PMI Cigarette Market Share						
Marlboro	9.2	% 7.6	% 1.6	9.2	% 7.8	% 1.4
Parliament	7.1	% 7.2	% (0.1)	6.9	% 7.2	% (0.3)
Virginia S.	3.8	% 4.0	% (0.2)	3.8	% 4.0	% (0.2)
Others	0.6	% 0.8	% (0.2)	0.5	% 0.7	% (0.2)
Total	20.7	% 19.6	% 1.1	20.4	% 19.7	% 0.7

In the second quarter, the decline of the total cigarette market reflected the impact of the January 2015 excise tax increase and related retail price increases. For the six months year-to-date, the total market declined by 26.6%, or by 20.2% excluding the impact of estimated inventory movements associated with the timing of the excise tax increase. The decline in our cigarette shipment volume in the second quarter and the six months year-to-date was in line with the lower total market, partly offset by share growth, driven by Marlboro, reflecting the positive impact of line-pricing to our principal domestic competitor's main brands.

In the Philippines, estimated tax-paid industry size, PMI cigarette shipment volume and market share performance are shown in the table below.

	Philippines Key Market Data Second-Quarter			Six Months Year-to-Date		
	2015	2014	Change % / p.p.	2015	2014	Change % / p.p.
Total Cigarette Market (billion units)	21.2	20.0	6.0 %	39.8	38.8	2.7 %
PMI Shipments (million units)	16,725	17,243	(3.0)%	32,629	33,408	(2.3)%
PMI Cigarette Market Share						
Marlboro	20.2	% 18.1	% 2.1	21.1	% 18.7	% 2.4
Fortune	32.1	% 36.0	% (3.9)	32.5	% 34.7	% (2.2)
Jackpot	13.7	% 17.6	% (3.9)	15.2	% 17.7	% (2.5)
Others	12.9	% 14.5	% (1.6)	13.2	% 15.1	% (1.9)

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Total	78.9	% 86.2	% (7.3)	82.0	% 86.2	% (4.2)
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In the second quarter and the six months year-to-date, the increase in the estimated total tax-paid industry cigarette volume reflected higher estimated duty-paid volume by our principal domestic competitor. The decline in our cigarette shipment volume in both periods was mainly due to lower consumption of low and super-low price brands, following consecutive price increases in late 2014 and early 2015, partly offset by the growth of Marlboro, reflecting the narrowing of retail price gaps with brands at the bottom end of the market.

Latin America & Canada:

Latin America & Canada (in millions)	For the Six Months Ended June 30,				
	2015	2014	Variance	%	
Net revenues	\$4,613	\$4,574	\$39	0.9	%
Excise taxes on products	3,080	3,051	29	1.0	%
Net revenues, excluding excise taxes on products	1,533	1,523	10	0.7	%
Operating companies income	555	467	88	18.8	%

For the six months ended June 30, 2015, net revenues, which include excise taxes billed to customers, increased by \$39 million. Excluding excise taxes, net revenues increased by \$10 million due primarily to:

• price increases (\$252 million), partly offset by
 • unfavorable currency (\$200 million) and
 • unfavorable volume/mix (\$46 million).

Operating companies income increased by \$88 million during the six months ended June 30, 2015. This increase was due primarily to:

• price increases (\$252 million) and
 • lower marketing, administration and research costs (\$11 million), partly offset by
 • unfavorable currency (\$95 million),
 • unfavorable volume/mix (\$50 million) and
 • higher manufacturing costs (\$33 million).

Latin America & Canada (in millions)	For the Three Months Ended June 30,				
	2015	2014	Variance	%	
Net revenues	\$2,394	\$2,451	\$(57)	(2.3)	)%
Excise taxes on products	1,587	1,641	(54)	(3.3)	)%
Net revenues, excluding excise taxes on products	807	810	(3)	(0.4)	)%
Operating companies income	325	265	60	22.6	%

For the three months ended June 30, 2015, net revenues decreased by \$57 million. Excluding excise taxes, net revenues decreased by \$3 million due primarily to:

• unfavorable currency (\$112 million) and
 • unfavorable volume/mix (\$22 million), partly offset by
 • price increases (\$128 million).

