Philip Morris International Inc.
Form 10-Q
November 01, 2013
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
(Mark One)

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

For the quarterly period ended September 30, 2013
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 New York, New York	10017
(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 þ 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 þ 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 þ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨
(Do not check if a smaller reporting company)

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

At October 30, 2013, there were 1,602,166,187 shares outstanding of the registrant's common stock, no par value per share.

Table of Contents

PHILIP MORRIS INTERNATIONAL INC.
TABLE OF CONTENTS

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

Table of Contents

PART I – FINANCIAL INFORMATION
Item 1. Financial Statements.
Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(in millions of dollars)
(Unaudited)

	September 30, 2013	December 31, 2012
ASSETS		
Cash and cash equivalents	$3,382	$2,983
Receivables (less allowances of $58 in 2013 and $56 in 2012)	3,659	3,589
Inventories:		
Leaf tobacco	3,821	3,548
Other raw materials	1,730	1,610
Finished product	2,475	3,791
	8,026	8,949
Deferred income taxes	364	450
Other current assets	585	619
Total current assets	16,016	16,590
Property, plant and equipment, at cost	13,898	13,879
Less: accumulated depreciation	7,315	7,234
	6,583	6,645
Goodwill (Note 5)	9,177	9,900
Other intangible assets, net (Note 5)	3,290	3,619
Investments in unconsolidated subsidiaries (Note 17)	665	24
Other assets	1,064	892
TOTAL ASSETS	$36,795	$37,670

See notes to condensed consolidated financial statements.
Continued

Table of Contents

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

	September 30, 2013	December 31, 2012
LIABILITIES		
Short-term borrowings (Note 12)	$3,668	$2,419
Current portion of long-term debt (Note 12)	1,255	2,781
Accounts payable	1,125	1,103
Accrued liabilities:		
Marketing and selling	520	527
Taxes, except income taxes	4,991	5,350
Employment costs	865	896
Dividends payable	1,522	1,418
Other	1,031	952
Income taxes	925	1,456
Deferred income taxes	116	114
Total current liabilities	16,018	17,016
Long-term debt (Note 12)	21,877	17,639
Deferred income taxes	1,807	1,875
Employment costs	2,500	2,574
Other liabilities	501	419
Total liabilities	42,703	39,523
Contingencies (Note 10)		
Redeemable noncontrolling interest (Note 7)	1,283	1,301
STOCKHOLDERS' (DEFICIT) EQUITY		
Common stock, no par value (2,109,316,331 shares issued in 2013 and 2012)	—	—
Additional paid-in capital	679	1,334
Earnings reinvested in the business	27,359	25,076
Accumulated other comprehensive losses	(4,820)	(3,604)
	23,218	22,806
Less: cost of repurchased stock (503,235,692 and 455,703,347 shares in 2013 and 2012, respectively)	30,647	26,282
Total PMI stockholders' deficit	(7,429)	(3,476)
Noncontrolling interests	238	322
Total stockholders' deficit	(7,191)	(3,154)
TOTAL LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY	$36,795	$37,670

See notes to condensed consolidated financial statements.

- 4-

Table of Contents

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

	For the Nine Months Ended September 30,	
	2013	2012
Net revenues	$59,639	$57,651
Cost of sales	7,808	7,692
Excise taxes on products	36,211	34,163
Gross profit	15,620	15,796
Marketing, administration and research costs	5,229	5,043
Asset impairment and exit costs (Note 2)	8	50
Amortization of intangibles	71	73
Operating income	10,312	10,630
Interest expense, net	721	633
Earnings before income taxes	9,591	9,997
Provision for income taxes	2,777	3,034
Net earnings	6,814	6,963
Net earnings attributable to noncontrolling interests	225	258
Net earnings attributable to PMI	$6,589	$6,705
Per share data (Note 8):		
Basic earnings per share	$4.02	$3.92
Diluted earnings per share	$4.02	$3.92
Dividends declared	$2.64	$2.39

See notes to condensed consolidated financial statements.

Table of Contents

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 September 30,	
	2013	2012
Net revenues	$20,629	$19,592
Cost of sales	2,618	2,584
Excise taxes on products	12,702	11,672
Gross profit	5,309	5,336
Marketing, administration and research costs	1,693	1,655
Asset impairment and exit costs (Note 2)	—	34
Amortization of intangibles	23	24
Operating income	3,593	3,623
Interest expense, net	239	211
Earnings before income taxes	3,354	3,412
Provision for income taxes	952	1,088
Net earnings	2,402	2,324
Net earnings attributable to noncontrolling interests	62	97
Net earnings attributable to PMI	$2,340	$2,227
Per share data (Note 8):		
Basic earnings per share	$1.44	$1.32
Diluted earnings per share	$1.44	$1.32
Dividends declared	$0.94	$0.85

See notes to condensed consolidated financial statements.

Table of Contents

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

	For the Nine Months Ended September 30, 2013	2012
Net earnings	$6,814	$6,963
Other comprehensive earnings (losses), net of income taxes:		
Currency translation adjustments, net of income taxes of $119 in 2013 and $31 in 2012	(1,383)	(20)
Change in net loss and prior service cost:		
Net losses and prior service costs, net of income taxes of $- in 2013 and ($1) in 2012	—	(2)
Amortization of net losses, prior service costs and net transition costs, net of income taxes of ($41) in 2013 and ($29) in 2012	178	121
Change in fair value of derivatives accounted for as hedges:		
Gains transferred to earnings, net of income taxes of $23 in 2013 and $1 in 2012	(158)	(8)
Gains (losses) recognized, net of income taxes of ($23) in 2013 and $3 in 2012	158	(17)
Total other comprehensive (losses) earnings	(1,205)	74
Total comprehensive earnings	5,609	7,037
Less comprehensive earnings attributable to:		
Noncontrolling interests	183	161
Redeemable noncontrolling interest	52	143
Comprehensive earnings attributable to PMI	$5,374	$6,733

See notes to condensed consolidated financial statements

- 7-

Table of Contents

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

	For the Three Months Ended September 30, 2013	2012
Net earnings	$2,402	$2,324
Other comprehensive earnings (losses), net of income taxes:		
Currency translation adjustments, net of income taxes of $95 in 2013 and $64 in 2012	(661)	546
Change in net loss and prior service cost:		
Net losses and prior service costs, net of income taxes of $- in 2013 and ($1) in 2012	—	(1)
Amortization of net losses, prior service costs and net transition costs, net of income taxes of ($14) in 2013 and ($8) in 2012	60	43
Change in fair value of derivatives accounted for as hedges:		
(Gains) losses transferred to earnings, net of income taxes of $9 in 2013 and $- in 2012	(63)	4
Gains (losses) recognized, net of income taxes of $- in 2013 and $4 in 2012	2	(29)
Total other comprehensive (losses) earnings	(662)	563
Total comprehensive earnings	1,740	2,887
Less comprehensive earnings attributable to:		
Noncontrolling interests	95	75
Redeemable noncontrolling interest	9	44
Comprehensive earnings attributable to PMI	$1,636	$2,768

See notes to condensed consolidated financial statements

- 8-

Table of Contents

Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Statements of Stockholders' (Deficit) Equity
for the Nine Months Ended September 30, 2013 and 2012
(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 Losses	Cost of Repurchased Stock	Noncontrolling Interests	Total
Balances, January 1, 2012	$—	$ 1,235	$ 21,757	$ (2,863)	$ (19,900)	$ 322	$ 551
Net earnings			6,705			132 (a)	6,837 (a)
Other comprehensive earnings (losses), net of income taxes				28		29 (a)	57 (a)
Issuance of stock awards and exercise of stock options		50			115		165
Dividends declared ($2.39 per share)			(4,068)				(4,068)
Payments to noncontrolling interests						(162)	(162)
Common stock repurchased					(4,540)		(4,540)
Balances, September 30, 2012	$—	$ 1,285	$ 24,394	$ (2,835)	$ (24,325)	$ 321	$ (1,160)
Balances, January 1, 2013	$—	$ 1,334	$ 25,076	$ (3,604)	$ (26,282)	$ 322	$ (3,154)
Net earnings			6,589			150 (a)	6,739 (a)
Other comprehensive earnings (losses), net of income taxes				(1,165)		(17) (a)	(1,182) (a)
Issuance of stock awards and exercise of stock options		17			135		152
Dividends declared ($2.64 per share)			(4,306)				(4,306)
Payments to noncontrolling interests						(176)	(176)
Purchase of subsidiary shares from noncontrolling interests		(672)		(51)		(41)	(764)
Common stock repurchased					(4,500)		(4,500)
Balances, September 30, 2013	$—	$ 679	$ 27,359	$ (4,820)	$ (30,647)	$ 238	$ (7,191)

(a) For the nine months ended September 30, 2012, net earnings attributable to noncontrolling interests exclude $126 million of earnings related to the redeemable noncontrolling interest, which is reported outside of the equity section in the condensed consolidated balance sheet. Other comprehensive earnings, net of income taxes, also exclude $17 million of net currency translation adjustment gains related to the redeemable noncontrolling interest at September 30,

2012. For the nine months ended September 30, 2013, net earnings attributable to noncontrolling interests exclude $75 million of earnings related to the redeemable noncontrolling interest, which is reported outside of the equity section in the condensed consolidated balance sheet. Other comprehensive earnings, net of income taxes, also exclude $23 million of net currency translation adjustment losses related to the redeemable noncontrolling interest at September 30, 2013.

See notes to condensed consolidated financial statements.

Table of Contents

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

	For the Nine Months Ended September 30, 2013	2012
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES		
Net earnings	$6,814	$6,963
Adjustments to reconcile net earnings to operating cash flows:		
Depreciation and amortization	659	665
Deferred income tax provision (benefit)	73	(109)
Asset impairment and exit costs, net of cash paid	(9)	19
Cash effects of changes, net of the effects from acquired and divested companies:		
Receivables, net	(206)	(392)
Inventories	546	(137)
Accounts payable	26	—
Income taxes	(606)	326
Accrued liabilities and other current assets	183	177
Pension plan contributions	(82)	(84)
Other	417	343
Net cash provided by operating activities	7,815	7,771
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES		
Capital expenditures	(821)	(719)
Investments in unconsolidated subsidiaries	(656)	(3)
Other	6	31
Net cash used in investing activities	(1,471)	(691)

See notes to condensed consolidated financial statements.

Continued

Table of Contents

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

	For the Nine Months Ended September 30, 2013	2012
CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES		
Short-term borrowing activity by original maturity:		
Net issuances - maturities of 90 days or less	$215	$1,367
Issuances - maturities longer than 90 days	1,610	478
Repayments - maturities longer than 90 days	(516)	(1,220)
Long-term debt proceeds	5,205	5,516
Long-term debt repaid	(2,738)	(2,237)
Repurchases of common stock	(4,516)	(4,557)
Dividends paid	(4,202)	(3,973)
Purchase of subsidiary shares from noncontrolling interests	(703)	—
Other	(258)	(262)
Net cash used in financing activities	(5,903)	(4,888)
Effect of exchange rate changes on cash and cash equivalents	(42)	75
Cash and cash equivalents:		
Increase	399	2,267
Balance at beginning of period	2,983	2,550
Balance at end of period	$3,382	$4,817

See notes to condensed consolidated financial statements.

Table of Contents

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 and other tobacco products in markets outside of the United States of America. Throughout these financial statements, the term "PMI" refers to Philip Morris International Inc. and its subsidiaries.
Basis of Presentation
The 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.
Certain prior years' amounts have been reclassified to conform with the current year's presentation, due to the separate disclosure of investments in unconsolidated subsidiaries. For further details, see Note 17. Investments in Unconsolidated Subsidiaries.
These statements should be read in conjunction with the audited consolidated financial statements and related notes, which appear in PMI's Annual Report to Shareholders and which are incorporated by reference into PMI's Annual Report on Form 10-K for the year ended December 31, 2012.

Note 2. Asset Impairment and Exit Costs:
Pre-tax asset impairment and exit costs consisted of the following:

(in millions)	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2013	2012	2013	2012
Separation programs:				
Asia	$—	$13	$—	$13
Latin America & Canada	—	24	—	8
Total separation programs	—	37	—	21
Contract termination charges:				
Asia	8	5	—	5
Total contract termination charges	8	5	—	5
Asset impairment charges:				
Asia	—	6	—	6
Latin America & Canada	—	2	—	2
Total asset impairment charges	—	8	—	8
Asset impairment and exit costs	$8	$50	$—	$34

Exit Costs
Separation Programs
On September 30, 2013, PMI announced its intention to restructure its global and regional functions based in Switzerland. The potential restructuring is expected to result in the elimination or relocation of approximately 170 positions. PMI expects to finalize its plans during the fourth quarter of 2013.

- 12-

In another initiative, PMI recorded pre-tax separation program charges of $37 million and $21 million for the nine months and three months ended September 30, 2012, respectively. The 2012 pre-tax separation program charges primarily related to severance costs associated with factory restructurings.

Contract Termination Charges

During the nine months ended September 30, 2013, PMI recorded exit costs of $8 million related to the termination of distribution agreements. During the third quarter of 2012, PMI recorded exit costs of $5 million related to the termination of a distribution agreement.

Movement in Exit Cost Liabilities

The movement in exit cost liabilities for the nine months ended September 30, 2013 was as follows:

(in millions)	
Liability balance, January 1, 2013	$20
Charges	8
Cash spent	(17)
Currency/other	—
Liability balance, September 30, 2013	$11

Cash payments related to exit costs at PMI were $17 million and $5 million for the nine months and three months ended September 30, 2013, respectively, and $31 million and $11 million for the nine months and three months ended September 30, 2012, respectively. Future cash payments for exit costs incurred to date are expected to be approximately $11 million, and will be substantially paid in 2014.

Asset Impairment Charges

During the third quarter of 2012, PMI recorded pre-tax asset impairment charges of $8 million related to factory restructurings.

Note 3. Stock Plans:

In May 2012, PMI's stockholders approved the Philip Morris International Inc. 2012 Performance Incentive Plan (the "2012 Plan"). The 2012 Plan replaced the 2008 Performance Incentive Plan (the "2008 Plan") and, as a result, there will be no additional grants under the 2008 Plan. Under the 2012 Plan, PMI may grant to eligible employees restricted stock, restricted stock units and deferred stock units, performance-based cash incentive awards and performance-based equity awards. Up to 30 million shares of PMI's common stock may be issued under the 2012 Plan. At September 30, 2013, shares available for grant under the 2012 Plan were 27,211,610.

In 2008, PMI adopted the Philip Morris International Inc. 2008 Stock Compensation Plan for Non-Employee Directors (the "Non-Employee Directors Plan"). A non-employee director is defined as a member of the PMI Board of Directors who is not a full-time employee of PMI or of any corporation in which PMI owns, directly or indirectly, stock possessing at least 50% of the total combined voting power of all classes of stock entitled to vote in the election of directors in such corporation. Up to 1 million shares of PMI common stock may be awarded under the Non-Employee Directors Plan. At September 30, 2013, shares available for grant under the plan were 783,905.

During the nine months ended September 30, 2013, PMI granted 2.8 million shares of deferred stock awards to eligible employees at a weighted-average grant date fair value of $88.43 per share. During the nine months ended September 30, 2012, PMI granted 3.2 million shares of deferred stock awards to eligible employees at a weighted-average grant date fair value of $79.58 per share. PMI recorded compensation expense related to stock awards of $172 million and $191 million during the nine months ended September 30, 2013 and 2012, respectively and $48 million and $55 million during the three months ended September 30, 2013 and 2012, respectively. As of September 30, 2013, PMI had $278 million of total unrecognized compensation cost related to non-vested restricted and 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.

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

During the nine months ended September 30, 2013, 3.2 million shares of PMI restricted stock and deferred stock awards vested. The grant date fair value of all the vested shares was approximately $157 million. The total fair value of restricted stock and deferred stock awards that vested during the nine months ended September 30, 2013 was approximately $288 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.
Pension Plans
Components of Net Periodic Benefit Cost
Net periodic pension cost consisted of the following:

	U.S. Plans For the Nine Months Ended September 30,		Non-U.S. Plans For the Nine Months Ended September 30,	
(in millions)	2013	2012	2013	2012
Service cost	$5	$5	$190	$143
Interest cost	12	12	126	142
Expected return on plan assets	(11)	(11)	(257)	(243)
Amortization:				
Net loss	8	7	151	92
Prior service cost	1	1	7	8
Net transition obligation	—	—	1	1
Net periodic pension cost	$15	$14	$218	$143

	U.S. Plans For the Three Months Ended September 30,		Non-U.S. Plans For the Three Months Ended September 30,	
(in millions)	2013	2012	2013	2012
Service cost	$1	$1	$63	$47
Interest cost	4	4	42	46
Expected return on plan assets	(3)	(3)	(84)	(81)
Amortization:				
Net loss	2	2	49	30
Prior service cost	—	—	2	4
Net transition obligation	—	—	—	1
Net periodic pension cost	$4	$4	$72	$47

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 $82 million were made to the pension plans during the nine months ended September 30, 2013. Currently, PMI anticipates making additional contributions during the remainder of 2013 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.

Table of Contents

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

Note 5. Goodwill and Other Intangible Assets, net:
Goodwill and other intangible assets, net, by segment were as follows:

(in millions)	Goodwill September 30, 2013	Goodwill December 31, 2012	Other Intangible Assets, net September 30, 2013	Other Intangible Assets, net December 31, 2012
European Union	$1,463	$1,448	$609	$647
Eastern Europe, Middle East & Africa	614	637	230	242
Asia	4,183	4,791	1,327	1,542
Latin America & Canada	2,917	3,024	1,124	1,188
Total	$9,177	$9,900	$3,290	$3,619

Goodwill is due primarily to PMI's acquisitions in Canada, Indonesia, Mexico, Greece, Serbia, Colombia and Pakistan, as well as the business combination in the Philippines in February 2010. The movements in goodwill from December 31, 2012 were as follows:

(in millions)	European Union	Eastern Europe, Middle East & Africa	Asia	Latin America & Canada	Total
Balances, December 31, 2012	$1,448	$637	$4,791	$3,024	$9,900
Changes due to:					
Currency	15	(23)	(608)	(107)	(723)
Balances, September 30, 2013	$1,463	$614	$4,183	$2,917	$9,177

Additional details of other intangible assets were as follows:

(in millions)	September 30, 2013 Gross Carrying Amount	September 30, 2013 Accumulated Amortization	December 31, 2012 Gross Carrying Amount	December 31, 2012 Accumulated Amortization
Non-amortizable intangible assets	$1,855		$2,046	
Amortizable intangible assets	1,964	$529	2,046	$473
Total other intangible assets	$3,819	$529	$4,092	$473

Non-amortizable intangible assets substantially consist of trademarks from PMI's acquisitions in Indonesia in 2005 and Mexico in 2007. Amortizable intangible assets primarily consist of certain trademarks, distribution networks and non-compete agreements associated with business combinations. The range of useful lives as well as the weighted-average remaining useful life of amortizable intangible assets at September 30, 2013 is as follows:

Description	Initial Estimated Useful Lives	Weighted-Average Remaining Useful Life
Trademarks	2 - 40 years	25 years
Distribution networks	20 - 30 years	14 years
Non-compete agreements	3 - 10 years	2 years
Other (including farmer contracts and intellectual property rights)	12.5 - 17 years	12 years

Pre-tax amortization expense for intangible assets during the nine months ended September 30, 2013 and 2012, was $71 million and $73 million, respectively, and $23 million and $24 million for the three months ended September 30, 2013 and 2012,

respectively. Amortization expense for each of the next five years is estimated to be $94 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, 2012 was due primarily to currency movements.
During the first quarter of 2013, PMI completed its annual review of goodwill and non-amortizable intangible assets for potential impairment, and no impairment charges were required as a result of this review.

