

Ex.^{mo} Senhor Deputado
Dr. Pedro Soares
Presidente da Comissão de Ambiente,
Ordenamento do Território,
Descentralização, Poder Local e Habitação
Palácio de S. Bento
Praça da Constituição de 1976
1249-068 Lisboa

Albarraque, 28 de maio de 2019

Assunto: Projeto que regulamenta o fim que deve ser atribuído às pontas de cigarros. N/refª: Tab 165/2019.

Ex.^{mo}. Senhor Presidente da Comissão de Ambiente, Ordenamento do Território, Descentralização, Poder Local e Habitação, Dr. Pedro Soares,

Tomamos a liberdade de nos dirigir a V. Ex.^a no contexto da recente apresentação pelo PAN do Projeto de Lei 1214/XIII, que regulamenta o fim que deve ser atribuído às pontas de cigarros.

A Tabaqueira, subsidiária da Philip Morris International (PMI), a maior empresa e detentora da principal operação industrial do setor do tabaco em Portugal, assumiu um firme compromisso com a sustentabilidade, que encara como parte integrante do seu modelo de negócio, enquanto meio para criar valor a curto, médio e longo prazos e, em simultâneo, de minimizar as externalidades negativas associadas aos seus produtos, operações e cadeia de valor.

A par do compromisso público que a nossa empresa assumiu de fazer tudo o que estiver ao seu alcance para contribuir para a construção de um futuro livre de fumo, mediante a substituição tão breve quanto possível dos cigarros tradicionais por produtos inovadores sem combustão e fumo, por conseguinte menos tóxicos e nessa medida melhores alternativas para os atuais fumadores, constituem também para nós orientações de importância estratégica relevantes a redução da nossa pegada ambiental, a gestão sustentável dos recursos limitados do planeta, o respeito pelas pessoas na nossa cadeia de valor e a excelência operacional.

Nessa linha, a empresa está empenhada em minimizar o seu impacto ambiental, através da redução da pegada de carbono e do uso da água, da redução do desperdício e de outras iniciativas, tendo já vindo a adotar inúmeras medidas para compreender e reagir de forma adequada a possíveis futuros

impactos na sua operação determinados por tendências globais como as alterações climáticas e a escassez de água.

Estamos conscientes dos impactos negativos que tem no ambiente o lixo originado pelos filtros dos produtos de tabaco com ou sem combustão e estamos empenhados em contribuir para a respetiva redução. No entanto, cremos que qualquer iniciativa legislativa nesse domínio encontrará melhor enquadramento no contexto da futura transposição da Diretiva dos Plásticos de Uso Único, recentemente adotada, aguardando publicação em breve no Jornal Oficial da União Europeia, que aborda já medidas relativas à responsabilidade alargada dos fabricantes, requisitos de marcação das embalagens e medidas de sensibilização aplicáveis à necessidade dos consumidores procederem a um descarte apropriado dos filtros. Tal permitiria uma abordagem mais abrangente do tema em apreço e porventura evitar transposições que possam eventualmente revelar-se dissonantes fruto da adoção prematura de legislação nacional sobre esse mesmo assunto.

A educação ambiental tem sido uma preocupação constante da Tabaqueira, que, em parceria com a Associação Bandeira Azul da Europa (ABAE / FEE Portugal) e um conjunto de municípios, lançou no passado uma campanha com o objetivo de consciencializar os fumadores adultos relativamente à necessidade de efetuarem um descarte adequado dos filtros dos cigarros, como forma de contribuírem para a proteção dos oceanos.

Aproveitamos para lhe dar a conhecer as iniciativas mais recentes levadas a cabo pela Tabaqueira precisamente no domínio da promoção de uma maior consciencialização ambiental. Referimos em especial a campanha atualmente em curso na cidade de Lisboa, no contexto da organização da *Regata de Portugal 2019 - "CADA COISA NO SEU LUGAR, o dos plásticos e das beatas não é no chão, nem no mar"*, cujo objetivo consiste em transmitir boas práticas ambientais, consciencializando em particular os fumadores adultos e os consumidores de produtos de tabaco sem combustão para a importância do papel que podem desempenhar na proteção dos oceanos ao descartarem os filtros em locais de recolha apropriados. Subordinada ao mote "*#QUEBREOHÁBITO, Não deite no chão. O que cai no chão, ao mar vai parar.*", a campanha procura sensibilizar a população para o lixo acumulado nos oceanos e a forma como este chega até lá - 80% do lixo encontrado no mar é depositado no chão em terra – e a importância da contribuição de todos para um ambiente mais cuidado.

Esta campanha, elucidativa do compromisso transversal assumido pela Tabaqueira para com a sustentabilidade e a transmissão de boas práticas ambientais, prosseguirá ao longo de 2019 a nível nacional.

Estamos também a considerar iniciativas-piloto, que preveem o apoio à distribuição e colocação de cinzeiros em localizações-chave, nomeadamente na cidade de Lisboa.

Aproveitamos ainda esta oportunidade para salientar que para a Tabaqueira, é inquestionável que a melhor opção se encontra sempre do lado da prevenção e da cessação do consumo de produtos de tabaco e que qualquer fumador adulto que tenha preocupações de saúde deve deixar de consumir quaisquer produtos de tabaco ou à base de nicotina. Contudo, existem inúmeras pessoas que não querem deixar de fumar e/ou que procuram alternativas que tenham o potencial de ser menos nocivas que os cigarros e que têm o direito de ser devidamente informadas sobre alternativas que impactem a redução de riscos e de nocividade dos seus comportamentos. Fruto da comercialização do tabaco aquecido, mais de 7 milhões de fumadores no mundo inteiro, 200.000 dos quais em Portugal, deixaram entretanto de fumar, a um ritmo que antes nunca fora alcançado pelas políticas tradicionais de prevenção de tabagismo, assentes, como não deve aliás deixar de ser, na prevenção e na cessação.

No âmbito do seu objetivo de contribuir para a construção um futuro livre de fumo, estamos ainda a trabalhar ativamente em soluções inovadoras para reduzir o lixo resultante do consumo dos nossos produtos sem combustão, procurando assegurar que o ciclo completo destes novos produtos seja gerido de forma sustentável, incluindo medidas de recolha e reciclagem aplicáveis não apenas aos dispositivos eletrónicos, mas também aos produtos de tabaco aquecido após a respetiva utilização.

Na medida em que o tabaco aquecido não envolve combustão, o filtro usado no produto não tem exposição ao fumo, não é necessária extinção após consumo e o cheiro prevalecente é muito menos intenso que os filtros dos cigarros. Assim, os respetivos consumidores dispõem de condições mais propícias para procederem ao descarte adequado do lixo resultante após consumo, o que naturalmente facilita também a aplicação a todo o processo de uma lógica de economia circular no

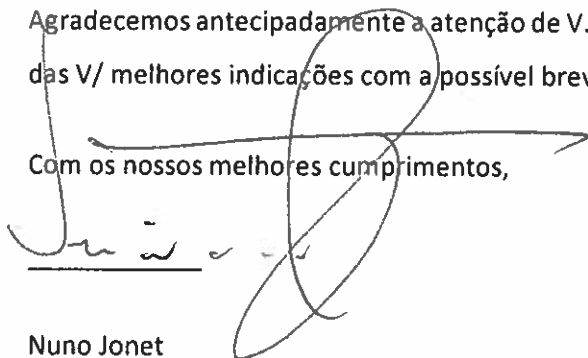


Por último, gostaríamos de solicitar a V.Ex.^a uma audiência em sede de Comissão Parlamentar para melhor expormos a nossa posição quanto ao tema em apreço que cremos passar, entre outras medidas, pelo descarte adequado das pontas de cigarro e por uma alteração no comportamento dos consumidores, o que implica uma maior consciencialização ambiental através de ações de sensibilização, mas poderá também envolver uma efetiva penalização através da aplicação de coimas a comportamentos por parte de consumidores que revelem um descarte desadequado dado ao lixo em geral e ao plástico e aos filtros em particular.

De qualquer dos modos, não deixaremos no decurso dos próximos dias de transmitir na pessoa de V. Ex.^a, enquanto Presidente da Comissão de Ambiente, Ordenamento do Território, Descentralização, Poder Local e Habitação, algumas comentários e observações relativos ao Projeto de Lei 1214/XIII.

Agradecemos antecipadamente a atenção de V. Ex.^a para o exposto e permanecemos na expectativa das V/ melhores indicações com a possível brevidade.

Com os nossos melhores cumprimentos,



Nuno Jonet
Administrador

Anexo:

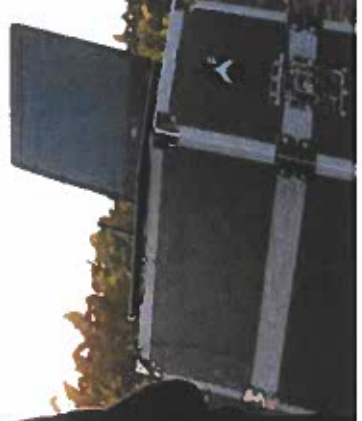
Última versão do relatório de sustentabilidade da PMI – 2018, divulgado no passado dia 15.05.19



PHILIP MORRIS INTERNATIONAL

SUSTAINABILITY
REPORT

2018



About PMI¹

Philip Morris International (PMI) is a leading international tobacco company engaged in the manufacture and sale of cigarettes, smoke-free products and associated electronic devices and accessories, and other nicotine-containing products in markets outside the U.S. PMI became a free-standing publicly traded company (NYSE: PMI) in March 2008, following a spin-off from Altria Group, the parent company of Philip Morris USA.

PMI is building a future on smoke-free products that, while not risk-free, are a much better choice than continuing to smoke. Through multidisciplinary capabilities in product development, state-of-the-art facilities, and scientific substantiation, PMI aims to ensure that its smoke-free products meet adult smoker preferences and rigorous regulatory requirements.

Our smoke-free product portfolio, IQOS, consists of heated tobacco and nicotine-containing vapor products. We estimate that some 6 million adult smokers around the world have already stopped smoking and switched to IQOS, which is currently available for sale in 44 markets. Our ambition is to completely replace cigarettes with smoke-free products, to the benefit of consumers, society, the company, and our shareholder(s).

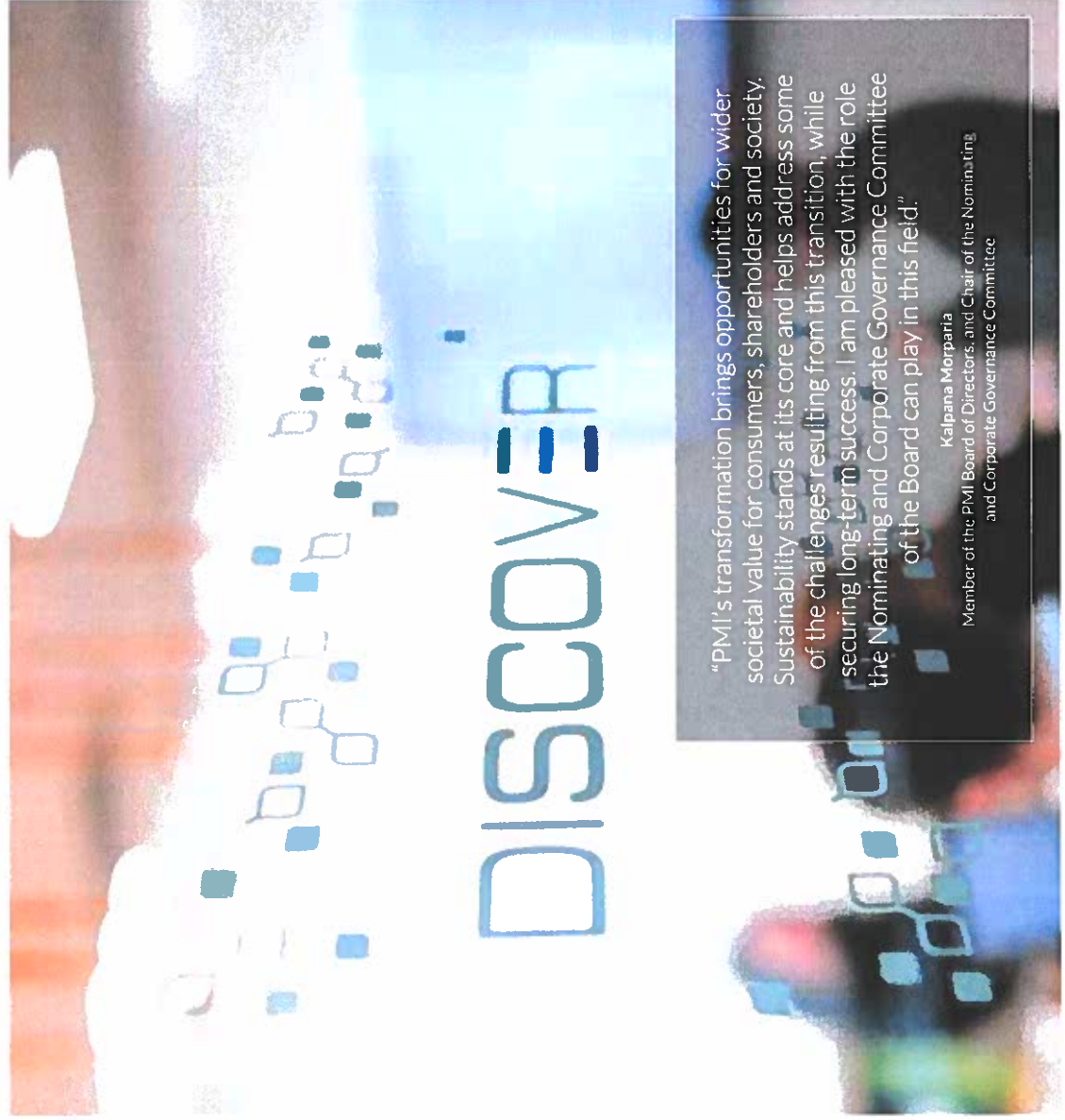
Sustainability at a glance

For us, sustainability is about creating long-term value while minimizing the negative externalities associated with our products, operations, and value chain.

PMI's Board of Directors understands our special responsibility as a tobacco company and expects us to continuously improve the sustainability of our business and value chain and to contribute to the global sustainability agenda.

This report sets out our sustainability material topics, our approach to managing them, and how we are progressing.

We provide detailed updates on our commitments, achievements, and challenges in the relevant sections of this report, along with many case studies. Our Chief Executive Officer and Chief Sustainability Officer also review the year and invite you to start a conversation with us.



“PMI’s transformation brings opportunities for wider societal value for consumers, shareholders and society. Sustainability stands at its core and helps address some of the challenges resulting from this transition, while securing long-term success. I am pleased with the role the Nominating and Corporate Governance Committee of the Board can play in this field.”