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Operating companies income increased by \$60 million during the three months ended June 30, 2015. This increase was due primarily to:

price increases (\$128 million) and
lower marketing, administration and research costs (\$24 million), partly offset by
unfavorable currency (\$51 million),
unfavorable volume/mix (\$24 million) and
higher manufacturing costs (\$19 million).

Latin America & Canada - PMI Cigarette Shipment Volume and Market share

In the second quarter, our cigarette shipment volume of 22.6 billion units decreased by 2.1%, notably due to Argentina and Mexico. Although shipment volume of Marlboro of 8.8 billion units decreased by 2.1%, our Latin America & Canada segment market share increased by 0.2 points to an estimated 14.9%. Market share of Marlboro increased notably in Argentina, Brazil and Colombia, by 0.5, 0.2 and 1.4 points to 24.3%, 9.4% and 9.1%, respectively. Shipment volume of Philip Morris of 4.6 billion units increased by 2.2%, driven notably by Canada.

For the six months year-to-date, our cigarette shipment volume of 43.8 billion units decreased by 1.7%, largely due to Argentina and Canada. Although shipment volume of Marlboro of 17.0 billion units decreased by 1.3%, our Latin America & Canada segment market share increased by 0.4 points to an estimated 14.8%. Market share of Marlboro increased notably in Argentina, Brazil and Colombia, by 0.4, 0.7 and 1.4 points to 24.4%, 9.5% and 9.0%, respectively. Shipment volume of Philip Morris of 9.4 billion units increased by 1.6%, driven notably by Canada.

Latin America & Canada - Market Discussions

In Argentina, industry size, PMI cigarette shipment volume and market share performance are shown in the table below.

	Argentina Key Market Data Second-Quarter			Six Months Year-to-Date		
	2015	2014	Change % / p.p.	2015	2014	Change % / p.p.
Total Cigarette Market (billion units)	9.4	10.0	(5.3)%	19.7	20.6	(4.4)%
PMI Shipments (million units)	7,463	7,656	(2.5)%	15,586	15,935	(2.2)%
PMI Cigarette Market Share						
Marlboro	24.3	% 23.8	% 0.5	24.4	% 24.0	% 0.4
Parliament	2.1	% 2.1	% —	2.1	% 2.1	% —
Philip Morris	45.3	% 42.9	% 2.4	44.9	% 43.1	% 1.8
Others	7.1	% 7.5	% (0.4)	7.3	% 7.5	% (0.2)
Total	78.8	% 76.3	% 2.5	78.7	% 76.7	% 2.0

In the second quarter and the six months year-to-date, the decline of the total cigarette market was mainly due to the cumulative impact of price increases in 2014 and 2015 and a challenging economic environment. The decrease in our shipment volume in the second quarter and six months year-to-date reflected a lower total market, partly offset by market share growth, driven by Marlboro and Philip Morris, reflecting the positive impact of the latter's capsule variants.

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In Canada, industry size, PMI cigarette shipment volume and market share performance are shown in the table below.

Canada Key Market Data								
	Second-Quarter			Six Months Year-to-Date				
	2015	2014	Change % / p.p.	2015	2014	Change % / p.p.		
Total Cigarette Market (billion units)	7.3	7.3	0.6	% 12.8	13.1	(2.2	)	%
PMI Shipments (million units)	2,647	2,707	(2.2	)%	4,700	4,932	(4.7	)%
PMI Cigarette Market Share								
Belmont	3.2	% 2.9	% 0.3	3.1	% 2.9	% 0.2		
Canadian Classics	10.2	% 10.3	% (0.1	)	10.4	% 10.7	% (0.3	)
Next	10.3	% 10.7	% (0.4	)	10.4	% 10.8	% (0.4	)
Others	12.5	% 13.3	% (0.8	)	12.8	% 13.4	% (0.6	)
Total	36.2	% 37.2	% (1.0	)	36.7	% 37.8	% (1.1	)