Note 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 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, 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 September 30, 2013, PMI had contracts with aggregate notional amounts of $16.2 billion. Of the $16.2 billion aggregate notional amount at September 30, 2013, $3.5 billion related to cash flow hedges, $2.6 billion related to hedges of net investments in foreign operations and $10.1 billion related to other derivatives that primarily offset currency exposures on intercompany financing.
The fair values of PMI’s foreign exchange contracts included in the condensed consolidated balance sheet as of September 30, 2013 and December 31, 2012, were as follows:

	Asset Derivatives			Liability Derivatives		
		Fair Value			Fair Value	
(in millions)	Balance Sheet Classification	At September 30, 2013	At December 31, 2012	Balance Sheet Classification	At September 30, 2013	At December 31, 2012
Foreign exchange contracts designated as hedging instruments	Other current assets	$142	$146	Other accrued liabilities	$14	$8
	Other assets	21	—	Other liabilities	24	—
Foreign exchange contracts not designated as	Other current assets	52	14	Other accrued liabilities	32	47

hedging instruments					
			Other liabilities	8	—
Total derivatives	$215	$160		$78	$55

Hedging activities, which represent movement in derivatives as well as the respective underlying transactions, had the following effect on PMI's condensed consolidated statements of earnings and other comprehensive earnings for the nine months and three months ended September 30, 2013 and 2012:

(in millions)	For the Nine Months Ended September 30, 2013				
Gain (Loss)	Cash Flow Hedges	Net Investment Hedges	Other Derivatives	Income Taxes	Total
Statement of Earnings:					
Net revenues	$213		$—		$213
Cost of sales	6		—		6
Marketing, administration and research costs	—		—		—
Operating income	219		—		219
Interest expense, net	(38)		—		(38)
Earnings before income taxes	181		—		181
Provision for income taxes	(23)		2		(21)
Net earnings attributable to PMI	$158		$2		$160
Other Comprehensive Earnings/(Losses):					
Gains transferred to earnings	$(181)			$23	$(158)
Recognized gains	181			(23)	158
Net impact on equity	$—			$—	$—
Currency translation adjustments		$(28)		$9	$(19)

(in millions)	For the Nine Months Ended September 30, 2012				
Gain (Loss)	Cash Flow Hedges	Net Investment Hedges	Other Derivatives	Income Taxes	Total
Statement of Earnings:					
Net revenues	$33		$—		$33
Cost of sales	19		—		19
Marketing, administration and research costs	—		—		—
Operating income	52		—		52
Interest expense, net	(43)		11		(32)
Earnings before income taxes	9		11		20
Provision for income taxes	(1)		1		—
Net earnings attributable to PMI	$8		$12		$20
Other Comprehensive Earnings/(Losses):					
Gains transferred to earnings	$(9)			$1	$(8)
Recognized losses	(20)			3	(17)
Net impact on equity	$(29)			$4	$(25)
Currency translation adjustments		$(11)		$4	$(7)

- 17-

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

(in millions)	For the Three Months Ended September 30, 2013				
Gain (Loss)	Cash Flow Hedges	Net Investment Hedges	Other Derivatives	Income Taxes	Total
Statement of Earnings:					
Net revenues	$88		$—		$88
Cost of sales	—		—		—
Marketing, administration and research costs	—		—		—
Operating income	88		—		88
Interest expense, net	(16)		(2)		(18)
Earnings before income taxes	72		(2)		70
Provision for income taxes	(9)		1		(8)
Net earnings attributable to PMI	$63		$(1)		$62
Other Comprehensive Earnings/(Losses):					
Gains transferred to earnings	$(72)			$9	$(63)
Recognized gains	2			—	2
Net impact on equity	$(70)			$9	$(61)
Currency translation adjustments		$(44)		10	$(34)

(in millions)	For the Three Months Ended September 30, 2012				
Gain (Loss)	Cash Flow Hedges	Net Investment Hedges	Other Derivatives	Income Taxes	Total
Statement of Earnings:					
Net revenues	$9		$—		$9
Cost of sales	—		—		—
Marketing, administration and research costs	—		—		—
Operating income	9		—		9
Interest expense, net	(13)		5		(8)
Earnings before income taxes	(4)		5		1
Provision for income taxes	—		1		1
Net earnings attributable to PMI	$(4)		$6		$2
Other Comprehensive Earnings/(Losses):					
Losses transferred to earnings	$4			$—	$4
Recognized losses	(33)			4	(29)
Net impact on equity	$(29)			$4	$(25)
Currency translation adjustments		$(11)		4	$(7)

Each type of hedging activity is described in greater detail below.
Cash Flow Hedges
PMI has entered into foreign exchange contracts to hedge foreign currency exchange risk related to certain forecasted transactions. The effective portion of gains and losses associated with qualifying cash flow hedge contracts is deferred as a component of accumulated other comprehensive losses until the underlying hedged transactions are reported in PMI's condensed consolidated statements of earnings. During the nine months and three months ended September 30,

2013 and 2012, ineffectiveness related to cash flow hedges was not material. As of September 30, 2013, PMI has hedged forecasted transactions for periods not exceeding

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

the next fifteen months. The impact of these hedges is included in operating cash flows on PMI's condensed consolidated statements of cash flows.

For the nine months and three months ended September 30, 2013 and 2012, foreign exchange contracts that were designated as cash flow hedging instruments impacted the condensed consolidated statements of earnings and comprehensive earnings as follows:

(pre-tax, in millions)	For the Nine Months Ended September 30,				
Derivatives in Cash Flow Hedging Relationship	Statement of Earnings Classification of Gain/(Loss) Reclassified from Other Comprehensive Earnings/(Losses) into Earnings	Amount of Gain/(Loss) Reclassified from Other Comprehensive Earnings/(Losses) into Earnings		Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings/(Losses) on Derivatives	
		2013	2012	2013	2012
Foreign exchange contracts				$ 181	$ (20)
	Net revenues	$213	$33		
	Cost of sales	6	19		
	Interest expense, net	(38)	(43)		
Total		$181	$9	$ 181	$ (20)

(pre-tax, in millions)	For the Three Months Ended September 30,				
Derivatives in Cash Flow Hedging Relationship	Statement of Earnings Classification of Gain/(Loss) Reclassified from Other Comprehensive Earnings/(Losses) into Earnings	Amount of Gain/(Loss) Reclassified from Other Comprehensive Earnings/(Losses) into Earnings		Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings/(Losses) on Derivatives	
		2013	2012	2013	2012
Foreign exchange contracts				$ 2	$ (33)
	Net revenues	$88	$9		
	Interest expense, net	(16)	(13)		
Total		$72	$(4)	$ 2	$ (33)

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 nine months ended September 30, 2013 and 2012, these hedges of net investments resulted in losses, net of income taxes, of $163 million and $30 million, respectively. For the three months ended September 30, 2013 and 2012, these hedges of net investments resulted in losses, net of income taxes, of $199 million and $70 million, respectively. These losses were reported as a component of accumulated other comprehensive losses within currency translation adjustments. For the nine months and three months ended September 30, 2013 and 2012, 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.

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

For the nine months and three months ended September 30, 2013 and 2012, foreign exchange contracts that were designated as net investment hedging instruments impacted the condensed consolidated statements of earnings and comprehensive earnings as follows:

(pre-tax, in millions)	For the Nine Months Ended September 30,				
Derivatives in Net Investment Hedging Relationship	Statement of Earnings Classification of Gain/(Loss) Reclassified from Other Comprehensive Earnings/(Losses) into Earnings	Amount of Gain/(Loss) Reclassified from Other Comprehensive Earnings/(Losses) into Earnings		Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings/(Losses) on Derivatives	
		2013	2012	2013	2012
Foreign exchange contracts				$(28)	$(11)
	Interest expense, net	$—	$—		

(pre-tax, in millions)	For the Three Months Ended September 30,				
Derivatives in Net Investment Hedging Relationship	Statement of Earnings Classification of Gain/(Loss) Reclassified from Other Comprehensive Earnings/(Losses) into Earnings	Amount of Gain/(Loss) Reclassified from Other Comprehensive Earnings/(Losses) into Earnings		Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings/(Losses) on Derivatives	
		2013	2012	2013	2012
Foreign exchange contracts				$(44)	$(11)
	Interest expense, net	$—	$—		

Other Derivatives
PMI has entered into foreign exchange contracts to hedge the foreign currency exchange and interest rate risks related to intercompany loans between certain subsidiaries, and third-party loans. While effective as economic hedges, no hedge accounting is applied for these contracts; therefore, the unrealized gains (losses) relating to these contracts are reported in PMI's condensed consolidated statements of earnings. For the nine months ended September 30, 2013 and 2012, the gains from contracts for which PMI did not apply hedge accounting were $67 million and $66 million, respectively. For the three months ended September 30, 2013 and 2012, the gains from contracts for which PMI did not apply hedge accounting were $87 million and $190 million, respectively. The gains from these contracts substantially offset the losses generated by the underlying intercompany and third-party loans being hedged.

As a result, for the nine months and three months ended September 30, 2013 and 2012, these items impacted the condensed consolidated statements of earnings as follows:

(pre-tax, in millions)	For the Three Months Ended September 30,				
Derivatives not Designated as Hedging Instruments	Statement of Earnings Classification of Gain/(Loss)	Amount of Gain/(Loss) Recognized in Earnings			
		For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
		2013	2012	2013	2012

Foreign exchange contracts	Interest expense, net	$—	$11	$(2	) $5

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

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 Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2013	2012	2013	2012
Gain at beginning of period	$92	$15	$153	$15
Derivative (gains)/losses transferred to earnings	(158)	(8)	(63)	4
Change in fair value	158	(17)	2	(29)
Gain/(loss) as of September 30,	$92	$(10)	$92	$(10)

At September 30, 2013, PMI expects $82 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.

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 13. Fair Value Measurements and Note 15. Balance Sheet Offsetting for additional discussion of derivative financial instruments.

Note 7. Redeemable Noncontrolling Interest:
Philippines Business Combination:
On February 25, 2010, PMI's affiliate, Philip Morris Philippines Manufacturing Inc. ("PMPMI"), and Fortune Tobacco Corporation ("FTC") combined their respective business activities by transferring selected assets and liabilities of PMPMI and FTC to a new company called PMFTC Inc. ("PMFTC"). PMPMI and FTC hold equal economic interests in PMFTC, while PMI manages the day-to-day operations of PMFTC and has a majority of its Board of Directors. Consequently, PMI accounted for the contributed assets and liabilities of FTC as a business combination.
The fair value of the assets and liabilities contributed by FTC in this non-cash transaction was determined to be $1.17 billion. FTC holds the right to sell its interest in PMFTC to PMI, except in certain circumstances, during the period from February 25, 2015, through February 24, 2018, at an agreed-upon value of $1.17 billion, which was recorded on PMI's condensed consolidated balance sheet as a redeemable noncontrolling interest at the date of the business combination.

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

With the consolidation of PMFTC, FTC's share of PMFTC's comprehensive income or loss is attributable to the redeemable noncontrolling interest, impacting the carrying value. To the extent that the attribution of these amounts would cause the carrying value to fall below the redemption amount of $1.17 billion, the carrying amount would be adjusted back up to the redemption value through stockholders' (deficit) equity. The movement in redeemable noncontrolling interest for the nine months ended September 30, 2013 was as follows:

(in millions)	
Redeemable noncontrolling interest at December 31, 2012	$1,301
Share of net earnings	75
Dividend payments	(70)
Currency translation losses	(23)
Redeemable noncontrolling interest at September 30, 2013	$1,283

The redeemable noncontrolling interest balance at September 30, 2012 was $1,276 million. The increase in redeemable noncontrolling interest from December 31, 2011 through September 30, 2012 of $64 million was due to $126 million of net earnings and $17 million of currency translation gains, partially offset by dividend payments of $79 million.

In future periods, if the fair value of 50% of PMFTC were to drop below the redemption value of $1.17 billion, the difference would be treated as a special dividend to FTC and would reduce PMI's earnings per share. Reductions in earnings per share may be partially or fully reversed in subsequent periods if the fair value of the redeemable noncontrolling interest increases relative to the redemption value. Such increases in earnings per share would be limited to cumulative prior reductions. At September 30, 2013, PMI determined that 50% of the fair value of PMFTC exceeded the redemption value of $1.17 billion.

Note 8. Earnings Per Share:

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

(in millions)	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2013	2012	2013	2012
Net earnings attributable to PMI	$6,589	$6,705	$2,340	$2,227
Less distributed and undistributed earnings attributable to share-based payment awards	35	36	12	12
Net earnings for basic and diluted EPS	$6,554	$6,669	$2,328	$2,215
Weighted-average shares for basic and diluted EPS	1,630	1,701	1,614	1,683

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 2013 and 2012 computations, there were no antidilutive stock options.

Note 9. Segment Reporting:

PMI's subsidiaries and affiliates are engaged in the manufacture and sale of cigarettes and other tobacco products in markets outside of the United States of America. Reportable segments for PMI are organized and managed by geographic region. PMI's reportable segments are European Union; Eastern Europe, Middle East & Africa; Asia; and Latin America & Canada.

PMI's management evaluates segment performance and allocates resources based on operating companies income, which PMI defines as operating income before general corporate expenses and amortization of intangibles. 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.

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

Segment data were as follows:

(in millions)	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2013	2012	2013	2012
Net revenues:				
European Union	$21,255	$20,654	$7,487	$6,904
Eastern Europe, Middle East & Africa	15,346	14,256	5,546	5,125
Asia	15,776	15,668	5,144	5,174
Latin America & Canada	7,262	7,073	2,452	2,389
Net revenues	$59,639	$57,651	$20,629	$19,592
Earnings before income taxes:				
Operating companies income:				
European Union	$3,227	$3,232	$1,207	$1,085
Eastern Europe, Middle East & Africa	2,968	2,805	1,088	1,047
Asia	3,567	4,068	1,097	1,297
Latin America & Canada	776	753	267	267
Amortization of intangibles	(71)	(73)	(23)	(24)
General corporate expenses	(155)	(155)	(43)	(49)
Operating income	10,312	10,630	3,593	3,623
Interest expense, net	(721)	(633)	(239)	(211)
Earnings before income taxes	$9,591	$9,997	$3,354	$3,412

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 10. 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 PM USA for tobacco product claims based in substantial part on products manufactured by PMI or contract manufactured for PMI by PM USA, and PM USA will indemnify PMI for tobacco product claims based in substantial part on products manufactured by PM USA, excluding tobacco products contract manufactured for PMI.

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

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

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

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

loss has been accrued in the consolidated financial statements for unfavorable outcomes in these cases, if any. Legal defense costs are expensed as incurred.

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

To date, we have paid only one judgment in a tobacco-related case. That judgment, including costs, was approximately €1,400 (approximately $1,920), 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 October 30, 2013, November 1, 2012 and November 1, 2011:

Type of Case	Number of Cases Pending as of October 30, 2013	Number of Cases Pending as of November 1, 2012	Number of Cases Pending as of November 1, 2011
Individual Smoking and Health Cases	61	75	84
Smoking and Health Class Actions	11	10	10
Health Care Cost Recovery Actions	15	15	11
Lights Class Actions	1	2	2
Individual Lights Cases	2	7	9
Public Civil Actions	3	4	3

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

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

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

Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
September 2009	Brazil/Bernhardt	Individual Smoking and Health	The Civil Court of Rio de Janeiro found for plaintiff and ordered Philip Morris Brasil to pay R$13,000 (approximately $6,000) in “moral damages.”	Philip Morris Brasil filed its appeal against the decision on the merits with the Court of Appeals in November 2009. In February 2010, without addressing the merits, the Court of Appeals annulled the trial court's decision and remanded the case to the trial court to issue a new ruling, which was required to address certain compensatory damage claims made by the plaintiff that the trial court did not address in its original ruling. In July 2010, the trial court reinstated its original decision, while specifically rejecting the compensatory damages claim. Philip Morris Brasil appealed this decision. In March 2011, the Court of Appeals affirmed the trial court's decision and denied Philip Morris Brasil's appeal. The Court of Appeals increased the amount of damages awarded to the plaintiff to R$100,000 (approximately $45,900). Philip Morris Brasil has appealed this decision.

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

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 moral or actual damages, which were to be assessed in a second phase of the case. The size of the class was not defined in the ruling.	In April 2004, the court clarified its ruling, awarding “moral damages” of R$1,000 (approximately $460) per smoker per full year of smoking plus interest at the rate of 1% per month, as of the date of the ruling. The court did not award actual damages, which were to be assessed in the second phase of the case. The size of the class was not estimated. Defendants appealed to the São Paulo Court of Appeals, which annulled the ruling in November 2008, finding that the trial court had inappropriately ruled without hearing evidence and returned the case to the trial court for further proceedings. In May 2011, the trial court dismissed the claim. Plaintiff has appealed. In addition, the defendants filed a constitutional appeal to the Federal Supreme Tribunal on the basis that the plaintiff did not have standing to bring the lawsuit. This appeal is still pending.

Pending claims related to tobacco products generally fall within the following categories:
Smoking and Health Litigation: These cases primarily allege personal injury and are brought by individual plaintiffs or on behalf of a class or purported class of individual plaintiffs. Plaintiffs' allegations of liability in these cases are based on various theories of recovery, including negligence, gross negligence, strict liability, fraud, misrepresentation, design defect, failure to warn, breach of express and implied warranties, violations of deceptive trade practice laws and consumer protection statutes. Plaintiffs in these cases seek various forms of relief, including compensatory and other damages, and injunctive and equitable relief. Defenses raised in these cases include licit activity, failure to state a claim, lack of defect, lack of proximate cause, assumption of the risk, contributory negligence, and statute of limitations.
As of October 30, 2013, there were a number of smoking and health cases pending against us, our subsidiaries or indemnitees, as follows:

•

- 61 cases brought by individual plaintiffs in Argentina (24), Brazil (24), Canada (2), Chile (3), Costa Rica (2), Greece (1), Italy (3), the Philippines (1) and Scotland (1), compared with 75 such cases on November 1, 2012, and 84 cases on November 1, 2011; and
- 11 cases brought on behalf of classes of individual plaintiffs in Brazil (2) and Canada (9), compared with 10 such cases on November 1, 2012 and November 1, 2011, respectively.

