

Philip Morris International Inc.  
Form 10-Q  
April 26, 2016  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q  
(Mark One)

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

For the quarterly period ended March 31, 2016  
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 (I.R.S. Employer  
incorporation or organization) Identification No.)

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

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

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company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

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

At April 22, 2016, there were 1,551,264,326 shares outstanding of the registrant’s common stock, no par value per share.

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

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## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements.

## Philip Morris International Inc. and Subsidiaries

## Condensed Consolidated Balance Sheets

(in millions of dollars)

(Unaudited)

	March 31, 2016	December 31, 2015
<b>ASSETS</b>		
Cash and cash equivalents	\$ 2,944	\$ 3,417
Receivables (less allowances of \$58 in 2016 and \$58 in 2015)	2,989	2,778
Inventories:		
Leaf tobacco	3,034	2,640
Other raw materials	1,615	1,613
Finished product	4,050	4,220
	8,699	8,473
Deferred income taxes	485	488
Other current assets	811	648
Total current assets	15,928	15,804
Property, plant and equipment, at cost	12,202	11,767
Less: accumulated depreciation	6,337	6,046
	5,865	5,721
Goodwill (Note 5)	7,683	7,415
Other intangible assets, net (Note 5)	2,664	2,623
Investments in unconsolidated subsidiaries (Note 15)	942	890
Other assets	1,539	1,503
<b>TOTAL ASSETS</b>	<b>\$ 34,621</b>	<b>\$ 33,956</b>

See notes to condensed consolidated financial statements.

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

	March 31, 2016	December 31, 2015
<b>LIABILITIES</b>		
Short-term borrowings (Note 11)	\$ 673	\$ 825
Current portion of long-term debt (Note 11)	2,437	2,405
Accounts payable	1,496	1,289
Accrued liabilities:		
Marketing and selling	536	640
Taxes, except income taxes	4,569	5,121
Employment costs	735	903
Dividends payable	1,591	1,589
Other	1,387	1,438
Income taxes	576	970
Deferred income taxes	91	206
Total current liabilities	14,091	15,386
Long-term debt (Note 11)	26,683	25,250
Deferred income taxes	1,378	1,543
Employment costs	2,602	2,566
Other liabilities	761	687
Total liabilities	45,515	45,432
Contingencies (Note 9)		
<b>STOCKHOLDERS' (DEFICIT) EQUITY</b>		
Common stock, no par value (2,109,316,331 shares issued in 2016 and 2015)	—	—
Additional paid-in capital	1,874	1,929
Earnings reinvested in the business	29,785	29,842
Accumulated other comprehensive losses	(8,914)	(9,402)
	22,745	22,369
Less: cost of repurchased stock (558,058,798 and 559,972,262 shares in 2016 and 2015, respectively)	35,498	35,613
Total PMI stockholders' deficit	(12,753)	(13,244)
Noncontrolling interests	1,859	1,768
Total stockholders' deficit	(10,894)	(11,476)
<b>TOTAL LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY</b>	<b>\$ 34,621</b>	<b>\$ 33,956</b>

See notes to condensed consolidated financial statements.



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

	For the Three Months Ended March 31,	
	2016	2015
Net revenues	\$16,788	\$17,352
Cost of sales	2,096	2,229
Excise taxes on products	10,705	10,736
Gross profit	3,987	4,387
Marketing, administration and research costs	1,496	1,494
Amortization of intangibles	18	22
Operating income	2,473	2,871
Interest expense, net	247	275
Earnings before income taxes	2,226	2,596
Provision for income taxes	630	785
Equity (income)/loss in unconsolidated subsidiaries, net	(9 )	(23 )
Net earnings	1,605	1,834
Net earnings attributable to noncontrolling interests	75	39
Net earnings attributable to PMI	\$1,530	\$1,795
Per share data (Note 7):		
Basic earnings per share	\$0.98	\$1.16
Diluted earnings per share	\$0.98	\$1.16
Dividends declared	\$1.02	\$1.00

See notes to condensed consolidated financial statements.

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

	For the Three Months Ended March 31,	
	2016	2015
Net earnings	\$1,605	\$1,834
Other comprehensive earnings (losses), net of income taxes:		
Change in currency translation adjustments:		
Unrealized gains (losses), net of income taxes of \$162 in 2016 and (\$434) in 2015	538	(1,343 )
Change in net loss and prior service cost:		
Net losses and prior service costs, net of income taxes of \$3 in 2016 and \$- in 2015	(10 )	—
Amortization of net losses, prior service costs and net transition costs, net of income taxes of (\$8) in 2016 and (\$12) in 2015	55	56
Change in fair value of derivatives accounted for as hedges:		
Gains (losses) recognized, net of income taxes of \$17 in 2016 and (\$2) in 2015	(62 )	25
(Gains) losses transferred to earnings, net of income taxes of (\$1) in 2016 and \$3 in 2015	(7 )	(27 )
Total other comprehensive earnings (losses)	514	(1,289 )
Total comprehensive earnings	2,119	545
Less comprehensive earnings attributable to:		
Noncontrolling interests	101	14
Comprehensive earnings attributable to PMI	\$2,018	\$531

See notes to condensed consolidated financial statements



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Philip Morris International Inc. and Subsidiaries  
 Condensed Consolidated Statements of Stockholders' (Deficit) Equity  
 For the Three Months Ended March 31, 2016 and 2015  
 (in millions of dollars, except per share amounts)  
 (Unaudited)

	PMI Stockholders' (Deficit) Equity						
	Additional Common Stock Paid-in Capital	Earnings Reinvested in the Business	Accumulated Other Comprehensive Losses	Cost of Repurchased Stock	Noncontrolling Interests		Total
Balances, January 1, 2015	\$-710	\$ 29,249	\$ (6,826 )	\$ (35,762 )	\$ 1,426		\$(11,203)
Net earnings		1,795			39		1,834
Other comprehensive earnings (losses), net of income taxes			(1,264 )		(25 )		(1,289 )
Issuance of stock awards	(97 )			134			37
Dividends declared (\$1.00 per share)		(1,555 )					(1,555 )
Payments to noncontrolling interests					(70 )		(70 )
Balances, March 31, 2015	\$-613	\$ 29,489	\$ (8,090 )	\$ (35,628 )	\$ 1,370		\$(12,246)
Balances, January 1, 2016	\$-1,929	\$ 29,842	\$ (9,402 )	\$ (35,613 )	\$ 1,768		\$(11,476)
Net earnings		1,530			75		1,605
Other comprehensive earnings (losses), net of income taxes			488		26		514
Issuance of stock awards	(56 )			115			59
Dividends declared (\$1.02 per share)		(1,587 )					(1,587 )
Payments to noncontrolling interests					(12 )		(12 )
Other	1				2		3
Balances, March 31, 2016	\$-1,874	\$ 29,785	\$ (8,914 )	\$ (35,498 )	\$ 1,859		\$(10,894)

See notes to condensed consolidated financial statements.

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

	For the Three Months Ended March 31,	
	2016	2015
<b>CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>		
Net earnings	\$1,605	\$1,834
Adjustments to reconcile net earnings to operating cash flows:		
Depreciation and amortization	175	192
Deferred income tax provision	10	132
Asset impairment and exit costs, net of cash paid	(14	) (160 )
Cash effects of changes:		
Receivables, net	(175	) 54
Inventories	49	393
Accounts payable	223	44
Income taxes	(485	) (535 )
Accrued liabilities and other current assets	(922	) (2,327 )
Pension plan contributions	(52	) (9 )
Other	48	7
Net cash provided by (used in) operating activities	462	(375 )
<b>CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES</b>		
Capital expenditures	(226	) (203 )
Investments in unconsolidated subsidiaries	(7	) (8 )
Other	(186	) 279
Net cash provided by (used in) investing activities	(419	) 68

See notes to condensed consolidated financial statements.

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

	For the Three Months Ended March 31,	
	2016	2015
<b>CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES</b>		
Short-term borrowing activity by original maturity:		
Net (repayments) issuances - maturities of 90 days or less	\$(136 )	\$2,237
Issuances - maturities longer than 90 days	—	13
Long-term debt proceeds	1,978	302
Long-term debt repaid	(827 )	(399 )
Repurchases of common stock	—	(48 )
Dividends paid	(1,585 )	(1,555 )
Sale (purchase) of subsidiary shares to (from) noncontrolling interests	6	—
Other	(29 )	(25 )
Net cash provided by (used in) financing activities	(593 )	525
Effect of exchange rate changes on cash and cash equivalents	77	(376 )
Cash and cash equivalents:		
Decrease	(473 )	(158 )
Balance at beginning of period	3,417	1,682
Balance at end of period	\$2,944	\$1,524

See notes to condensed consolidated financial statements.