In the second quarter, the increase of the total cigarette market was mainly driven by favorable estimated trade inventory movements of competitors' products. Excluding the impact of these inventory movements, the total cigarette market declined by 0.7%. For the six months year-to-date, the total market declined by 2.2% or by 5.3% excluding estimated trade inventory movements, mainly due to the impact of tax-driven price increases in 2014 and 2015. The decrease in our cigarette shipment volume in the second quarter was mainly due to market share declines of our low price brands, notably Next and Quebec Classic, partially offset by share growth of premium Belmont and super-low price Philip Morris. The decrease in our cigarette shipment volume for the six months year-to-date was mainly due to the same factors as in the second quarter, as well as a lower total market.

In Mexico, industry size, PMI cigarette shipment volume and market share performance are shown in the table below.

Mexico Key Market Data								
	Second-Quarter			Six Months Year-to-Date				
	2015	2014	Change % / p.p.	2015	2014	Change % / p.p.		
Total Cigarette Market (billion units)	8.6	8.4	1.9	% 16.1	15.6	3.2		%
PMI Shipments (million units)	5,891	5,991	(1.7	)%	10,887	10,862	0.2	%
PMI Cigarette Market Share								
Marlboro	47.5	% 49.3	% (1.8	)	46.5	% 48.2	% (1.7	)
Delicados	10.7	% 11.5	% (0.8	)	10.8	% 11.1	% (0.3	)
Benson & Hedges	4.6	% 5.2	% (0.6	)	4.6	% 5.2	% (0.6	)
Others	5.7	% 5.0	% 0.7		5.6	% 5.0	% 0.6	
Total	68.5	% 71.0	% (2.5	)	67.5	% 69.5	% (2.0	)

In the second quarter, the increase of the total cigarette market was unfavorably impacted by the timing of estimated trade inventory movements compared to the second quarter of 2014. Excluding the impact of these inventory movements, the total cigarette market increased by 3.2%. For the six months year-to-date, the total market increased by 3.2% or by 1.3% excluding estimated trade inventory movements. The decrease in our cigarette shipment volume in the second quarter was mainly due to market share declines. Our cigarette shipment volume for the six months year-to-date increased by 0.2%. The decline in our market share in the second quarter and six months year-to-date was mainly due to Marlboro, reflecting adult smoker down-trading and the timing of price increases by our principal

competitor in the first quarter of 2015, partly offset by gains for certain low price local trademark brands.

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Financial Review

Net Cash Provided by Operating Activities

During the first six months of 2015, net cash provided by operating activities of \$3.3 billion decreased by \$120 million compared with the first six months of 2014. The change was due primarily to unfavorable currency movements of \$1.6 billion, partly offset by lower working capital requirements and earnings growth, excluding currency.

Excluding currency, the favorable movements in working capital were due primarily to the following:

- more cash provided by accounts receivable, primarily due to the timing of sales and cash collections; and
- less cash used for income taxes, primarily due to the timing of payments.

Net Cash Used in Investing Activities

During the first six months of 2015, net cash used in investing activities of \$224 million decreased by \$320 million compared with the first six months of 2014. The change was due primarily to higher net cash received related to derivatives designated as net investment hedges and the 2014 purchase of Nicocigs Limited.

In June 2014, we acquired 100% of Nicocigs Limited, a leading U.K.-based e-vapor company, for the final purchase price of \$103 million, net of cash acquired, with additional contingent payments of up to \$77 million, primarily relating to performance targets over a three-year period. For further details, see Note 16. Acquisitions and Other Business Arrangements to our condensed consolidated financial statements.

Our capital expenditures were \$413 million and \$508 million during the six months ended June 30, 2015 and 2014, respectively. The 2015 expenditures were primarily related to investments in Reduced-Risk Products, productivity-enhancing programs, and equipment for new products.

Net Cash Used in Financing Activities

During the first six months of 2015, net cash used in financing activities of \$2.6 billion decreased by \$847 million compared with the first six months of 2014. The change was due primarily to the cash used in 2014 to repurchase our common stock pursuant to our share repurchase program and short-term borrowing activity, partially offset by lower net cash proceeds in 2015 from long-term debt. On February 5, 2015 we announced that we do not plan any share repurchases in 2015.