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) unspecified damages on behalf of all smokers nationwide, former smokers, and their relatives; (ii) unspecified damages on behalf of people exposed to environmental tobacco smoke ("ETS") nationwide, and their relatives; and (iii) reimbursement of the health care costs allegedly incurred for the treatment of tobacco-related diseases by all Brazilian States and Municipalities, and the Federal District. In an interim ruling issued in December 2007, the trial court limited the scope of this claim to the State of São Paulo only. In December 2008, the Seventh Civil Court of São Paulo issued a decision declaring that it lacked jurisdiction because the case involved issues similar to the ADESF case discussed above and should be transferred to the Nineteenth Lower Civil Court in São Paulo where the ADESF case is pending. The court further stated that these cases should be consolidated for the purposes of judgment. In April 2010, the São Paulo Court of Appeals reversed the Seventh Civil Court's decision that consolidated the cases, finding that they are based on different legal claims and are progressing at different stages of proceedings. This case was returned to the Seventh Civil Court of São Paulo, and our subsidiary filed its closing arguments in December 2010. In March 2012, the trial court dismissed the case on the merits. This decision has been appealed.

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

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

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

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

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

In the sixth class action pending in Canada, Dorion v. Canadian Tobacco Manufacturers' Council, et al., The Queen's Bench, Alberta, Canada, filed June 15, 2009, we, our subsidiaries, and our indemnitees (PM USA and Altria Group, Inc.), and other members of the industry are defendants. The plaintiff, an individual smoker, alleges her own addiction to tobacco products and chronic bronchitis and severe sinus infections resulting from the use of tobacco products. She is seeking compensatory and unspecified punitive damages on behalf of a proposed class comprised of all smokers, their estates, dependents and family members,

restitution of profits, and reimbursement of government health care costs allegedly caused by tobacco products. To date, we, our subsidiaries, and our indemnitees have not been properly served with the complaint. No activity in this case is anticipated while plaintiff's counsel pursues the class action filed in Saskatchewan (see description of Adams, above).
In the seventh class action pending in Canada, McDermid v. Imperial Tobacco Canada Limited, et al., Supreme Court, British Columbia, Canada, filed June 25, 2010, we, our subsidiaries, and our indemnitees (PM USA and Altria Group, Inc.), and other members of the industry are defendants. The plaintiff, an individual smoker, alleges his own addiction to tobacco products and heart disease resulting from the use of tobacco products. He is seeking compensatory and unspecified punitive damages on behalf of a proposed class comprised of all smokers who were alive on June 12, 2007, and who suffered from heart disease allegedly caused by smoking, their estates, dependents and family members, plus disgorgement of revenues earned by the defendants from January 1, 1954 to the date the claim was filed. Defendants have filed jurisdictional challenges on the grounds that this action should not proceed during the pendency of the Saskatchewan class action (see description of Adams, above).

In the eighth class action pending in Canada, Bourassa v. Imperial Tobacco Canada Limited, et al., Supreme Court, British Columbia, Canada, filed June 25, 2010, we, our subsidiaries, and our indemnitees (PM USA and Altria Group, Inc.), and other members of the industry are defendants. The plaintiff, the heir to a deceased smoker, alleges that the decedent was addicted to tobacco products and suffered from emphysema resulting from the use of tobacco products. She is seeking compensatory and unspecified punitive damages on behalf of a proposed class comprised of all smokers who were alive on June 12, 2007, and who suffered from chronic respiratory diseases allegedly caused by smoking, their estates, dependents and family members, plus disgorgement of revenues earned by the defendants from January 1, 1954 to the date the claim was filed. Defendants have filed jurisdictional challenges on the grounds that this action should not proceed during the pendency of the Saskatchewan class action (see description of Adams, above).

In the ninth class action pending in Canada, Suzanne Jacklin v. Canadian Tobacco Manufacturers' Council, et al., Ontario Superior Court of Justice, filed June 20, 2012, we, our subsidiaries, and our indemnitees (PM USA and Altria Group, Inc.), and other members of the industry are defendants. The plaintiff, an individual smoker, alleges her own addiction to tobacco products and COPD resulting from the use of tobacco products. She is seeking compensatory and unspecified 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 October 30, 2013, there were 15 health care cost recovery cases pending against us, our subsidiaries or indemnitees in Canada (9), Nigeria (5) and Spain (1), compared with 15 such cases on November 1, 2012 and 11 such cases on November 1, 2011.

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

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

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

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

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

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

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

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

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

In the first health care cost recovery case in Nigeria, The Attorney General of Lagos State v. British American Tobacco (Nigeria) Limited, et al., High Court of Lagos State, Lagos, Nigeria, filed March 13, 2008, we and other members of the industry are defendants. Plaintiff seeks reimbursement for the cost of treating alleged smoking-related diseases for the past 20 years, payment of anticipated costs of treating alleged smoking-related diseases for the next 20 years, various forms of injunctive relief, plus punitive damages. We are in the process of making challenges to service and the court's jurisdiction. Currently, the case is stayed in the trial court pending the appeals of certain co-defendants relating to service objections. We currently have no employees, operations or assets in Nigeria.

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

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

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

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

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

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 October 30, 2013, the following lights cases were pending against our subsidiaries or indemnitees:

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

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

In the class action pending in Israel, El-Roy, et al. v. Philip Morris Incorporated, et al., District Court of Tel-Aviv/Jaffa, Israel, filed January 18, 2004, our subsidiary and our indemnitees (PM USA and our former importer) are defendants. The plaintiffs filed a purported class action claiming that the class members were misled by the descriptor "lights" into believing that lights cigarettes are safer than full flavor cigarettes. The claim seeks recovery of the purchase price of lights cigarettes and compensation for distress for each class member. Hearings took place in November and December 2008 regarding whether the case meets the legal requirements necessary to allow it to proceed as a class action. The parties' briefing on class certification was completed in March 2011. In November 2012, the court denied class certification and dismissed the individual claims. Plaintiffs have appealed, and an oral hearing has been scheduled for September 2014.

Public Civil Actions: Claims have been filed either by an individual, or a public or private entity, seeking to protect collective or individual rights, such as the right to health, the right to information or the right to safety. Plaintiffs' allegations of liability in these cases are based on various theories of recovery including product defect, concealment, and misrepresentation. Plaintiffs in these cases seek various forms of relief including injunctive relief such as banning cigarettes, descriptors, smoking in certain places and advertising, as well as implementing communication campaigns and reimbursement of medical expenses incurred by public or private institutions.
As of October 30, 2013, there were 3 public civil actions pending against our subsidiaries in Argentina (1), Brazil (1), and Venezuela (1), compared with 4 such cases on November 1, 2012, and 3 such cases on November 1, 2011.
In the public civil action in Argentina, Asociación Argentina de Derecho de Danos v. Massalin Particulares S.A., et al., Civil Court of Buenos Aires, Argentina, filed February 26, 2007, our subsidiary and another member of the industry are defendants. The plaintiff, a consumer association, seeks the establishment of a relief fund for reimbursement of medical costs associated with diseases allegedly caused by smoking. Our subsidiary filed its answer in September 2007. In March 2010, the case file was transferred to the Federal Court on Administrative Matters after the Civil Court granted the plaintiff's request to add the national government as a co-plaintiff in the case. The case is currently in the evidentiary stage.
In the previously reported case in Argentina, Conciencia Ciudadana Mejorar Asociación Civil, et al.v. Massalin Particulares S.A., 4th Civil & Commercial Court of Zarate, Argentina, filed September 20, 2012, our subsidiary was a defendant. Plaintiffs, a civil association and an individual, sought an order requiring our subsidiary to place information regarding tar, nicotine, and carbon monoxide yields on the packages of cigarettes in the Marlboro brand family. Plaintiffs also sought moral and punitive damages. On June 24, 2013, the trial court dismissed this case without prejudice upon plaintiffs' voluntary motion seeking dismissal. Plaintiffs did not appeal, and the case is now terminated. We will no longer report this case.
In the public civil action in Brazil, The Brazilian Association for the Defense of Consumer Health ("SAUDECON") v. Philip Morris Brasil Industria e Comercio Ltda. and Souza Cruz S.A., Civil Court of City of Porto Alegre, Brazil, filed November 3, 2008, our subsidiary is a defendant. The plaintiff, a consumer organization, is asking the court to establish a fund that will be used to provide treatment to smokers who claim to be addicted and who do not otherwise have access to smoking cessation treatment. Plaintiff requests that each defendant's liability be determined according to its market share. In May 2009, the trial court dismissed the case on the merits. Plaintiff has appealed.

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 11. Income Taxes:

Income tax provisions for jurisdictions outside the United States, 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.

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

PMI's effective tax rates for the nine months and three months ended September 30, 2013 were 29.0% and 28.4%, respectively. PMI's effective tax rates for the nine months and three months ended September 30, 2012 were 30.3% and 31.9%, respectively. The effective tax rate for the nine months ended September 30, 2013 was unfavorably impacted by the additional expense associated with the Act ($17 million). The effective tax rates for the nine months and three months ended September 30, 2012, were unfavorably impacted by an additional income tax provision of $79 million following the conclusion of the IRS examination of Altria's consolidated tax returns for the years 2004-2006. Prior to March 28, 2008, PMI was a wholly-owned subsidiary of Altria. Excluding these special 2013 and 2012 tax items discussed in this paragraph, the change in the effective tax rate for the nine months and three months ended September 30, 2013 was primarily due to earnings mix and repatriation cost differences.

The effective tax rates are based on PMI's full-year geographic earnings mix projections and cash repatriation plans. Changes in earnings mix 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 twelve months, certain tax examinations will close, which could result in a change in unrecognized tax benefits along with related interest and penalties. An estimate of any possible change cannot be made at this time.

Note 12. Indebtedness:

Short-term Borrowings:

At September 30, 2013 and December 31, 2012, PMI's short-term borrowings, consisting of commercial paper and bank loans to certain PMI subsidiaries, had a carrying value of $3,668 million and $2,419 million, respectively. The fair value of PMI's short-term borrowings, based on current market interest rates, approximates carrying value.

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

Long-term Debt:
At September 30, 2013 and December 31, 2012, PMI's long-term debt consisted of the following:

(in millions)	September 30, 2013	December 31, 2012
U.S. dollar notes, 0.312% to 6.875% (average interest rate 4.198%), due through 2043	$14,517	$14,702
Foreign currency obligations:		
Euro notes, 1.750% to 5.875% (average interest rate 3.339%), due through 2033	7,164	3,724
Swiss franc notes, 0.875% to 2.000% (average interest rate 1.240%), due through 2021	1,267	1,579
Other (average interest rate 3.629%), due through 2024	184	415
	23,132	20,420
Less current portion of long-term debt	1,255	2,781
	$21,877	$17,639

Other foreign currency debt above includes mortgage debt in Switzerland at September 30, 2013 and December 31, 2012, and debt from our business combination in the Philippines at December 31, 2012. Other foreign currency debt also includes capital lease obligations.

PMI's debt offerings in the first nine months of 2013 were as follows:
(in millions)

Type		Face Value	Interest Rate	Issuance	Maturity
U.S. dollar notes	(a)	$400	Floating	March 2013	February 2015
U.S. dollar notes	(b)	$600	2.625%	March 2013	March 2023
U.S. dollar notes	(b)	$850	4.125%	March 2013	March 2043
EURO notes	(c)	€1,250 (approximately $1,621)	1.750%	March 2013	March 2020
EURO notes	(c)	€750 (approximately $972)	2.750%	March 2013	March 2025
EURO notes	(d)	€500 (approximately $648)	3.125%	June 2013	June 2033
Swiss franc notes	(e)	CHF200 (approximately $217)	0.875%	March 2013	March 2019

(a) Interest on these notes is payable quarterly in arrears beginning in May 2013. The notes will bear interest from date of issuance at a rate per annum, reset quarterly, equal to three month LIBOR plus 0.05%.
(b) Interest on these notes is payable semiannually in arrears beginning in September 2013.
(c) Interest on these notes is payable annually in arrears beginning in March 2014.
(d) Interest on these notes is payable annually in arrears beginning in June 2014.
(e) Interest on these notes is payable annually in arrears beginning in March 2014.

The net proceeds from the sale of the securities listed in the table above were used to meet PMI's working capital requirements, to repurchase PMI's common stock, to refinance debt and for general corporate purposes.

Credit Facilities:

On February 12, 2013, PMI entered into a 364-day revolving credit facility in the amount of $2.0 billion.

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

At September 30, 2013, PMI's total committed credit facilities were as follows:

(in billions)

Type	Committed Credit Facilities
364-day revolving credit, expiring February 11, 2014	$2.0
Multi-year revolving credit, expiring March 31, 2015	2.5
Multi-year revolving credit, expiring October 25, 2016	3.5
Total facilities	$8.0

At September 30, 2013, there were no borrowings under these committed credit facilities.

Note 13. Fair Value Measurements:

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

Level 1 - Quoted prices in active markets for identical assets or liabilities;

Level 2 - Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

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

Derivative Financial Instruments – Foreign Exchange Contracts

PMI assesses the fair value of its derivative financial instruments, which consist of deliverable and non-deliverable foreign exchange forward contracts, foreign currency swaps and foreign currency options, using internally developed models that use, as their basis, readily observable market inputs. The fair value of PMI’s foreign exchange forward contracts is determined by using the prevailing foreign exchange spot rates and interest rate differentials, and the respective maturity dates of the instruments. The fair value of PMI’s currency options is determined by using a Black-Scholes methodology based on foreign exchange spot rates and interest rate differentials, currency volatilities and maturity dates. PMI’s derivative financial instruments have been classified within Level 2 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 $17 million of capital lease obligations, was $23,115 million at September 30, 2013. 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.

- 34-

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

The aggregate fair values of PMI’s derivative financial instruments and debt as of September 30, 2013, were as follows:

(in millions)	Fair Value at September 30, 2013	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	$215	$—	$215	$—
Total assets	$215	$—	$215	$—
Liabilities:				
Debt	$24,037	$23,855	$182	$—
Foreign exchange contracts	78	—	78	—
Total liabilities	$24,115	$23,855	$260	$—

Note 14. Accumulated Other Comprehensive Losses:
PMI’s accumulated other comprehensive losses, net of taxes, consisted of the following:

(in millions)	At September 30, 2013	At December 31, 2012	At September 30, 2012
Currency translation adjustments	$(1,724)	$(331)	$(358)
Pension and other benefits	(3,188)	(3,365)	(2,467)
Derivatives accounted for as hedges	92	92	(10)
Total accumulated other comprehensive losses	$(4,820)	$(3,604)	$(2,835)

Reclassifications from Other Comprehensive Earnings

The movements in accumulated other comprehensive losses and the related tax impact, for each of the components above, that is due to current period activity and reclassifications to the income statement are shown on the condensed consolidated statements of comprehensive earnings for the nine months and three months ended September 30, 2013 and 2012. The movement in currency translation adjustments for the nine months ended September 30, 2013 was also impacted by the purchase of the remaining shares of the Mexican tobacco business. 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.

Note 15. Balance Sheet Offsetting:

Foreign Exchange Contracts

PMI uses deliverable and non-deliverable forward foreign exchange contracts, foreign currency swaps and foreign currency options, collectively referred to as foreign exchange contracts, to mitigate its exposure to changes in exchange and interest rates from third-party and intercompany actual and forecasted transactions. Substantially all of

PMI's foreign exchange contracts are subject to master netting arrangements, whereby the right to offset occurs in the event of default by a participating party. While these contracts contain the enforceable right to offset through close-out netting rights, PMI elects to present them on a gross basis in the 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.

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

The effects of these foreign exchange contract assets and liabilities on PMI's condensed consolidated balance sheets were as follows:

(in millions)	Gross Amounts Recognized	Gross Amount Offset in the Condensed Consolidated Balance Sheet	Net Amounts Presented in the Condensed Consolidated Balance Sheet	Gross Amounts Not Offset in the Condensed Consolidated Balance Sheet: Financial Instruments	Gross Amounts Not Offset in the Condensed Consolidated Balance Sheet: Cash Collateral Received/Pledged	Net Amount
At September 30, 2013						
Assets						
Foreign exchange contracts	$215	$—	$215	$(48)	$(126)	$41
Liabilities						
Foreign exchange contracts	$78	$—	$78	$(48)	$(13)	$17
At December 31, 2012						
Assets						
Foreign exchange contracts	$160	$—	$160	$(24)	$—	$136
Liabilities						
Foreign exchange contracts	$55	$—	$55	$(24)	$—	$31

Note 16. Acquisitions and Other Business Arrangements:

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

Note 17. Investments in Unconsolidated Subsidiaries:

At September 30, 2013 and December 31, 2012, PMI had total investments in unconsolidated subsidiaries of $665 million and $24 million, respectively, which were accounted for under the equity method of accounting. On September 30, 2013, PMI acquired a 49% equity interest in United Arab Emirates-based Arab Investors-TA (FZC) (“AITA”) for approximately $625 million. As a result of this transaction, PMI holds an approximate 25% economic interest in Société des Tabacs Algéro-Emiratie (“STAEM”), an Algerian joint venture which is 51% owned by AITA and 49% by the Algerian state-owned enterprise Société Nationale des Tabacs et Allumettes SpA. STAEM manufactures and distributes under license some of PMI’s brands. The initial investment in AITA was recorded at cost and is included in investments in unconsolidated subsidiaries on the condensed consolidated balance sheet at

September 30, 2013.

As of September 30, 2013, PMI had approximately $85 million in receivables relating to agreements with its unconsolidated subsidiaries within the EEMA Region. These agreements, which are in the ordinary course of business, are primarily for distribution, contract manufacturing and licenses. Earnings from investments in unconsolidated subsidiaries were insignificant for the nine months and three months ended September 30, 2013 and 2012.

Table of Contents

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 and other tobacco products in markets outside the United States of America. We manage our business in four segments:

- European Union;
- Eastern Europe, Middle East & Africa ("EEMA");
- Asia; and
- Latin America & Canada.

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

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

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

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

Table of Contents

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

Consolidated Operating Results for the Nine Months Ended September 30, 2013 – The changes in our reported diluted earnings per share (“diluted EPS”) for the nine months ended September 30, 2013, from the comparable 2012 amounts, were as follows:

	Diluted EPS	% Growth
For the nine months ended September 30, 2012	$3.92	
2012 Asset impairment and exit costs	0.02	
2012 Tax items	0.05	
Subtotal of 2012 items	0.07	
2013 Asset impairment and exit costs	—	
2013 Tax items	(0.01)	
Subtotal of 2013 items	(0.01)	
Currency	(0.23)	
Interest	(0.04)	
Change in tax rate	0.04	
Impact of lower shares outstanding and share-based payments	0.16	
Operations	0.11	
For the nine months ended September 30, 2013	$4.02	2.6%

Asset Impairment and Exit Costs – During the nine months ended September 30, 2013, we recorded pre-tax asset impairment and exit costs of $8 million (less than one cent impact on diluted EPS) related to the termination of distribution agreements in Asia. During the nine months ended September 30, 2012, we recorded pre-tax asset impairment and exit costs of $50 million ($29 million after tax and noncontrolling interests or $0.02 per share) primarily related to factory restructurings in Asia and in Latin America & Canada, as well as a contract termination charge in Asia.

On September 30, 2013, we announced our intention to restructure our global and regional functions based in Switzerland. The potential restructuring is expected to result in the elimination or relocation of approximately 170 positions. We expect to finalize the plans during the fourth quarter of 2013, and anticipate that the charge associated with the restructuring will reduce diluted EPS by approximately $0.03 in the fourth quarter of 2013.