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

Note 1. Background and Basis of Presentation:

Background

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

Basis of Presentation

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

Certain prior years' amounts have been reclassified to conform with the current year's presentation, as reflected in Note 8. Segment Reporting. The changes did not have an impact on PMI's consolidated financial position, results of operations or cash flows in any of the periods presented.

These statements should be read in conjunction with the audited consolidated financial statements and related notes, which appear in PMI’s Annual Report on Form 10-K for the year ended December 31, 2015.

Note 2. Asset Impairment and Exit Costs:

During the three months ended March 31, 2016 and 2015, PMI did not incur asset impairment and exit costs.

Movement in Exit Cost Liabilities

The movement in exit cost liabilities for the three months ended March 31, 2016 was as follows:

(in millions)

Liability balance, January 1, 2016	\$54
Charges, net	—
Cash spent	(14 )
Currency/other	2
Liability balance, March 31, 2016	\$42

Cash payments related to exit costs at PMI were \$14 million and \$160 million for the three months ended March 31, 2016 and 2015, respectively. Future cash payments for exit costs incurred to date are expected to be approximately \$42 million, and will be substantially paid by the end of 2017.

Note 3. Stock Plans:

In May 2012, PMI’s shareholders approved the Philip Morris International Inc. 2012 Performance Incentive Plan (the “2012 Plan”). Under the 2012 Plan, PMI may grant to eligible employees restricted stock, restricted stock units and deferred stock units (collectively referred to as restricted share 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 March 31, 2016, shares available for grant under the 2012 Plan were 21,608,980.

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

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shares of PMI common stock may be awarded under the Non-Employee Directors Plan. At March 31, 2016, shares available for grant under the plan were 691,432.

Restricted share unit (RSU) awards

During the three months ended March 31, 2016, PMI granted 1.2 million shares of RSU awards to eligible employees at a weighted-average grant date fair value of \$89.02 per share. During the three months ended March 31, 2015, PMI granted 1.5 million shares of RSU awards to eligible employees at a grant date fair value of \$82.28 per share. PMI recorded compensation expense related to RSU awards of \$41 million and \$58 million during the three months ended March 31, 2016 and 2015, respectively. As of March 31, 2016, PMI had \$198 million of total unrecognized compensation cost related to non-vested RSU 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, disability or normal retirement, or separation from employment by mutual agreement after reaching age 58.

During the three months ended March 31, 2016, 2.1 million shares of PMI RSU awards vested. The grant date fair value of all the vested shares was approximately \$190 million. The total fair value of RSU awards that vested during the three months ended March 31, 2016 was approximately \$196 million.

Performance share unit (PSU) awards

During the three months ended March 31, 2016, PMI granted PSU awards to certain executives. The PSU awards require the achievement of certain performance factors, which are predetermined at the time of grant, over a three-year performance cycle. PMI's performance metrics consist of PMI's Total Shareholder Return (TSR) relative to a predetermined peer group, PMI's currency neutral compound annual adjusted operating companies income growth rate, excluding acquisitions, and PMI's performance against specific measures of PMI's innovation. The aggregate of the weighted performance factors for the three metrics determines the percentage of PSUs that will vest at the end of the three-year performance cycle. Each vested PSU entitles the participant to one share of common stock. An aggregate weighted PSU performance factor of 100 will result in the targeted number of PSUs being vested. The minimum percentage of PSUs that can vest is zero, with a maximum percentage of 200. Participants are entitled to dividend equivalents for any vested PSUs, at the end of the performance cycle.

During the three months ended March 31, 2016, PMI granted 0.4 million shares of PSU awards to eligible employees. The grant date fair value of the PSU market based awards subject to the TSR performance factor is \$104.60 per share, which was determined by using the Monte Carlo simulation model. The grant date fair value of the PSU awards subject to the other performance factors is \$89.02 per share, which was determined by using the average of the high and low market price of PMI's stock at the date of grant. PMI recorded compensation expense related to PSU awards of \$12 million during the three months ended March 31, 2016. As of March 31, 2016, PMI had \$29 million of total unrecognized compensation cost related to non-vested PSU awards. The cost is recognized over the original restriction period of the awards, which is typically three years after the date of the award, or upon death, disability or reaching the age of 58.

Note 4. Benefit Plans:

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

benefits for non-U.S. retired employees are covered through local government plans.

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## Pension Plans

## Components of Net Periodic Benefit Cost

Net periodic pension cost consisted of the following:

	U.S. Plans For the Three Months Ended March 31, 2016		Non-U.S. Plans For the Three Months Ended March 31, 2015	
(in millions)	2016	2015	2016	2015
Service cost	\$1	\$ 1	\$50	\$51
Interest cost	4	5	31	36
Expected return on plan assets	(3 )	(4 )	(81 )	(83 )
Amortization:				
Net loss	1	3	44	46
Prior service cost	1	—	1	1
Net periodic pension cost	\$4	\$ 5	\$45	\$51

## 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 \$52 million were made to the pension plans during the three months ended March 31, 2016. Currently, PMI anticipates making additional contributions during the remainder of 2016 of approximately \$59 million to its pension plans, based on current tax and benefit laws. However, this estimate is subject to change as a result of changes in tax and other benefit laws, as well as asset performance significantly above or below the assumed long-term rate of return on pension assets, or changes in interest rates.

## Note 5. Goodwill and Other Intangible Assets, net:

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

	Goodwill		Other Intangible Assets, net	
(in millions)	March 31, 2016	December 31, 2015	March 31, 2016	December 31, 2015
European Union	\$1,349	\$ 1,310	\$ 514	\$ 516
Eastern Europe, Middle East & Africa	381	374	202	201
Asia	3,705	3,581	1,118	1,087
Latin America & Canada	2,248	2,150	830	819
Total	\$7,683	\$ 7,415	\$ 2,664	\$ 2,623

Goodwill primarily reflects PMI's acquisitions in Canada, Colombia, Greece, Indonesia, Mexico, Pakistan and Serbia, as well as the business combination in the Philippines. The movements in goodwill from December 31, 2015, were as follows:

(in millions)	European Union	Eastern Europe,	Asia	Latin America &	Total
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		Middle East & Africa		Canada	
Balances, December 31, 2015	\$ 1,310	\$ 374	\$3,581	\$ 2,150	\$7,415
Changes due to:					
Currency	39	7	124	98	268
Balances, March 31, 2016	\$ 1,349	\$ 381	\$3,705	\$ 2,248	\$7,683

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Additional details of other intangible assets were as follows:

(in millions)	March 31, 2016		December 31, 2015	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Non-amortizable intangible assets	\$1,559		\$1,527	
Amortizable intangible assets	1,650	\$ 545	1,609	\$ 513
Total other intangible assets	\$3,209	\$ 545	\$3,136	\$ 513

Non-amortizable intangible assets substantially consist of trademarks from PMI's acquisitions in Indonesia in 2005 and Mexico in 2007. Amortizable intangible assets primarily consist of certain trademarks and distribution networks associated with business combinations. The gross carrying amount, the range of useful lives as well as the weighted-average remaining useful life of amortizable intangible assets at March 31, 2016, were as follows:

(dollars in millions)	Gross Carrying Amount	Initial Estimated Useful Lives	Weighted-Average Remaining Useful Life
Trademarks	\$ 1,409	2 - 40 years	21 years
Distribution networks	153	5 - 30 years	11 years
Other (including farmer contracts and intellectual property rights)	88	4 - 17 years	10 years
	\$ 1,650		

Pre-tax amortization expense for intangible assets during the three months ended March 31, 2016 and 2015 was \$18 million and \$22 million, respectively. Amortization expense for each of the next five years is estimated to be \$73 million or less, assuming no additional transactions occur that require the amortization of intangible assets. The increase in the gross carrying amount of other intangible assets from December 31, 2015, was due to currency movements.