Dividends paid in the first six months of 2015 and 2014 were \$3.1 billion and \$3.0 billion, respectively. The increase reflects a higher dividend rate in 2015, partially offset by lower shares outstanding as a result of our share repurchases in 2014.

Debt and Liquidity

We define cash and cash equivalents as short-term, highly liquid investments, readily convertible to known amounts of cash that mature within a maximum of three months and have an insignificant risk of change in value due to interest rate or credit risk changes. As a policy, we do not hold any investments in structured or equity-linked products. Our cash and cash equivalents are predominantly held in short-term bank deposits with institutions having a long-term rating of A- or better.

Credit Ratings – The cost and terms of our financing arrangements as well as our access to commercial paper markets may be affected by applicable credit ratings. At June 30, 2015, our credit ratings and outlook by major credit rating agencies were as follows:

	Short-term	Long-term	Outlook
Moody's	P-1	A2	Stable
Standard & Poor's	A-1	A	Stable
Fitch	F1	A	Stable

On July 10, 2015, Fitch affirmed our long-term credit rating at "A" and short-term at "F1", but it revised our outlook to Negative from Stable. We do not expect the Fitch negative outlook to have an impact on our borrowing costs. On July 17, 2015, Standard & Poor's affirmed our long-term credit rating at "A" and short-term at "A-1", as well as our "Stable" outlook.

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Credit Facilities – On January 23, 2015, we entered into an agreement to extend the term of our existing \$2.0 billion 364-day revolving credit facility effective February 10, 2015, from February 10, 2015 to February 9, 2016. On January 23, 2015, we also entered into an agreement to extend the term of our existing \$2.5 billion multi-year revolving credit facility, effective February 28, 2015, from February 28, 2019 to February 28, 2020.

At June 30, 2015, our committed credit facilities and commercial paper outstanding were as follows:

(in billions)

Type	Committed Credit Facilities	Commercial Paper
364-day revolving credit, expiring February 9, 2016	\$2.0	
Multi-year revolving credit, expiring February 28, 2020	2.5	
Multi-year revolving credit, expiring October 25, 2016	3.5	
Total facilities	\$8.0	

Commercial paper outstanding \$0.8

At June 30, 2015, there were no borrowings under the committed credit facilities, and the entire committed amounts were available for borrowing.

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

Each of these facilities requires us to maintain a ratio of consolidated earnings before interest, taxes, depreciation and amortization (“consolidated EBITDA”) to consolidated interest expense of not less than 3.5 to 1.0 on a rolling four-quarter basis. At June 30, 2015, our ratio calculated in accordance with the agreements was 11.5 to 1.0. These facilities do not include any credit rating triggers, material adverse change clauses or any provisions that could require us to post collateral. We expect to continue to meet our covenants. The terms “consolidated EBITDA” and “consolidated interest expense,” both of which include certain adjustments, are defined in the facility agreements previously filed with the U.S. Securities and Exchange Commission.

In addition to the committed credit facilities discussed above, certain of our subsidiaries maintain short-term credit arrangements to meet their respective working capital needs. These credit arrangements, which amounted to approximately \$2.4 billion at June 30, 2015 and \$3.2 billion at December 31, 2014, are for the sole use of our subsidiaries. Borrowings under these arrangements amounted to \$898 million at June 30, 2015, and \$1.2 billion at December 31, 2014.

Commercial Paper Program – We have commercial paper programs in place in the U.S. and in Europe. Our commercial paper programs in place in the U.S. and in Europe currently have an aggregate issuance capacity of \$8.0 billion.

At June 30, 2015 we had \$813 million in commercial paper outstanding. At December 31, 2014, we had no commercial paper outstanding.

We expect that the existence of the commercial paper program and the committed credit facilities, coupled with our operating cash flows, will enable us to meet our liquidity requirements.