Income Taxes – Our effective income tax rate for the nine months ended September 30, 2013 decreased by 1.3 percentage points to 29.0%. The effective tax rate for the nine months ended September 30, 2013, was unfavorably impacted by the additional expense associated with the enactment of the American Taxpayer Relief Act of 2012 ($17 million). The effective tax rate for the nine months ended September 30, 2012, was unfavorably impacted by an additional income tax provision of $79 million following the conclusion of the IRS examination of Altria Group, Inc.'s ("Altria") consolidated tax returns for the years 2004-2006. Prior to March 28, 2008, we were a wholly-owned subsidiary of Altria. The special tax items discussed in this paragraph decreased our diluted EPS by $0.01 in 2013, and $0.05 in 2012. Excluding the impact of these special tax items, the change in tax rate that increased our diluted EPS by $0.04 per share in 2013 was primarily due to earnings mix and repatriation cost differences.

Currency – The unfavorable currency impact during the reporting period was due primarily to the Argentine peso, Australian dollar, Indonesian rupiah, Japanese yen, Russian ruble and Swiss franc, partially offset by the Euro and Mexican peso.

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

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

Table of Contents

Operations – The increase in diluted EPS of $0.11 from our operations was due to the following segments:

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

partially offset by:

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

Consolidated Operating Results for the Three Months Ended September 30, 2013 – The changes in our reported diluted EPS for the three months ended September 30, 2013, from the comparable 2012 amounts, were as follows:

	Diluted EPS	% Growth
For the three months ended September 30, 2012	$1.32	
2012 Asset impairment and exit costs	0.01	
2012 Tax items	0.05	
Subtotal of 2012 items	0.06	
2013 Asset impairment and exit costs	—	
2013 Tax items	—	
Subtotal of 2013 items	—	
Currency	(0.09)	
Interest	(0.01)	
Change in tax rate	0.03	
Impact of lower shares outstanding and share-based payments	0.05	
Operations	0.08	
For the three months ended September 30, 2013	$1.44	9.1 %

Asset Impairment and Exit Costs – During the three months ended September 30, 2012, we recorded pre-tax asset impairment and exit costs of $34 million ($21 million after tax and noncontrolling interests or $0.01 per share) primarily related to factory restructurings in Asia and Latin America & Canada, as well as a contract termination charge in Asia.

Income Taxes – Our effective income tax rate for the three months ended September 30, 2013 decreased by 3.5 percentage points to 28.4%. The effective tax rate for the three months ended September 30, 2012, was unfavorably impacted by an additional income tax provision of $79 million following the conclusion of the IRS examination of Altria's consolidated tax returns for the years 2004-2006. This additional tax provision decreased our diluted EPS by $0.05 per share in 2012. Excluding the impact of this additional provision in 2012, the change in tax rate that increased our diluted EPS by $0.03 in 2013 was primarily due to earnings mix and repatriation cost differences.

Currency – The unfavorable currency impact during the reporting period was due primarily to the Argentine peso, Australian dollar, Indonesian rupiah, Japanese yen and Swiss franc, partially offset by the Euro.

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

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

Operations – The increase in diluted EPS of $0.08 from our operations was due primarily to the following segments:

- EEMA: Higher pricing, partially offset by unfavorable volume/mix and higher costs; and

- 39-

Table of Contents

- European Union: Higher pricing, partially offset by unfavorable volume/mix;

partially offset by:

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

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

2013 Forecasted Results - On October 17, 2013, we revised our 2013 full-year reported diluted EPS forecast to be in a range of $5.35 to $5.40, versus $5.17 in 2012. This forecast includes the unfavorable special tax item of $0.01 per share associated with the enactment of the American Taxpayer Relief Act of 2012 reported in the first quarter of 2013, an anticipated 2013 fourth-quarter charge, related to a previously announced organizational restructuring, of approximately $0.03 per share and reflects a cautious outlook regarding certain markets. Excluding an unfavorable currency impact, at prevailing exchange rates, of approximately $0.33 for the full-year 2013 and the tax item and restructuring charge, reported diluted earnings per share are projected to increase by approximately 10% versus adjusted diluted earnings per share of $5.22 in 2012. This forecast includes a one-year gross productivity and cost savings target for 2013 of approximately $300 million and a share repurchase target for 2013 of $6.0 billion.

We calculated 2012 adjusted diluted EPS as reported diluted EPS of $5.17, plus the $0.02 per share charge related to discrete tax items and the $0.03 per share charge related to asset impairment and exit costs.

This 2013 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 these projections.

Adjusted diluted EPS is not a U.S. GAAP measure. 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.

Table of Contents

Discussion and Analysis

Consolidated Operating Results

See pages 67-71 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 Nine Months Ended September 30,		For the Three Months Ended September 30,	
(in millions)	2013	2012	2013	2012
Cigarette volume:				
European Union	140,659	151,222	48,969	51,629
Eastern Europe, Middle East & Africa	220,034	226,472	76,902	81,388
Asia	226,503	244,009	73,296	79,507
Latin America & Canada	69,774	72,214	23,957	24,007
Total cigarette volume	656,970	693,917	223,124	236,531
Net revenues:				
European Union	$21,255	$20,654	$7,487	$6,904
Eastern Europe, Middle East & Africa	15,346	14,256	5,546	5,125
Asia	15,776	15,668	5,144	5,174
Latin America & Canada	7,262	7,073	2,452	2,389
Net revenues	$59,639	$57,651	$20,629	$19,592
Excise taxes on products:				
European Union	$14,798	$14,191	$5,206	$4,779
Eastern Europe, Middle East & Africa	8,837	8,063	3,261	2,918
Asia	7,751	7,275	2,601	2,413
Latin America & Canada	4,825	4,634	1,634	1,562
Excise taxes on products	$36,211	$34,163	$12,702	$11,672
Operating income:				
Operating companies income:				
European Union	$3,227	$3,232	$1,207	$1,085
Eastern Europe, Middle East & Africa	2,968	2,805	1,088	1,047
Asia	3,567	4,068	1,097	1,297
Latin America & Canada	776	753	267	267
Amortization of intangibles	(71)	(73)	(23)	(24)
General corporate expenses	(155)	(155)	(43)	(49)
Operating income	$10,312	$10,630	$3,593	$3,623

As discussed in Note 9. 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 before general corporate expenses and amortization of intangibles. We believe it is appropriate to disclose this measure to help investors analyze the business performance and trends of our various business segments.

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

Table of Contents

Consolidated Operating Results for the Nine Months Ended September 30, 2013

The following discussion compares our consolidated operating results for the nine months ended September 30, 2013, with the nine months ended September 30, 2012.

Our cigarette shipment volume of 657.0 billion units decreased by 36.9 billion units (5.3%), driven by a total industry volume decline and lower share. The decline in our cigarette shipment volume mainly reflected:

- in the European Union, the unfavorable impact of excise tax-driven price increases, the weak economic and employment environment, the growth of the other tobacco products ("OTP") category, and the prevalence of illicit trade;
- in EEMA, the impact of tax-driven price increases, illicit trade and the weakening of the economy in Russia, an increase in illicit trade in Turkey and the impact of tax-driven price increases and an increase in illicit trade in Ukraine, partly offset by growth in Egypt and the Middle East;
- in Asia, the unfavorable impact of the disruptive January 2013 excise tax increase in the Philippines, which reduced our shipment volume by 18.4 billion units or 26.8%, partly offset by higher volumes in Indonesia; and
- in Latin America & Canada, primarily due to a lower total cigarette market in Argentina and Brazil.

Excluding the Philippines, our cigarette shipment volume was down by 3.0%, and our total tobacco volume was down by 2.7% (including OTP in cigarette equivalent units).

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

Total cigarette shipments of Marlboro of 216.3 billion units decreased by 4.4%, due primarily to declines in: the European Union, notably France, Greece, the Netherlands, Poland, Spain and the United Kingdom, partly offset by Italy; EEMA, primarily the Middle East, Russia, Turkey and Ukraine, partly offset by North Africa; Asia, primarily due to Japan, Korea and the Philippines, partly offset by Indonesia and Vietnam; and Latin America & Canada, mainly Argentina, Brazil and Mexico. Excluding the Philippines, total cigarette shipments of Marlboro declined by 2.1%.

Total cigarette shipments of L&M of 71.4 billion units were up by 2.6%, driven notably by Egypt, Russia and Saudi Arabia, partly offset by Algeria, Germany, Greece, Romania and Turkey. Total cigarette shipments of Bond Street of 33.4 billion units decreased by 6.0%, due primarily to Russia and Ukraine. Total cigarette shipments of Parliament of 33.1 billion units were up by 3.1%, due primarily to Kazakhstan, Russia and Turkey, partly offset by Japan and Ukraine. Total cigarette shipments of Philip Morris of 26.0 billion units decreased by 8.9%, due primarily to Italy and the Philippines, partly offset by Argentina. Total cigarette shipments of Chesterfield of 25.7 billion units were down by 5.3%, due primarily to Italy, Russia, Spain and Ukraine, partly offset by Germany, Portugal and Turkey. Total cigarette shipments of Lark of 21.9 billion units decreased by 9.4%, due predominantly to Japan and Turkey.

Our OTP consist mainly of tobacco for roll-your-own and make-your-own cigarettes, pipe tobacco, cigars and cigarillos. Total shipment volume of OTP, in cigarette equivalent units, grew by 3.3% to 24.0 billion cigarette equivalent units, notably in Belgium, France, Hungary and Italy, partly offset by Germany and South Africa.

Total shipment volume for cigarettes and OTP combined was down by 5.0%.

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

	For the Nine Months Ended September 30,			
(in millions)	2013	2012	Variance	%
Net revenues	$59,639	$57,651	$1,988	3.4%
Excise taxes on products	36,211	34,163	2,048	6.0%
Net revenues, excluding excise taxes on products	$23,428	$23,488	$(60)	(0.3)%

Table of Contents

Currency movements decreased net revenues by $694 million and net revenues, excluding excise taxes on products by $466 million. The $466 million decrease was due primarily to the Argentine peso, Australian dollar, Brazilian real, Indonesian rupiah, Japanese yen and Russian ruble, partially offset by the Euro, Mexican peso and Philippine peso.

Net revenues shown in the table above include $1,389 million in 2013 and $1,273 million in 2012 related to sales of OTP. These net revenue amounts include excise taxes billed to customers. Excluding excises taxes, net revenues for OTP were $544 million in 2013 and $503 million in 2012.

Net revenues, which include excise taxes billed to customers, increased by $2.0 billion (3.4%). Excluding excise taxes, net revenues decreased by $60 million (0.3%) to $23.4 billion. This decrease was due to:

- unfavorable volume/mix ($1.1 billion) and
- unfavorable currency ($466 million), partly offset by
- price increases ($1.5 billion).

Excise taxes on products increased by $2.0 billion (6.0%), due to:

- higher excise taxes resulting from changes in retail prices and tax rates ($3.8 billion), partly offset by
- volume/mix ($1.5 billion) and
- favorable currency ($228 million).

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 Nine Months Ended September 30,				
(in millions)	2013	2012	Variance	%	
Cost of sales	$7,808	$7,692	$116	1.5	%
Marketing, administration and research costs	5,229	5,043	186	3.7	%
Operating income	10,312	10,630	(318)	(3.0	)%

Cost of sales increased $116 million (1.5%), due to:

- higher manufacturing costs ($363 million, principally in Indonesia), partly offset by
- volume/mix ($206 million) and
- favorable currency ($41 million).

With regard to tobacco leaf prices, we continue to expect modest increases going forward, broadly in line with sourcing country inflation, as the market has now stabilized. However, we are incurring some cost pressure in 2013, driven in large measure by historical leaf tobacco price changes that will continue to affect our product costs in the current year, higher prices for cloves and higher prices for a number of other direct materials we use in the production of our brands.

Marketing, administration and research costs increased by $186 million (3.7%), due to:

- higher expenses ($184 million, including the annualization of business infrastructure investments in Russia) and
- unfavorable currency ($2 million).

Operating income decreased by $318 million (3.0%). This decrease was due primarily to:

- unfavorable volume/mix ($906 million),
- unfavorable currency ($427 million),

- higher manufacturing costs ($363 million) and

- higher marketing, administration and research costs ($184 million), partly offset by
- price increases ($1.5 billion) and
- lower pre-tax charges for asset impairment and exit costs ($42 million).

Interest expense, net, of $721 million increased $88 million, due primarily to higher average debt levels, partially offset by lower average interest rates on debt.

Our effective tax rate decreased by 1.3 percentage points to 29.0%. The effective tax rate for the nine months ended September 30, 2013 was unfavorably impacted by the additional expense associated with the Act ($17 million). The effective tax rate for the nine months ended September 30, 2012, was unfavorably impacted by an additional income tax provision of $79 million following the conclusion of the IRS examination of Altria's consolidated tax returns for the years 2004-2006. The effective tax rate is based on our full-year geographic earnings mix 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.

Net earnings attributable to PMI of $6.6 billion decreased $116 million (1.7%). This decrease was due primarily to lower operating income and higher interest expense, net, partially offset by a lower effective tax rate. Diluted and basic EPS of $4.02 increased by 2.6%. Excluding an unfavorable currency impact of $0.23, diluted EPS increased by 8.4%.

Consolidated Operating Results for the Three Months Ended September 30, 2013

The following discussion compares our consolidated operating results for the three months ended September 30, 2013, with the three months ended September 30, 2012.

Our cigarette shipment volume of 223.1 billion units decreased by 13.4 billion units (5.7%), due principally to a total industry volume decline. The decrease in our cigarette shipment volume mainly reflected:

- in the European Union, the unfavorable impact of excise tax-driven price increases, the weak economic and employment environment, the share growth of the OTP category, and the prevalence of non-duty paid products, partially offset by a higher market share;
- in EEMA, the impact of price increases in Russia in the first and third quarters of 2013, an increase in illicit trade and a weak economy; and
- in Asia, the unfavorable impact of the disruptive January 2013 excise tax increase in the Philippines, and lower share and the reversal of trade inventory movements in Pakistan following the excise tax increase in the second quarter of 2013, partly offset by Indonesia.

Excluding the Philippines, our cigarette shipment volume decreased by 4.1%, and our total tobacco volume was down by 4.0% (including OTP in cigarette equivalent units).

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

Total cigarette shipments of Marlboro of 75.2 billion units decreased by 2.5%, due primarily to declines in: the European Union, notably France and Spain, partly offset by Italy; EEMA, primarily Russia and Ukraine, partly offset by North Africa; Asia, predominantly the Philippines, partly offset by Japan reflecting the launch of Marlboro Clear Taste in September; and Latin America & Canada, mainly Mexico. Excluding the Philippines, total cigarette shipments of Marlboro decreased by 0.3%.

Total cigarette shipments of L&M of 24.1 billion units decreased by 2.1%, driven notably by Algeria, Egypt and Turkey, partly offset by Germany and Thailand. Total cigarette shipments of Bond Street of 11.9 billion units decreased by 7.2%, due predominantly to Russia and Ukraine. Total cigarette shipments of Parliament of 11.8 billion units increased by 0.4%, driven by Turkey, partly offset by Japan. Total cigarette shipments of Philip Morris of 8.8 billion units decreased by 6.6%, due primarily to Italy and the Philippines, partly offset by Argentina. Total cigarette shipments of Chesterfield of 9.2 billion units decreased by 1.9%, due

Table of Contents

primarily to Russia and Ukraine, partly offset by Germany and Turkey. Total cigarette shipments of Lark of 7.2 billion units decreased by 11.9%, due predominantly to Japan and Turkey.
Total shipment volume of OTP, in cigarette equivalent units, decreased by 1.7% to 7.8 billion cigarette equivalent units, due mainly to a decline in Southern Africa, partly offset by growth in the European Union, notably in Italy.
Total shipment volume for cigarettes and OTP, in cigarette equivalent units, decreased by 5.5%.
Our net revenues and excise taxes on products were as follows:

	For the Three Months Ended September 30,			
(in millions)	2013	2012	Variance	%
Net revenues	$20,629	$19,592	$1,037	5.3 %
Excise taxes on products	12,702	11,672	1,030	8.8 %
Net revenues, excluding excise taxes on products	$7,927	$7,920	$7	0.1 %

Currency movements decreased net revenues by $109 million and net revenues, excluding excise taxes on products, by $120 million. The $120 million decrease was due primarily to the Argentine peso, Australian dollar, Indonesian rupiah and Japanese yen, partially offset by the Euro.

Net revenues shown in the table above include $467 million in 2013 and $419 million in 2012 related to sales of OTP. These net revenue amounts include excise taxes billed to customers. Excluding excises taxes, net revenues for OTP were $181 million in 2013 and $168 million in 2012.

Net revenues, which include excise taxes billed to customers, increased by $1.0 billion (5.3%). Excluding excise taxes, net revenues increased by $7 million (0.1%) to $7.9 billion. This increase was due to:

- price increases ($488 million), partly offset by
- unfavorable volume/mix ($361 million) and
- unfavorable currency ($120 million).

Excise taxes on products increased by $1.0 billion (8.8%), due primarily to:

- higher excise taxes resulting from changes in retail prices and tax rates ($1.3 billion), partly offset by
- volume/mix ($298 million).

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

	For the Three Months Ended September 30,			
(in millions)	2013	2012	Variance	%
Cost of sales	$2,618	$2,584	$34	1.3 %
Marketing, administration and research costs	1,693	1,655	38	2.3 %
Operating income	3,593	3,623	(30)	(0.8)%

Cost of sales increased by $34 million (1.3%), due to:

- higher manufacturing costs ($94 million, principally in Indonesia) and
- unfavorable currency ($12 million), partly offset by
- volume/mix ($72 million).

Marketing, administration and research costs increased by $38 million (2.3%), due to:

- unfavorable currency ($28 million) and
- higher expenses ($10 million).

- 45-

Table of Contents

Operating income decreased by $30 million (0.8%), due primarily to:

- unfavorable volume/mix ($289 million),
- unfavorable currency ($160 million),
- higher manufacturing costs ($94 million) and
- higher marketing, administration and research costs ($10 million), partly offset by
- price increases ($488 million) and
- the absence of the 2012 pre-tax charges for asset impairment and exit costs ($34 million).

Interest expense, net, of $239 million increased $28 million, due primarily to higher average debt levels, partially offset by lower average interest rates on debt.

Our effective tax rate decreased by 3.5 percentage points to 28.4%. The effective tax rate for the three months ended September 30, 2012, was unfavorably impacted by an additional income tax provision of $79 million following the conclusion of the IRS examination of Altria's consolidated tax returns for the years 2004-2006. The effective tax rate is based on our full-year geographic earnings mix 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.

Net earnings attributable to PMI of $2.3 billion increased $113 million (5.1%). This increase was due primarily to a lower effective tax rate, partially offset by lower operating income and higher interest expense, net. Diluted and basic EPS of $1.44 increased by 9.1%. Excluding an unfavorable currency impact of $0.09, diluted EPS increased by 15.9%.