During the first quarter of 2016, PMI completed its annual review of goodwill for potential impairment using the market valuation approach. No impairment charge was 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 and interest rates by creating offsetting exposures. PMI is not a party to leveraged derivatives and, by policy, does not use derivative financial instruments for speculative purposes. Financial instruments qualifying for hedge accounting must maintain a specified level of effectiveness between the hedging instrument and the item being hedged, both at inception and throughout the hedged period. PMI formally documents the nature and relationships between the hedging instruments and hedged items, as well as its risk-management objectives, strategies for undertaking the various hedge transactions and method of assessing hedge effectiveness. Additionally, for hedges of forecasted transactions, the significant characteristics and expected terms of the forecasted transaction must be specifically identified, and it must be probable that each forecasted transaction will occur. If it were deemed probable that the forecasted transaction would not occur, the gain or loss would be recognized in earnings. PMI reports its net transaction gains or losses in marketing, administration and research costs

on the condensed consolidated statements of earnings.

PMI uses deliverable and non-deliverable forward foreign exchange contracts, foreign currency swaps and foreign currency options, collectively referred to as foreign exchange contracts ("foreign exchange contracts"), and interest rate contracts to mitigate its exposure to changes in exchange and interest rates from third-party and intercompany actual and forecasted transactions. The primary currencies to which PMI is exposed include the Australian dollar, Euro, Indonesian rupiah, Japanese yen, Mexican peso, Russian ruble, Swiss franc and Turkish lira. At March 31, 2016, PMI had contracts with aggregate notional amounts of \$25.3

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(Unaudited)

billion of which \$3.7 billion related to cash flow hedges, \$7.2 billion related to hedges of net investments in foreign operations and \$14.4 billion related to other derivatives that primarily offset currency exposures on intercompany financing.

The fair value of PMI's foreign exchange contracts included in the condensed consolidated balance sheets as of March 31, 2016 and December 31, 2015, were as follows:

(in millions)	Asset Derivatives Balance Sheet Classification	Fair Value		Liability Derivatives Balance Sheet Classification	Fair Value	
		At March 31, 2016	At December 31, 2015		At March 31, 2016	At December 31, 2015
Foreign exchange contracts designated as hedging instruments	Other current assets	\$ 199	\$ 301	Other accrued liabilities	\$ 33	\$ 26
	Other assets	149	181	Other liabilities	228	117
Foreign exchange contracts not designated as hedging instruments	Other current assets	100	7	Other accrued liabilities	30	29
	Other assets	63	85	Other liabilities	8	—
Total derivatives		\$ 511	\$ 574		\$ 299	\$ 172

For the three months ended March 31, 2016 and 2015, PMI's cash flow and net investment hedging instruments impacted the condensed consolidated statements of earnings and comprehensive earnings as follows:

(pre-tax, millions)	For the Three Months Ended March 31,				
	Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings/(Losses) on Derivatives		Statement of Earnings Classification of Gain/(Loss) Reclassified from Other Comprehensive Earnings/(Losses) into Earnings	Amount of Gain/(Loss) Reclassified from Other Comprehensive Earnings/(Losses) into Earnings	
	2016	2015		2016	2015
Derivatives in Cash Flow Hedging Relationship					
Foreign exchange contracts	\$ (79 )	\$ 27			
			Net revenues	\$ 5	\$ 30
			Cost of sales	14	—
			Marketing, administration and research costs	4	7
			Interest expense, net	(17 )	(7 )
Derivatives in Net Investment Hedging Relationship					

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Foreign exchange contracts	(197 )	286		
Total	\$ (276 )	\$ 313	\$ 6	\$ 30

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Cash Flow Hedges

PMI has entered into foreign exchange contracts to hedge foreign currency exchange risk related to certain forecasted transactions. The effective portion of gains and losses associated with qualifying cash flow hedge contracts is deferred as a component of accumulated other comprehensive losses until the underlying hedged transactions are reported in PMI's condensed consolidated statements of earnings. During the three months ended March 31, 2016 and 2015, ineffectiveness related to cash flow hedges was not material. As of March 31, 2016, PMI has hedged forecasted transactions for periods not exceeding the next twenty-one months with the exception of one foreign exchange contract that expires in May 2024. The impact of these hedges is primarily included in operating cash flows on PMI's condensed consolidated statement of cash flows.

Hedges of Net Investments in Foreign Operations

PMI designates certain foreign currency denominated debt and foreign exchange contracts as net investment hedges of its foreign operations. For the three months ended March 31, 2016 and 2015, these hedges of net investments resulted in gains (losses), net of income taxes, of \$(267) million and \$835 million, respectively. These gains/(losses) were reported as a component of accumulated other comprehensive losses within currency translation adjustments. For the three months ended March 31, 2016 and 2015, ineffectiveness related to net investment hedges was not material. Other investing cash flows on PMI's condensed consolidated statements of cash flows include the premiums paid for, and settlements of, net investment hedges.

Other Derivatives

PMI has entered into foreign exchange contracts to hedge the foreign currency exchange and interest rate risks related to intercompany loans between certain subsidiaries, and third-party loans. While effective as economic hedges, no hedge accounting is applied for these contracts; therefore, the unrealized gains (losses) relating to these contracts are reported in PMI's condensed consolidated statements of earnings. For the three months ended March 31, 2016 and 2015, the gains (losses) from contracts for which PMI did not apply hedge accounting were \$91 million and \$(751) million, respectively. The gains/(losses) from these contracts substantially offset the losses and gains generated by the underlying intercompany and third-party loans being hedged.

For the three months ended March 31, 2016 and 2015, the net impact of these contracts on the condensed consolidated statements of earnings was not material.

Qualifying Hedging Activities Reported in Accumulated Other Comprehensive Losses

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

(in millions)	For the Three Months Ended March 31, 2016 2015	
Gain as of January 1,	\$59	\$123
Derivative gains transferred to earnings	(7 )	(27 )
Change in fair value	(62 )	25
Gain/(loss) as of March 31,	\$(10)	\$121

At March 31, 2016, PMI expects \$8 million of derivative losses that are included in accumulated other comprehensive losses to be reclassified to the condensed consolidated statement of earnings within the next twelve months. These losses 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



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its exposure to credit risk through the use of credit approvals and credit limits, and by selecting and continuously monitoring a diverse group of major international banks and financial institutions as counterparties.

## Fair Value

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

## Note 7. Earnings Per Share:

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

(in millions)	For the Three Months Ended March 31,	
	2016	2015
Net earnings attributable to PMI	\$1,530	\$1,795
Less distributed and undistributed earnings attributable to share-based payment awards	5	7
Net earnings for basic and diluted EPS	\$1,525	\$1,788
Weighted-average shares for basic and diluted EPS	1,550	1,548

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 2016 and 2015 computations, there were no antidilutive stock awards.

## Note 8. Segment Reporting:

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

PMI’s management evaluates segment performance and allocates resources based on operating companies income, which PMI defines as operating income, excluding general corporate expenses and amortization of intangibles, plus equity (income)/loss in unconsolidated subsidiaries, net. Interest expense, net, and provision for income taxes are centrally managed and, accordingly, such items are not presented by segment since they are excluded from the measure of segment profitability reviewed by management.

In the fourth quarter of 2015, to further align with the Member State composition of the European Union, PMI transferred the management of its operations in Bulgaria, Croatia, Romania and Slovenia from its Eastern Europe, Middle East & Africa segment to its European Union segment, resulting in the reclassification of prior year amounts between the two segments.

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Segment data were as follows:

(in millions)	For the Three Months Ended March 31,	
	2016	2015
Net revenues:		
European Union	\$6,143	\$6,222
Eastern Europe, Middle East & Africa	3,997	4,147
Asia	4,689	4,764
Latin America & Canada	1,959	2,219
Net revenues	\$16,788	\$17,352
Earnings before income taxes:		
Operating companies income:		
European Union	\$906	\$927
Eastern Europe, Middle East & Africa	633	866
Asia	778	934
Latin America & Canada	229	230
Amortization of intangibles	(18 )	(22 )
General corporate expenses	(46 )	(41 )
Less:		
Equity (income)/loss in unconsolidated subsidiaries, net	(9 )	(23 )
Operating income	2,473	2,871
Interest expense, net	(247 )	(275 )
Earnings before income taxes	\$2,226	\$2,596

## Note 9. Contingencies:

## Tobacco-Related Litigation

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

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

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

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

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

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

The table below lists the number of tobacco-related cases pending against us and/or our subsidiaries or indemnitees as of April 22, 2016, April 30, 2015 and May 1, 2014:

Type of Case	Number of Cases Pending as of April 22, 2016	Number of Cases Pending as of April 30, 2015	Number of Cases Pending as of May 1, 2014
Individual Smoking and Health Cases	66	61	65
Smoking and Health Class Actions	11	11	11
Health Care Cost Recovery Actions	16	16	15
Lights Class Actions	—	—	1
Individual Lights Cases	3	2	2
Public Civil Actions	3	2	2

Since 1995, when the first tobacco-related litigation was filed against a PMI entity, 444 Smoking and Health, Lights, Health Care Cost Recovery, and Public Civil Actions in which we and/or one of our subsidiaries and/or indemnitees were a defendant have been terminated in our favor. Twelve cases have had decisions in favor of plaintiffs. Nine of these cases have subsequently reached final resolution in our favor and three remain on appeal.