Kalpana Morparia
Member of the PMI Board of Directors, and Chair of the Nominating
and Corporate Governance Committee

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Recognitions:



Letter from the Chief Executive Officer



“To us, sustainability is about replacing cigarettes with better alternatives, addressing sustainability challenges across our value chain, and seizing opportunities to add value to society.”

Dear Reader,

Can a tobacco company be sustainable? Smoking cigarettes causes serious disease, and the best way to avoid the harm of smoking is never to start, or to quit. Governments around the world heavily regulate and tax cigarettes to discourage smoking – and rightly so. The reality today is that roughly one in five adults around the world smokes. The World Health Organization (WHO) projects that the total number of smokers remains relatively stable at about 1.1 billion people. In this context, can PMI truly add value, not only to shareholders, but also to society?

We know that quitting is the best option, but we want to provide less harmful alternatives to smoking for those who don't quit. Many years of research and various commercialization attempts eventually led to the launch of IQOS at the end of 2014. This product was very well received by adult smokers, exceeding all our expectations. The early success of IQOS gave me the confidence to set out a new course for the company in 2016: to replace cigarettes with less harmful products as fast as possible. Our vision has been, step by step, turning into reality ever since.

In 2018, smoke-free products represented 13.8% of our total net revenues. In three countries, such revenues exceeded those of our combustible products. I am proud to say that, in just four years, an estimated 6.6 million adult smokers have stopped smoking and switched to IQOS. We continue to shift company resources towards achieving our ambition: 97% of our investment in research and development (R&D) and 60% of our global commercial expenditure were dedicated to smoke-free products in 2018. Seven of our 44 factories around the world currently produce the consumables for these products.

Our sustainability ambition extends to the way we operate, manage our social impact, and reduce our environmental footprint. Society's expectations of businesses are changing, and we must play our part in addressing global challenges. To make sure we focus our efforts where we should, we conducted a sustainability materiality analysis in 2018 which will serve as the basis for the development of our 2025 sustainability strategy.

We are proud of the progress made in 2018, thanks to the hard work and dedication of our employees and partners across the world. Our pilot human rights impact assessment took place in Mexico, and our Agricultural Labor Practices program was strengthened to better address the recurring issues in our tobacco supply chain. Also, worldwide representation of women in our management rose to 35.2%, on track to reach our goal of 40% by 2022. Our environmental efforts were recognized in the Carbon

Disclosure Project (CDP) Climate A list for the fifth consecutive year, and we achieved our CO₂ emissions reduction target for scope 1 and 2 ahead of time. Our factory in Brazil was certified by the Alliance for Water Stewardship (AWS), a first for any company in Latin America. We have set the direction for a more robust supplier due-diligence approach and further embedded sustainability throughout functions and markets.

Big challenges remain. To make our vision truly global and inclusive, we need a more diverse product portfolio and innovative routes to market. We also face a lack of awareness of smoke-free products among smokers. Governments play a crucial role here. They can influence the pace and scale of switching away from cigarettes by adopting risk-proportionate regulations and providing smokers with accurate information.

We share stakeholder concerns about youth initiation. The benefits that smoke-free products bring to adult smokers should not come at the cost of an increase in youth use of nicotine products. Our marketing code is strong and enforced globally. Two recent independent studies in Japan and Switzerland show that the use of heated tobacco products among middle-school and high-school students is extremely low. But I recognize that skepticism remains. We are carefully reviewing and where necessary improving the steps PMI takes across all of its business activities to ensure youth are not targeted or encouraged to use any of our products.

Let's come back to my initial question: can a tobacco company be sustainable? Absolutely, by taking every step possible to completely replace cigarettes with better alternatives, addressing its sustainability challenges across its value chain, and seizing opportunities to add value to society. This is what PMI is committed to doing, and our Sustainability Report 2018 is a means for you to assess our progress.

I cordially invite you to comment, challenge, and guide us as we transform our company towards a more sustainable smoke-free future.

Andre Calantzopoulos
Chief Executive Officer

Interview with the Chief Sustainability Officer



“Transformation cannot succeed without sustainability, and sustainability would not be achieved without transformation.”

Huub Savelkoul, you are the first Chief Sustainability Officer (CSO) at PMI. What does it mean for the company?

As a company, we have been working for many years to make our business more sustainable, focused on very specific challenges that we face in parts of our business. Over the last years, the number of sustainability initiatives became more widespread across different functions. To take a truly holistic and proactive perspective on sustainability, across all aspects of our business, the company decided the moment had come to institute the CSO position. It is a sign of PMI's commitment to take our company's sustainability to the next level.

This comes at the right time, as the company progresses on its transformation and opens up further to the outside world. An external focus enables us to learn from others as well as to share our experience with them, ultimately helping us all improve our sustainability efforts.

It is also a strong message to employees and people interested in joining our company about the seriousness of our sustainability endeavor.

Your company's focus is on transforming its business. How do you see the connection to sustainability?

It is much more than just a connection; both lay at the foundation of our ambition towards a smoke-free future. Transformation cannot succeed without sustainability, and sustainability would not be achieved without transformation.

The shift the company has taken by replacing cigarettes with less harmful alternatives is at the core of addressing our main sustainability impact. This was highlighted again in the sustainability materiality analysis we carried out last year.

We need to be coherent, which means excelling in all four pillars of our sustainability strategy. This is even more important as the transformation brings about its own challenges from a social and environmental perspective.

How do external stakeholders react when you introduce yourself and explain your role?

As a tobacco company, some stakeholders may question our motives. Part of my job is to make our work and ambition known to the many stakeholders who actually don't know much about PMI. Very often, I am confronted with negative generalizations. People believe that all tobacco companies are the same. But of course, this is not the case, just as companies in other sectors differ from each other.

In my experience, we can overcome this lack of awareness and trust through dialogue and disclosure: we need to diligently explain and show what we do. Our business transparency metrics on page 118 are one example of relevant disclosure; they allow people to see how we are shifting our company's resources to achieve a smoke-free future.

And last but not least, we need to listen and respond to feedback. No company is perfect, and PMI certainly can improve. Dialogue enables us to learn and change the way we operate, where needed.

What are your main priorities going forward?

You will see in this report, we set targets in a number of areas, but we would like to develop a more comprehensive set of 2025 objectives. That will be one of our priorities for 2019.

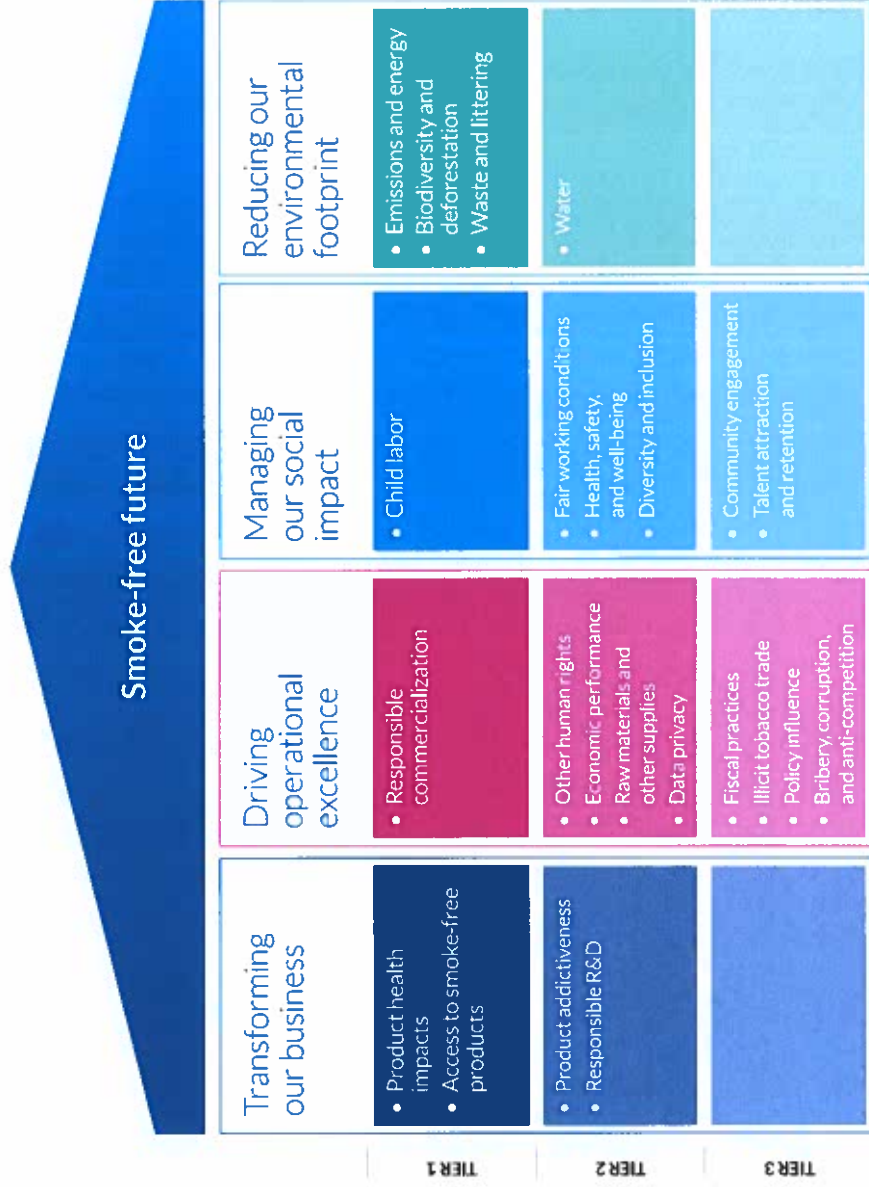
We can be proud of a number of long-standing ambitious programs, such as our sustainable agriculture work, or our programs to address climate change. A second priority is to replicate such successes in other sustainability areas across the company, particularly in those that are new to us, such as the recycling of IQOS devices electronics.

I also want to make sure that we have the sustainability fundamentals in place across the company, for instance by systematizing our non-financial data management, and making progress on impact valuation to explain our work in the language of the financial community.

In brief, I want to bring sustainability leadership to PMI.

Our approach to sustainability

Genuine sustainability for a tobacco company starts with addressing the negative health impacts of its products. This means, first and foremost, developing and commercializing less harmful alternatives to cigarettes while managing our social and environmental impacts across our operations and value chain.



We know it is the right thing to do. We are committed to setting ambitious goals, working hard to reach them, and communicating transparently on our progress.

To ensure that our sustainability work aligns with societal expectations and focuses where we can have the greatest impact, we conducted a new sustainability materiality analysis in 2018 (see page 113) to set priorities across the four pillars of our strategy. As we write, we are crafting our new 2025 sustainability strategy based on the results of that analysis.

We are prioritizing the tier 1 topics of our strategy (see chart on the left), for which we will set ambitious objectives, and will publicly report our progress annually:

- Developing less harmful alternatives to cigarettes and providing global and inclusive access to them is imperative for our consumers and society at large, and is fundamental to our long-term success;
 - Considering the harmful nature and addictiveness of our products, we must ensure that they are commercialized responsibly, aiming to prevent youth from accessing and using them;
 - We do not condone child labor in our supply chain, and we continue to focus considerable resources to prevent and address this issue; and
 - Climate change poses a threat to our planet and could have consequences on our work. We address it through our efforts on emissions reduction. Other top environmental priorities are waste and littering management, and preservation of biodiversity, land, and forest.
- We continue to manage and measure progress on our tier 2 and tier 3 topics, but we do not report on them as comprehensively as on tier 1 topics.

Working towards the UN Sustainable Development Goals (SDGs)

Our business strategy aims to contribute to making the SDGs a reality. Our SDG prioritization is the result of a four-step process we undertook as part of our sustainability materiality analysis in 2018, which took the following approach:

- 1 We mapped our sustainability work to the 17 SDGs and 169 targets;
- 2 We identified the SDGs where we believe we can have the greatest positive impact;
- 3 These SDGs were aligned to our sustainability strategy; and
- 4 The SDG wheel was developed based on the tiered structure of our strategy. Considering the health impact of our products, SDG 3 was identified as the goal we can contribute most to, whereas human rights is an encompassing concept relevant to all SDGs.



Human Rights

LEARN MORE ON OUR APPROACH TO SUSTAINABILITY

PMI's sustainability materiality analysis on **page 113** ▶

How we engage with stakeholders on **page 111** ▶

PMI's sustainability governance and management on **page 116** ▶

Our Global Reporting Initiative cross-reference index on **www.pmi.com** ▶

Taking decisive actions where we can have the greatest impact: Primary SDGs

SDG 3 Cigarette smoking causes serious disease. By replacing cigarettes with less harmful alternatives we can significantly reduce the negative impact of our products on individuals and society.

SDG 8 We ensure good working conditions for all our employees and expect our suppliers to do the same for the benefit of over one million workers throughout our value chain.

SDG 12 We improve the life-cycle impacts of our products – from reducing the environmental impacts of tobacco growing, to efficient low-carbon manufacturing, litter prevention and recycling programs.

SDG 13 Our energy-efficiency programs in our operations and our alternative curing fuels program in our tobacco leaf supply chain contribute to mitigating the risk of climate change.

SDG 14 Our Environmental Commitment (our Policy) governs our management approach to waste and water to ensure that all effluents released are within, or better than, levels required by regulations in the countries where we operate.

SDG 15 We are committed to protecting biodiversity, especially forested areas affected by our operations, particularly in the supply chain of tobacco leaf and paper-based packaging.

Creating value at PMI in 2018

OUR MISSION

Unsmoke the world

WHAT WE DO

Replace cigarettes with less harmful tobacco and nicotine products for the benefit of adults who would otherwise continue to smoke



Above: Tobacco seedlings in Brazil

INPUTS

HUMAN

77,400
Employees

42.1%
Women employees

>100
Employee nationalities

>350,000
Farmers contracted by PMI and our suppliers in 27 countries

INTELLECTUAL

\$383m
Total R&D expenditure

92%
Of our total R&D expenditure related to smoke-free products

2
R&D centers

>400
Scientists, engineers, and technicians

MANUFACTURING

44
Owned manufacturing facilities

26
Third-party manufacturers

7
Of PMI-owned manufacturing facilities producing smoke-free products

\$1.4bn
Capital expenditure

NATURAL

>330,000 tons
Packed tobacco sourced

9.1m
Gigajoules energy consumed in PMI facilities

4.4m
Water use (mm³)

3
Most significant direct materials purchased: printed paper board used in packaging, acetate tow used in filter making and fine paper

FINANCIAL

\$10bn
Annual spend on supply chain beyond tobacco

A
Long-term credit rating by Standard & Poor's, Fitch, and A2 by Moody's

\$31.8bn
Total debt

1st
Largest publicly traded tobacco company by market capitalization

SOCIAL

>36,000
Suppliers

5.9m
Retailers selling PMI products

>230
Partners implementing our charitable contributions programs

31
PMI IMPACT projects selected for funding in 2018

TRANSFORMATION ACROSS THE VALUE CHAIN

R&D

Our research and development work is the catalyst for our transformation. The harm reduction potential of smoke-free products must be scientifically substantiated.