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 faces 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:

- actual and proposed tobacco legislation and regulation;
- actual and proposed excise tax increases, as well as changes in excise tax structures and retail selling price regulations;
- price gaps and changes in price gaps between premium and mid-price and low-price brands and between cigarettes and other tobacco products;
- increased efforts by tobacco control advocates and governments to “denormalize” smoking and impose extreme regulatory requirements impacting our ability to communicate with adult consumers and differentiate our products from competitors' products, including legislation to mandate plain (generic) packaging resulting in the expropriation of our brands and trademarks;
- actual and proposed extreme regulatory requirements related to the ingredients in tobacco products, including restrictions and complete bans;
- other actual and proposed restrictions affecting tobacco manufacturing, testing and performance standards and requirements, packaging, marketing, advertising, product display and sales;
- governmental and private bans and restrictions on smoking;
- illicit trade in cigarettes and other tobacco products, including counterfeit, contraband and so called "illicit whites," as well as non-tax paid volume by local manufacturers;

- actual and proposed restrictions on imports in certain jurisdictions;

- pending and threatened litigation as discussed in Note 10. Contingencies; and
- governmental investigations.

In the ordinary course of business, many factors can affect the timing of sales to customers, including the timing of holidays and other annual or special events, the timing of promotions, customer incentive programs and customer inventory programs, as well as the actual or speculated timing of pricing actions and tax-driven price increases.

Framework Convention on Tobacco Control: The World Health Organization's (“WHO”) Framework Convention on Tobacco Control (“FCTC”) entered into force in February 2005. As of October 2013, 176 countries, as well as the European Union, have become Parties to the FCTC. The FCTC is the first international public health treaty, and its objective is to establish a global agenda for tobacco regulation with the purpose of reducing initiation of tobacco use and encouraging cessation. The treaty recommends (and, in certain instances, requires) Parties to have in place or enact legislation that would:

- establish specific actions to prevent youth smoking;
- restrict and/or eliminate all tobacco product advertising, marketing, promotions and sponsorships;
- initiate public education campaigns to inform the public about the health consequences of smoking and the benefits of quitting;
- implement regulations imposing tobacco product testing, disclosure and performance standards;
- impose health warning requirements on tobacco product packaging;
- adopt measures aimed at eliminating illicit trade in tobacco products;
- restrict smoking in public places;
- implement public health-based fiscal policies (tax and price measures);
- adopt and implement measures that ensure that packaging and labeling, including descriptive terms, do not create the false impression that one brand of tobacco products is safer than another;
- phase out or restrict duty free tobacco sales; and
- encourage litigation against tobacco product manufacturers.

In many respects, the areas of regulation we support mirror provisions of the FCTC. For example, we have long advocated for laws that strictly prohibit the sale of tobacco products to minors, limit public smoking, mandate the placement of health warnings on tobacco product packaging, and regulate product content to ensure that changes to the product do not increase the adverse health effects of smoking and to establish a regulatory framework for reduced risk products. We also strongly support the use of tax and price policies to achieve public health objectives, provided that they do not result in increased illicit trade. We do not, however, agree with the current views of the WHO and others who are pursuing policies that have gone far beyond the original text of the FCTC treaty.

For example, following the entry into force of the FCTC, the Conference of the Parties (“CoP”), the governing body of the FCTC, has adopted several guidelines proposed by tobacco control advocates and supported by WHO that provide non-binding recommendations which purport to supplement specific articles of the treaty. The recommendations include measures that we strongly oppose, such as point-of-sale display bans, plain packaging, a ban on all forms of communications to adult smokers, measures to prohibit or restrict ingredients that may increase the palatability or attractiveness of tobacco products, bans on charitable contributions, measures to prevent the use of journalistic expression or political commentary “for the promotion of tobacco use,” bans on retailer incentive programs and limits on tobacco industry involvement in the development of tobacco policy and regulations.

These recommendations and the actions of the WHO and others reflect an extreme application of the treaty, are not based on sound evidence of a public health benefit, and in many cases are likely to lead to adverse consequences. The evidence does not show that these measures will help achieve the public health goals of the original treaty provisions. In fact, as we discuss below, some of these extreme measures are likely to undermine the original goals of the FCTC and public health by leading to a further increase in illicit trade and the proliferation of low-price cigarettes. Moreover, measures such as plain packaging, will result in the expropriation of our trademarks, harm competition and violate international treaties.

Although to date only a few governments have adopted these extreme measures, it is not possible to predict whether or to what extent the various FCTC guidelines and WHO recommendations will be adopted. If governments choose to implement regulation based on these extreme recommendations, such regulation may adversely affect our business, volume, results of operations, cash

Table of Contents

flows and financial position. In some instances, including those described below, where such regulation has been adopted, we have commenced legal proceedings challenging the regulation. To the extent such proceedings are still pending, it is not possible to predict their outcome.

Excise Taxes: Tobacco products are subject to substantial excise taxes and to other product taxation worldwide. Significant increases in tobacco-related taxes or fees have been proposed or enacted and are likely to continue to be proposed or enacted. For example, in 2012, the Philippines enacted a new excise tax law that increased the excise tax on the premium-price segment by more than 100% and on the low-price segment by nearly 340% in 2013 and provides for further significant increases primarily affecting the lower tier until both tiers are merged in 2017. In addition, in certain jurisdictions, our products are subject to tax structures that discriminate against premium-price products and manufactured cigarettes.

Excessive and disruptive tax increases and discriminatory tax structures, which we oppose, are expected to continue to have an adverse impact on our sales of cigarettes, due to lower consumption levels and to a shift in consumer purchases from premium to non-premium, discount, other low-price or low-taxed tobacco products, such as fine cut tobacco, and/or illicit products. Such tax increases and tax structures undermine public health and ultimately undercut government revenue objectives.

At the fifth session of the CoP held in November 2012, the Parties considered, but did not adopt, guidelines on price and tax measures to reduce the demand for tobacco but instead adopted a brief “set of guiding principles and recommendations for implementation of Article 6,” which does not include extreme tax proposals. An inter-session drafting group will prepare and present new draft guidelines for consideration at the sixth session of the CoP in 2014.

EU Tobacco Products Directive: In December 2012, the European Commission adopted its proposal for a significantly revised EU Tobacco Products Directive (2001/37/EC). In June and October of this year, respectively, the Council of Ministers (comprising the Member States’ health ministers) and the European Parliament adopted their own proposals.

Among other things, the proposals considered in the ongoing legislative process include a ban on menthol cigarettes as of the transposition date or up to five years thereafter, as well as other broad restrictions that could operate as a complete ban on the use of ingredients. Further, the Commission’s proposal includes a ban on slim cigarettes and oversized health warnings covering 75% of the front and back panels. The proposals of the Parliament and the Council would continue to allow the sale of slim cigarettes and would require the front and back panel health warnings to cover 65% of the pack. All proposals provide for health warnings covering 50% of the side panels of cigarette packs and, to varying degrees, mandatory sizes and shapes for tobacco packaging, and additional restrictions on product descriptions and brand differentiation.

Member States would also have the option to further standardize tobacco packaging, including, under certain conditions, by introducing plain packaging. The proposals of the Commission and the Council would require some or all non-traditional nicotine-containing products, such as certain e-cigarettes and certain reduced-risk products under development, to obtain approval under the Medicinal Products Directive (2001/83/EC). In addition, by seeking to prohibit accurate, substantiated product labels related to reduced risk, all three current proposals would introduce further hurdles to the commercialization of reduced-risk products in the EU.

The Commission, the Council, and the Parliament must now agree on the final legislative text, which would then need to be approved by a vote of the Parliament and the Council. The legislative process for adopting a new Tobacco Products Directive could conclude by the end of 2013 or early 2014, with implementation approximately 18 to 24 months after adoption. It is not possible to predict the ultimate outcome of this legislative process.

Plain Packaging: We strongly oppose plain packaging, which not only constitutes an expropriation of our valuable trademarks, but is a pure and simple confiscation of the core of our business. We believe that transforming the industry into a low-price commodity business will not reduce consumption, smoking prevalence or initiation. Indeed, there is no sound evidence that plain packaging will have any measurable impact on smoking behavior. Even many public health advocates agree today that plain packaging will have no impact on current smokers and claim that the measure is intended to reduce initiation among youth. However, the data do not support that claim either. On the contrary, over time plain packaging is likely to be counterproductive from a public health perspective because it will spur an increase in illicit trade and result in overall lower tobacco prices, which in turn will lead to increased consumption, especially among youth. Further, increased illicit trade will hurt the legitimate industry, its entire supply chain and government revenues. Moreover, plain packaging imposes on free competition and trade as well as the use of intellectual property; it violates the terms of: (1) the Agreement on Trade-Related Aspects of Intellectual Property Rights (“TRIPS”), which prohibits unjustified encumbrances on trademarks and protects geographical indications; (2) the Paris Convention, which prevents acts that constitute unfair competition; and (3) the Agreement on Technical Barriers to Trade, which prohibits regulations that constitute unnecessary barriers to trade. We will take all steps necessary to ensure that all constituencies understand the adverse consequences of plain packaging and to obtain all protection and relief to which we are entitled under the law.

Plain packaging went into effect in Australia in December 2012. The Australian law bans the use of company branding, logos and colors on packaging of all tobacco products for sale to consumers other than the brand name and variant, which may be printed only in specified locations and in a uniform font. It also imposes restrictions on the branding of individual cigarettes.

The Australian plain packaging legislation triggered three legal challenges. Our Australian subsidiary, Philip Morris Limited ("PML"), and other major tobacco companies filed lawsuits against the government in the High Court of Australia arguing that by implementing plain packaging, the government violated the Australian Constitution because it acquired property without compensation. The High Court initially heard the cases brought by certain British American Tobacco companies ("BAT") and by JT International. In August 2012, the High Court issued its ruling in favor of the government. In the court's written reasons, published in October 2012, a majority of the Justices recognized that plain packaging deprived the plaintiffs of property. However, because no "benefit" inured to the government or a third party, the court held that plain packaging did not violate the Australian Constitution. We expect that the court's ruling will also apply to PML's case. Given the particular nature of the Australian Constitution, we do not expect the decision to be a significant adverse precedent in other jurisdictions. In fact, we expect that the court's finding that plain packaging deprives tobacco manufacturers of their intellectual property would raise serious questions about the legality of plain packaging legislation in other jurisdictions.

Our subsidiary, Philip Morris Asia Limited, has initiated international arbitration proceedings against the Australian government pursuant to the Hong Kong-Australia Bilateral Investment Treaty (the "Investment Treaty"). Formal proceedings under the Investment Treaty commenced in November 2011. In the arbitration, Philip Morris Asia Limited is seeking substantial compensation from the Australian government. The arbitration may take several years to complete.

Five World Trade Organization ("WTO") members, Ukraine, Honduras, the Dominican Republic, Cuba and Indonesia, have initiated WTO dispute settlement proceedings against Australia. They claim, among other things, that plain packaging creates unnecessary barriers to trade in violation of the WTO Agreement on Technical Barriers to Trade; unjustifiably encumbers the use of trademarks and reduces the protection of geographical indications in violation of TRIPS; and will create confusion among consumers in violation of the Paris Convention. In September 2012, Ukraine requested a panel to hear the dispute, which the Dispute Settlement Body of the WTO has established. Thirty-four countries and the European Union have intervened as third parties in the Ukrainian case, including Indonesia, China, Japan, Korea and the United States. In September 2013, at the request of Honduras, the Dispute Settlement Body established a panel to hear the dispute between Honduras and Australia. The Dominican Republic has also requested that a panel be formed to hear its dispute against Australia. Although Australia blocked this initial request, the panel will be established automatically should the Dominican Republic renew its request. Cuba and Indonesia are still undertaking consultations with Australia, which is the first step in the dispute settlement process. WTO dispute settlement proceedings can take several years to complete. It is not possible to predict the outcome of these cases.

Even though plain packaging was already recommended in 2008 under the FCTC guidelines adopted by the third CoP, to date no country other than Australia has adopted this measure, although several countries are considering it. For example, the UK and New Zealand have conducted consultations to consider plain packaging. In July 2013, nearly one year after the close of an extensive public consultation, the UK government announced that it will wait until the impact of plain packaging in Australia can be measured "before making a final decision on this policy in England" and confirmed that plain packaging "remains a policy under consideration." In New Zealand, the government announced in February 2013 that it would agree in principle to follow Australia but that it would "wait and see what happens with Australia's legal cases" before adopting legislation and/or implementing regulation. Thus, plain packaging is not expected to be implemented in New Zealand, if at all, until the WTO and other challenges to Australia's legislation are resolved. In May 2013, the Irish Minister of Health announced his intention to seek plain packaging legislation in 2014. In September 2013, the Irish Government published its legislative priority list for the autumn session, which included plain packaging. However, at this time, no draft legislation has been proposed, and it is not possible to predict whether or when legislation may be proposed or enacted.

In addition, in some instances, such as under the recent proposal of the European Commission, excessively large health warnings, combined with other standardization measures and packaging restrictions, may impact our ability to use our distinctive brands and trademarks as these measures approximate, or are substantially equivalent to, plain packaging.

Restrictions and Bans on the Use of Ingredients and Disclosure Laws: Until several years ago, efforts to regulate the use of ingredients have focused on whether ingredients increase the toxicity and/or addictiveness of cigarette smoke. Increasingly, however, tobacco control advocates and some regulators, including the WHO, the European Commission and individual governments, are considering regulating or have regulated cigarette ingredients with the stated objective of reducing the “palatability” or “attractiveness” of cigarette smoke, smoking and/or tobacco products. We oppose regulations that would ban ingredients for the purpose of reducing the palatability or attractiveness of tobacco products because, in light of the millions of smokers in countries like Canada, the UK and China who prefer cigarettes without ingredients, there is no reasonable basis to conclude that an ingredient ban would reduce smoking prevalence or youth smoking initiation. Indeed, we do not believe it is appropriate to use “attractiveness,” which is an inherently subjective and variable term, as a basis for regulation of ingredients, let alone bans of entire product categories. It also lacks scientific, empirically verified criteria.

In November 2010, the fourth session of the CoP adopted “partial” and “provisional” guidelines on Articles 9 and 10 of the FCTC (regulation of contents and disclosure of tobacco products). Among other things, these guidelines recommend that Parties implement measures to prohibit or restrict ingredients and colorings that may increase the palatability or attractiveness of tobacco products. The CoP determined that these guidelines will have to be periodically re-assessed “in light of the scientific evidence and country experience.” The Working Group on Articles 9 and 10 is expected to present a set of recommendations focused on toxicity and addictiveness at future sessions of the CoP.

In March 2012, Brazil's National Sanitation Agency ("ANVISA") published a resolution that prohibits the use of all synthetic and natural substances with flavoring or aromatic properties, with a limited exception to allow for the use of sugars to replace those lost during the tobacco leaf-drying process. In September 2012, Sinditabaco (a tobacco industry union of which Philip Morris Brasil Ltda. is a member) filed a lawsuit in Brazilian federal court against ANVISA challenging the ingredients ban. The lawsuit claims that ANVISA lacks authority to institute the ban, failed to produce evidence justifying or supporting the ban, failed to comply with due process and proportionality requirements and ignored the unintended consequences of the measure, such as encouraging illicit trade. In December 2012, the trial court granted Sinditabaco a preliminary injunction, suspending the effectiveness of the resolution until a full hearing of the dispute. Earlier this year, ANVISA appealed the injunction order. In April 2013, the Court of Appeals denied ANVISA's appeal and upheld the preliminary injunction. ANVISA then filed two separate motions seeking the suspension and reversal, respectively, of the preliminary injunction, both of which have been denied by the courts. ANVISA subsequently filed further appeals against the preliminary injunction, and those appeals are pending. In addition to the Sinditabaco lawsuit, two other lawsuits have been filed by industry associations in Brazil challenging the ingredients ban. It is not possible to predict the outcome of these cases.

We oppose bans or sweeping restrictions on ingredients such as those published in Brazil or the ban on menthol proposed by the European Commission, which are arbitrary and without any scientific evidence demonstrating a public health benefit. We support regulations that would restrict the use of ingredients that are determined, based on sound scientific testing methods and data, to significantly increase the adverse health effects of tobacco smoke or youth smoking initiation.

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. In jurisdictions where it is not possible to obtain appropriate assurances of trade secret protection, we will seek to resolve the matter with governments through alternative means.

Bans on Display of Tobacco Products at Retail: In a few of our markets, governments have banned the display of tobacco products at the point of sale (“display bans”), while in other countries proposals for display bans have been specifically rejected. In some countries, proposals are currently under consideration. We oppose display bans on the grounds that they unnecessarily restrict competition and encourage illicit trade -- consequences that undermine public health objectives. Further, analysis of the impacts of display bans in several markets show that they have not reduced smoking prevalence and initiation, or had any material beneficial impact on 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 of our markets, governments require large and often graphic health warnings on cigarette packs, consistent with, and often larger than, the FCTC minimum of 30% of the front and back of the pack. For instance, Egypt, Hong Kong, Panama, and Singapore are among the growing number of countries requiring health warnings occupying 50% of the front and back of the pack. In countries where health warnings are not required, we place them on packaging voluntarily in the official language or languages of the country.

To date, only a few countries have implemented warnings covering more than 50% of the front and/or back of the pack. They include Australia (75% front and 90% back), Mexico (30% front and 100% back), Uruguay (80% front and back) and Canada (75% front and back).

Table of Contents

We support health warning requirements designed to inform consumers of the risks of smoking and defer to governments on the content of the warnings except for content that vilifies tobacco companies or is not justified by the actual repercussions of smoking. With respect to warning size, e.g. 50% or larger, the data show that disproportionately increasing the size of health warnings does not effectively reduce tobacco consumption. For this reason, and because it infringes upon our intellectual property rights, leaving insufficient space for our distinctive trademarks and pack designs, we oppose extremely large health warnings. In a few markets, we have commenced legal proceedings challenging extreme warning size requirements or content that does not reflect the actual effects of smoking. For instance, most recently in Thailand, two affiliates of PMI challenged an April 2013 Ministry of Public Health notification mandating health warnings covering 85% of the front and back of cigarette packs manufactured in or imported into Thailand as of October 2013 with full compliance at the retail level required 90 days later. The complaint to the Administrative Court of Bangkok asserts that the Ministry of Public Health lacks the authority to require the 85% health warnings and failed to afford our affiliates the due process required by law. The complaint also states that the notification is unconstitutional because it is excessive and violates the rights to property and to engage in free and fair competition. In August 2013, the Administrative Court granted an injunction suspending the 85% health warning requirement pending a full hearing of the dispute. The Ministry of Public Health has filed an appeal to the Supreme Administrative Court to reverse the injunction and a petition to suspend the injunction pending its review.

We believe governments should continue to educate the public on the serious health effects of smoking. Our corporate web site, www.pmi.com, includes, among other things, the views of public health authorities on smoking, disease causation in smokers, addiction and exposure to environmental tobacco smoke ("ETS"). The site reflects our agreement with the medical and scientific consensus that cigarette smoking is addictive and causes lung cancer, heart disease, emphysema and other serious diseases in smokers. The web site advises the public to rely on the messages of public health authorities in making all smoking-related decisions. The information on our web site is not, and shall not be deemed to be, a part of this document or incorporated into any filings we make with the U.S. Securities and Exchange Commission ("SEC").