Debt – Our total debt was \$29.2 billion at June 30, 2015 and \$29.5 billion at December 31, 2014.

On February 21, 2014, we filed a shelf registration statement with the U.S. Securities and Exchange Commission, under which we may from time to time sell debt securities and/or warrants to purchase debt securities over a three-year period.

Guarantees – At June 30, 2015, we were contingently liable for \$0.8 billion of guarantees of our own performance, which were primarily related to excise taxes on the shipment of our products. There is no liability in the condensed consolidated financial statements associated with these guarantees. At June 30, 2015, our third-party guarantees were insignificant.

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Equity and Dividends

As discussed in Note 3. Stock Plans to our condensed consolidated financial statements, during the six months ended June 30, 2015, we granted 1.5 million shares of deferred stock awards to eligible employees at a grant date fair value of \$82.28 per share. Equity awards generally vest three or more years after the date of the award, subject to earlier vesting on death or disability or normal retirement, or separation from employment by mutual agreement after reaching age 58.

In May 2012, our stockholders approved the Philip Morris International Inc. 2012 Performance Incentive Plan (the "2012 Plan"). The 2012 Plan replaced the 2008 Performance Incentive Plan (the "2008 Plan") and, as a result, there will be no additional grants under the 2008 Plan. Under the 2012 Plan, we may grant to eligible employees restricted stock, restricted stock units and deferred stock units, performance-based cash incentive awards and performance-based equity awards. Up to 30 million shares of our common stock may be issued under the 2012 Plan. At June 30, 2015, shares available for grant under the 2012 Plan were 23,252,170.

On August 1, 2012, we began repurchasing shares under a three-year \$18.0 billion share repurchase program that was authorized by our Board of Directors in June 2012. From August 1, 2012 through June 30, 2015, we repurchased 144.6 million shares of our common stock at a cost of \$12.7 billion under this repurchase program. During the first six months of 2015, we did not repurchase our common stock. On February 5, 2015, we announced that we do not plan any share repurchases in 2015. During the first six months of 2014, we repurchased 27.0 million shares at a cost of \$2.25 billion. During the second quarter of 2014, we repurchased 11.6 million shares at a cost of \$1.0 billion. Dividends paid in the first six months of 2015 were \$3.1 billion. During the third quarter of 2014, our Board of Directors approved a 6.4% increase in the quarterly dividend to \$1.00 per common share. As a result, the present annualized dividend rate is \$4.00 per common share.

Market Risk

Counterparty Risk - We predominantly work with financial institutions with strong short- and long-term credit ratings as assigned by Standard & Poor's and Moody's. These banks are also part of a defined group of relationship banks. Non-investment grade institutions are only used in certain emerging markets to the extent required by local business needs. We have a conservative approach when it comes to choosing financial counterparties and financial instruments. As such we do not invest or hold investments in any structured or equity-linked products. The majority of our cash and cash equivalents is currently invested in bank deposits maturing within less than 30 days.

We continuously monitor and assess the credit worthiness of all our counterparties.

Derivative Financial Instruments - We operate in markets outside of the United States of America, with manufacturing and sales facilities in various locations throughout the world. Consequently, we use certain financial instruments to manage our foreign currency and interest rate exposure. We use derivative financial instruments principally to reduce our exposure to market risks resulting from fluctuations in foreign exchange rates by creating offsetting exposures. We are not a party to leveraged derivatives and, by policy, do not use derivative financial instruments for speculative purposes.

See Note 6. Financial Instruments, Note 12. Fair Value Measurements, and Note 14. Balance Sheet Offsetting to our condensed consolidated financial statements for further details on our derivative financial instruments and the related collateral arrangements.

Contingencies

See Note 9. Contingencies to our condensed consolidated financial statements for a discussion of contingencies.

Cautionary Factors That May Affect Future Results

Forward-Looking and Cautionary Statements

We may from time to time make written or oral forward-looking statements, including statements contained in filings with the SEC, in reports to stockholders and in press releases and investor webcasts. You can identify these forward-looking statements by use of words such as "strategy," "expects," "continues," "plans," "anticipates,"

"believes," "will," "estimates," "intends," "projects," "goals," "targets" and other words of similar meaning. You can also identify them by the fact that they do not relate strictly to historical or current facts.