Our product portfolio needs to meet adult consumer expectations and allow more inclusive access.

Our portfolio now includes electronic devices, which need to be designed to fit into the circular economy.

Sourcing

The sourcing of raw materials and other supplies evolves and is increasingly diversified as we transform our company. We engage with our partners in electronic devices to implement our Responsible Sourcing Principles.

We are working with tobacco farmers to transition to other crops as we expect gradual increases in our tobacco leaf requirements over time.

Manufacturing

Manufacturing of smoke-free products requires different processes and equipment. Such a transition also impacts our environmental footprint, which we seek to reduce.

As we convert our traditional cigarette factories to produce smoke-free products, we are also equipping our employees with new skills.

Commercialization

A different regulatory framework is key to make smoke-free products known and available to adult consumers.

A new commercialization approach is required towards more consumer centrality. Additional specialists to engage with adult smokers, retail spaces including flagship stores, customer care infrastructure and digital platforms, and recycling options are essential to our success.

OUTPUTS

150m

People consuming our products

4,600

Patents granted worldwide related to smoke-free products

90%

Tobacco purchased at no risk of deforestation or old growth forest

36%

Reduction in scope 1+2 CO₂e emissions since 2010

86.9%

Employees trained on PMI Guidebook for Success (our Code of Conduct)

119

Illegal tobacco manufacturing factories closed

\$74.2bn

Excise taxes on PMI products

\$2.4bn

Corporate income taxes

9.6m

IQOS users, out of which 6.6m users who have stopped smoking and switched to IQOS

44

Markets in which IQOS is available for sale

89%

Prompt actions resolved relating to child labor incidences in our tobacco supply chain

84%

Waste recycled in our factories

0.13

Lost Time Incident Rate per 200,000 hours worked

>300,000

People reached through our charitable contributions

\$29.6bn

Net revenues, out of which 13.8% from smoke-free products

\$7.9bn

Net earnings attributable to PMI



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Our business

In our transformative journey towards a smoke-free future, we rely on our expertise in building great brands, in innovating and inventing, and in surpassing adult consumer expectations.

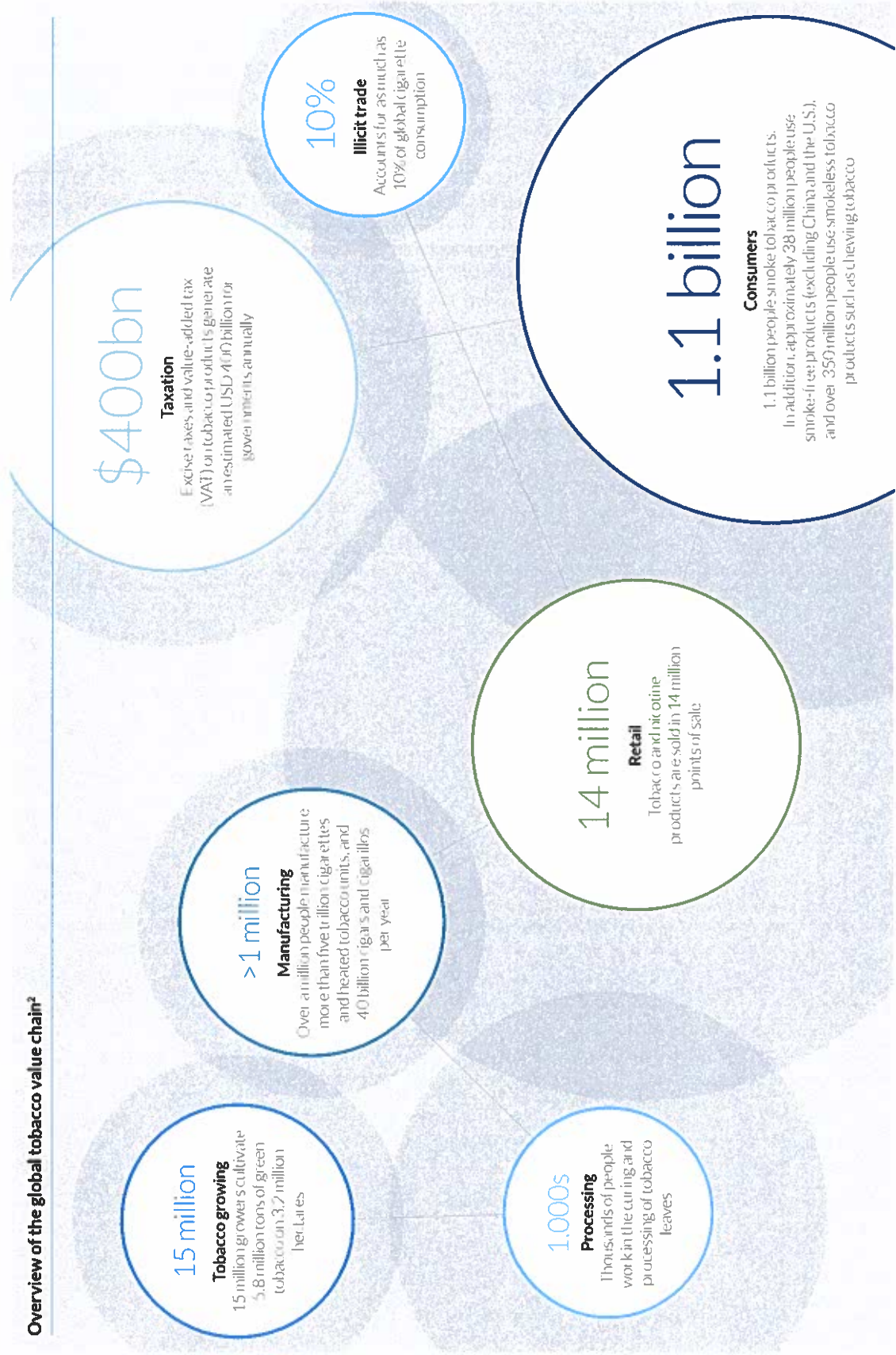


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Our business environment

Overview of the global tobacco value chain²



Our business environment continued

Consumers

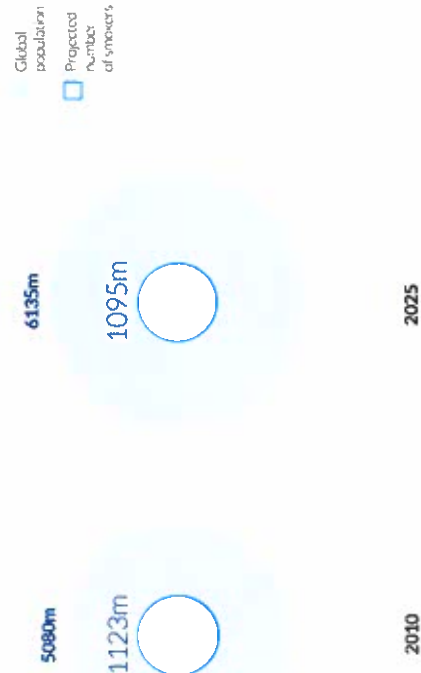
Today an estimated 1.1 billion men and women around the world smoke cigarettes or other combustible tobacco products. The latest WHO projections indicate a fall in smoking prevalence (age 15+) from 22.1% in 2010 to an estimated 17.3% by 2025. At the same time, the global population is growing by around 70 million people per year. The combined effect of a growing population and a declining smoking prevalence results in a virtually unchanged total number of smokers by 2025.

Importantly, WHO member states want faster change by encouraging cessation and discouraging initiation – targeting a reduction in prevalence of tobacco use of 30% by 2025 (2010 baseline). Even if the WHO prevalence target is achieved, there will still be around 980 million smokers by 2025. It is these hundreds of millions of men and women who stand to gain the most from less harmful alternatives.

Projected smoking prevalence



Projected number of smokers



Above: An IQOS store in Athens, Greece

These projections are based on WHO/UN data and refer to age 15+

Market dynamics

The tobacco and nicotine market is characterized by a range of products, including combustible tobacco products (cigarettes, fine-cut tobacco, pipe tobacco, cigars and cigarillos), smokeless tobacco products (snus, chewing tobacco, moist snuff), and smoke-free products (electronic cigarettes and heated tobacco products).

While the number of consumers of tobacco and nicotine products around the world remains largely unchanged, the total tobacco industry volume trend in the international market, which excludes China and the U.S., has been declining by an average 2.3% per year over the last five years. Cigarette retail price increases, often as a result of tax increases, and restrictions on where people are allowed to smoke, are reducing the average daily consumption of cigarettes among smokers. In addition, illicit trade also affects the legitimate industry's sales volumes.

The total value of the global tobacco market continues to grow as volume declines are more than offset by tax and price increases. PMI's average combustible tobacco pricing variance over the last ten years has been approximately 6.5%.

The emergence of smoke-free products is also contributing to the decline in combustible products. In 2018, the international retail value for heated tobacco and nicotine-containing e-vapor products was estimated at around USD 18 billion, reflecting year-on-year growth of around 70%, driven by higher volume. Heated tobacco products accounted for more than two-thirds of this total value, and were the main driver of the growth.

Over recent years, some governments have started legalizing marijuana for medical and/or recreational purposes. Significant growth in this market is expected, and some tobacco companies have started looking into this space. PMI does not sell marijuana products and has no plans to enter this business.



Above: An IQOS 3 device

Our business environment continued

Regulation and taxation of tobacco and nicotine products

The risks of smoking have led regulators to impose rigorous restrictions and high excise taxes on cigarettes. Such restrictions are comprehensive, covering packaging and health warnings, use of ingredients, adver-tising, promotions and sponsorships, and smoking in public spaces.

Much of the regulation that shapes the business environment in which the tobacco industry operates is driven by WHO's Framework Convention on Tobacco Control (FCTC),

which entered into force in 2005. To date, 180 countries and the European Union (EU) are parties to the FCTC, which requires a suite of measures.

The regulation of smoke-free products is in its early stage, as the category is still emerging. There is no global consensus among regulators on how to regulate or tax smoke-free products. Some aim to encourage them as products presenting less risk for smokers and an opportunity for public health, while others severely restrict or ban such products from the marketplace.

Our perspective

We view government regulation of tobacco and nicotine products as essential and support effective measures to reduce smoking prevalence. The most harmful tobacco products, such as cigarettes and other combustible products, should be subject to the most restrictive measures. Regulation should also ensure that adults who would otherwise continue to smoke have access to alternative products, and to truthful and non-misleading information. [See more on page 34](#)

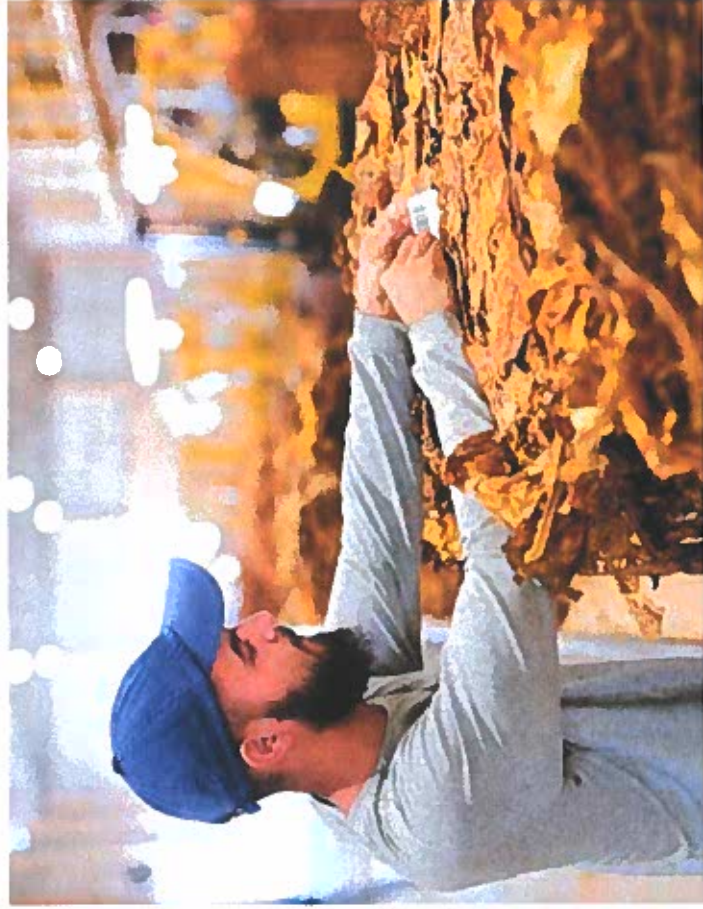
Illicit trade

The illicit tobacco trade provides a cheap and unregulated supply of tobacco products. It undermines efforts to reduce smoking prevalence, damages legitimate businesses, stimulates organized crime, increases corruption, and reduces government tax revenue. It is estimated that illicit trade accounts for as much as 10% of global cigarette consumption and that governments are losing USD 40 billion in tax revenues each year as a result.

Many countries have introduced or are considering actions to prevent illicit trade. In 2012, the FCTC adopted the Protocol to Eliminate Illicit Trade in Tobacco Products (the "Protocol"), which includes supply chain control measures, enforcement in free trade zones, controls on duty free and internet sales, and tracking and tracing technologies. With 54 signatories and 48 party ratifications, the Protocol came into force in September 2018 and its measures will now start to be implemented via national legislation. In October 2018, in their first meeting, the parties to the Protocol decided to produce a comprehensive report on good practices for tracking and tracing systems, and to prepare a conceptual framework for global information-sharing to combat illicit tobacco trade.

Our perspective

The illicit tobacco trade is large and demands integrated action. From our side, we focus on controlling our supply chains to prevent the diversion of our products. For 15 years, we have been operating a global tracking and tracing system for our products, covering all markets. We also work with governments and other partners in the public and private sectors to combat illicit trade. [See more on page 60](#)



Above: A production technician in Bahia, Brazil

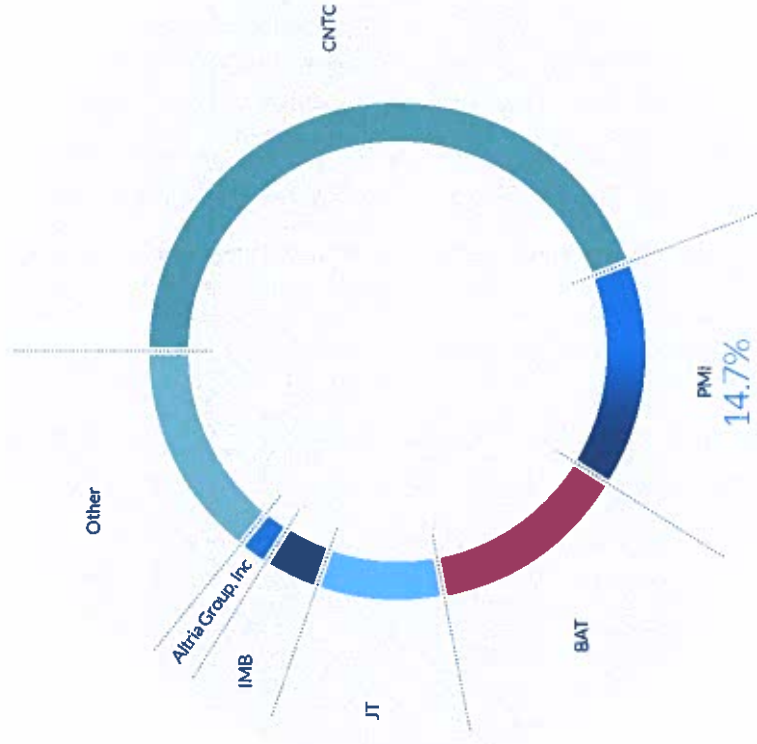
Competition

The tobacco sector includes two companies that are focused on their home country – the China National Tobacco Company (CNTC) in China and Altria Group, Inc. in the U.S. – and four large international tobacco manufacturers: British American Tobacco (BAT), Japan Tobacco (JT), Imperial Brands (IMB) and PMI. Together, these six companies account for over 85% of global cigarette sales. Regional and local companies, including state-owned enterprises, count for the remaining 15%.