Other Packaging Restrictions: Tobacco control advocates and some regulators are calling for further restrictions on packaging, including standardizing the shape, format and lay-out of packaging, as well as broad restrictions on how the space left for branding and product descriptions can be used. Such measures further restrict our ability to provide information to consumers and to differentiate our brands from those of our competitors.

Many countries, including all EU Member States, prohibit descriptors such as “lights,” “mild” and “low tar.” We do not oppose these types of descriptor bans.

Some public health advocates, governments, and the FCTC guidelines have sought the implementation of, and in some cases have passed, restrictions on packaging and labeling that prohibit (1) the use of colors that are alleged to suggest that a brand is less harmful than others, (2) specific descriptive phrases deemed to be misleading, including, for example, “premium,” “full flavor,” “international,” “gold,” “silver,” and “menthol” and (3) in one country, all but one pack variation per brand. The measures considered in the legislative process for the EU's Tobacco Products Directive would also prohibit any references on the pack to taste and flavor as well as pack design elements suggesting a “positive lifestyle effect.” We believe such regulations are unreasonably broad, unnecessarily limit brand and product differentiation, are anticompetitive, prevent us from providing consumers with factual information about our products, unduly restrict our intellectual property and violate international trade agreements. We oppose these broad packaging restrictions and in some instances have commenced litigation to challenge them.

Bans and Restrictions on Advertising, Marketing, Promotions and Sponsorships: For many years, countries have imposed partial or total bans on tobacco advertising, marketing, promotions and sponsorships. The FCTC calls for a “comprehensive ban on advertising, promotion and sponsorship” and requires governments that have no constitutional constraints to ban all forms of advertising. Where constitutional constraints exist, the FCTC requires governments to restrict to the fullest extent possible advertising on radio and television, advertising in print and other media, including the Internet, and sponsorships of international events within five years of the effective date of a country's ratification of the FCTC. The FCTC also requires disclosure of expenditures on advertising, promotion and sponsorship where such activities are not prohibited. The CoP-adopted guidelines recommend that governments adopt extreme and sweeping prohibitions, including all forms of communications to adult smokers. We oppose complete bans on advertising and communications. We believe that the available evidence does not support the contention that limitations on marketing are effective in reducing smoking prevalence, but we would generally not oppose such limitations as long as manufacturers retain the ability to communicate directly and effectively to adult smokers.

Restrictions on Product Design and Emissions: Tobacco control advocates and some regulators are calling for regulations to further standardize tobacco products themselves by, for example, requiring 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. We believe that there is no correlation between product design variations and overall smoking rates or youth smoking initiation, nor any scientific evidence showing a health benefit that would result from product design restrictions.

Table of Contents

Many countries, including all EU Member States, have established, and continue to consider reducing, maximum yields of tar, nicotine and/or carbon monoxide, as measured by the ISO standard test method. Several countries, including Brazil and Canada, require manufacturers to test and report by-brand yields of up to 47 of the more than 100 smoke constituents that have been identified as potential causes of smoking-related diseases. No country to date has adopted ceilings based on an alternative test method or for other smoke constituents, although the concept of “selective constituent reduction” is supported by some public health advocates. At the fifth session of the CoP in November 2012, the working group on FCTC Articles 9 and 10 was tasked with preparing draft guidelines or a progress report, to be presented at the sixth session of the CoP, regarding testing and measuring five selected tobacco contents and nine selected smoke constituents using methods validated by the WHO. It is not certain whether and when actual testing requirements and/or ceilings will be recommended by the CoP and whether individual countries will adopt them. We agree with those scientists who have argued that selectively reducing some constituents in conventional cigarettes will not lead to a meaningful reduction in disease and thus will not benefit public health and could mislead consumers into believing that conventional cigarettes with regulated (i.e., reduced) levels of these constituents are safer.

Reduced cigarette ignition propensity standards have been adopted in several of our markets, for instance in Australia, Canada and the EU, and are being considered in several others. At the fifth session of the CoP in November 2012, guidelines were adopted that recommend that Parties introduce the same reduced ignition propensity standards as adopted by the U.S., Canada, Australia and the EU. Reduced ignition propensity standards should be uniform across jurisdictions, technically feasible and apply equally to all manufacturers. However, we believe that the experience from countries that have mandated reduced ignition propensity requirements for several years -- namely the U.S. and Canada -- should be thoroughly examined to evaluate the effectiveness of such requirements, in particular in terms of reducing the risk of cigarette-ignited fires, before additional countries consider introducing such standards.

Restrictions on Public Smoking: The pace and scope of public smoking restrictions have increased significantly in most of our markets. In the EU, all countries have regulations in place that restrict or ban smoking in public and/or work places, restaurants, bars and nightclubs. Some EU Member States allow narrow exemptions from smoking bans, for instance for separate smoking rooms in the hospitality sector, but others have banned virtually all indoor public smoking. In other regions, many countries have adopted or are likely to adopt regulations introducing substantial public smoking restrictions similar to those in the EU. 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). The FCTC requires Parties to adopt restrictions on public smoking. The CoP-adopted guidelines on public smoking are based on the premise that any exposure to ETS is harmful. The guidelines call for total bans in all indoor public places, defining “indoor” broadly, and reject any exemptions based on the type of venue (e.g., nightclubs). On private place smoking, such as in cars and homes, the guidelines recommend increased education on the risk of exposure to ETS.

We support a single, consistent public health message on the health effects of exposure to ETS. Our web site states that “the conclusions of public health authorities on secondhand smoke warrant public health measures that regulate smoking in public places” and that “outright bans are appropriate in many places.” For example, we support banning smoking in schools, playgrounds and other facilities for youth and in indoor public places where general public services are provided, such as public transportation vehicles, supermarkets, public spaces in indoor shopping centers, cinemas, banks and post offices. We believe, however, that governments can and should seek a balance between the desire to protect non-smokers from exposure to ETS and allowing the millions of people who smoke to do so in some public places. In the hospitality sector, such as restaurants, bars, cafés and other entertainment establishments, the law should grant private business owners the flexibility to permit, restrict or prohibit smoking. In the workplace, designated smoking rooms can provide places for adults to smoke. Finally, we oppose legislation that would prohibit smoking outdoors (beyond outdoor places and facilities for children) and in private places such as homes, apartments and cars.

Illicit Trade: 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 2011 and for approximately 11% of total cigarette consumption in 2012. Regulatory measures and related governmental actions to prevent the illicit manufacture and trade of tobacco products are being considered by a number of jurisdictions. At the fifth session of the CoP in November 2012, the Protocol to Eliminate Illicit Trade in Tobacco Products (the “Protocol”) was adopted. The Protocol 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. In the EU, the European Commission's proposal for revising the Tobacco Products Directive contains tracking and tracing measures that are based to some extent on the Protocol but, unlike the Protocol, also require tracking at pack level down to retail, which we believe is not only unnecessarily burdensome but not feasible, while at the same time providing no incremental benefit in the fight against illicit trade. The European

Table of Contents

Parliament has further proposed that the technology used for tracking and tracing should belong to and be operated by economic entities without any legal or commercial link to the tobacco industry.

It is not possible to predict how long it will take for the required number of Parties to ratify the Protocol, which will enter into force 90 days after the 40th country ratifies it. So far, no government has ratified the Protocol. Nor is it possible to predict when Parties will implement the Protocol's measures in national legislation or to what extent the measures outlined in the Protocol will be effective in curbing the growth of, or even eliminating, illicit trade. Among other things, the effectiveness of any legislative measure required under the Protocol will depend on whether and how such measure is adopted and implemented in national legislation across the world, and, critically, the level of actual enforcement of such national legislation.

We support strict regulations and enforcement measures to prevent all forms of illicit trade in tobacco products. Governments agree that illicit trade is an extremely serious issue. It creates a cheap and unregulated source of tobacco products, thus undermining efforts to reduce smoking, especially among youth, damages legitimate businesses, stimulates organized crime and results in massive amounts of corruption and lost tax revenue. We therefore believe that in addition to taking direct measures against illicit trade, governments, when assessing proposed regulation, such as display bans, plain packaging, ingredients bans or tax increases, should always carefully consider the potential implications of such regulations on illicit trade.

Cooperation Agreements to Combat Illicit Trade of Cigarettes: In 2004, we entered into an agreement with the European Commission (acting on behalf of the European Union) that provides for broad cooperation with European law enforcement agencies on anti-contraband and anti-counterfeit efforts. All EU Member States, except Croatia, which became a Member State on July 1, 2013, have signed the agreement. Under the terms of the agreement, we agreed to make financial contributions in the form of 13 payments over 12 years. Commencing in July 2007, we began making payments of approximately $75 million a year over the final 10 years of the agreement, each of which is to be adjusted based on certain variables, including our market share in the EU in the year preceding payment. We record these payments as an expense in cost of sales when product is shipped. We are also required to pay the excise taxes, VAT and customs duties on qualifying product seizures of up to 90 million cigarettes and are subject to payments of five times the applicable taxes and duties if qualifying product seizures exceed 90 million cigarettes in a given year. To date, our annual payments related to product seizures have been immaterial.

In 2009, our subsidiaries Philip Morris Colombia and Coltabaco entered into an Investment and Cooperation Agreement with the Republic of Colombia, together with the Departments of Colombia and the Capital District of Bogotá, to promote investment in and cooperation on anti-contraband and anti-counterfeit efforts with respect to the Colombian tobacco market. The agreement provides $200 million in funding to the Colombian governments over a 20-year period to address issues of mutual interest, such as combating the illegal cigarette trade, including the threat of counterfeit tobacco products, and increasing the quality and quantity of locally grown tobacco.

In June 2012, we announced that we will contribute €15 million to INTERPOL over a three-year period to support the agency's global initiative to combat trans-border crime involving illicit goods, including tobacco products. The contribution to INTERPOL's Fund For A Safer World will be used for coordination of information gathering, training programs for law enforcement officials, development of product authentication standards and public information campaigns.

Labor Conditions for Tobacco Workers: In July 2010, Human Rights Watch published a report raising issues related to labor conditions for tobacco workers in Kazakhstan, particularly migrant workers. We have undertaken both an internal and third party review of our labor practices and policies in Kazakhstan and subsequently globally. In reviewing our policies and practices, we have sought the advice of local and international non-profit organizations with expertise in the area of fair labor practices. During 2011, we began implementing our comprehensive

Agricultural Labor Practices ("ALP") Code, which strengthens and expands our existing practices and policies. This includes setting additional principles and standards for working conditions on tobacco farms, tailored training programs and regular external assessments to monitor the progress we, our suppliers, and farmers make. To date, over 2,900 field technicians in 30 countries have received in-depth training on the ALP Code, including child labor, forced labor prevention and safe work environment requirements. During 2012, these field technicians communicated our expectations to approximately 497,000 independent farmers with whom our affiliates or suppliers have contracts. In 2013, the U.S. Department of Labor removed tobacco in Kazakhstan from its list of goods produced by child labor or forced labor. A progress report on our ALP program is available on our web site at www.pmi.com. The information on our web site is not, and shall not be deemed to be, a part of this document or incorporated into any filings we make with the SEC.

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 (“EZD”s) 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.

Table of Contents

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 our affiliate's Marlboro advertising campaign do not comply with the applicable tobacco advertising law. The order requires our affiliate to stop this particular campaign throughout Germany and remove all outdoor advertisements within one month from its effective date and point-of-sale materials within three months. Our affiliate does not believe the allegations properly reflect the facts and the law and filed a challenge in the Munich Administrative Court against the order.

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 to the Attorney General for resolution. In October 2013, a press report indicated that the Attorney General issued a prosecution order. Based on what is known to PM Thailand at this stage, 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 World Trade Organization (“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 decided 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. Although the Philippines contends that to date Thailand has not fully complied, the parties remain engaged in consultations to address the outstanding issues. At a WTO meeting in June 2013, the Philippines 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.

Reduced-Risk Products

One of our strategic priorities is to develop, assess and commercialize a portfolio of innovative products with the potential to reduce the risk of smoking-related diseases in comparison to conventional cigarettes. In the U.S. regulatory context these products are referred to as modified-risk tobacco products (“MRTPs”). Our efforts are guided by the following key objectives:

- to develop a range of products with the taste, sensory experience and ritual characteristics that adult smokers will accept as alternatives to cigarettes;
- to substantiate a significant reduction of risk for the individual adult smoker as well as a reduction of harm for the population as a whole, based on robust scientific evidence derived from well-established assessment processes; and
- to advocate for the development of regulatory frameworks for the assessment, approval and commercialization of reduced-risk products, including the communication of substantiated reductions in risk to consumers.

We believe the elimination of combustion via tobacco heating and other innovative systems for aerosol generation is the most promising path to reduce risk, and, accordingly, the reduced-risk products we are developing are based on platforms that do not involve combustion. These platforms are in various stages of development. One platform is in the early stages of clinical trials and industrial scale-up, another is in its final development phase, and the third requires further product development. We are also developing other potential platforms.

Table of Contents

We are proceeding with all other aspects that lead to commercialization of reduced-risk products. We are planning to build one or two new factories to produce reduced-risk products in Europe. We anticipate capital expenditures in the range of €500 million to €600 million ($685 million to $822 million) over a three-year period to achieve the capacity to produce 30 billion reduced-risk product units per year. This expenditure will be close to double the level of a conventional cigarette factory of equivalent output.

We are on track to achieve our 30 billion unit manufacturing capacity target in 2016. We have commenced five out of eight planned sets of full clinical studies with results expected in 2014. We are carrying out full consumer acceptance tests for one product platform. Early results are positive with high rates of acceptance, taste liking and exclusive use.

Our approach to individual risk assessment is to use cessation as the benchmark, because the short-term and long-term effects of smoking cessation are well known, and the closer the clinical data derived from adult smokers who switch to one of our reduced-risk products resemble the data from those who quit, the more confident one can be that the product reduces risk.

The United States has established a regulatory framework for assessing MRTPs under the jurisdiction of the Food and Drug Administration (the “FDA”). Future FDA actions are likely to influence the regulatory approach of other interested governments. In March 2012, the FDA released draft guidance establishing the types and levels of evidence necessary to qualify a product as an MRTP. The draft guidance recommends studies that are generally in line with PMI's assessment approach, which we have shared with the FDA. In parallel, we are beginning engagement with regulators in the EU, as well as in a number of other markets.

In June 2013, the UK Medicines and Healthcare Products Regulatory Agency ("MHRA") announced that, beginning in 2016, the government intends to regulate electronic cigarettes and non-tobacco nicotine-containing products, which would include non-tobacco reduced-risk products, as medicine.

While we continue to target a launch in the first markets in the 2016-17 period, there can be no assurance that we will succeed in our efforts or that regulators will permit the marketing of our reduced-risk products with claims of reduced risk or reduced harm.

Acquisitions and Other Business Arrangements

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

Investments in Unconsolidated Subsidiaries

On September 30, 2013, we acquired a 49% equity interest in United Arab Emirates-based Arab Investors-TA (FZC) (“AITA”) for approximately $625 million. As a result of this transaction, we hold an approximate 25% economic interest in Société des Tabacs Algéro-Emiratie (“STAEM”), an Algerian joint venture which is 51% owned by AITA and 49% by the Algerian state-owned enterprise Société Nationale des Tabacs et Allumettes SpA. STAEM manufactures and distributes under license some of our brands. The initial investment in AITA was recorded at cost and is included in investments in unconsolidated subsidiaries on the condensed consolidated balance sheet at September 30, 2013. We project this equity investment in AITA to be accretive to our earnings per share as of 2014.

Trade Policy

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

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

Table of Contents

In April 2013, OFAC granted us a license to sell cigarettes to customers for import into the Iran duty free market. To date, we have not made any sales under this license.

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 Sudan.
We do not sell products in Cuba and Syria.
To our knowledge, none of our commercial arrangements result in the governments of any country identified by the U.S. government as a state sponsor of terrorism, nor entities controlled by those governments, receiving cash or acting as intermediaries in violation of U.S. laws.
Certain states within the U.S. have enacted legislation permitting state pension funds to divest or abstain from future investment in stocks of companies that do business with certain countries that are sanctioned by the U.S. We do not believe such legislation has had a material effect on the price of our shares.

Operating Results – Nine Months Ended September 30, 2013
The following discussion compares operating results within each of our reportable segments for the nine months ended September 30, 2013, with the nine months ended September 30, 2012.
European Union. Net revenues, which include excise taxes billed to customers, increased by $601 million (2.9%). Excluding excise taxes, net revenues decreased by $6 million (0.1%) to $6.5 billion. This decrease was due to:

- unfavorable volume/mix ($396 million), partly offset by
- price increases ($270 million) and
- favorable currency ($120 million).

The net revenues of the European Union segment include $1,132 million in 2013 and $1,022 million in 2012 related to sales of OTP. Excluding excise taxes, OTP net revenues for the European Union segment were $398 million in 2013 and $355 million in 2012.
Operating companies income of $3.2 billion decreased by $5 million (0.2%). This decrease was due to:

- unfavorable volume/mix ($322 million) and
- higher manufacturing costs ($28 million), partly offset by
- price increases ($270 million),
- favorable currency ($53 million) and
- lower marketing, administration and research costs ($22 million).

The total cigarette market in the European Union declined by 7.9% to 364.6 billion units, due primarily to tax-driven price increases, the unfavorable economic and employment environment, particularly in southern Europe, the growth of the OTP category, and the prevalence of non-duty paid products. Although our cigarette shipment volume in the European Union declined by 7.0% to 140.7 billion units, due principally to a lower total market across the region, our market share was up by 0.6 share points to 38.6%. The total OTP market in the European Union of 122.2 billion cigarette equivalent units increased by 0.3%, reflecting an increase in the total fine cut market, up by 0.5% to 106.6 billion cigarette equivalent units.
While shipment volume of Marlboro of 69.2 billion units decreased by 4.0%, mainly due to a lower total market, market share was up by 0.5 share points to 19.0%.
Despite a shipment volume decline for L&M of 4.2% to 24.8 billion units, market share was up by 0.2 share points to 6.8%.

Shipment volume of Chesterfield of 14.2 billion units was up by 3.5% and market share was up by 0.2 share points to 4.0%, driven by gains notably in Austria, the Czech Republic, Portugal, Spain and the United Kingdom, partly offset by Germany.

Table of Contents

Although shipment volume of Philip Morris of 7.3 billion units declined by 12.0%, market share was up by 0.3 share points to 2.0%, with gains notably in France and Italy.

Our shipment volume of OTP of 16.1 billion cigarette equivalent units grew by 5.3%, reflecting a higher total market and share. Our OTP total market share was 13.0%, up by 0.8 share points, driven by gains in the fine cut category, notably in France, up by 1.8 share points to 26.7%, Hungary, up by 2.7 share points to 9.1%, Italy, up by 8.5 share points to 36.4%, Poland, up by 1.0 share point to 19.3%, Portugal, up by 10.8 share points to 30.7% and Spain, up by 2.1 share points to 13.4%.