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

Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
February 2004	Brazil/The Smoker Health Defense Association	Class Action	The Civil Court of São Paulo found defendants liable without hearing evidence. In April 2004, the court awarded “moral damages” of R\$1,000 (approximately \$280) per smoker per full year of smoking plus interest at the rate of 1% per month, as of the date of the ruling. The court did not assess actual damages, which were to be assessed in a second phase of the case. The size of the class was not defined in the ruling.	Defendants appealed to the São Paulo Court of Appeals, which annulled the ruling in November 2008, finding that the trial court had inappropriately ruled without hearing evidence and returned the case to the trial court for further proceedings. In May 2011, the trial court dismissed the claim. Plaintiff appealed the decision. In February 2015, the appellate court unanimously dismissed plaintiff's appeal. In September 2015, plaintiff appealed to the Superior Court of Justice. In addition, the defendants filed a constitutional appeal to the Federal Supreme Tribunal on the basis that plaintiff did not have standing to bring the lawsuit. This appeal is still pending.
May 27, 2015	Canada/Cecilia Létourneau	Class Action	On May 27, 2015, the Superior Court of the District of Montreal, Province of Quebec ruled in favor of the Létourneau class on liability and awarded a total of CAD 131 million (approximately \$103 million) in punitive damages, allocating CAD 46 million (approximately \$36.3 million) to our subsidiary. The trial court ordered defendants to	In June 2015, our subsidiary commenced the appellate process with the Court of Appeal of Quebec. Our subsidiary also filed a motion to cancel the trial court's order for payment into a trust notwithstanding appeal. In July 2015, the Court of Appeal granted the motion to cancel and overturned the trial court's ruling that our subsidiary make the payment into a trust. In August 2015, plaintiffs filed a motion for security with the Court of Appeal covering both the Létourneau case and the Blais case described

pay the full punitive damage award into a trust within 60 days. The court did not order the payment of compensatory damages.

below. In October 2015, the Court of Appeal granted the motion and ordered our subsidiary to furnish security totaling CAD 226 million (approximately \$178 million) to cover both the Létourneau and Blais cases. A hearing for the merits appeal is scheduled in November 2016. (See below for further detail.)

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Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
May 27, 2015	Canada/Conseil Québécois Sur Le Tabac Et La Santé and Jean-Yves Blais	Class Action	On May 27, 2015, the Superior Court of the District of Montreal, Province of Quebec ruled in favor of the Blais class on liability and found the class members' compensatory damages totaled approximately CAD 15.5 billion (approximately \$12.2 billion), including pre-judgment interest. The trial court awarded compensatory damages on a joint and several liability basis, allocating 20% to our subsidiary (approximately CAD 3.1 billion including pre-judgment interest (approximately \$2.4 billion)). The trial court awarded CAD 90,000 (approximately \$71,000) in punitive damages, allocating CAD 30,000 (approximately \$23,700) to our subsidiary. The trial court ordered defendants to pay CAD 1 billion (approximately \$789 million) of the compensatory damage award, CAD 200 million (approximately \$158 million) of which is our subsidiary's portion, into a trust within 60 days.	In June 2015, our subsidiary commenced the appellate process with the Court of Appeal of Quebec. Our subsidiary also filed a motion to cancel the trial court's order for payment into a trust notwithstanding appeal. In July 2015, the Court of Appeal granted the motion to cancel and overturned the trial court's ruling that our subsidiary make the payment into a trust. In August 2015, plaintiffs filed a motion for security with the Court of Appeal. In October 2015, the Court of Appeal granted the motion and ordered our subsidiary to furnish security totaling, together with the Létourneau case, CAD 226 million (approximately \$178 million). A hearing for the merits appeal is scheduled in November 2016. (See below for further detail.)

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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 April 22, 2016, there were a number of smoking and health cases pending against us, our subsidiaries or indemnitees, as follows:

66 cases brought by individual plaintiffs in Argentina (31), Brazil (20), Canada (2), Chile (8), Costa Rica (2), Italy (1), the Philippines (1) and Scotland (1), compared with 61 such cases on April 30, 2015, and 65 cases on May 1, 2014; and

11 cases brought on behalf of classes of individual plaintiffs in Brazil (2) and Canada (9), compared with 11 such cases on April 30, 2015 and 11 such cases on May 1, 2014.

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 all addicted smokers and former smokers, and injunctive relief. In 2004, the trial court found defendants liable without hearing evidence and awarded "moral damages" of R\$1,000 (approximately \$280) per smoker per full year of smoking plus interest at the rate of 1% per month, as of the date of the ruling. The court did not award actual damages, which were to be assessed in the second phase of the case. The size of the class was not estimated. Defendants appealed to the São Paulo Court of Appeals, which annulled the ruling in November 2008, finding that the trial court had inappropriately ruled without hearing evidence and returned the case to the trial court for further proceedings. In May 2011, the trial court dismissed the claim. Plaintiff appealed the decision. In February 2015, the appellate court unanimously dismissed plaintiff's appeal. In September 2015, plaintiff appealed to the Superior Court of Justice. In addition, the defendants filed a constitutional appeal to the Federal Supreme Tribunal on the basis that plaintiff did not have standing to bring the lawsuit. This appeal is still pending.

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



arguments in December 2010. In March 2012, the trial court dismissed the case on the merits. In January 2014, the São Paulo Court of Appeals rejected plaintiff's appeal and affirmed the trial court decision. In July 2014, plaintiff appealed to the Superior Court of Justice.

In the first class action pending in Canada, *Cecilia Létourneau v. Imperial Tobacco Ltd., Rothmans, Benson & Hedges Inc. and JTI Macdonald Corp.*, Quebec Superior Court, Canada, filed in September 1998, our subsidiary and other Canadian manufacturers (Imperial Tobacco Canada Ltd. and JTI-MacDonald Corp.) are defendants. The plaintiff, an individual smoker, sought compensatory and punitive damages for each member of the class who is deemed addicted to smoking. The class was certified in 2005. Trial began in March 2012 and concluded in December 2014. The trial court issued its judgment on May 27, 2015. The trial court found our subsidiary and two other Canadian manufacturers liable and awarded a total of CAD 131 million (approximately \$103 million) in punitive damages, allocating CAD 46 million (approximately \$36 million) to our subsidiary. The trial court found that defendants violated the Civil Code of Quebec, the Quebec Charter of Human Rights and Freedoms, and the Quebec Consumer Protection Act by failing to warn adequately of the dangers of smoking. The trial court also found that defendants conspired to

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prevent consumers from learning the dangers of smoking. The trial court further held that these civil faults were a cause of the class members' addiction. The trial court rejected other grounds of fault advanced by the class, holding that: (i) the evidence was insufficient to show that defendants marketed to youth, (ii) defendants' advertising did not convey false information about the characteristics of cigarettes, and (iii) defendants did not commit a fault by using the descriptors light or mild for cigarettes with a lower tar delivery. The trial court estimated the size of the addiction class at 918,000 members but declined to award compensatory damages to the addiction class because the evidence did not establish the claims with sufficient accuracy. The trial court ordered defendants to pay the full punitive damage award into a trust within 60 days and found that a claims process to allocate the awarded damages to individual class members would be too expensive and difficult to administer. The trial court ordered a briefing on the proposed process for the distribution of sums remaining from the punitive damage award after payment of attorneys' fees and legal costs. In June 2015, our subsidiary commenced the appellate process by filing its inscription of appeal of the trial court's judgment with the Court of Appeal of Quebec. Our subsidiary also filed a motion to cancel the trial court's order for payment into a trust within 60 days notwithstanding appeal. In July 2015, the Court of Appeal granted the motion to cancel and overturned the trial court's ruling that our subsidiary make the payment into a trust within 60 days. In August 2015, plaintiffs filed a motion with the Court of Appeal seeking security in both the Létourneau case and the Blais case described below. In October 2015, the Court of Appeal granted the motion and ordered our subsidiary to furnish security totaling CAD 226 million (approximately \$178 million), in the form of cash into a court trust or letters of credit, in six equal consecutive quarterly installments of approximately CAD 37.6 million (approximately \$29.7 million) beginning in December 2015 through March 2017. See the Blais description for further detail concerning the security order. The Court of Appeal has scheduled a hearing for the merits appeal in November 2016. Our subsidiary and PMI believe that the findings of liability and damages were incorrect and should ultimately be set aside on any one of many grounds, including the following: (i) holding that defendants violated Quebec law by failing to warn class members of the risks of smoking even after the court found that class members knew, or should have known, of the risks, (ii) finding that plaintiffs were not required to prove that defendants' alleged misconduct caused injury to each class member in direct contravention of binding precedent, (iii) creating a factual presumption, without any evidence from class members or otherwise, that defendants' alleged misconduct caused all smoking by all class members, (iv) holding that the addiction class members' claims for punitive damages were not time-barred even though the case was filed more than three years after a prominent addiction warning appeared on all packages, and (v) awarding punitive damages to punish defendants without proper consideration as to whether punitive damages were necessary to deter future misconduct.