As in other consumer goods sectors, manufacturers compete primarily on the basis of product quality, brand recognition, brand loyalty, taste, R&D, innovation, packaging, customer service, marketing, advertising, and retail price. Increasingly, competition also focuses on the development and commercialization of smoke-free tobacco and nicotine products. Tobacco manufacturers are shifting their focus to different degrees towards the development of such products, in particular e-cigarettes and heated tobacco products.

Our global market share 2018, including cigarettes and heated tobacco units

The e-cigarette was invented in 2003 in China and has become increasingly popular over the last decade, in particular in the U.S. and Europe. Initially, there were numerous start-up companies active in the category, followed by established tobacco companies. The first heated tobacco products were launched by various manufacturers, including PMI, in the late 1990s, without commercial success. The launch of IQOS at the end of 2014 marked the first real breakthrough for a heated tobacco product, with 1.5 million smokers having switched to IQOS by the end of 2016. Soon, other manufacturers started to launch their own heated tobacco products, such as BAT's Clo. In addition, hybrid products that combine aspects of e-cigarettes and heated tobacco products, were launched, such as Ploom TECH by JT.



Our perspective

Starting in 2016, we focused on transforming our business towards smoke-free products. At the end of 2018, we held a 57% retail value share in the smoke-free product category outside of China and the U.S., and around 6.6 million people have stopped smoking and switched to IQOS. In that geography, our volume share for cigarettes and heated tobacco products combined climbed from 27.9% in 2017 to 28.4% in 2018. A 0.8% market share growth for heated tobacco products more than compensated for a 0.3% decline in cigarette share.

Our business environment continued

Megatrends

Our long-term success requires us to monitor and take into account major social, environmental, economic, political, or technological changes. We see seven megatrends particularly relevant to our work within the wider context of sustainable development, representing an opportunity for PMI to lead change.

TECHNOLOGICAL PROGRESS

New technologies are rapidly emerging, including in robotics, artificial intelligence, and virtual reality. Coupled with rapid digitalization, these advances allow for productivity enhancements and new ways of engaging with consumers. It also comes with risks related to new employment patterns, data privacy, brand safety, and also human rights.



CHANGING CONSUMER EXPECTATIONS

Consumers' preferences and behaviors are evolving, requiring companies to constantly adapt their products and commercialization mechanisms. Consumers are changing their purchasing habits, often combining both offline and online channels. In today's connected world, they can provide immediate feedback on products and experiences, enabling direct interaction with manufacturers. Well-informed consumers are also increasingly concerned about their health, and are changing their consumption patterns accordingly.



CLIMATE CHANGE

Climate change is one of the most pressing issues of our time. As its impacts are becoming more and more visible, participating nations to the Paris Agreement within the United Nations Framework Convention on Climate Change committed to keep global temperature increases this century well below 2° Celsius above pre-industrial levels. Governments are considering various regulatory and market-based mechanisms to lower carbon emissions. Many of those are directed at businesses, which must enhance their efforts in reducing greenhouse gas emissions and improving energy efficiency.



SUSTAINABILITY

Consumers, governments and other stakeholders expect businesses to operate responsibly and transparently. Regulatory and reporting requirements are increasing, requiring higher due diligence and more actions from businesses along their value chain.



DEMOGRAPHIC CHANGE

Demographic trajectories and pace of change vary greatly among countries and regions. Along with migration flows, those changes carry important impacts, notably on the workforce. Integrating the new generations of employees into the workplace brings challenges and opportunities, especially for companies seeking to transform.



EROSION OF TRUST

In a context marked by a loss of faith in traditional institutions and overwhelming amounts of sometimes unreliable information, it is becoming increasingly difficult for people to make sound decisions. To secure the trust of their consumers, corporations need to transparently disclose relevant information and communicate responsibly through the right channels.



INEQUALITY

Income inequality is on the rise nearly everywhere around the globe. Growth has disproportionately benefited higher income groups while lower income households have been left behind. This threatens social cohesion and economic growth. In many countries, smoking is more common among lower income adults, exacerbating health inequalities. Smoke-free products present an opportunity to reduce such inequalities, as we further develop our product portfolio and new business models to address pricing barriers.



Our products and brands

We have built our company on a portfolio of leading cigarette brands that are the choice of 150 million consumers worldwide. Our cigarettes 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 cigarette brands, including *Marlboro*, *L&M*, *Chesterfield*, *Philip Morris*, *Parliament* and *Bond Street*, that are among the 15 most popular cigarette brands outside of China and the U.S. *Marlboro* is the world's best-selling international cigarette, which in 2018 accounted for approximately 36% of our total cigarette shipment volume and held a 9.7% share of the international cigarette market.

Our smoke-free product development is based on the elimination of combustion, which we believe is the most promising path to providing a better consumer choice for those who would otherwise continue to smoke. We recognize that no single smoke-free product will appeal to all adult smokers. This is why we have adopted a portfolio approach, including both heated tobacco products and nicotine-containing vapor products that are intended to appeal to a variety of distinct adult consumer preferences. Our current smoke-free product portfolio contains four platforms – all under the umbrella brand and name *IQOS* – in various stages of development and commercialization.

Our smoke-free product platforms

The science

IQOS HeatControl Technology

Brand

HEATED TOBACCO PRODUCTS

Platform 1



Our leading smoke-free platform is a precisely controlled heating device into which a specially designed tobacco unit is inserted and heated to generate a flavorful nicotine-containing aerosol. We market our heated tobacco units under brand names such as *HEETS* and *Marlboro HeatSticks*. *IQOS* was first introduced in Nagoya, Japan and Milan, Italy in 2014, and, as of December 31, 2018, *IQOS* is available for sale in 44 markets, including Duty Free. In 2018, our *IQOS* heated tobacco unit consumables would have qualified as a top-15 international tobacco brand by market share, an unprecedented achievement for a new tobacco brand.

Platform 2



Our second heated tobacco platform, *TEEPS*, uses a pressed carbon heat source which, when ignited, generates a nicotine-containing aerosol by heating tobacco. The patented design of *TEEPS* prevents the tobacco from burning. The consumer puffs on *TEEPS* to inhale a flavorful nicotine-containing vapor until the end of the experience. We completed a small-scale city test of *TEEPS*, which we had initiated in December 2017 in Santo Domingo, the Dominican Republic, and are working on improving this product and incorporating our learning into our future plans.

NICOTINE-CONTAINING E-VAPOR PRODUCTS

Platform 3



We are also developing products inspired by technology that we acquired in 2011 from Professor Jed Rose of Duke University – one of the world's leading experts on nicotine and smoking – and his co-inventors. Our scientists continue to develop this technology to replicate the feel and ritual of smoking without tobacco and without burning. One of the products under development is called *STEEM*. Unlike an e-cigarette, this product generates an aerosol of nicotine salt formed by the chemical reaction of nicotine with a weak organic acid.

Platform 4



Our fourth platform consists of e-vapor products that use nicotine extracted from tobacco leaves. These battery-powered devices – commonly known as e-cigarettes – vaporize a liquid solution containing nicotine and flavors. In 2018, we successfully introduced our first *IQOS MESH* product in the U.K. on a limited scale. We are making further investments to support our e-vapor manufacturing capacity, and plan to meaningfully enter the e-vapor category later in 2019 and expand in 2020 as we build capacity.

Our global footprint³

Key

- Tobacco sourcing
- Manufacturing facilities:
- Combustible products only
- Smoke-free products; partially or exclusively
- Markets where IQOS is available

>180

Markets where we sell our products

44

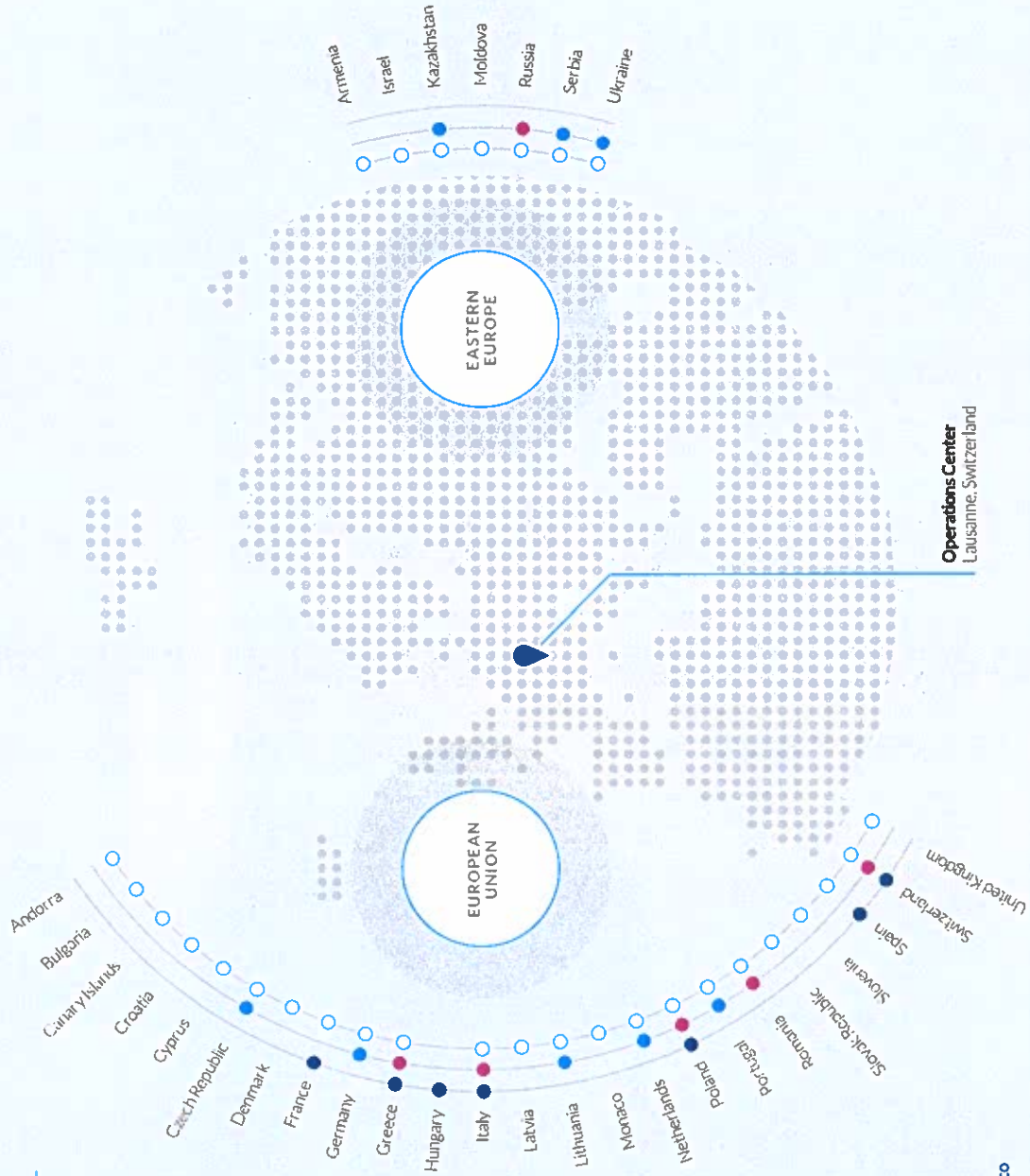
Markets where IQOS is available

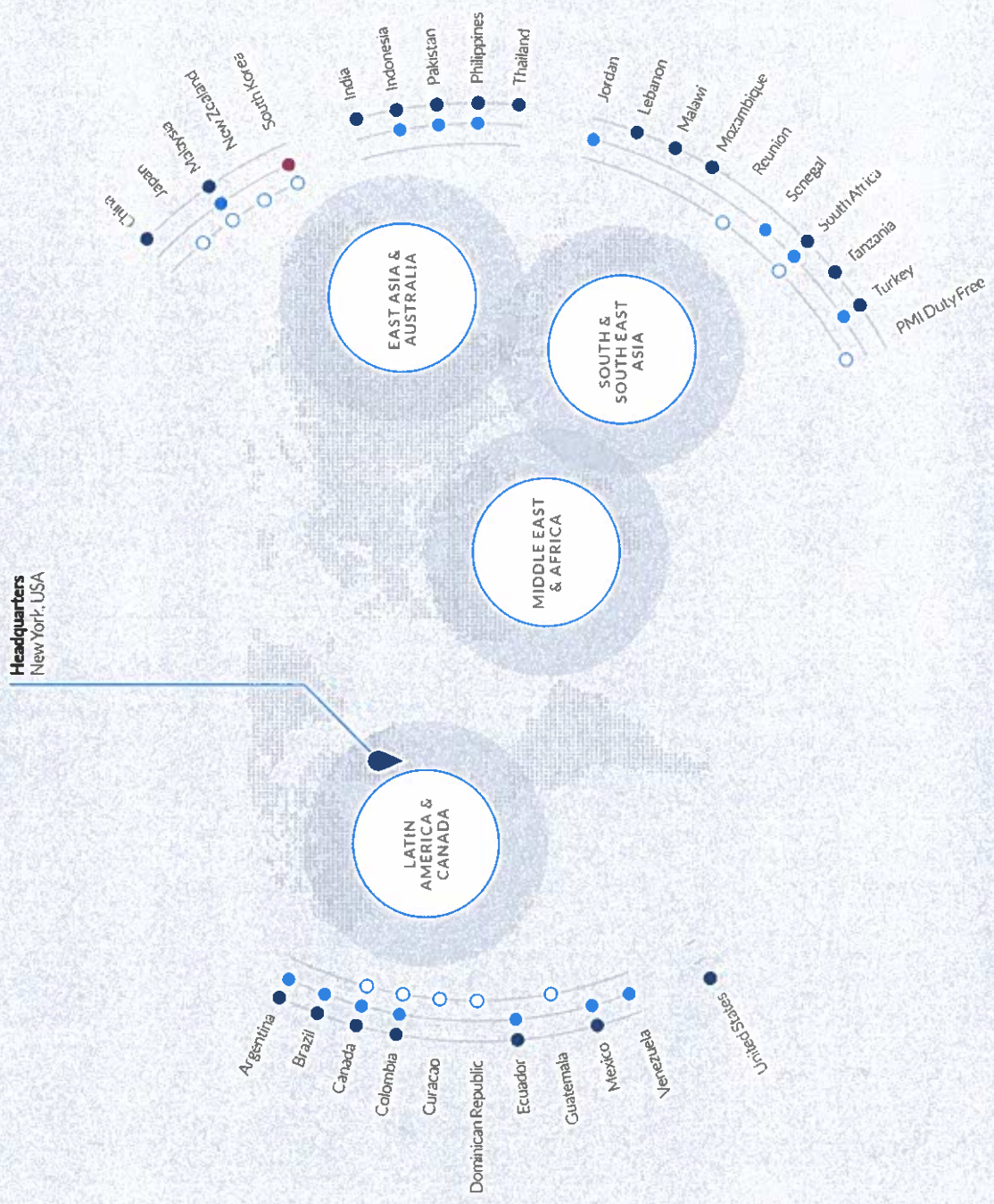
27

Countries where farmers contracted by PMI and our suppliers are located

>350,000

Farms from which PMI and our suppliers source tobacco





44

PMI-owned manufacturing facilities and 26 third-party manufacturing facilities

7

PMI-owned manufacturing facilities partially or fully dedicated to smoke-free products