We cannot guarantee that any forward-looking statement will be realized, although we believe we have been prudent in our plans and assumptions. Achievement of future results is subject to risks, uncertainties and inaccurate assumptions. Should known or

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unknown risks or uncertainties materialize, or should underlying assumptions prove inaccurate, actual results could vary materially from those anticipated, estimated or projected. Investors should bear this in mind as they consider forward-looking statements and whether to invest in or remain invested in our securities. In connection with the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995, we are identifying important factors that, individually or in the aggregate, could cause actual results and outcomes to differ materially from those contained in any forward-looking statements made by us; any such statement is qualified by reference to the following cautionary statements. We elaborate on these and other risks we face throughout this document, particularly in the “Business Environment” section. You should understand that it is not possible to predict or identify all risk factors. Consequently, you should not consider the following to be a complete discussion of all potential risks or uncertainties. We do not undertake to update any forward-looking statement that we may make from time to time, except in the normal course of our public disclosure obligations.

Risks Related to Our Business and Industry

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

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

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

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

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

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

Governmental actions, combined with the diminishing social acceptance of smoking and private actions to restrict smoking, have resulted in reduced industry volume in many of our markets, and we expect that such factors will continue to reduce consumption levels and will increase down-trading and the risk of counterfeiting, contraband, “illicit whites” and legal cross-border purchases. Significant regulatory developments will take place over the next few years in most of our markets, driven principally by the FCTC. The FCTC is the first international public health treaty on tobacco, and its objective is to establish a global agenda for tobacco regulation. The FCTC has led to increased efforts by tobacco control advocates and public health organizations to reduce the palatability and attractiveness of tobacco products to adult smokers. Regulatory initiatives that have been proposed, introduced or enacted include:

- restrictions on or licensing of outlets permitted to sell cigarettes;
- the levying of substantial and increasing tax and duty charges;
- restrictions or bans on advertising, marketing and sponsorship;
- the display of larger health warnings, graphic health warnings and other labeling requirements;
- restrictions on packaging design, including the use of colors, and plain packaging;
- restrictions on packaging and cigarette formats and dimensions;

• restrictions or bans on the display of tobacco product packaging at the point of sale and restrictions or bans on cigarette vending machines;
• requirements regarding testing, disclosure and performance standards for tar, nicotine, carbon monoxide and other smoke constituents;

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disclosure, restrictions or bans of tobacco product ingredients;
increased restrictions on smoking in public and work places and, in some instances, in private places and outdoors;
restrictions on the sale of potentially reduced-risk tobacco products and other nicotine-containing products;
elimination of duty free sales and duty free allowances for travelers; and
encouraging litigation against tobacco companies.

Our operating income could be significantly affected by regulatory initiatives resulting in a significant decrease in demand for our brands, in particular requirements that lead to a commoditization of tobacco products, as well as any significant increase in the cost of complying with new regulatory requirements.

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

There is litigation related to tobacco products pending in certain jurisdictions. Damages claimed in some tobacco-related litigation are significant and, in certain cases in Brazil, Canada and Nigeria, range into the billions of U.S. dollars. We anticipate that new cases will continue to be filed. The FCTC encourages litigation against tobacco product manufacturers. It is possible that our consolidated results of operations, cash flows or financial position could be materially affected in a particular fiscal quarter or fiscal year by an unfavorable outcome or settlement of certain pending litigation. Please see Note 9. Contingencies to our condensed consolidated financial statements for a discussion of pending litigation.