In France, the total cigarette market was down by 9.5% to 36.1 billion units, mainly reflecting the unfavorable impact of price increases in the fourth quarter of 2012 and July 2013, an increase in the prevalence of non-duty paid products, growth of the fine cut category, and a weak economy. Although our shipments of 14.7 billion units were down by 7.0%, market share was up by 0.7 share points to 40.2%, mainly driven by the resilience of premium Philip Morris, up by 0.9 share points to 9.1%, and the growth of Chesterfield, up by 0.1 share point to 3.4%. Market shares of Marlboro and L&M were down by 0.1 and 0.2 share points to 24.7% and 2.5%, respectively. The total industry fine cut category was up by 3.3% to 10.5 billion cigarette equivalent units. Our market share of the fine cut category was up by 1.8 share points to 26.7%.

In Germany, the total cigarette market was down by 4.2% to 60.3 billion units, primarily reflecting the first quarter reversal of trade inventory purchases of competitors' products made in December 2012 ahead of the January 2013 excise tax increase. Although our shipments of 21.7 billion units were down by 3.8%, market share was up by 0.2 share points to 36.0%, with Marlboro and L&M up by 0.8 and 0.1 share points to 22.0% and 10.7%, respectively, partially offset by Chesterfield, down by 0.6 share points to 1.7%. The total fine cut category was up by 0.2% to 31.3 billion cigarette equivalent units. Our market share of the fine cut category was down by 0.2 share points to 14.5%.

In Italy, the total cigarette market was down by 6.8% to 55.7 billion units, reflecting an unfavorable economic and employment environment and the prevalence of illicit trade and substitute products. Although our shipments of 29.8 billion units were down by 7.4%, largely due to the lower total market, market share was up by 0.3 share points to 53.3%, with Marlboro, up by 0.5 share points to 25.9%. Market share of Philip Morris was up by 1.1 share points to 2.3%, benefiting from the 2012 launch of Philip Morris Selection in the low-price segment, partly offset by Chesterfield, down by 0.1 share point to 3.5% and Diana in the low-price segment, down by 0.9 share points to 11.6%, impacted by the availability of non-duty paid products. The total industry fine cut category was down by 5.5% to 4.4 billion cigarette equivalent units, reflecting the 2012 excise tax-driven reduction of the price gap differential with cigarettes. Our market share of the fine cut category was up by 8.5 share points to 36.4%, driven by the launch of Marlboro Red and Gold fine cut.

In Poland, the total cigarette market was down by 10.7% to 36.3 billion units, mainly reflecting the unfavorable impact of price increases in the first quarter of 2013 and the availability of non-duty paid OTP. Although our shipments of 13.0 billion units were down by 10.1%, market share was up by 0.3 share points to 35.9%. Market shares of Marlboro and L&M were up by 0.5 and 1.5 share points to 11.3% and 17.4%, respectively, and share of Chesterfield was up slightly by 0.1 share point to 2.0%. While the total industry fine cut category was down by 11.8% to 2.7 billion cigarette equivalent units, reflecting the prevalence of the aforementioned non-duty paid OTP, our market share of the category increased by 1.0 share point to 19.3%.

In Spain, the total cigarette market was down by 11.8% to 36.6 billion units, mainly reflecting the impact of price increases in 2012 and the first and third quarters of 2013, the unfavorable economic and employment environment, the growth of the OTP category and illicit trade. Although our shipments of 11.2 billion units were down by 11.5%, driven by the lower total market, our market share was up by 0.9 share points to 31.2%, with higher shares of Marlboro and Chesterfield, up by 0.6 and 0.4 share points to 14.8% and 9.3%, respectively. Market shares of Philip Morris and L&M were flat at 0.7% and 6.3%, respectively. The total industry fine cut category was up by 14.6% to 8.4 billion cigarette equivalent units. Our market share of the fine cut category was up by 2.1 share points to 13.4%.

Eastern Europe, Middle East & Africa. Net revenues, which include excise taxes billed to customers, increased by $1.1 billion (7.6%). Excluding excise taxes, net revenues increased by $316 million (5.1%) to $6.5 billion. This increase was due to:

- price increases ($571 million), partly offset by
- unfavorable volume/mix ($207 million) and
- unfavorable currency ($48 million).

Table of Contents

Operating companies income of $3.0 billion increased by $163 million (5.8%). This increase was due to:

- price increases ($571 million), partly offset by
- unfavorable volume/mix ($156 million),
- higher marketing, administration and research costs ($130 million, principally related to the annualization of expenditures to expand our business infrastructure in Russia),
- unfavorable currency ($63 million) and
- higher manufacturing costs ($59 million).

Our cigarette shipment volume in EEMA decreased by 2.8% to 220.0 billion units, mainly reflecting the increase in illicit trade in Turkey and Ukraine and the impact of tax-driven price increases and a weak economy in Russia, partly offset by the Middle East and North Africa. Cigarette shipment volume of our premium brands decreased by 0.8%, due primarily to Marlboro, down by 2.5% to 62.9 billion units, partly offset by Parliament, up by 5.2% to 24.2 billion units.

In Russia, the total cigarette market decreased by an estimated 8%. Our shipment volume of 66.5 billion units decreased by 7.2%, reflecting the impact of tax-driven price increases and a weakening of the economy. Shipment volume of our premium portfolio was down by 5.9%, driven by Marlboro, down by 21.4%, partly offset by Parliament, up by 2.0%. In the mid-price segment, shipment volume was down by 10.7%, mainly due to Chesterfield, down by 18.4%, partially offset by L&M, up by 6.6%. In the low-price segment, shipment volume was down by 6.1%, driven by Bond Street, Optima and Apollo Soyuz, down by 5.7%, 11.6% and 17.9%, respectively. Our market share of 26.1%, as measured by Nielsen, was down 0.3 share points. Market share of Parliament was up by 0.2 share points to 3.3%; Marlboro was down by 0.2 share points to 1.7%; L&M was up by 0.2 share points to 2.8%; Chesterfield was down by 0.4 share points to 3.0%; Bond Street was up by 0.1 share point to 6.5%; and Next was up by 0.2 share points to 3.1%.

In Turkey, the total cigarette market decreased by an estimated 8% to 66.6 billion units, primarily reflecting the reversal of trade inventory purchases in the fourth quarter of 2012, ahead of the January 2013 excise tax increase, and an increase in illicit trade. Our shipment volume of 32.4 billion units decreased by 8.5%. Our market share, as measured by Nielsen, decreased by 0.1 share point to 45.3%, driven by low-price L&M and Lark, down by 1.0 and 0.6 share points to 7.5% and 11.5%, respectively, partly offset by premium Parliament and mid-price Muratti, up by 1.0 and 0.4 share points to 9.8% and 6.9%, respectively. Market share of Marlboro was down by 0.2 share points to 8.9%.

In Ukraine, the total cigarette market declined by an estimated 12% to 57.1 billion units, reflecting the impact of tax-driven price increases in the first half of 2013 and an increase in illicit trade. Our shipment volume of 19.3 billion units decreased by 5.0%. Our market share, as measured by Nielsen, was up by 1.2 share points to 33.5%, mainly due to growth from our low-price segment brands of Bond Street, Optima and President. Share for premium Parliament was up by 0.1 share point to 3.3%. Market share of Marlboro was down by 0.2 share points to 5.6%.

Asia. Net revenues, which include excise taxes billed to customers, increased by $108 million (0.7%). Excluding excise taxes, net revenues decreased by $368 million (4.4%) to $8.0 billion. This decrease was due to:

- unfavorable currency ($458 million) and
- unfavorable volume/mix ($414 million, primarily due to the Philippines), partly offset by
- price increases ($504 million).

Operating companies income of $3.6 billion decreased by $501 million (12.3%). This decrease was due to:

- unfavorable currency ($393 million),
- unfavorable volume/mix ($329 million),
- higher manufacturing costs ($233 million, principally in Indonesia) and
- higher marketing, administration and research costs ($66 million), partly offset by
- price increases ($504 million) and

- lower pre-tax charges for asset impairment and exit costs ($16 million).

Our cigarette shipment volume of 226.5 billion units decreased by 7.2%, due primarily to the decline in the Philippines. Excluding the Philippines, our cigarette shipment volume increased by 0.5%, driven mainly by Indonesia, partly offset by Japan and Pakistan.

Table of Contents

Shipment volume of Marlboro of 56.7 billion units was down by 7.1%. Excluding the Philippines, Marlboro shipment volume increased by 2.4%, driven by Indonesia, partly offset by Japan and Korea.
In Indonesia, the total cigarette market was up by 1.6% to 226.8 billion units. The total cigarette market for the full-year 2013 is estimated to increase by approximately 2%. Our shipment volume of 82.4 billion units grew by 4.2%. Our market share was up by 0.9 share points to 36.3%, driven notably by Sampoerna A in the premium segment, up by 0.5 share points to 14.4%, and mid-price U Mild, up by 1.1 share points to 4.2%. Marlboro's market share was up by 0.5 share points to 5.3% and its share of the “white” cigarettes segment, which represents 6.9% of the total cigarette market, increased by 5.4 share points to 76.3%.
In Japan, the total cigarette market decreased by 2.1% to 143.5 billion units. Our shipment volume of 42.4 billion units was down by 2.1%, primarily due to a lower total market and lower market share. Our market share was down by 0.9 share points to 26.9%, reflecting continued significant product introductions and promotional activities by our principal competitor. Marlboro's market share decreased by 0.2 share points to 12.2%. Share of Lark and Philip Morris was down by 0.3 and 0.1 share points to 8.1% and 2.2%, respectively, partially offset by Virginia S., up by 0.1 share point to 2.1%.
In Korea, the total cigarette market decreased by 2.0% to 66.1 billion units. Our shipment volume of 12.8 billion units decreased by 1.7%, reflecting a lower industry volume. Our market share was up by 0.1 share point to 19.4%. Market share of Marlboro decreased 0.3 share points to 7.7%. Market share of Parliament and Virginia S. increased by 0.3 and 0.2 share points to 6.9% and 4.2%, respectively.
In the Philippines, the total tax-paid cigarette market decreased by 17.8% to 61.5 billion units. Our shipment volume of 50.4 billion units was down by 26.8%, primarily reflecting: the unfavorable impact of the disruptive excise tax increase in January 2013, which resulted in a recommended retail selling price increase for premium Marlboro and low-price Fortune of approximately 60% and 70%, respectively; the reversal of the prior-year trade inventory build-up in anticipation of the tax increase; and a very significant increase in non-tax paid volume by local manufacturers that allows the maintenance of extremely low retail prices. Our market share declined by 10.1 share points to 81.9%. Marlboro's market share was down by 4.3 share points to 16.6%. Share of low-price Fortune was down by 16.7 share points to 33.5%.

Latin America & Canada. Net revenues, which include excise taxes billed to customers, increased by $189 million (2.7%). Excluding excise taxes, net revenues decreased by $2 million (0.1%) to $2.4 billion. This decrease was due to:

- unfavorable volume/mix ($95 million) and
- unfavorable currency ($80 million), partly offset by
- price increases ($173 million).

Operating companies income of $776 million increased by $23 million (3.1%). This increase was due to:

- price increases ($173 million) and
- the absence of the 2012 pre-tax charges for asset impairment and exit costs ($26 million), partly offset by
- unfavorable volume/mix ($99 million),
- higher manufacturing costs ($43 million),
- unfavorable currency ($25 million) and
- higher marketing, administration and research costs ($9 million).

Our cigarette shipment volume in Latin America & Canada of 69.8 billion units decreased by 3.4%, principally due to a lower total market in Brazil, following the May 2012 and January 2013 tax-driven price increases, and a lower total market in Argentina. Shipment volume of Marlboro of 27.5 billion units decreased by 3.8%, mainly reflecting total market declines in Argentina and Brazil and a lower share in Mexico, partly offset by market share gains in Colombia.
In Argentina, the total cigarette market decreased by 2.9% to 31.2 billion units, largely due to a weak economy. Our cigarette shipment volume of 23.6 billion units decreased by 2.5%. Our market share was up by 0.4 share points to 75.3%, driven by mid-price Philip Morris, up by 1.9 share points to 41.1%, partly offset by Marlboro and low-price

Next, down by 0.5 and 0.6 share points to 23.8% and 2.6%, respectively.
In Canada, the total estimated tax-paid cigarette market was down by 1.6% to 21.6 billion units. Although our cigarette shipment volume of 8.0 billion units declined by 0.1%, market share was up by 0.5 share points to 37.1%, with premium brand Belmont up by 0.2 share points to 2.6%, and low-price brand Next up by 1.9 share points to 9.8%, partly offset by mid-price Number 7 and

Table of Contents

low-price Accord, down by 0.2 and 0.4 share points, to 4.3% and 2.9%, respectively. Market share of mid-price Canadian Classics was up by 0.1 share point to 10.2%.

In Mexico, the total cigarette market was up by 0.7% to 24.8 billion units, primarily reflecting trade inventory movements, partly offset by the impact of January price increases in 2012 and 2013. Our cigarette shipment volume of 18.0 billion units decreased by 0.4%. Our market share declined by 0.8 share points to 72.8% due to intense price competition. Market share of Marlboro and Benson and Hedges was down by 2.0 and 0.7 share points to 51.7% and 5.6%, respectively, partly offset by market share of low-price Delicados, up by 0.6 share points to 11.1%, and our other local low-price brands increased by a combined 1.3 share points to 4.2%.

Operating Results – Three Months Ended September 30, 2013

The following discussion compares operating results within each of our reportable segments for the three months ended September 30, 2013, with the three months ended September 30, 2012.

European Union. Net revenues, which include excise taxes billed to customers, increased by $583 million (8.4%). Excluding excise taxes, net revenues increased by $156 million (7.3%) to $2.3 billion. This increase was due to:

- price increases ($125 million) and
- favorable currency ($118 million), partly offset by
- unfavorable volume/mix ($87 million).

The net revenues of the European Union segment include $380 million in 2013 and $332 million in 2012 related to sales of OTP. Excluding excise taxes, OTP net revenues for the European Union segment were $134 million in 2013 and $115 million in 2012.

Operating companies income of $1.2 billion increased by $122 million (11.2%). This increase was due primarily to:

- price increases ($125 million) and
- favorable currency ($63 million), partly offset by
- unfavorable volume/mix ($68 million).

The total cigarette market in the European Union of 130.5 billion units decreased by 5.4%, representing a more modest rate of decline compared to the 10.6% and 8.0% decrease in the first and second quarters of 2013, respectively. The decrease was due primarily to the impact of tax-driven price increases, the unfavorable economic and employment environment and the prevalence of non-duty paid products. The total OTP market in the European Union of 42.3 billion cigarette equivalent units increased by 0.7%, reflecting a larger total fine cut market, up by 0.3% to 37.0 billion cigarette equivalent units. Although our cigarette shipment volume in the European Union of 49.0 billion units decreased by 5.2%, due principally to a lower total market across the region, our market share increased by 0.2 share points to 38.3%.

While shipment volume of Marlboro of 24.2 billion units decreased by 3.0%, mainly due to a lower total market, market share increased by 0.1 share point to 18.8%.

Shipment volume of L&M increased by 1.3% to 9.0 billion units and market share increased by 0.4 share points to 6.9%.

Shipment volume of Chesterfield of 5.0 billion units increased by 5.7% and market share increased by 0.1 share point to 4.0%, driven by gains, notably in Austria, the Czech Republic, Portugal and the UK, partly offset by Germany.

Although shipment volume of Philip Morris of 2.5 billion units decreased by 13.1%, market share increased by 0.2 share points to 1.9%, with gains notably in France and Italy.

Our shipments of OTP of 5.3 billion cigarette equivalent units increased by 6.0%, driven by higher share. Our OTP total market share was 12.8%, up by 1.0 share point, driven by gains in the fine cut category, notably in France, up by 1.9 share points to 26.4%, Italy, up by 14.0 share points to 40.3%, Poland, up by 3.1 share points to 21.0%, Portugal, up by 13.4 share points to 30.7%, and Spain, up by 2.3 share points to 14.2%.

In France, the total cigarette market of 12.2 billion units decreased by 10.8%, mainly reflecting the unfavorable impact of price increases in the fourth quarter of 2012 and July 2013, an increase in the prevalence of non-duty paid products, growth of the fine cut category, and a weak economy. Although our shipments of 4.8 billion units decreased by 6.8%, market share increased by 1.1

Table of Contents

share points to 40.0%, mainly driven by the resilience of premium Philip Morris, up by 0.7 share points to 8.9%, reinforced by the Philip Morris Green variants, which were introduced in February 2013, and the growth of Chesterfield, up by 0.1 share point to 3.4%. Market shares of Marlboro and L&M increased by 0.1 share point each to 24.6% and 2.6%, respectively. The total industry fine cut category of 3.5 billion cigarette equivalent units increased by 0.7%. Our market share of the category increased by 1.9 share points to 26.4%.

In Germany, the total cigarette market of 21.9 billion units increased by 0.8%, mainly reflecting the favorable impact of competitors' trade inventory movements. The underlying total market is estimated to have declined by 2.7%, largely due to the impact of price increases in the second quarter of 2013. Our shipments of 7.6 billion units decreased by 1.4%. Market share decreased by 0.7 share points to 34.5%, mainly due to Marlboro and Chesterfield, down by 0.5 and 0.6 share points to 20.5% and 1.7%, respectively, partly offset by L&M, up by 0.5 share points to 10.7%. The total industry fine cut category of 10.9 billion cigarette equivalent units was flat. Our market share of the category was down by 0.3 share points to 13.7%.

In Italy, the total cigarette market of 20.1 billion units decreased by 4.1%, reflecting an unfavorable economic and employment environment and the prevalence of illicit trade and substitute products. Although our shipments of 10.2 billion units decreased by 5.4%, market share increased by 0.1 share point to 53.3%, with Marlboro up by 0.3 share points to 26.2%. Market share of Philip Morris increased by 1.3 share points to 2.5%, benefiting from the 2012 launch of Philip Morris Selection in the low-price segment, partially offset by Chesterfield, down by 0.1 share point to 3.5%, and Diana in the low-price segment, down by 1.1 share points to 11.1%, impacted by the growth of the super-low price segment and the availability of non-duty paid products. The total industry fine cut category of 1.5 billion cigarette equivalent units decreased by 1.9%, reflecting the 2012 excise tax-driven reduction of the price gap differential with cigarettes. Our market share of the category increased by 14.0 share points to 40.3%, driven by Marlboro Red and Gold fine cut.

In Poland, the total cigarette market of 12.7 billion units decreased by 8.3%, mainly reflecting the unfavorable impact of price increases in the first quarter of 2013, and the availability of non-duty paid OTP. Although our shipments of 4.7 billion units decreased by 7.4%, our market share increased by 0.3 share points to 37.4%, driven by Marlboro, up by 0.3 share points to 11.9% and by L&M and Chesterfield, up by 2.3 and 0.3 share points to 18.8% and 2.2%, respectively. While the total industry fine cut category of 0.8 billion cigarette equivalent units decreased by 6.5%, reflecting the prevalence of non-duty paid OTP, our market share of the category increased by 3.1 share points to 21.0%.