49%

Net revenues from developed markets*

51%

Net revenues from emerging markets*

Our global footprint continued

Our workforce

77,400 Employees worldwide >100 Employee nationalities

Employees worldwide

Employee nationalities



Our workforce by gender

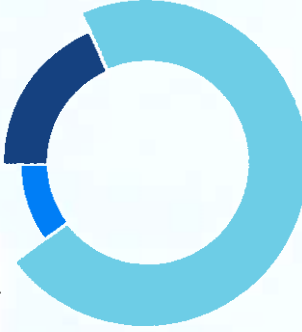
Men 57.9%

Women 42.1%

Our workforce by age group

9.8% above 50 years old

18.6% below 30 years old



71.6% 30-50 years old

Sustainability, a core strategy for our business

At the heart of our business strategy is our ambition to lead the transition of our company, and eventually the tobacco industry, towards the replacement of cigarettes with high-quality scientifically substantiated smoke-free products for adult consumers.

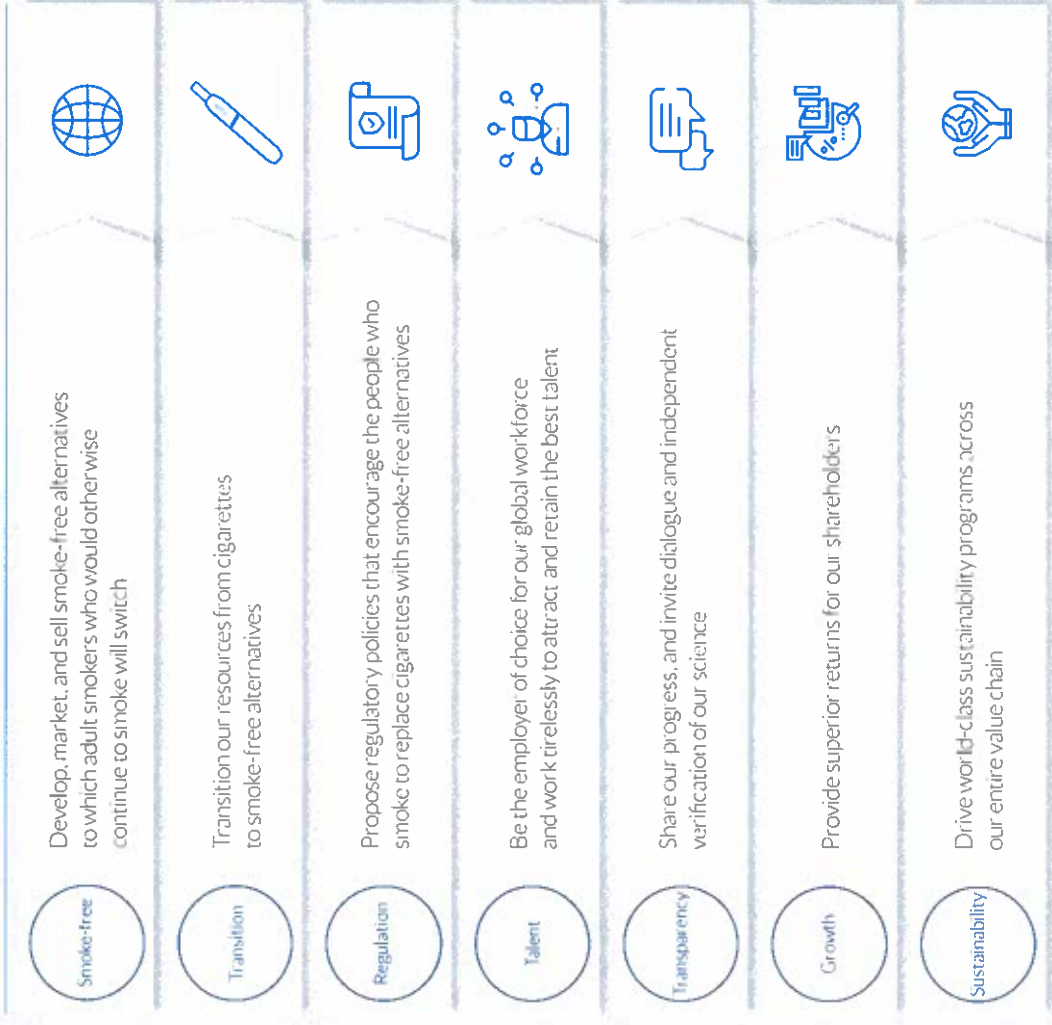
In 1847, Mr. Philip Morris opened a shop on London's Bond Street. Ever since, we have built our business success on products that meet the preferences of adult smokers. Today, we are building our future on smoke-free products that are a much better choice than continued smoking. In our transformative journey, we will rely on our expertise in building great brands, in innovating and inventing, and in surpassing adult consumer expectations.

Our sustainability strategy, which covers our products, operations and value chain, is an integral part of PMI's vision of a smoke-free future. It has four pillars:

- Transforming our business;
- Driving operational excellence;
- Managing our social impact; and
- Reducing our environmental footprint.

[Read more on page 4](#)

Our ambition towards a smoke-free future is supported by seven core strategies:



LEARN MORE ON OUR BUSINESS:

- [Our Tobacco and Nicotine Database](#)
 - [2018 Philip Morris International Inc. Annual Report](#)
 - [PMI's Investor Information book](#)
 - [2018 PMI Form 10-K](#)
- on www.pmi.com

PILLAR 1

Transforming our business

We aim to minimize the negative impact of cigarette use on public health, by replacing cigarettes with less harmful alternatives.

To this end, we have developed a portfolio of smoke-free products under the IQOS brand name, and, assessing their impact on the individual smoker and the overall effect on public health with rigorous scientific methods. Our research and development work aligns with international standards, and we are committed to transparently sharing our results as we progress.

Seeking to provide men and women who will not quit with access to smoke-free products, we are re-allocating company resources from our cigarette business to the manufacturing and sales of smoke-free products.

Our smoke-free products are not risk-free. They contain nicotine and are addictive.

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Case study Early adopter market – how is it going in Japan?	32
Product addictive ness	37
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Image: Employees in PMI's manufacturing facility in Crepellano, Italy



Addressing product health impacts



Above: Scientists in PMI's R&D center in Neuchâtel, Switzerland

Foreword

For around 20 years, PMI has been working on better alternatives to cigarettes. Experts and many regulatory bodies, such as the U.S. FDA, agree that the primary cause of smoking-related diseases is not nicotine, but the inhalation of harmful and potentially harmful constituents (HPHCs) formed as a result of burning tobacco.

Cigarette smoking is a well-established ritual and switching to an alternative method of nicotine consumption takes time. While reduced risk product development based on technological innovation and scientific substantiation is key, consumer acceptance for such new products is also necessary to achieve a smoke-free future. PMI's portfolio of alternative products shows how we can leave combustion behind, globally.

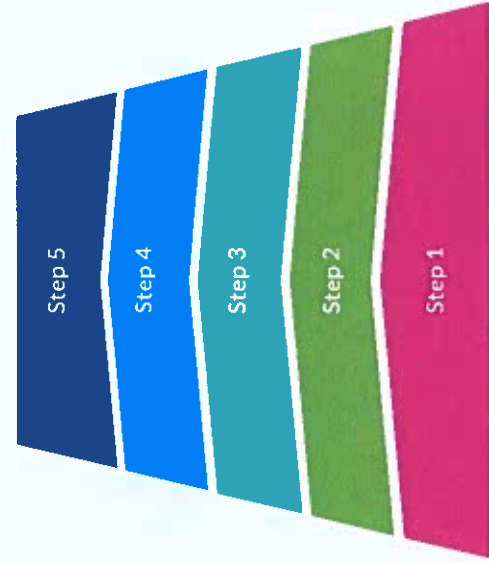
Addressing product health impacts continued

Progress in 2018

Scientific assessment of our smoke-free products

Our scientific assessment across all our product platforms follows the same five-stage approach. It is a step-by-step program that covers initial development, assessment, perception, and impacts over the long term. Here is a summary of the scientific assessment program. For further details, please visit PMI Science website.

Overview of our scientific assessment program



Step 1 Product design and aerosol chemistry

Assessment of a smoke-free product's risk reduction potential relies on the quality of the initial product design and on strict manufacturing controls to ensure that the product delivers a consistent aerosol. We design our products to generate an aerosol without combustion of tobacco. We then test our products to ensure that the design leads to an overall and significant reduction in harmful and potentially harmful constituents (PHCs) in the aerosol, in comparison with cigarette smoke. In this initial phase of developing a product, we verify that the product's design does not pose any additional risks to those already known for cigarettes. Only then can we begin to conduct further research.

Step 2 Toxicological assessment

Our next step is to verify the potential of a smoke-free product's aerosol to reduce risk compared with cigarette smoke by measuring a reduction in toxicity as well as a reduction in risk using laboratory models. If risks are reduced significantly, we move on to clinical studies. We employ standard toxicology as well as advanced systems toxicology methods to assess whether the reduction in PHCs leads to a reduced impact of our product aerosol on the biological mechanisms underlying smoking-related diseases.

Step 3 Clinical assessment

Once we have completed our laboratory research, we conduct clinical studies with adult smokers to understand whether switching to smoke-free products reduces their exposure to harmful compounds. We also determine whether this leads to a favorable change in clinical risk markers associated with smoking-related diseases. The effects measured in smokers who switch to a smoke-free product are compared with those in smokers who continue to smoke cigarettes. These results are then assessed against smoking cessation as reported in the scientific literature.

Step 4 Perception and behavior assessment

We conduct extensive studies to understand a smoke-free product's potential to benefit public health, including understanding how different groups of people perceive the risk profile of a given smoke-free product and the likelihood they will adapt and use the product instead of cigarettes. The program also attempts to assess the risk of unintended consequences (e.g. initiation or relapse). We can use this information to make predictions of the likely effect of commercializing a smoke-free product on population harm.

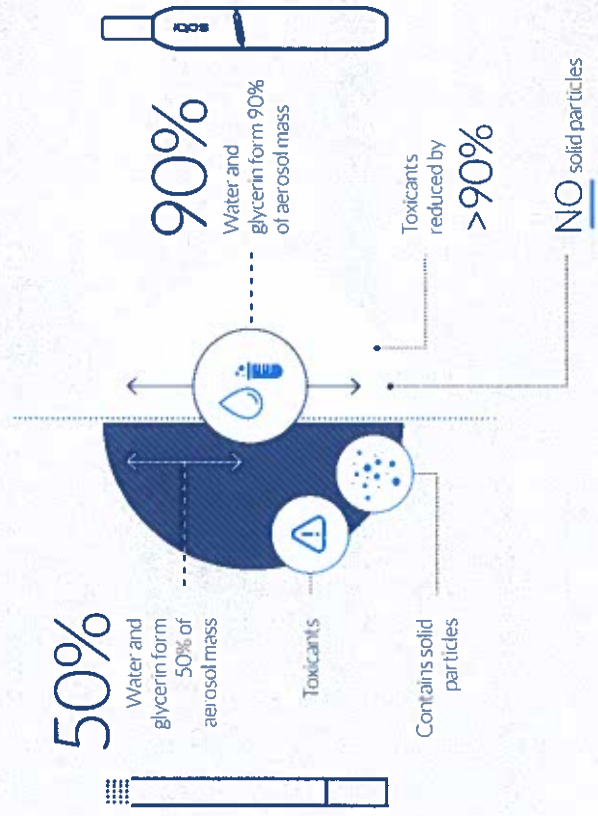
Step 5 Long-term assessment

We monitor and research the use of our smoke-free products once they are on the market in order to assess the product's contribution to harm reduction. This is done by collecting a set of qualitative and quantitative data on the use of the smoke-free product in real-world conditions.

The IQOS aerosol is not smoke

The term aerosol is commonly used in chemistry to describe a gaseous suspension of fine solid particles and/or liquid droplets. Unlike burning cigarettes, the IQOS device heats a specially formulated tobacco blend using an electronically controlled heater to temperatures well below that necessary to initiate combustion. This heating releases nicotine and flavors, generating an aerosol that is not smoke. Experiments performed under specific nitrogen and air conditions confirm the absence of combustion in the IQOS device. The absence of combustion and smoke has been validated by experts in countries such as the U.S., U.K., Italy, Japan, New Zealand, and Poland.³

Smoke and aerosol were collected on a Cambridge filter pad using Health Canada Intense smoking regime; this showed the following:



Above: A laboratory analyst in PMI's Greek, Papastratos manufacturing facility





Addressing product health impacts continued

We have numerous scientific studies on Platform 1, our main smoke-free product. They conclude that IQOS does not generate smoke and that its tobacco vapor has on average 95% lower levels of H-PT-ICs than cigarette smoke.⁶ This does not necessarily equal a 95% reduction in risk, which can only be fully quantified based on long-term epidemiological studies.

The clinical studies conducted to date also conclude that smokers who completely switched to IQOS significantly reduced their exposure to 15 key toxicants, approaching levels observed in the cessation groups. The totality of the evidence to date shows that, while not risk-free, switching to IQOS presents less risk than continuing to smoke.

An overview of the progress across all our platforms as of December 31, 2018 is presented here.

After we receive the results of our scientific studies mentioned here, in accordance with standard scientific practices, we intend to share the conclusions in scientific forums and to submit them for inclusion in peer-reviewed publications.