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

We compete primarily on the basis of product quality, brand recognition, brand loyalty, taste, innovation, packaging, service, marketing, advertising and price. We are subject to highly competitive conditions in all aspects of our business. The competitive environment and our competitive position can be significantly influenced by weak economic conditions, erosion of consumer confidence, competitors' introduction of lower-price products or innovative products, higher tobacco product taxes, higher absolute prices and larger gaps between retail price categories, and product regulation that diminishes the ability to differentiate tobacco products. Competitors include three large international tobacco companies and several regional and local tobacco companies and, in some instances, state-owned tobacco enterprises, principally in Algeria, China, Egypt, Taiwan, Thailand and Vietnam. Industry consolidation and privatizations of state-owned enterprises have led to an overall increase in competitive pressures. Some competitors have different profit and volume objectives and some international competitors are susceptible to changes in different currency exchange rates.

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

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

There is an increasing number of conflicts, including in the Middle East and Ukraine. Political uncertainty, including potential effects from economic sanctions by the U.S. or other governments, could lead to significant disruptions to our business.

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

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

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We may be unable to anticipate changes in consumer preferences or to respond to consumer behavior influenced by economic downturns.

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

- promote brand equity successfully;
- anticipate and respond to new consumer trends;
- develop new products and markets and broaden brand portfolios;
- improve productivity; and
- be able to protect or enhance margins through price increases.

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

We lose revenues as a result of counterfeiting, contraband, cross-border purchases and non-tax-paid volume produced by local manufacturers.

Large quantities of counterfeit cigarettes are sold in the international market. We believe that Marlboro is the most heavily counterfeited international cigarette brand, although we cannot quantify the revenues we lose as a result of this activity. In addition, our revenues are reduced by contraband, legal cross-border purchases and non-tax-paid volume produced by local manufacturers.

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

Investigations include allegations of contraband shipments of cigarettes, allegations of unlawful pricing activities within certain markets, allegations of underpayment of customs duties and/or excise taxes, allegations of false and misleading usage of descriptors and allegations of unlawful advertising. We cannot predict the outcome of those investigations or whether additional investigations may be commenced, and it is possible that our business could be materially affected by an unfavorable outcome of pending or future investigations. See “Management's Discussion and Analysis of Financial Condition and Results of Operations-Operating Results by Business Segment-Business Environment-Governmental Investigations” for a description of certain governmental investigations to which we are subject.

We may be unsuccessful in our attempts to introduce Reduced-Risk Products, and regulators may not permit reduced exposure or risk claims or the commercialization of these products.

We continue to seek ways to develop commercially viable new product technologies with the potential to reduce exposure to harmful constituents in smoke and individual risk and population harm, all in comparison to smoking combustible cigarettes. Our goal is to develop products whose potential to reduce exposure, individual risk and population harm can be substantiated by rigorous scientific studies and that provide adult smokers the taste, sensory experience, nicotine delivery profile and ritual characteristics that are similar to those currently provided by combustible cigarettes. We may not succeed in these efforts. If we do not succeed, but others do, we may be at a competitive disadvantage. Furthermore, we cannot predict whether regulators will permit the marketing of tobacco products or other nicotine-containing products with claims of reduced exposure or risk as compared with combustible cigarettes. A prohibition on any such claims could significantly undermine the commercial viability of these products. Our reported results could be adversely affected by unfavorable currency exchange rates, and currency devaluations could impair our competitiveness.

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

The repatriation of our foreign earnings, changes in the earnings mix, and changes in U.S. tax laws may increase our effective tax rate. Our ability to receive payments from foreign subsidiaries or to repatriate royalties and dividends could be restricted by local country currency exchange controls.

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Because we are a U.S. holding company, our most significant source of funds is distributions from our non-U.S. subsidiaries. Under current U.S. tax law, in general we do not pay U.S. taxes on our foreign earnings until they are repatriated to the U.S. as distributions from our non-U.S. subsidiaries. These distributions may result in a residual U.S. tax cost. It may be advantageous to us in certain circumstances to significantly increase the amount of such distributions, which could result in a material increase in our overall effective tax rate. Additionally, the Obama Administration has indicated that it favors changes in U.S. tax law that would fundamentally change how our earnings are taxed in the U.S. If enacted and depending upon its precise terms, such legislation could increase our overall effective tax rate. Certain countries in which we operate have adopted or could institute currency exchange controls that limit or prohibit our local subsidiaries' ability to make payments outside the country.