In the second class action pending in Canada, Conseil Québécois Sur Le Tabac Et La Santé and Jean-Yves Blais v. Imperial Tobacco Ltd., Rothmans, Benson & Hedges Inc. and JTI Macdonald Corp., Quebec Superior Court, Canada, filed in November 1998, our subsidiary and other Canadian manufacturers (Imperial Tobacco Canada Ltd. and JTI-MacDonald Corp.) are defendants. The plaintiffs, an anti-smoking organization and an individual smoker, sought compensatory and punitive damages for each member of the class who allegedly suffers from certain smoking-related diseases. The class was certified in 2005. Trial began in March 2012 and concluded in December 2014. The trial court issued its judgment on May 27, 2015. The trial court found our subsidiary and two other Canadian manufacturers liable and found that the class members' compensatory damages totaled approximately CAD 15.5 billion, including pre-judgment interest (approximately \$12.2 billion). The trial court awarded compensatory damages on a joint and several liability basis, allocating 20% to our subsidiary (approximately CAD 3.1 billion, including pre-judgment interest (approximately \$2.4 billion)). In addition, the trial court awarded CAD 90,000 (approximately \$71,000) in punitive damages, allocating CAD 30,000 (approximately \$23,700) to our subsidiary and found that defendants violated the Civil Code of Quebec, the Quebec Charter of Human Rights and Freedoms, and the Quebec Consumer Protection Act by failing to warn adequately of the dangers of smoking. The trial court also found that defendants conspired to prevent consumers from learning the dangers of smoking. The trial court further held that these civil

faults were a cause of the class members' diseases. The trial court rejected other grounds of fault advanced by the class, holding that: (i) the evidence was insufficient to show that defendants marketed to youth, (ii) defendants' advertising did not convey false information about the characteristics of cigarettes, and (iii) defendants did not commit a fault by using the descriptors light or mild for cigarettes with a lower tar delivery. The trial court estimated the disease class at 99,957 members. The trial court ordered defendants to pay CAD 1 billion (approximately \$789 million) of the compensatory damage award into a trust within 60 days, CAD 200 million (approximately \$158 million) of which is our subsidiary's portion and ordered briefing on a proposed claims process for the distribution of damages to individual class members and for payment of attorneys' fees and legal costs. In June 2015, our subsidiary commenced the appellate process by filing its inscription of appeal of the trial court's judgment with the Court of Appeal of Quebec. Our subsidiary also filed a motion to cancel the trial court's order for payment into a trust within 60 days notwithstanding appeal. In July 2015, the Court of Appeal granted the motion to cancel and overturned the trial court's ruling that our subsidiary make an initial payment within 60 days. In August 2015, plaintiffs filed a motion with the Court of Appeal seeking an order that defendants place irrevocable letters of credit totaling CAD 5 billion (approximately \$3.9 billion) into trust, to secure the judgments in both the Létourneau and Blais cases. Plaintiffs subsequently withdrew their motion for security against JTI-MacDonald Corp. and proceeded only against our subsidiary and Imperial Tobacco Canada Ltd. In October 2015, the Court of Appeal granted the motion and ordered our subsidiary to furnish security totaling CAD

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226 million (approximately \$178 million) to cover both the Létourneau and Blais cases. Such security may take the form of cash into a court trust or letters of credit, in six equal consecutive quarterly installments of approximately CAD 37.6 million (approximately \$29.7 million) beginning in December 2015 through March 2017. The Court of Appeal ordered Imperial Tobacco Canada Ltd. to furnish security totaling CAD 758 million (approximately \$598 million) in seven equal consecutive quarterly installments of approximately CAD 108 million (approximately \$85 million) beginning in December 2015 through June 2017. In March 2016, our subsidiary made its second quarterly installment of security for approximately CAD 37.6 million (approximately \$29.7 million) into a court trust. This payment is included in other assets on the condensed consolidated balance sheets and in cash used in operating activities in the condensed consolidated statements of cash flows. The Court of Appeal ordered that the security is payable upon a final judgment of the Court of Appeal affirming the trial court's judgment or upon further order of the Court of Appeal. The Court of Appeal has scheduled a hearing for the merits appeal in November 2016. Our subsidiary and PMI believe that the findings of liability and damages were incorrect and should ultimately be set aside on any one of many grounds, including the following: (i) holding that defendants violated Quebec law by failing to warn class members of the risks of smoking even after the court found that class members knew, or should have known, of the risks, (ii) finding that plaintiffs were not required to prove that defendants' alleged misconduct caused injury to each class member in direct contravention of binding precedent, (iii) creating a factual presumption, without any evidence from class members or otherwise, that defendants' alleged misconduct caused all smoking by all class members, (iv) relying on epidemiological evidence that did not meet recognized scientific standards, and (v) awarding punitive damages to punish defendants without proper consideration as to whether punitive damages were necessary to deter future misconduct.

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

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

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

In the sixth class action pending in Canada, *Dorion v. Canadian Tobacco Manufacturers' Council, et al.*, The Queen's Bench, Alberta, Canada, filed June 15, 2009, we, our subsidiaries, and our indemnitees (PM USA and Altria), and

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

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

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their estates, dependents and family members, plus disgorgement of revenues earned by the defendants from January 1, 1954, to the date the claim was filed.

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

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

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

As of April 22, 2016, there were 16 health care cost recovery cases pending against us, our subsidiaries or indemnitees in Canada (10), Korea (1) and Nigeria (5), compared with 16 such cases on April 30, 2015 and 15 such cases on May 1, 2014.

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

In the second health care cost recovery case filed in Canada, *Her Majesty the Queen in Right of New Brunswick v. Rothmans Inc., et al.*, Court of Queen's Bench of New Brunswick, Trial Court, New Brunswick, Fredericton, Canada, filed March 13, 2008, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of New Brunswick based on legislation enacted in the province. This legislation is similar to the law introduced in British Columbia that authorizes the

government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a “tobacco related wrong.” Pre-trial discovery is ongoing.

In the third health care cost recovery case filed in Canada, Her Majesty the Queen in Right of Ontario v. Rothmans Inc., et al., Ontario Superior Court of Justice, Toronto, Canada, filed September 29, 2009, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Ontario based on legislation enacted in the province. This legislation is similar to the laws introduced in British Columbia and New Brunswick that authorize the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a “tobacco related wrong.” Defendants are scheduled to file their defenses in April 2016.

In the fourth health care cost recovery case filed in Canada, Attorney General of Newfoundland and Labrador v. Rothmans Inc., et al., Supreme Court of Newfoundland and Labrador, St. Johns, Canada, filed February 8, 2011, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Newfoundland and Labrador based on legislation enacted in the province that is similar to the laws introduced in

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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.” Defendants are scheduled to file their defenses in May 2016.

In the fifth health care cost recovery case filed in Canada, Attorney General of Quebec v. Imperial Tobacco Limited, et al., Superior Court of Quebec, Canada, filed June 8, 2012, we, our subsidiary, our indemnitee (PM USA), and other members of the industry are defendants. The claim was filed by the government of the province of Quebec based on legislation enacted in the province that is similar to the laws enacted in several other Canadian provinces. The legislation authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a “tobacco related wrong.” Defendants filed their defenses in December 2014 and July 2015. Pre-trial discovery is ongoing.