Heated tobacco products ⁷		Products without tobacco	
<p>Platform 1 Electrically Heated Tobacco System⁸</p> 	<p>Platform 2 Carbon-Heated Tobacco Product (CHTP)⁹</p> 	<p>Platform 3 E-vapor product using nicotine salt</p> 	<p>Platform 4 E-vapor products (commercialized under various trademarks)</p> 
<p>Assessment progress</p> <p>We have conducted a series of clinical studies for this platform, the results of which were included in our submission to the U.S. Food and Drug Administration (FDA). The results of the first six-month term of the 6+6 month exposure response study were received at the end of 2017, and the related report was completed and submitted to the FDA in the second quarter of 2018. The study showed that all eight of the co-primary clinical risk endpoints moved in the same direction in the group that switched to IQOS as observed for smoking cessation, with statistically significant changes in five of the eight endpoints compared with ongoing smoking. The results of the second six-month term of the 6+6 month exposure response study were received for analysis in the second quarter of 2018; the related report is under preparation. In addition, as set out in our submission to the FDA referenced above, we completed an 18-month combined chronic toxicity and carcinogenicity study in mice, which was ongoing at the time of our FDA submission. We shared the results with the FDA in August 2018.</p>	<p>The results of our pharmacokinetic study (that measured the nicotine pharmacokinetic profile as well as subjective effects) and of our five-day reduced exposure study indicate that this platform could be an acceptable substitute for adult smokers who seek an alternative to cigarettes. The reduced exposure study results showed a substantial reduction in relevant biomarkers of exposure to the measured H-PT-ICs in those who switched to Platform 2 compared with those who continued to smoke cigarettes over a five-day period. The sustainability of this reduction as well as changes in clinical risk markers were assessed in a three-month reduced exposure study. The results of this study were received at the end of 2017, and the related report was finalized in the second quarter of 2018.</p>	<p>We have explored two routes for this platform, one with electronics and one without, and conducted nicotine pharmacokinetic studies with both versions. The results of the pharmacokinetic study related to the version without electronics were received, and the related report was finalized in the fourth quarter of 2018. The results indicate this product's potential as an acceptable alternative to continued cigarette smoking in terms of product satisfaction. We will also initiate a clinical product use and adaptation study.</p>	<p>We conducted a nicotine pharmacokinetic study in 2017. The results of this study were received in the second quarter of 2018 for analysis, and the related report was finalized in the fourth quarter of 2018. The results of this study indicate that IQOS MESH products are an effective means of nicotine delivery while being a satisfying alternative for e-cigarette users. We will also initiate a clinical reduced exposure study to measure selected biomarkers of exposure to H-PT-ICs and assess changes in clinical risk markers.</p>

Peer reviews and independent reviews of our science

We are confident in the quality of our research and we welcome high-quality independent research on our smoke-free products. We are committed to act on any reliable information that can improve our methods or that challenges our findings. A growing number of peer-reviewed publications can be found on the PMI Science website.

Our scientific results are also being supported by independent research. Several government agencies are taking an interest in validating the available evidence on IQOS or conducting research of their own. Overall, these reports so far conclude that IQOS aerosol contains lower levels of harmful and potentially harmful compounds than cigarette smoke, and some of the reports go on to say that this reduction in toxicants is likely to lead to reduced risk of harm from IQOS compared with cigarettes.

We provide here an overview of independent government agency studies until year-end 2018.

United Kingdom

The UK Committee on Toxicity conducted a review of available evidence on two heated tobacco products, one of which is IQOS, and concluded that these products "are likely to reduce risks for smokers." Public Health England relied on this review in its subsequent report, concluding that "the available evidence suggests that heated tobacco products may be considerably less harmful than tobacco cigarettes and more harmful than e-cigarettes."

Netherlands

The Dutch National Institute for Public Health and the Environment, a member of the WHO Tobacco Laboratory Network, published a "fact sheet on novel tobacco products that are heated," concluding that "the use of heated sticks with the IQOS is harmful to health, but probably less harmful than smoking tobacco cigarettes, based on its aerosol chemistry measurements, which are of the same order of magnitude as in the data of Philip Morris

Germany

The German Federal Institute for Risk Assessment, a branch of the Federal Ministry for Food and Agriculture and a member of the WHO Tobacco Laboratory Network, conducted a laboratory study on IQOS. The study found that reductions in selected toxicants measured by the Institute "are likely to reduce toxicant exposure." The results of the aerosol chemistry measurements in this study were overall in line with our own

United States

The U.S. Food and Drug Administration (FDA) published a Briefing Document in preparation for its Tobacco Product Scientific Advisory Committee (TPSAC) meeting on IQOS as part of its review of PMI's Modified Risk Tobacco Product Application (MRTPA). The document, which offered a balanced view of the totality of evidence available on IQOS, included a section explaining the results of the FDA's IQOS aerosol chemistry measurements.

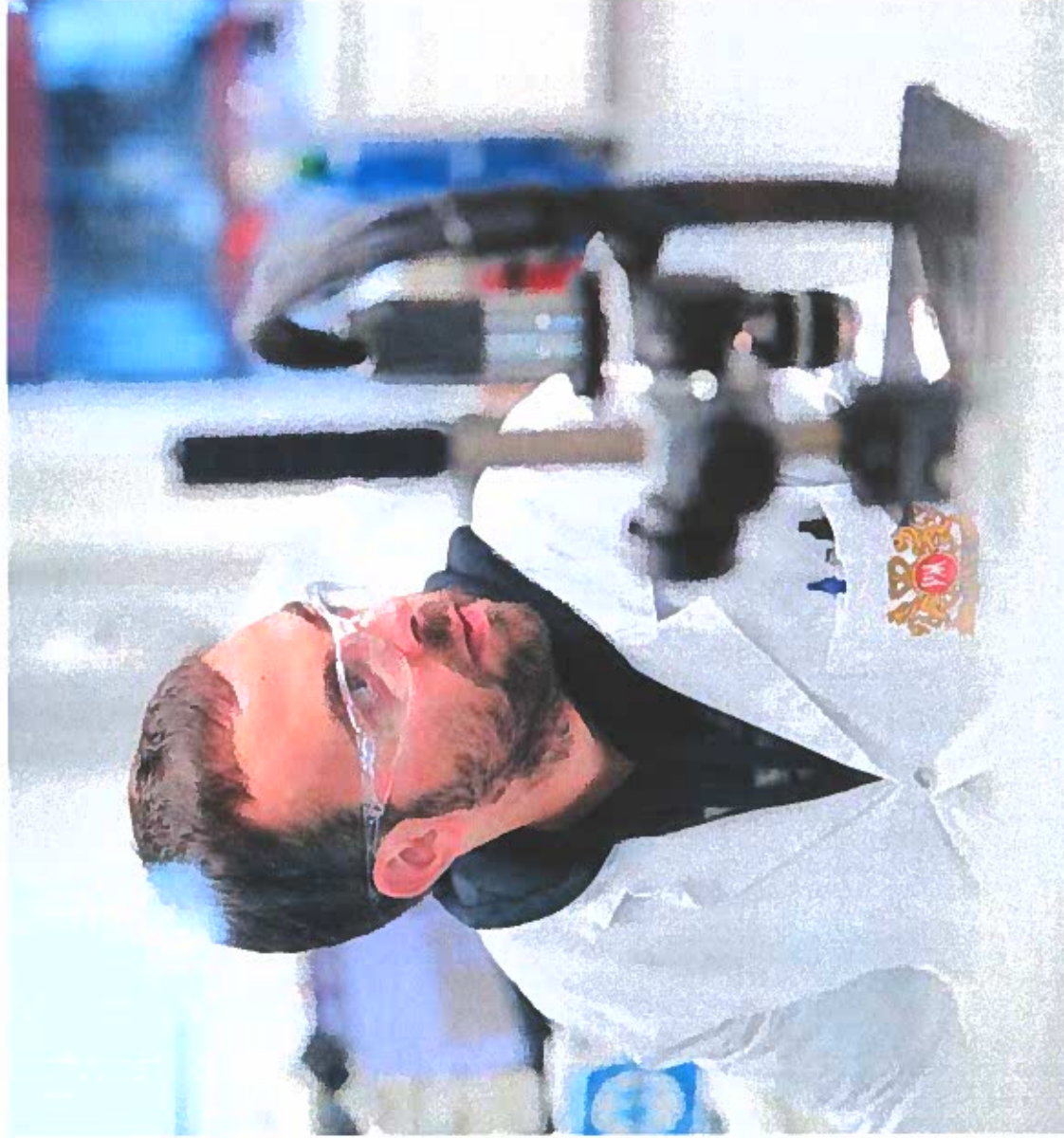
It mentioned that "The independent testing performed by FDA's Southeast Tobacco Laboratory confirmed the lower levels of selected HPHCs in the aerosol from the heated sticks compared to mainstream cigarette smoke." TPSAC confirmed that the evidence supported the statement that switching completely to IQOS significantly reduces exposure to harmful chemicals. On April 30, 2019, the FDA confirmed that IQOS is

Korea

Data from the Korea Ministry of Food and Drug Safety (MFDS), a member of the WHO Tobacco Laboratory Network, confirm lower levels of harmful chemicals in three heated tobacco products, finding over 70% average reduction in the levels of nine harmful chemicals in the aerosol compared with levels found in the smoke of the top five cigarette brands in Korea. "However, instead of focusing on the significant reductions in harmful chemicals compared with cigarette smoke, MFDS points to "tar" measurements to judge the relative

risk of tobacco products. But major public health organizations, including the WHO, agree that "tar" is not an appropriate measure for comparing the harmfulness of different tobacco products. They also agree that when comparing tobacco products, whether they are cigarettes or heated tobacco products, it is much more important to analyze the levels of individual toxicants in the smoke or aerosol. In fact, the WHO said in 2015, that "tar need not be measured, as it is not a sound basis for regulation, and the levels can be misleading."

Addressing product health impacts continued



Above: A scientist in PMI's R&D center in Neuchâtel, Switzerland

PM Equity Partner (PMEP) – Solutions for a better world

PM Equity Partner, PMI's Corporate Venture Capital Fund, actively invests in technologies and businesses that support PMI's vision for a smoke-free future and that promote a better life for underprivileged communities, responding to today's evolving consumer and societal expectations.

Through these investments, we expand our global effort to improve the quality of life of society, and learn better to integrate new technologies and more agile operating models into PMI's business. Our portfolio companies are able to tap into PMI's extensive R&D capabilities, operational and marketing excellence, and deep involvement in the agricultural supply chain.

PMEP invests in early and growth stage companies that share the vision for healthier consumer goods, improved human health, and sustainable environment.

Biognosys is an example of an investment made by PMEP, enhancing the impact of our science, based on a disruptive solution that enables full proteomic profiling. By comparing the proteins present in affected samples with the ones present in normal samples, Biognosys' technology can identify changes in expression of proteins that are related to organ toxicity. Therefore, a proteomic profile (or protein signature) can be used to diagnose a specific condition and to check how well the body responds to certain treatments or exposure. By quantifying proteins with extraordinary precision and depth, Biognosys enables PMI to identify biomarkers in scientific studies and understand the biological impact of switching to IQOS through the monitoring of key biomarkers.

Post-market surveillance

IQOS has now been commercialized for more than four years, and our understanding of actual consumer use of the product across a broad range of countries has improved.

We have established IQOS adult owner panels in 15 countries. These dynamic longitudinal studies, which involve approximately 95,000 participants across 15 countries, allow us to measure the usage patterns of IQOS adult owners over time. Data from these IQOS owner panels show that the large majority of IQOS adult owners have converted to IQOS (IQOS being more than 95% of their tobacco consumption). Converted IQOS adult owners range from 58% in Japan to 82% in Greece (as of August 2018).

Among IQOS adult owners who have converted, the number of heated tobacco units consumed per day is in general similar to the average daily consumption of cigarettes among adult smokers.

In Japan, Germany, and Italy, we have also initiated repeated cross-sectional studies in the adult general population and in IQOS owners, with the main objective of describing current and past use of tobacco and nicotine containing products. During the first year of the Japanese cross-sectional post-market study, we have surveyed a representative sample of approximately 5,000 participants from the adult general population and a sample

of 2,000 IQOS owners. The data confirm that IQOS is reaching the intended audience, adult smokers, and is of very limited interest to adults who have never used nicotine products before, or adults who had already completely stopped using nicotine products.

According to a study commissioned by the Japanese Ministry of Health, conducted between December 2017 and February 2018, among 27,275 middle-school and 42,142 high-school Japanese students, the use of heated tobacco products is extremely low and lower than smoking cigarettes.¹¹ The proportion of students who have ever used heated tobacco products was 1.1% for middle-school students (2.6% for cigarettes) and 7.2% for high-school students (5.1% for cigarettes). The proportion of monthly users was respectively 0.5% among middle-school students (0.6% for cigarettes) and 0.9% among high-school students (1.5% for cigarettes). Finally, the percentage of daily users was 0.1% for both middle-school and high-school students (respectively 0.1% and 0.5% for cigarettes).

A study conducted in Switzerland in 2018 by the independent foundation Addiction Suisse¹² found that regular use of heated tobacco products among 14 and 15-year-old boys and girls is practically negligible, and essentially limited to cigarette smoker's.



Above: Employees in PMI's office in Tokyo, Japan

Addressing product health impacts continued

PERFORMANCE AND NEXT STEPS

In 2018, 92% of our total R&D expenditure related to smoke-free products; these expenditures include the costs related to clinical studies, the development of new machinery, prototypes, and product acceptability testing. The R&D expenditure for our combustible tobacco products is largely related to legal compliance requirements, such as the measurement and reporting of tar, nicotine, and carbon monoxide for cigarettes, and adaptation to regulatory changes.

Our R&D work, and its associated innovations, has resulted in 4,600 patents granted for smoke-free technologies as of the end of 2018. We are the 45th largest patent filer of European patent applications, making us the only tobacco company in the European Patent Office's list of top 50 applicants. In Switzerland, where most of our research is conducted, we are the second largest patent filer of international patent applications.