In Spain, the total cigarette market of 13.2 billion units decreased by 11.3%, mainly due to the impact of price increases in 2012 and the first and third quarters of 2013, the unfavorable economic and employment environment and illicit trade. Although our shipments of 3.8 billion units decreased by 13.5%, our market share increased by 0.1 share point to 31.1%, driven by higher share of Marlboro, up by 0.5 share points to 15.3%. Market share of Chesterfield was flat at 8.9%, and share of Philip Morris and L&M was down by 0.1 share point and 0.2 share points to 0.8% and 6.0%, respectively. The total industry fine cut category of 2.7 billion cigarette equivalent units decreased by 5.5%, due to tax-driven price increases in the first and third quarters. Our market share of the category increased by 2.3 share points to 14.2%.

Eastern Europe, Middle East & Africa. Net revenues, which include excise taxes billed to customers, increased by $421 million (8.2%). Excluding excise taxes, net revenues increased by $78 million (3.5%) to $2.3 billion. This increase was due to:

- price increases ($201 million), partly offset by
- unfavorable volume/mix ($114 million) and
- unfavorable currency ($9 million).

Operating companies income of $1.1 billion increased by $41 million (3.9%). This increase was due to:

- price increases ($201 million), partly offset by

- unfavorable volume/mix ($91 million),
- unfavorable currency ($32 million),
- higher manufacturing costs ($19 million) and
- higher marketing, administration and research costs ($18 million).

Our cigarette shipment volume in EEMA of 76.9 billion units decreased by 5.5%, mainly due to the Middle East, Russia and Serbia, partly offset by North Africa. Our cigarette shipment volume of premium brands decreased by 1.1%, due principally to Marlboro, down by 2.4% to 22.2 billion units, partly offset by Parliament, up by 4.3% to 8.9 billion units.

In Russia, our shipment volume of 23.0 billion units decreased by 10.1%, mainly due to the unfavorable impact of tax-driven price

Table of Contents

increases, illicit trade and a weak economy. Shipment volume of our premium portfolio decreased by 8.1%, mainly due to Marlboro and Parliament, down by 16.7% and 4.1%, respectively. In the mid-price segment, shipment volume decreased by 15.3%, mainly due to Chesterfield, down by 20.7%. In the low-price segment, shipment volume decreased by 8.4%, mainly due to Bond Street, Optima and Apollo Soyuz, down by 7.7%, 14.6% and 22.5%, respectively. Our market share of 26.1%, as measured by Nielsen, was down by 0.5 share points. Market share of Parliament increased by 0.2 share points to 3.4%, Marlboro decreased by 0.2 share points to 1.7%, L&M increased by 0.3 share points to 2.9%, Chesterfield decreased by 0.5 share points to 3.0%, Bond Street decreased by 0.2 share points to 6.4%, and Next increased by 0.3 share points to 3.2%.

In Turkey, the total cigarette market of 24.8 billion units decreased by an estimated 5%, primarily reflecting the renewed growth of illicit trade. Our shipment volume of 12.6 billion units decreased by 2.4%. Our market share, as measured by Nielsen, increased by 0.1 share point to 46.2%, mainly driven by premium Parliament and mid-price Muratti, up by 1.1 and 0.3 share points to 10.3% and 6.9%, respectively, partly offset by Marlboro, down by 0.2 share points to 9.1%, and low-price L&M, down by 1.2 share points to 7.3%.

In Ukraine, the total cigarette market of 20.1 billion units decreased by an estimated 14%, mainly reflecting the impact of tax-driven price increases in the first quarter of 2013 and an increase in illicit trade. Although our shipment volume of 6.9 billion units decreased by 5.9%, our market share, as measured by Nielsen, increased by 0.7 share points to 33.3%, mainly due to growth from our low-price segment brands of Bond Street, Optima and President. Share for premium Parliament increased by 0.1 share point to 3.3%. Share of Marlboro decreased by 0.2 share points to 5.5%.

Asia. Net revenues, which include excise taxes billed to customers, decreased by $30 million (0.6%). Excluding excise taxes, net revenues decreased by $218 million (7.9%) to $2.5 billion. This decrease was due to:

- unfavorable currency ($196 million) and
- unfavorable volume/mix ($144 million, primarily due to the Philippines), partly offset by
- price increases ($122 million).

Operating companies income of $1.1 billion decreased by $200 million (15.4%). This decrease was due primarily to:

- unfavorable currency ($178 million),
- unfavorable volume/mix ($106 million) and
- higher manufacturing costs ($56 million, principally in Indonesia driven mainly by higher clove prices), partly offset by
- price increases ($122 million) and
- the absence of the 2012 pre-tax charges for asset impairment and exit costs ($24 million).

Our cigarette shipment volume of 73.3 billion units decreased by 7.8%, due primarily to the lower total market in the Philippines, and lower share and the reversal of trade inventory movements in Pakistan following the excise tax increase in the second quarter of 2013, partly offset by share growth in Indonesia. Excluding the Philippines, our cigarette shipment volume decreased by 2.8%. Shipment volume of Marlboro of 19.5 billion units decreased by 1.6%. Excluding the Philippines, shipment volume of Marlboro increased by 9.6%, primarily reflecting the launch of Marlboro Clear Taste in Japan, as well as market share growth in Indonesia and Vietnam.

In Indonesia, the total cigarette market of 74.1 billion units increased by 0.3%. Our shipment volume of 27.1 billion units increased by 1.6%. Our market share increased by 0.4 share points to 36.6%, driven notably by Sampoerna A in the premium segment, up by 0.6 share points to 14.8%, and mid-price U Mild, up by 0.9 share points to 4.3%. Market share of Dji Sam Soe in the premium segment decreased by 1.4 share points to 6.7%, mainly due to a retail price change ahead of competition. Marlboro's market share increased by 0.5 share points to 5.4% and its share of the “white” cigarettes segment, representing 7.0% of the total cigarette market, increased by 5.7 share points to 77.8%.

In Japan, the total cigarette market of 50.0 billion units decreased by 1.2%. Our shipment volume of 13.5 billion units decreased by 2.0%, principally due to a lower total market and share. Our market share decreased by 1.0 share point to 26.5%, reflecting the impact of our principal competitor's brand launches and significant promotional activities. Marlboro's market share decreased by 0.3 share points to 12.2%. Share of Lark and Philip Morris decreased by 0.3 and

0.2 share points to 7.9% and 2.1%, respectively. Share of Virginia S. was flat at 2.0%.

In Korea, the total cigarette market of 23.6 billion units decreased by 2.7%. Although our shipment volume of 4.6 billion units decreased slightly by 0.6%, market share increased by 0.4 share points to 19.4%. Market share of Marlboro and Parliament

Table of Contents

increased by 0.2 and 0.5 share points to 7.7% and 6.9%, respectively. Market share of Virginia S. decreased by 0.1 share point to 4.3%.

In the Philippines, the total industry cigarette volume of 23.0 billion units was estimated to have decreased by 6.7%, reflecting a partial, but insufficient, improvement in declared tax-paid volume by our main local competitor, as well as government tax enforcement. Our shipment volume of 17.8 billion units decreased by 20.7%, primarily reflecting the unfavorable impact of the disruptive excise tax increase in January 2013 and the prevalence of non-duty paid domestic product. Our market share decreased by 13.6 share points to 77.2%, primarily due to down-trading to competitors' brands. Marlboro's market share decreased by 5.9 share points to 15.3%. Share of low-price Fortune decreased by 22.6 share points to 27.5%, partly offset by gains from our other local low-price brands.

Latin America & Canada. Net revenues, which include excise taxes billed to customers, increased by $63 million (2.6%). Excluding excise taxes, net revenues decreased by $9 million (1.1%) to $818 million. This decrease was due to:

- unfavorable currency ($33 million) and
- unfavorable volume/mix ($16 million), partly offset by
- price increases ($40 million).

Operating companies income was flat at $267 million. The movements in operating companies income were related to:

- price increases ($40 million) and
- the absence of the 2012 pre-tax charges for asset impairment and exit costs ($10 million), offset by
- unfavorable volume/mix ($24 million),
- unfavorable currency ($13 million),
- higher marketing, administration and research costs ($9 million) and
- higher manufacturing costs ($4 million).

Our cigarette shipment volume in Latin America & Canada of 24.0 billion units decreased by 0.2%, principally due to a lower total market and share in Mexico. Shipment volume of Marlboro of 9.2 billion units decreased by 3.0%, mainly reflecting a lower total market and share in Mexico, partly offset by higher share in Brazil and Colombia.

In Argentina, the total cigarette market of 10.3 billion units increased by 1.1%. Our cigarette shipment volume of 7.9 billion units increased by 2.1%. Our market share increased by 1.0 share point to 76.0%, driven by mid-price Philip Morris, up by 2.4 share points to 42.2%, reflecting the positive impact of its capsule variants, partly offset by low-price Next, down by 0.7 share points to 2.4%. Share of Marlboro decreased by 0.3 share points to 23.7%.

In Canada, the total cigarette market of 7.7 billion units decreased by 2.4%. Our cigarette shipment volume of 2.9 billion units increased by 0.1% and market share increased by 1.5 share points to 38.4%, with premium brands Benson & Hedges and Belmont up by 0.2 share points each to 2.5% and 2.8%, respectively. Market share of low-price brand Next was up by 2.1 share points to 10.5%, partly offset by mid-price Number 7 and low-price Accord, down by 0.3 share points each to 4.2% and 2.9%, respectively. Market share of mid-price Canadian Classics was up by 0.5 share points to 10.6%.

In Mexico, the total cigarette market of 8.4 billion units decreased by 0.9%. Our cigarette shipment volume of 6.0 billion units decreased by 2.5%. Our market share decreased by 1.2 share points to 72.4%, due mainly to: unfavorable segment mix following the impact of price increases in January 2013; and a competitor's launch of brands in a 15s per pack format, at price parity with 14s, in the low price segment. While market share of Marlboro and Benson & Hedges decreased by 3.1 and 0.6 share points to 50.5% and 5.5%, respectively, our share of the premium price segment increased by 1.1 share points to 90.9%. Market share of low-price Delicados, increased by 1.2 share points to 11.7%, and our other local low-price brands increased by a combined 1.3 share points to 4.5%.

Financial Review

Net Cash Provided by Operating Activities

Net cash provided by operating activities of $7.8 billion during the first nine months of 2013 increased by $44 million from the comparable 2012 period. The increase was due primarily to higher pension provisions in 2013 (included in other operating cash flows), partially offset by an increase in our working capital requirements.

Table of Contents

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

- more cash used for income taxes ($932 million), principally related to the timing of payments and lower income tax provisions; partly offset by
- more cash provided by inventories ($683 million), primarily due to lower finished goods inventories (mainly payback of 2012 forestalling attributable to tax-driven price increases), partly offset by an increase in leaf tobacco inventory; and
- less cash used for accounts receivable ($186 million), primarily due to lower trade purchases and the timing of cash collections.

Net Cash Used in Investing Activities

Net cash used in investing activities of $1.5 billion during the first nine months of 2013 increased by $780 million from the comparable 2012 period, due primarily to increased investments in unconsolidated subsidiaries ($653 million) and higher capital expenditures ($102 million).

As previously discussed, on September 30, 2013, we acquired a 49% equity interest in United Arab Emirates-based Arab Investors-TA (FZC) for approximately $625 million. For further details, see Note 17. Investments in Unconsolidated Subsidiaries.

Our capital expenditures were $821 million and $719 million during the nine months ended September 30, 2013 and 2012, respectively. The 2013 expenditures were primarily related to investments in productivity-enhancing programs, equipment for new products and the expansion of our capacity in Indonesia.

Net Cash Used in Financing Activities

During the first nine months of 2013, net cash used in financing activities was $5.9 billion, compared with net cash used in financing activities of $4.9 billion during the first nine months of 2012. During the first nine months of 2013, we used a total of $12.7 billion to repurchase our common stock, pay dividends, repay debt and purchase subsidiary shares from noncontrolling interests. These uses were partly offset by proceeds from our debt offerings and short-term borrowings in 2013 of $7.0 billion. During the first nine months of 2012, we used a total of $12.0 billion to repurchase our common stock, pay dividends and repay debt. These uses were partially offset by proceeds from our debt offerings and short-term borrowings in 2012 of $7.4 billion.

Dividends paid in the first nine months of 2013 and 2012 were $4.2 billion and $4.0 billion, respectively. The increase reflects a higher dividend rate in 2013, partially offset by lower shares outstanding as a result of our share repurchase programs.

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 September 30, 2013, 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

Table of Contents

Credit Facilities – On February 12, 2013, we entered into a 364-day revolving credit facility in the amount of $2.0 billion. At September 30, 2013, 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 11, 2014	$2.0	
Multi-year revolving credit, expiring March 31, 2015	2.5	
Multi-year revolving credit, expiring October 25, 2016	3.5	
Total facilities	$8.0	
Commercial paper outstanding		$2.7

At September 30, 2013, 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 September 30, 2013, our ratio calculated in accordance with the agreements was 14.6 to 1.0. These facilities do not include any credit rating triggers, material adverse change clauses or any provisions that could require 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 $2.3 billion at September 30, 2013 and $2.0 billion at December 31, 2012, are for the sole use of our subsidiaries. Borrowings under these arrangements amounted to $941 million at September 30, 2013, and $447 million at December 31, 2012.

Commercial Paper Program - We have commercial paper programs in place in the U.S. and in Europe. At September 30, 2013 and December 31, 2012, we had $2.7 billion and $2.0 billion, respectively, of commercial paper outstanding.

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

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 $26.8 billion at September 30, 2013 and $22.8 billion at December 31, 2012.

On February 28, 2011, 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.

Table of Contents

Our debt offerings in the first nine months of 2013 were as follows:
(in millions)

Type		Face Value	Interest Rate	Issuance	Maturity
U.S. dollar notes	(a)	$400	Floating	March 2013	February 2015
U.S. dollar notes	(b)	$600	2.625%	March 2013	March 2023
U.S. dollar notes	(b)	$850	4.125%	March 2013	March 2043
EURO notes	(c)	€1,250 (approximately $1,621)	1.750%	March 2013	March 2020
EURO notes	(c)	€750 (approximately $972)	2.750%	March 2013	March 2025
EURO notes	(d)	€500 (approximately $648)	3.125%	June 2013	June 2033
Swiss franc notes	(e)	CHF200 (approximately $217)	0.875%	March 2013	March 2019

(a) Interest on these notes is payable quarterly in arrears beginning in May 2013. The notes will bear interest from date of issuance at a rate per annum, reset quarterly, equal to three month LIBOR plus 0.05%.
(b) Interest on these notes is payable semiannually in arrears beginning in September 2013.
(c) Interest on these notes is payable annually in arrears beginning in March 2014.
(d) Interest on these notes is payable annually in arrears beginning in June 2014.
(e) Interest on these notes is payable annually in arrears beginning in March 2014.

The net proceeds from the sale of the securities listed in the table above were used to meet our working capital requirements, to repurchase our common stock, to refinance debt and for general corporate purposes.

Guarantees - At September 30, 2013, we were contingently liable for $0.7 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 September 30, 2013, our third-party guarantees were insignificant.

Equity and Dividends

As discussed in Note 3. Stock Plans to our condensed consolidated financial statements, during the nine months ended September 30, 2013, we granted 2.8 million shares of deferred stock awards to eligible employees at a weighted-average grant date fair value of $88.43 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 September 30, 2013, shares available for grant under the 2012 Plan were 27,211,610.

On August 1, 2012 we began repurchasing shares under a new three-year $18.0 billion share repurchase program that was authorized by our Board of Directors in June 2012. From August 1, 2012 through September 30, 2013, we repurchased 82.3 million shares of our common stock at a cost of $7.4 billion under this new repurchase program. During the first nine months of 2013, we repurchased 50.1 million shares at a cost of $4.5 billion. During the third quarter of 2013, we repurchased 16.7 million shares at a cost of $1.5 billion.

As previously announced on February 7, 2013, we have a share repurchase target amount for 2013 of $6.0 billion. Dividends paid in the first nine months of 2013 were $4.2 billion. During the third quarter of 2013, our Board of Directors announced a 10.6% increase in the quarterly dividend to $0.94 per common share. As a result, the present annualized dividend rate is $3.76 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, 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 13. Fair Value Measurements, and Note 15. 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 10. 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 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

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."

Table of Contents

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 downtrading and the risk of counterfeiting, contraband and cross-border purchases. Significant regulatory developments will take place over the next few years in most of our markets, driven principally by the World Health Organization's Framework Convention on Tobacco Control ("FCTC"). 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;
- 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;
- 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 ("ETS") could substantially reduce our profitability and could severely impair our liquidity.
There is litigation related to tobacco products pending in certain jurisdictions. Damages claimed in some tobacco-related litigation are significant and, in certain cases in Brazil, Canada, Israel and Nigeria, range into the billions of U.S. dollars. We anticipate that new cases will continue to be filed. The 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 10. Contingencies to our condensed consolidated financial statements for a discussion of tobacco-related 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.

Table of Contents

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

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. In certain markets, we are dependent on governmental approvals of various actions such as price changes.

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.

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 downtrading 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 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 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 such as “lights” and “ultra lights” 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 produce products with the potential to reduce the risk of smoking-related diseases compared to conventional cigarettes.

We continue to seek ways to develop commercially viable new product technologies that may reduce the risk of smoking-related diseases. Our goal is to develop products whose potential for risk reduction can be substantiated and provide adult smokers the taste, sensory experience and smoking ritual characteristics that are as close as possible to those currently provided by conventional 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 with claims of reduced risk and harm, which could significantly undermine the commercial viability of these products.

Table of Contents

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 will translate 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.
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 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 profitability may suffer if we are unable to introduce new products or enter new markets successfully, to raise prices or maintain an acceptable proportion of our sales of higher margin products and sales in higher margin geographies.

We may be unable to expand our brand portfolio through successful acquisitions and 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 impacts 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, 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

Table of Contents

revenue, assets or personal or other sensitive data, 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.

Table of Contents

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.

Table of Contents

Part II - OTHER INFORMATION

Item 1. Legal Proceedings.

See Note 10. 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, 2012. There have been no material changes to the risk factors disclosed in our Annual Report on Form 10-K.

Table of Contents

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 September 30, 2013 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
July 1, 2013 – July 31, 2013 (1)	4,227,940	$88.62	69,784,284	$11,727,363,593
August 1, 2013 – August 31, 2013 (1)	8,651,737	$86.39	78,436,021	$10,979,951,821
September 1, 2013 – September 30, 2013 (1)	3,837,390	$86.75	82,273,411	$10,647,045,918
Pursuant to Publicly Announced Plans or Programs	16,717,067	$87.04		
July 1, 2013 – July 31, 2013 (3)	6,624	$87.44		
August 1, 2013 – August 31, 2013 (3)	1,130	$89.26		
September 1, 2013 – September 30, 2013 (3)	1,937	$83.58		
For the Quarter Ended September 30, 2013	16,726,758	$87.04		

(1) On June 13, 2012, our Board of Directors authorized a new share repurchase program of $18 billion over three years. The new 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.

(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 restricted and deferred stock awards, or exercised stock options, and used shares to pay all, or a portion of, the related taxes and/or option exercise price.

Table of Contents

Item 6. Exhibits.

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.

Table of Contents

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

November 1, 2013