In the sixth health care cost recovery case filed in Canada, Her Majesty in Right of Alberta v. Altria Group, Inc., et al., Supreme Court of Queen's Bench Alberta, Canada, filed June 8, 2012, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Alberta based on legislation enacted in the province that is similar to the laws enacted in several other Canadian provinces. The legislation authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a “tobacco related wrong.” Defendants filed their defenses in March 2016.

In the seventh health care cost recovery case filed in Canada, Her Majesty the Queen in Right of the Province of Manitoba v. Rothmans, Benson & Hedges, Inc., et al., The Queen's Bench, Winnipeg Judicial Centre, Canada, filed May 31, 2012, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Manitoba based on legislation enacted in the province that is similar to the laws enacted in several other Canadian provinces. The legislation authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a “tobacco related wrong.” Defendants filed their defenses in September 2014. Discovery is scheduled to begin in 2017.

In the eighth health care cost recovery case filed in Canada, The Government of Saskatchewan v. Rothmans, Benson & Hedges Inc., et al., Queen's Bench, Judicial Centre of Saskatchewan, Canada, filed June 8, 2012, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Saskatchewan based on legislation enacted in the province that is similar to the laws enacted in several other Canadian provinces. The legislation authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a “tobacco related wrong.” Defendants filed their defenses in February 2015. Discovery is scheduled to begin in 2017.

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

In the tenth health care cost recovery case filed in Canada, Her Majesty the Queen in Right of the Province of Nova Scotia v. Rothmans, Benson & Hedges Inc., et al., Supreme Court of Nova Scotia, Canada, filed January 2, 2015, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Nova Scotia based on legislation enacted in the province that is similar to the laws enacted in several other Canadian provinces. The legislation authorizes the government to file a direct



action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a “tobacco related wrong.” Defendants filed their defenses in July 2015. Discovery is scheduled to begin in 2017. In the first health care cost recovery case in Nigeria, The Attorney General of Lagos State v. British American Tobacco (Nigeria) Limited, et al., High Court of Lagos State, Lagos, Nigeria, filed March 13, 2008, we and other members of the industry are defendants. Plaintiff seeks reimbursement for the cost of treating alleged smoking-related diseases for the past 20 years, payment of anticipated costs of treating alleged smoking-related diseases for the next 20 years, various forms of injunctive relief, plus punitive damages. We are in the process of making challenges to service and the court's jurisdiction. Currently, the case is stayed in the trial court pending the appeals of certain co-defendants relating to service objections.

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

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

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

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

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

**Lights Cases:** These cases, brought by 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 April 22, 2016, there were 3 lights cases brought by individual plaintiffs pending against our subsidiaries or indemnitees in Chile (2) and Italy (1), compared with 2 such cases on April 30, 2015, and 2 such cases on May 1, 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 April 22, 2016, there were 3 public civil actions pending against our subsidiaries in Argentina (1), Romania (1) and Venezuela (1), compared with 2 such cases on April 30, 2015, and 2 such cases on May 1, 2014.

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

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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 a newly filed action in Romania, Foundation for the Defense of Citizens against Abuses of the State (FACIAS) v. the State of Romania, Philip Morris România (PMR) and Philip Morris Trading SLR (PMTR), et al., Administrative and Fiscal Litigation Section of the Bucharest Tribunal, filed November 20, 2015, our subsidiaries, several other members of the industry, and the State of Romania through various of its institutions are defendants. The plaintiff, a non-governmental organization, asks the court to compel the government to enact legislation as directed by the 2014 EU Tobacco Product Directive and to establish a fund for the treatment of smoking-related diseases and promotion of tobacco control efforts. The plaintiff also seeks an order directing that 1% of the excise taxes collected from tobacco manufacturers, "as well as an amount representing 1% of the turnover" of tobacco manufacturers and distributors, be used to finance the fund. It is unclear whether the "1% of turnover" is sought from the tobacco company defendants or the government. Our subsidiaries answered the complaint in December 2015. In January 2016, the Tribunal ruled that it lacked jurisdiction. The case was transferred to the Bucharest Court of Appeals, which has jurisdiction to hear administrative cases involving the central government. In March 2016, the Bucharest Court of Appeal announced its dismissal of plaintiff's claims as inadmissible. A written ruling is expected in the second quarter 2016. The plaintiff may appeal.

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

The Department of Special Investigations of the government of Thailand has been conducting an investigation into alleged underpayment by our subsidiary, Philip Morris (Thailand) Limited ("PM Thailand"), of customs duties and excise taxes relating to imports from the Philippines covering the period 2003-2007. On January 18, 2016, the Public Prosecutor filed charges against our subsidiary and seven former and current employees in the Bangkok Criminal Court alleging that PM Thailand and the individual defendants jointly and with the intention to defraud the Thai government, under declared import prices of cigarettes to avoid full payment of taxes and duties in connection with 272 import entries of cigarettes from the Philippines during the period of July 2003 to June 2006. The government is seeking a fine of approximately THB 80.8 billion (approximately \$2.30 billion). The first hearing, held in April 2016, focused on preliminary procedural matters. The case is now in the pre-trial evidentiary phase. PM Thailand contends that its declared import prices are in compliance with the Customs Valuation Agreement of the World Trade Organization and Thai law and that the allegations of the Public Prosecutor are inconsistent with several decisions already taken by Thai Customs and other Thai governmental agencies.

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

Note 10. Income Taxes:

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

PMI's effective tax rates for the three months ended March 31, 2016 and 2015 were 28.3% and 30.2%, respectively. PMI estimates that its full-year 2016 effective tax rate will be approximately 28%. The effective tax rate for the three months ended March 31, 2015, was unfavorably impacted by changes to repatriation assertions on certain foreign subsidiary historical earnings (\$58 million).

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Excluding the effect of the 2015 repatriation assertion changes, the change in the effective tax rate for the three months ended March 31, 2016, as compared to the three months ended March 31, 2015, was primarily due to earnings mix by taxing jurisdiction and repatriation cost differences.

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

PMI is regularly examined by tax authorities around the world and is currently under examination in a number of jurisdictions. The U.S. federal statute of limitations remains open for the years 2012 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 11. Indebtedness:

## Short-term Borrowings:

At March 31, 2016 and December 31, 2015, PMI's short-term borrowings, consisting of bank loans to certain PMI subsidiaries, had a carrying value of \$673 million and \$825 million, respectively. The fair value of PMI's short-term borrowings, based on current market interest rates, approximates carrying value.

## Long-term Debt:

At March 31, 2016 and December 31, 2015, PMI's long-term debt consisted of the following:

(in millions)	March 31, December 31,	
	2016	2015
U.S. dollar notes, 1.125% to 6.375% (average interest rate 3.612%), due through 2044	\$ 20,079	\$ 18,091
Foreign currency obligations:		
Euro notes, 1.750% to 3.125% (average interest rate 2.433%), due through 2033	6,844	7,423
Swiss franc notes, 0.750% to 2.000% (average interest rate 1.217%), due through 2024	1,737	1,690
Other (average interest rate 3.126%), due through 2024	460	451
	29,120	27,655
Less current portion of long-term debt	2,437	2,405
	\$ 26,683	\$ 25,250

Other foreign currency debt above includes mortgage debt in Switzerland, capital lease obligations and a bank loan in the Philippines.

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PMI's debt issuances in the first three months of 2016 were as follows:  
 (in millions)

Type	Face Value	Interest Rate	Issuance	Maturity
U.S. dollar notes <sup>(a)</sup>	\$500	1.375%	February 2016	February 2019
U.S. dollar notes <sup>(a)</sup>	\$750	1.875%	February 2016	February 2021
U.S. dollar notes <sup>(a)</sup>	\$750	2.750%	February 2016	February 2026

<sup>(a)</sup> Interest on these notes is payable semi-annually in arrears beginning in August 2016.

The net proceeds from the sale of the securities listed in the table above will be used for general corporate purposes.  
 Credit Facilities:

On January 27, 2016, PMI entered into an agreement to amend and extend its existing \$2.0 billion 364-day revolving credit facility from February 9, 2016 to February 7, 2017. On January 27, 2016, PMI also entered into an agreement to extend the term of its existing \$2.5 billion multi-year revolving credit facility from February 28, 2020 to February 28, 2021.