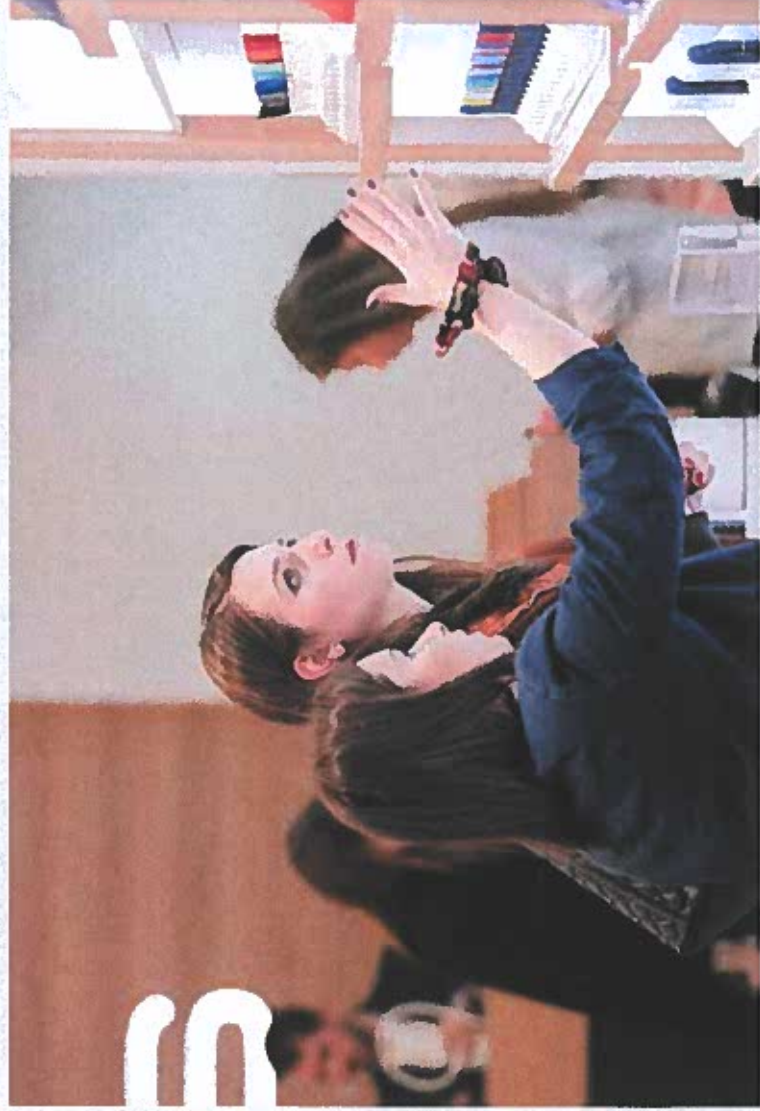
We will continue to engage with the scientific community to verify the public health benefits of our products. Disease risk-reduction studies are ongoing as part of the long-term work on IQOS. In short, PMI is continuing and expanding the scope of its program of work and allocating significant investments accordingly.

	2016	2017	2018
R&D expenditure (smoke-free/total)	77%	74%	92%
Patents granted relating to smoke-free products (cumulative)	1,800	2,900	4,600



Above: A laboratory analyst in PMI's Greek affiliate, Pappastator, manufacturing facility

Providing access to smoke-free products



Above: A customer in an IQOS store in Athens, Greece

Foreword

Developing scientifically substantiated smoke-free products that are an acceptable alternative to cigarettes is only the first step. The next big step is to make them available to all men and women smoking cigarettes or other combustible products. For more than five years, we have been ramping up production capacity for smoke-free products. We are also shifting people and resources in marketing and sales towards these products, while at the same time rethinking our approach as we move from the business-to-business model of cigarette sales towards a business-to-consumer commercial approach necessary for smoke-free products.

Our aspirational target for our business transformation was formulated using WHO "base case" projections as the counterfactual scenario. Based on these projections, which do not include the effect of smoke-free products, and assuming no changes in market shares, there would be 145 million smokers buying PMI cigarettes by 2025. The WHO aims to further reduce smoking prevalence by strengthening traditional tobacco control measures such as tax increases. The WHO 2025 target in this respect, translated to our consumer base, implies a 15 million reduction to 130 million smokers of PMI products by 2025.

Our smoke-free strategy supplements these efforts by the WHO. Our aspiration is that, by 2025, at least 40 million people who would otherwise have smoked cigarettes will have switched to our smoke-free products (up from 6.6 million people at the end of 2018), reducing the number of PMI cigarette smokers by a total 55 million by 2025. In other words, our aspiration is to reduce smoking almost four times faster than the target set by WHO.

Providing access to smoke-free products continued

Progress in 2018

Converting manufacturing facilities from cigarettes to smoke-free products

As we are expanding the sales of smoke-free products to more countries, we needed to significantly invest in converting existing cigarette factories. This includes capital expenditure, as for instance new machinery is required for the production and packaging of heated tobacco units. Our colleagues working in these factories were extensively trained to be ready for the new production environment.

In 2018, our factories in South Korea, Russia, Greece, and Poland all started to produce heated tobacco units or other nicotine-containing products, bringing the total of factories partially or fully converted to smoke-free products to seven.

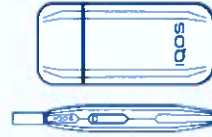
Launching IQOS 3

A second major milestone in 2018 was the launch of our next generation IQOS device, IQOS 3 and IQOS 3 MULTI in mid-November. These new devices integrate extensive consumer insights and feedback to improve design and user experience while maintaining taste, sensory attributes, and ritual – all underpinned by strong scientific substantiation. Specifically, the new devices are more robust, more intuitive in use, and are faster charging. When launching IQOS 3, we maintained the previous version (IQOS 2.4) on the market at a reduced price, thereby making the switch away from cigarettes more affordable.

IQOS device progression

2014: IQOS 2.2

Pilots in Nagoya, Japan and Milan, Italy



- Base device

2016: IQOS 2.4

Product reliability and improvements



- Aesthetics
- Automatic blade cleaning
- Easier holder insertion

2017: IQOS 2.4+

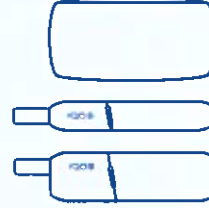
Product reliability and improvements



- Aesthetics
- Reinforced opening
- Faster charging of holder
- Bluetooth connectivity
- Improved user interface
- Utility accessories
- Mobile app

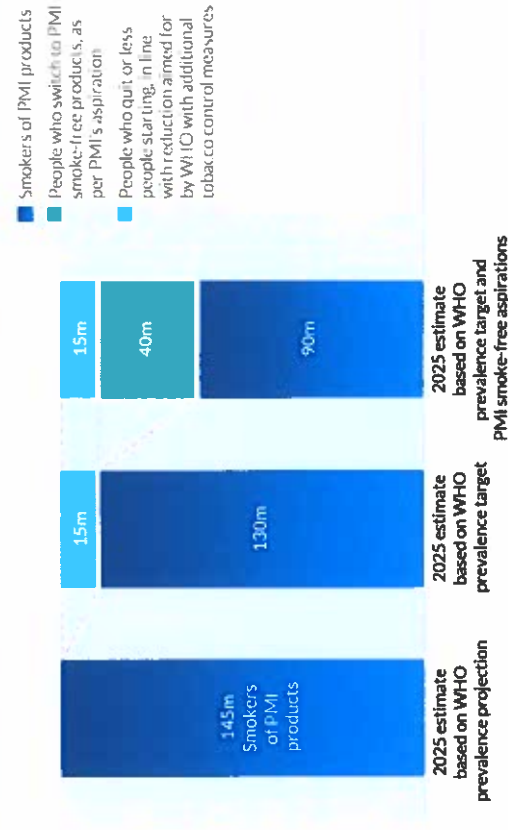
2018: IQOS 3 and IQOS 3 Multi

Continued innovation



- New design language
- More robust (ProtectPlus™)
- Faster charging of holder
- Sequential heating
- More intuitive
- Portfolio of accessories
- Compact
- Personalization

Consumers of PMI products – projection 2025 (assuming constant PMI market share)



Allocating more than half of our global commercial expenditure to smoke-free products

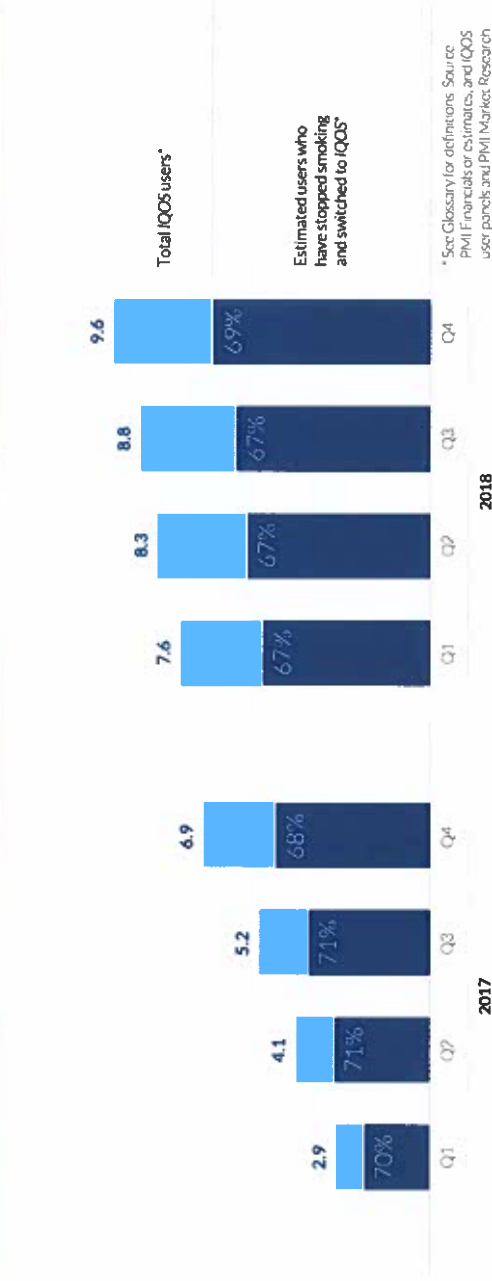
Historically, we ran a relatively simple business in a strict regulatory environment. Today, we are moving to an innovative product in an evolving and complex regulatory environment, with a high-tech consumer relationship and a more diverse supply chain.

A smoke-free future means greater scale and diversity of up-front investments than those required for launching a cigarette brand.

We are shifting from a business-to-business model to a consumer-centric model to assist smokers with the transition to smoke-free products. Our efforts are aimed at overcoming previously unseen challenges: increased time to communicate product benefits, consumer acceptance of a different ritual, and their willingness to stay with the product throughout the conversion process. It means additional specialists to engage with adult smokers, customized retail spaces including flagship stores, consumer care infrastructure, and digital platforms.

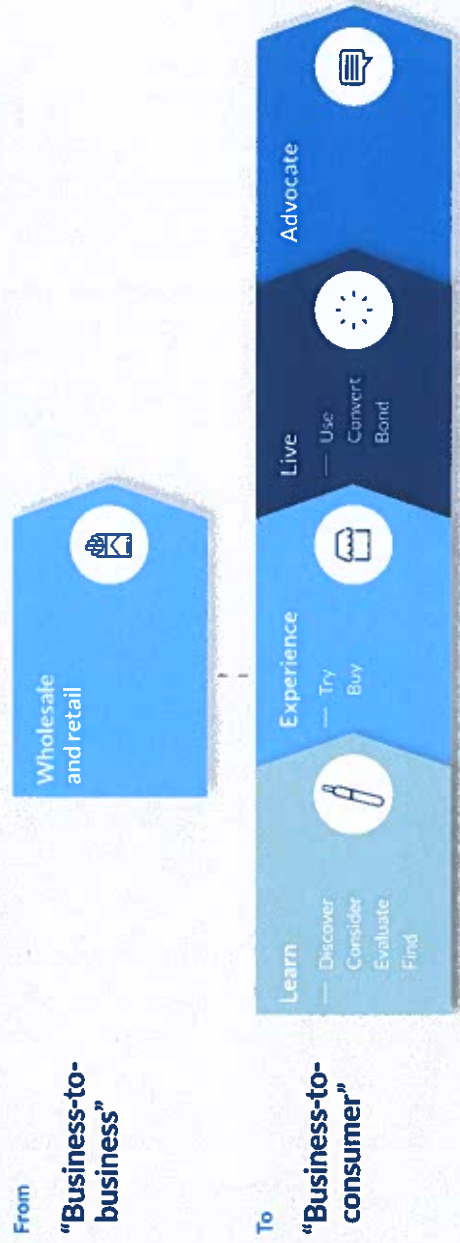
We adapt and learn: since our launch in Japan and Italy over four years ago, we have for instance fine-tuned our capacity, inventory, and distribution in order to avoid product shortages that could work against switching. We have already significantly re-allocated budgets and people from our cigarette business. Smoke-free products represent 5.1% of our sales volume, but 60% of our global commercial expenditure is dedicated to their commercialization.

Continued IQOS user growth (in millions)



* See Glossary for definitions. Source: PMI Financials estimates, and IQOS user panels and PMI Market Research

Smoke-free products: increasing interactions with adult consumers



CASE STUDY

Early adopter market – how is it going in Japan?



 **> 50%**
OPM Japan's net revenues from smoke-free products in 2018

 **600**
Total workforce at our customer call center in Japan

Above: Customer service in OPM store in Japan

CASE STUDY

Early adopter market – how is it going in Japan?

Japan is a tangible and powerful example of how we are living our transformation journey. In 2014, the revenue from smoke-free products sales for PMI Japan stood close to 0%. In 2018, it was more than half of total sales. We have been able to pioneer an entirely different market category allowing adult smokers to switch to less harmful alternatives.

In parallel with the commercialization of heated tobacco products, which commenced in 2014, smoking prevalence has fallen to 19.4% in 2018 (versus 20.8% in 2014). As the market leader of this new category, PMI Japan increased its total tobacco market share, as many IQOS users have switched from competitive brands of combustible cigarettes.

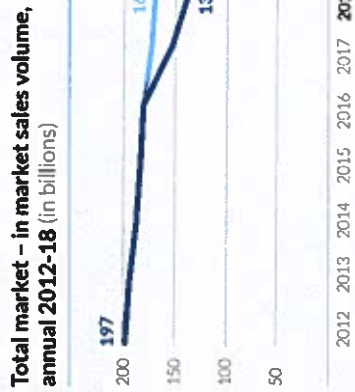
In Japan, we intensify our focus on the "whole user experience," how to meet adult consumer expectations as they evolve, and ensuring that our teams deliver on our ambition.

The year 2018 saw some challenges in the Japanese market for smoke-free products where we witnessed more reluctance in switching away from cigarettes beyond the innovator and early adopter adult smoker segments, despite the increased availability of competitive offerings. PMI continues to bring innovation and superior experience to the category. To address the needs of such consumers, we began to implement a number of initiatives such as shortening the registration process or enhancing the product to suit user styles. Most importantly, we launched IQOS 3 and IQOS 3 MULTI, and increased the number of consumer touchpoints.

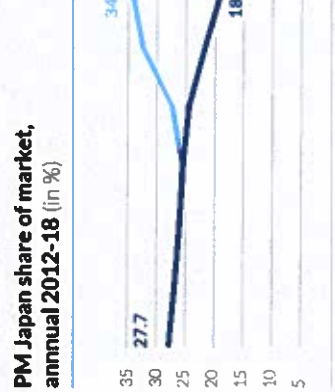
Inside PM Japan, our organization transformation continues with significant developments in compensation, benefits, work-life balance, and childcare support, and an open office environment. We have significantly improved gender diversity, of new hires in 2018, 48% were women.