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

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

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

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

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

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

Our ability to implement our strategy of attracting and retaining the best global talent may be impaired by the decreasing social acceptance of cigarette smoking.

The tobacco industry competes for talent with consumer products and other companies that enjoy greater societal acceptance. As a result, we may be unable to attract and retain the best global talent.

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

We use information systems to help manage business processes, collect and interpret business data and communicate internally and externally with employees, suppliers, customers and others. Some of these information systems are managed by third-party service providers. We have backup systems and business continuity plans in place, and we take care to protect our systems and data from unauthorized access. Nevertheless, failure of our systems to function as intended, or penetration of our systems by outside parties intent on extracting or corrupting information or otherwise disrupting business processes, could result in loss of revenue, assets or personal or other sensitive data, litigation and regulatory action, cause damage to our reputation and that of our brands and result in significant remediation and other costs to us.

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

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

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Item 4. Controls and Procedures.

PMI carried out an evaluation, with the participation of PMI's management, including PMI's Chief Executive Officer and Chief Financial Officer, of the effectiveness of PMI's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based upon that evaluation, PMI's Chief Executive Officer and Chief Financial Officer concluded that PMI's disclosure controls and procedures are effective. There have been no changes in PMI's internal control over financial reporting during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, PMI's internal control over financial reporting.

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Part II - OTHER INFORMATION

Item 1. Legal Proceedings.

See Note 9. Contingencies of the Notes to the Condensed Consolidated Financial Statements included in Part I – Item 1 of this report for a discussion of legal proceedings pending against Philip Morris International Inc. and its subsidiaries.

Item 1A. Risk Factors.

Information regarding Risk Factors appears in “MD&A – Cautionary Factors That May Affect Future Results,” in Part I – Item 2 of this Form 10-Q and in Part I – Item 1A. Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2014. There have been no material changes to the risk factors disclosed in our Annual Report on Form 10-K.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Our share repurchase activity for each of the three months in the quarter ended June 30, 2015 was as follows:

Period	Total Number of Shares Repurchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)	Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs
April 1, 2015 – April 30, 2015 (1)	—	\$—	144,643,396	\$5,347,045,761
May 1, 2015 – May 31, 2015 (1)	—	\$—	144,643,396	\$5,347,045,761
June 1, 2015 – June 30, 2015 (1)	—	\$—	144,643,396	\$5,347,045,761
Pursuant to Publicly Announced Plans or Programs	—	\$—		
April 1, 2015 – April 30, 2015 (3)	16,398	\$83.66		
May 1, 2015 – May 31, 2015 (3)	897	\$83.00		
June 1, 2015 – June 30, 2015 (3)	363	\$82.92		
For the Quarter Ended June 30, 2015	17,658	\$83.61		

On June 13, 2012, our Board of Directors authorized a share repurchase program of \$18 billion over three years.

(1) The program commenced on August 1, 2012 after the completion of the three-year \$12 billion program in July 2012. These share repurchases have been made pursuant to the \$18 billion program. On February 5, 2015, we announced that we do not plan any share repurchases in 2015.

(2) Aggregate number of shares repurchased under the above-mentioned share repurchase program as of the end of the period presented.

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

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Item 6. Exhibits.

3.1	Amended and Restated By-Laws of Philip Morris International Inc., effective immediately prior to the 2015 Annual Meeting of Shareholders (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K filed March 13, 2015).
10.1	Summary of Supplemental Pension Plan of Philip Morris in Switzerland.
10.2	Supplemental Equalization Plan (amended and restated as of June 29, 2015).
12	Statement regarding computation of ratios of earnings to fixed charges.
31.1	Certification of the Registrant's Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Registrant's Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Registrant's Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of the Registrant's Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase.
101.DEF	XBRL Taxonomy Extension Definition Linkbase.
101.LAB	XBRL Taxonomy Extension Label Linkbase.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase.

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Signature

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PHILIP MORRIS INTERNATIONAL INC.

/s/ JACEK OLCZAK

Jacek Olczak
Chief Financial Officer

July 30, 2015

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