At March 31, 2016, PMI's total committed credit facilities were as follows:

(in billions)

Type	Committed Credit Facilities
364-day revolving credit, expiring February 7, 2017	\$ 2.0
Multi-year revolving credit, expiring February 28, 2021	2.5
Multi-year revolving credit, expiring October 1, 2020	3.5
Total facilities	\$ 8.0

At March 31, 2016, there were no borrowings under these committed credit facilities, and the entire committed amounts were available for borrowing.

#### Note 12. Fair Value Measurements:

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

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

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

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





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

**Derivative Financial Instruments**

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

**Debt**

The fair value of PMI's outstanding debt, which is utilized solely for disclosure purposes, is determined using quotes and market interest rates currently available to PMI for issuances of debt with similar terms and remaining maturities. The aggregate carrying value of PMI's debt, excluding short-term borrowings and \$14 million of capital lease obligations, was \$29,106 million at March 31, 2016. 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.

The aggregate fair values of PMI's derivative financial instruments and debt as of March 31, 2016, were as follows:

(in millions)	Fair Value at March 31, 2016	Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>				
Foreign exchange contracts	\$511	\$ —	\$ 511	\$ —
Total assets	\$511	\$ —	\$ 511	\$ —
<b>Liabilities:</b>				
Debt	\$31,912	\$ 31,432	\$ 480	\$ —
Foreign exchange contracts	299	—	299	—
Total liabilities	\$32,211	\$ 31,432	\$ 779	\$ —

**Note 13. Accumulated Other Comprehensive Losses:**

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

(in millions)	At March 31, 2016	At December 31, 2015	At March 31, 2015
Currency translation adjustments	\$(5,617)	\$(6,129)	\$(5,247)
Pension and other benefits	(3,287)	(3,332)	(2,964)
Derivatives accounted for as hedges	(10)	59	121
Total accumulated other comprehensive losses	\$(8,914)	\$(9,402)	\$(8,090)

## Reclassifications from Other Comprehensive Earnings

The movements in accumulated other comprehensive losses and the related tax impact, for each of the components above, that are due to current period activity and reclassifications to the income statement are shown on the condensed consolidated statements of comprehensive earnings for the three months ended March 31, 2016 and 2015. For additional information, see Note 4. Benefit Plans and Note 6. Financial Instruments for disclosures related to PMI's pension and other benefits, and derivative financial instruments, respectively.

## Note 14. Balance Sheet Offsetting:

## Derivative Financial Instruments

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

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

(in millions)	Gross Amounts Recognized	Gross Amount Offset in the Condensed Consolidated Balance Sheet	Net Amounts Presented in the Condensed Consolidated Balance Sheet	Gross Amounts Not			Net Amount
				Offset in the Condensed Consolidated Balance Sheet	Financial Instrument Rate	Cash Received	
At March 31, 2016							
Assets							
Foreign exchange contracts	\$ 511	\$	—\$ 511	\$(209)	\$ (273	)	\$ 29
Liabilities							
Foreign exchange contracts	\$ 299	\$	—\$ 299	\$(209)	\$ (63	)	\$ 27
At December 31, 2015							
Assets							
Foreign exchange contracts	\$ 574	\$	—\$ 574	\$(131)	\$ (432	)	\$ 11
Liabilities							
Foreign exchange contracts	\$ 172	\$	—\$ 172	\$(131)	\$ (30	)	\$ 11

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## Note 15. Investments in Unconsolidated Subsidiaries:

At March 31, 2016 and December 31, 2015, PMI had total investments in unconsolidated subsidiaries of \$942 million and \$890 million, respectively, which were accounted for under the equity method of accounting. Equity method investments are initially recorded at cost. Under the equity method of accounting, the investment is adjusted for PMI's proportionate share of earnings or losses and movements in currency translation adjustments. The carrying value of our equity method investments at March 31, 2016 and December 31, 2015 exceeded our share of the unconsolidated subsidiaries' book value by \$824 million and \$806 million, respectively. The difference between the investment carrying value and the amount of underlying equity in net assets, excluding \$765 million and \$744 million attributable to goodwill as of March 31, 2016 and December 31, 2015, respectively, is being amortized on a straight-line basis over the underlying assets' estimated useful lives of 3 to 20 years. At March 31, 2016, PMI received no dividends from unconsolidated subsidiaries. At December 31, 2015, PMI received year-to-date dividends from unconsolidated subsidiaries of \$127 million.

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

PMI acquired in 2013 from Megapolis Investment BV a 20% equity interest in Megapolis Distribution BV, the holding company of CJSC TK Megapolis ("Megapolis"), PMI's distributor in Russia, for a purchase price of \$760 million. An additional payment of up to \$100 million, which is contingent on Megapolis's operational performance over the four fiscal years following the closing of the transaction, will also be made by PMI if the performance criteria are satisfied. PMI has also agreed to provide Megapolis Investment BV with a \$100 million interest-bearing loan. PMI and Megapolis Investment BV have agreed to set off any future contingent payments owed by PMI against the future repayments due under the loan agreement. Any loan repayments in excess of the contingent consideration earned by the performance of Megapolis are due to be repaid, in cash, to PMI on March 31, 2017. At December 31, 2013, PMI had recorded a \$100 million asset related to the loan receivable and a discounted liability of \$86 million related to the contingent consideration. The initial investment in Megapolis was recorded at cost and is included in investments in unconsolidated subsidiaries on the condensed consolidated balance sheets.

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

	For the	
	Three	
	Months	
	Ended	
	March 31,	
(in millions)	2016	2015
Net revenues	\$ 777	\$ 896

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

	At	At
(in millions)	March	December
	31,	31, 2015
	2016	
Receivables	\$ 319	\$ 64

Notes receivable \$ 102 \$ 100  
Other liabilities \$ 100 \$ 100

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

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Philip Morris International Inc. and Subsidiaries  
Notes to Condensed Consolidated Financial Statements  
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Note 16. Acquisitions and Other Business Arrangements:

As announced in June 2015, PMI's subsidiary PT HM Sampoerna Tbk. ("Sampoerna"), of which PMI held a 98.18% interest, was required to comply with the January 30, 2014, Indonesian Stock Exchange ("IDX") regulation requiring all listed public companies to have at least a 7.5% public shareholding by January 30, 2016. In order to comply with this requirement, Sampoerna conducted a rights issue (the "Rights Issue"). The exercise price for the rights was set at Rp. 77,000 per share, a 1.349% premium to the closing price on the IDX as of September 30, 2015. In connection with the Rights Issue, PT Philip Morris Indonesia ("PMID"), a fully consolidated subsidiary of PMI, sold 264,209,711 of the rights to third-party investors. Delivery of the rights sold took place on October 26, 2015. The total net proceeds from the Rights Issue were \$1.5 billion at prevailing exchange rates on the closing date. The sale of the rights resulted in an increase to PMI's additional paid-in capital of \$1.1 billion during the fourth quarter of 2015.

In June 2014, PMI acquired 100% of Nicocigs Limited, a leading U.K.-based e-vapor company, for the final purchase price of \$103 million, net of cash acquired, with additional contingent payments of up to \$77 million, primarily relating to performance targets over a three-year period. As of March 31, 2016, PMI does not anticipate that the performance targets will be met.

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

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

Note 17. Sale of Accounts Receivable:

To mitigate risk and enhance cash and liquidity management PMI sells trade receivables to unaffiliated financial institutions. These arrangements allow PMI to sell, on an ongoing basis, certain trade receivables without recourse. The trade receivables sold are generally short-term in nature and are removed from the condensed consolidated balance sheets. PMI sells trade receivables under two types of arrangements, servicing and non-servicing. For servicing arrangements, PMI continues to service the sold trade receivables on an administrative basis and does not act on behalf of the unaffiliated financial institutions. When applicable, a servicing liability is recorded for the estimated fair value of the servicing. The amounts associated with the servicing liability were not material as of March 31, 2016 and March 31, 2015. Under the non-servicing arrangements, PMI does not provide any administrative support or servicing after the trade receivables have been sold to the unaffiliated financial institutions.

Cumulative trade receivables sold for the three months ended March 31, 2016 and March 31, 2015, were \$1.9 billion and \$0.3 billion, respectively. PMI's operating cash flows were positively impacted by the amount of the trade receivables sold and derecognized from the condensed consolidated balance sheets, which remained outstanding with

the unaffiliated financial institutions. The trade receivables sold that remained outstanding under these arrangements as of March 31, 2016 and March 31, 2015, were \$589 million, and \$108 million, respectively. The net proceeds received are included in cash provided by operating activities in the condensed consolidated statements of cash flows. The difference between the carrying amount of the trade receivables sold and the sum of the cash received is recorded as a loss on sale of trade receivables within marketing, administration and research costs in the consolidated statements of earnings. For the three months ended March 31, 2016 and 2015, the loss on sale of trade receivables was not material.

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Philip Morris International Inc. and Subsidiaries  
Notes to Condensed Consolidated Financial Statements  
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Note 18. New Accounting Standards:

On February 25, 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update ASU 2016-02, “Leases” (“ASU 2016-02”). ASU 2016-02 requires organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Additionally, ASU 2016-02 modifies current guidance for lessors' accounting. ASU 2016-02 is effective for interim and annual reporting periods beginning on or after January 1, 2019, with early adoption permitted. PMI is currently assessing the impact that the adoption of ASU 2016-02 will have on its financial position or results of operations.

On January 5, 2016, the FASB issued Accounting Standard Update ASU 2016-01, “Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities” (“ASU 2016-01”). ASU 2016-01 will require equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. Additionally, ASU 2016-01 also changes certain disclosure requirements and other aspects of current U.S. GAAP. ASU 2016-01 is effective for interim and annual reporting periods beginning on or after January 1, 2018. PMI is currently assessing the impact that the adoption of ASU 2016-01 will have on its financial position or results of operations.

On November 20, 2015, the FASB issued Accounting Standard Update ASU 2015-17, “Balance Sheet Classification of Deferred Taxes” (“ASU 2015-17”). ASU 2015-17 requires that all deferred tax assets and liabilities, along with any related valuation allowance, be classified as noncurrent on the balance sheet. ASU 2015-17 is effective for interim and annual reporting periods beginning on or after January 1, 2017 with early adoption permitted. Entities can apply the final standard either prospectively, for all deferred tax assets and liabilities, or retrospectively with disclosures providing qualitative information about the effects of the accounting change on prior periods. The adoption of ASU 2015-17 will not have a material impact on PMI's consolidated results of operations, financial position or cash flows.

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

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

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

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





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Item 2.

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

Description of Our Company

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

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

Our products are sold in more than 180 markets, and in many of these markets 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 are engaged in the development and commercialization of Reduced Risk Products ("RRPs"). RRPs is the term we use to refer to products with the potential to reduce individual risk and population harm in comparison to smoking cigarettes.

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.

Certain prior years' amounts have been reclassified to conform with the current year's presentation. In the fourth quarter of 2015, to further align with the Member State composition of the European Union, PMI transferred the management of its operations in Bulgaria, Croatia, Romania and Slovenia from its EEMA segment to its European Union segment, resulting in the reclassification of prior year amounts between the two segments. The changes did not have an impact on our consolidated financial position, results of operations or cash flows in any of the periods presented.



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## Executive Summary

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

Consolidated Operating Results for the Three Months Ended March 31, 2016 – The changes in our reported diluted earnings per share ("diluted EPS") for the three months ended March 31, 2016, from the comparable 2015 amounts, were as follows:

	Diluted EPS	% Growth
For the three months ended March 31, 2015	\$ 1.16	
2015 Asset impairment and exit costs	—	
2015 Tax items	—	
Subtotal of 2015 items	—	
2016 Asset impairment and exit costs	—	
2016 Tax items	—	
Subtotal of 2016 items	—	
Currency	(0.19	)
Interest	0.01	
Change in tax rate	0.03	
Impact of shares outstanding and share-based payments	(0.01	)
Operations	(0.02	)
For the three months ended March 31, 2016	\$ 0.98	(15.5 )%

Currency – The unfavorable currency impact during the reporting period results from the strengthening of the U.S. dollar, especially against the Argentine peso, Australian dollar, Canadian dollar, Egyptian pound, Euro, Indonesian rupiah, Japanese yen, Kazakh tenge, Mexican peso, Russian ruble and Turkish lira. This unfavorable currency movement has impacted our profitability across our primary revenue markets and local currency cost bases.

Income Taxes – Our effective income tax rate for the three months ended March 31, 2016 decreased by 1.9 percentage points to 28.3%. The change in the tax rate increased our diluted EPS by \$0.03 per share in 2016. The effective tax rate during the first quarter of 2015 was unfavorably impacted by changes to repatriation assertions on certain foreign subsidiary historical earnings (\$58 million). Excluding the effect of the 2015 repatriation assertion changes, the change in the effective tax rate for the three months ended March 31, 2016, as compared to the three months ended March 31, 2015, was primarily due to earnings mix by taxing jurisdiction and repatriation cost differences. We estimate that our full-year 2016 effective tax rate will be approximately 28%.

Operations – The decrease in diluted EPS of \$0.02 from our operations in the table above was due primarily to the following segments:

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

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

2016 Forecasted Results - On April 19, 2016, we increased our 2016 full-year reported diluted EPS forecast to be in a range of \$4.40 to \$4.50, at prevailing exchange rates at that time, versus \$4.42 in 2015. Excluding an unfavorable currency impact, at then-

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prevailing rates, of approximately \$0.45 per share for the full-year 2016, the reported diluted earnings per share range represents an increase of approximately 10% to 12% versus adjusted diluted earnings per share of \$4.42 in 2015. This forecast does not include any share repurchases in 2016. We estimate 2016 international cigarette volume, excluding the People's Republic of China and the U.S., to decline by approximately 2.0% to 2.5%, in line with the estimated decline of 2.4% in 2015.

We calculated 2015 adjusted diluted EPS as reported diluted EPS of \$4.42, plus the \$0.03 per share charge related to asset impairment and exit costs, less the \$0.03 per share benefit related to discrete tax items.

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

This 2016 guidance excludes the impact of any future acquisitions, unanticipated asset impairment and exit cost charges, future changes in currency exchange rates and any unusual events. The factors described in the "Cautionary Factors That May Affect Future Results" section of the following "Discussion and Analysis" represent continuing risks to this forecast.

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## Discussion and Analysis

## Consolidated Operating Results

See pages 64-68 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:

(in millions)	For the Three Months Ended March 31,	
	2016	2015
Cigarette volume:		
European Union	45,993	44,810
Eastern Europe, Middle East & Africa	63,126	62,632
Asia	65,222	70,125
Latin America & Canada	21,700	21,190
Total cigarette volume	196,041	198,757
Net revenues:		
European Union	\$6,143	\$6,222
Eastern Europe, Middle East & Africa	3,997	4,147
Asia	4,689	4,764
Latin America & Canada	1,959	2,219
Net revenues	\$16,788	\$17,352
Excise taxes on products:		
European Union	\$4,280	\$4,271
Eastern Europe, Middle East & Africa	2,395	2,363
Asia	2,721	2,609
Latin America & Canada	1,309	1,493
Excise taxes on products	\$10,705	\$10,736
Operating income:		
Operating companies income:		
European Union	\$906	\$927
Eastern Europe, Middle East & Africa	633	866
Asia	778	934
Latin America & Canada	229	230
Amortization of intangibles	(18 )	(22 )
General corporate expenses	(46 )	(41 )
Less:		
Equity (income)/loss in unconsolidated subsidiaries, net	(9 )	(23 )
Operating income	\$2,473	\$2,871

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

References to total international cigarette market, defined as worldwide cigarette volume excluding the United States, total cigarette market, total market and market shares throughout this "Discussion and Analysis" reflect our best estimates of tax-paid volumes based on a number of internal and external sources.



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Consolidated Operating Results for the Three Months Ended March 31, 2016

The following discussion compares our consolidated operating results for the three months ended March 31, 2016, with the three months ended March 31, 2015.

Our cigarette shipment volume decreased by 1.4%, or by 1.7% excluding favorable net estimated inventory movements, reflecting declines in:

•Asia, principally Indonesia, Pakistan and the Philippines, partly offset by Korea;

partially offset by growth in:

•European Union, driven notably by France, Italy, Poland and Spain, partly offset by the United Kingdom;

•EEMA, driven by Egypt and Tunisia in North Africa, Turkey and Ukraine, partly offset by Algeria and Russia; and

•Latin America & Canada, driven mainly by Mexico, partly offset by Argentina.

The decrease was further offset by the favorable estimated impact of the leap year.

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

PMI Cigarette Shipment Volume by  
Brand (Million Units)

	First-Quarter			
	2016	2015	Change	
Marlboro	67,985	67,247	1.1	%
L&M	23,690	22,678	4.5	%
Parliament	10,137	9,570	5.9	%
Bond Street	9,721	9,180	5.9	%
Chesterfield	10,176	9,540		