Above: Sheo Lih Goh, President, PM Japan



Source: Tobacco Institute of Japan IMS and PMI Estimate of smoke-free products includes competitive smoke-free products IMS



Source: Tobacco Institute of Japan IMS and PMI Estimate of Market Denominator = Cigarettes + Smoke-free products including JT's PloomTECH and BAT's Glo consumables IMS

Importantly for the transformation and for the consumer, we have further shifted resources to support the smoke-free product category growth. We have invested in our digital teams, bringing in people from outside our industry with the skills necessary to measure and enhance the quality of the consumer experience across all channels at each stage of the consumer journey.

To widen the appeal to new target segments among current adult smokers who would otherwise not quit cigarettes, we now have a 14-day, no-obligation product loan program, an option to have an extra device holder, and have also introduced HEETS consumables at a more affordable price point and with a new taste to complement the existing Marlboro HeatSticks available at a premium price. Our call center has a workforce of 600 and is based in Japan, so new customers can reach for help online or by phone.

Stakeholder engagement in Japan is positive; industry and society are accepting IQOS more readily, an example is Fuji Transport, which has endorsed the concept of "smoke-free" in its operations and only allows use of heated tobacco products inside the cabin of its trucks.



Below: A call center employee in Fukuoka, Japan

Providing access to smoke-free products continued

Regulation of smoke-free products

People often ask when we will stop selling cigarettes. Our objective is to reach this moment as soon as possible by replacing cigarettes with smoke-free products. But this clearly depends on a number of factors out of our control, in particular the action from regulatory and public health authorities. In the most extreme cases, such as in Australia and Singapore, smoke-free products are banned, while cigarettes remain legal. We find it difficult to understand that governments would only allow the most dangerous tobacco product for sale, and prevent their citizens from accessing better alternatives.

The large majority of countries allow the sale of smoke-free products, but the regulatory environment varies substantially. As a result, it is easier in some countries than others to make people who smoke aware of alternatives to cigarettes and how they should use them. A recent survey¹ shows that nearly all (94%) respondents share the belief that consumers should have the right to know if such better alternatives exist.

Until recently, no country had any specific product standards for heated tobacco products. However, Russia, Ukraine, and Kazakhstan have now adopted quality and safety standards for

the consumables, and in Kazakhstan for the devices, and defined methods for demonstrating the absence of combustion.

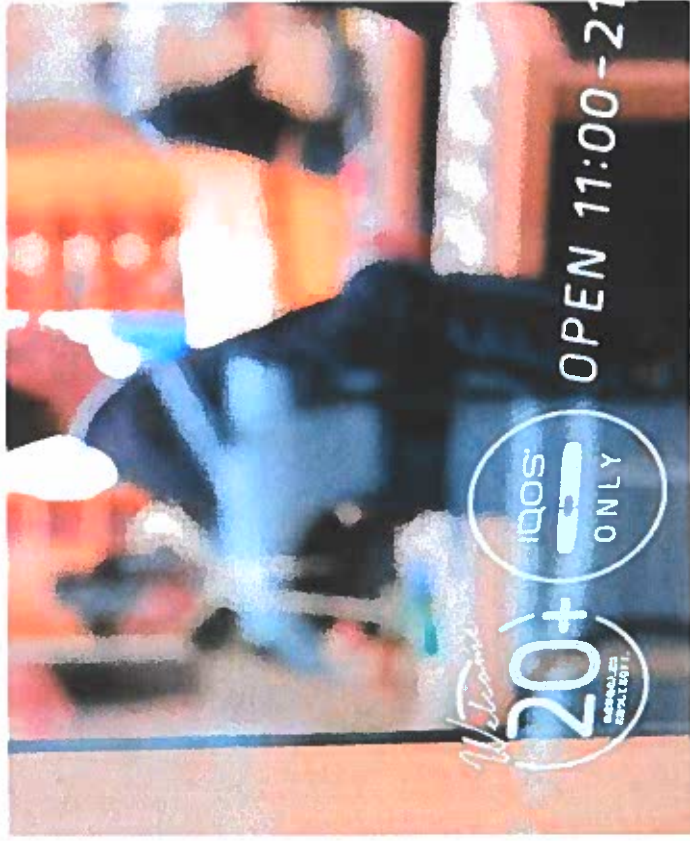
In Europe, all EU member states have transposed the EU Tobacco Products Directive, including the provisions on novel tobacco products, such as heated tobacco products and e-cigarettes. Most EU member states require a notification submitted six months before the intended commercialization of a novel tobacco product, and some require pre-market authorizations for the introduction of such products.

In some markets, regulators and public health bodies are developing new frameworks for smoke-free products. For example, in the U.K., a report published in 2018 by the Science and Technology Committee of the House of Commons concluded that e-cigarettes are significantly less harmful to health than smoking tobacco and that heated tobacco products may also offer a public health benefit despite their relative risk.² The report called for a risk-proportionate regulatory environment for both e-cigarettes and heated tobacco products and noted that e-cigarettes should remain the least taxed, cigarettes the most taxed, with heated tobacco products falling between the two. Furthermore, the U.K. Committee on Advertising Practice announced the removal of a prohibition on health claims in the advertising of e-cigarettes in the U.K., effective November 2018, with a review of this decision on market practices after 12 months.

Recently, the New Zealand government announced plans to introduce risk-proportionate regulation covering all tobacco and nicotine products. At the end of 2018, following a rise in the use of e-cigarettes among minors in the U.S., the FDA announced a policy framework that restricts the sales of flavored e-cigarettes (other than tobacco and menthol flavors). It also announced its intention to remove from the market certain e-cigarettes that are appealing to or marketed at youth. PMI fully agrees that youth should not consume any type of tobacco and nicotine product. Our marketing code strictly prohibits any activity that targets youth and we support regulatory measures that will make it less likely that youth start consuming tobacco and nicotine products.

More generally, PMI supports and advocates for risk-proportionate regulation, whereby cigarettes are subject to the most restrictive regulation, and smoke-free products are subject to regulation that encourages smokers to switch completely. In addition, we recommend that governments ensure that smokers who want to continue using tobacco or nicotine products have truthful and non-misleading information and are encouraged to switch to less harmful alternatives.

Long term, we can envisage a time when demand measures that encourage smokers to switch can be supplemented with supply measures on a country-by-country basis. We are committed to continue leading the industry in this massive transformation, and will be ready to support industry-wide supply-side measures as soon as scientifically substantiated smoke-free products have become widely acceptable and a large majority of smokers in a country have switched to them.



Above: An IQOS store in Ginzza, Japan

Inclusive access to smoke-free products

Our goal to replace cigarettes with smoke-free products extends to all smokers of all income levels and to all countries worldwide. We are only at the beginning of commercializing a fully fledged portfolio of smoke-free products and realize that additional efforts are necessary to find products that are affordable and acceptable to consumers in different parts of the world.

Of course, we continue to work on developing different product platforms that can help achieve this goal. We are also experimenting with other solutions to reduce the financial barrier of switching to smoke-free products, such as the temporary lending of IQOS devices, combined with promotional offers where permitted by local legislation.

Today, IQOS is sold in a few upper-middle-income countries, including Guatemala, South Africa, and Kazakhstan, and we have put in place a team to focus specifically on low and middle income countries (LMICs as defined by the World Bank classification) and how to include them in our vision for a smoke-free future.

Question to Goekhan Aladag, Director for Smoke-Free Products in LMICs

PMI is successfully commercializing IQOS in numerous developed countries with higher levels of income and health awareness, but what about developing countries? How is the issue of access to better alternatives considered for LMICs?

We started our transformation journey a few years ago with the aim of offering a better choice for all 1.1 billion smokers, regardless of where they live or what segment of the population they represent.

I am currently working with dedicated teams to provide affordable and innovative alternatives, as well as tailored business models for LMICs. These efforts are focused on providing a sustainable model for adult smokers living in these countries.

Our goal is to accelerate the end of smoking worldwide, including in developing countries, by making sure that all smokers that would otherwise continue to smoke have the right kind of access, awareness, and ability to afford better products.

In addition to developing and commercializing innovative solutions, my role is also to find a way to make sure consumers in these countries can be made aware that there are better alternatives to cigarettes.

In that regard, and without a doubt, governments play a key role in appropriately creating frameworks that encourage the promotion of less harmful alternatives for smokers. For me, the key learning here is that the more awareness is built in collaboration with authorities and civil society, the faster cigarettes will be replaced.

Working in this role, I often get asked whether our smoke-free vision and reduced-risk product proposition is a solution reserved for the developed world and what we are doing to help smokers in LMICs.

Clearly, every smoker in the world deserves access to better products. We are committed to do our part and come up with products and business models that make scientifically substantiated smoke-free products affordable and accessible to consumers in LMICs. It is part of the disruption we are driving and there is no blueprint – so we are building everything from scratch.



Above: An IQOS store in Bogotá, Colombia

Providing access to smoke-free products continued

PERFORMANCE AND NEXT STEPS

Two years ago, we introduced a set of business transformation metrics to make the actions we are taking to pursue our smoke-free vision measurable and verifiable. This year, we have expanded the number of metrics to better illustrate the massive changes taking place at PMI.

In 2015, only two of our manufacturing facilities produced smoke-free products for commercialization purposes. In 2018, seven manufacturing facilities were producing IQOS heated tobacco units and other nicotine-containing products, up from three factories in 2017.

Our commercial expenditure ratio shows how much of our total global spend on marketing, consumer engagement, and trade activities is dedicated to smoke-free products. Last year, more than half of our global commercial expenditure was dedicated to smoke-free products, which is remarkable considering that we have not yet launched smoke-free products in the majority of our markets.

The net revenue ratio refers to the proportion of our net revenues (operating revenues net of sales and promotional incentives) that is generated by the sales of smoke-free products (including electronic devices and accessories). Excise taxes are excluded from the net revenue figures.

Compared with last year, we have added two metrics to better illustrate the rapidity of our progress at individual market level. These new metrics show the number of our markets in which net revenues of smoke-free products

exceeded 10% or 50% of our total net revenues. In three markets already, smoke-free products have become the biggest part of our business.

Last three metrics show our smoke-free product shipment volumes (including both heated tobacco units and e-cigarettes) and our combustible tobacco product shipment volume (mainly cigarettes), as well as smoke-free product volumes as a percentage of total volume. It is our ambition that, by 2025, at least 30% of our shipment volume will come from smoke-free products.

Last, but most importantly, the table shows the number of people who are using IQOS and how many of them have stopped smoking completely. By the end of 2018, there were 6.6 million adult men and women who had stopped smoking and switched to IQOS.

In terms of next steps, we will continue executing our strategy to provide all smokers with access to the best smoke-free products.

As we developed and started to commercialize Platform 1, we have not been idle on the other platforms. Following the pilot of Platform 4 in the UK, we will be ready in 2019 to enter more markets with e-vapor products at scale.

We will continue engaging with external stakeholders to build support for the opportunity that a smoke-free future provides for consumers and society more broadly. We recognize that societal support is an essential step to enable the introduction of regulatory frameworks that can end cigarette smoking rapidly by encouraging smokers to consider smoke-free products.

And finally, we will continue to build our internal capabilities so that our organization is always fit for purpose and at the leading edge of technology, science, and user experience.

Business transformation metrics⁶

	2015	2016	2017	2018	Aspirations ⁷
Number of factories producing smoke-free products out of total number of factories	2 out of 48	2 out of 48	3 out of 46	7 out of 44	
Commercial expenditure (smoke-free/total)	8%	15%	39%	60%	
Net revenues ⁸ (smoke-free/total)	0.7%	2.7%	12.7%	13.8%	38–42% by 2025
Number of markets where net revenues from smoke-free products exceed 10% of total net revenues	0	1	5	19	
Number of markets where net revenues from smoke-free products exceed 50% of total net revenues	0	0	1	3	
Smoke-free product ⁹ shipment volume (billion units)	0.8	7.7	36	42	90–100 by 2021 ¹⁰ >250 by 2025
Combustible product ⁹ shipment volume (billion units)	881	845	791	767	<550 by 2025
Smoke-free product shipment ratio ⁹ (smoke-free/total)	0.1%	0.9%	4.4%	5.1%	>30% by 2025
Total IQOS users (in millions) ¹¹	0.2	2.1	6.9	9.6	
Estimated users who have stopped smoking and switched to IQOS (in millions) ¹¹	n/a	1.5	4.7	6.6	>40 by 2025

Product addictiveness



Nicotine is the substance in cigarette smoke that stimulates the brain and affects the mood, creating an effect that smokers will often describe as helping them to relax and concentrate at the same time, but it is also nicotine that causes the addiction and makes it so hard to quit.

Our smoke-free products allow adult consumers to enjoy tobacco in a way less harmful than cigarette smoking, delivering nicotine without smoke. They are designed to significantly reduce or eliminate the formation of HPHCs, while approaching, as much as possible, the taste, nicotine delivery, and ritual characteristics of cigarettes in order for people who smoke to switch to the alternative product.

Let's be clear on the scientific facts about nicotine. As FDA Commissioner Gottlieb has stated: "The nicotine in cigarettes is not directly responsible for the cancer, lung disease, and heart disease."²⁵ Decades of scientific research show that the primary cause of smoking-related disease is the HPHCs formed by the combustion of tobacco. But nicotine is addictive and it is not risk-free. It can increase a person's heart rate and blood pressure, which can be problematic for those with pre-existing heart disease or severe high blood pressure. Pregnant or breastfeeding women should refrain from nicotine use altogether. Nicotine-containing products should not be used by, or sold to, minors (see more on page 41.)

All this being said, without nicotine delivery and the overall sensory experience, it is likely that smoke-free products would not be viable alternatives for current adult smokers, making nicotine necessary to achieving tobacco-harm reduction.

We are working hard to achieve a future without cigarettes. As society progresses towards the elimination of the most harmful form of nicotine delivery, there needs to be a societal debate on the risks and potential benefits of long-term nicotine use, comparing it objectively with a wide range of other mood-changing substances such as caffeine, alcohol, or THC in certain countries. Nicotine is used by over 1 billion people every day. And with the right delivery method, nicotine use does not need to harm others. The world will definitely be a better place without cigarettes, but it is very difficult to see how this can be achieved without alternatives that deliver an acceptable sensory experience and nicotine.

Our responsibility in this domain has three aspects. First, we need to do our utmost to ensure that all our products are commercialized in a responsible way, helping to prevent youth nicotine initiation. Second, we monitor the use of our smoke-free products after launch on the market. This post-market surveillance will help us assess potential changes in prevalence, relapse, and complete quit rates towards nicotine abstinence, comparing cigarettes and smoke-free products. And third, we will continue to share our science and our post-market surveillance data relating to the risks and potential benefits of nicotine use to encourage a science-based and objective debate on this important societal question.

Responsible R&D

We have recruited more than 400 scientists, engineers, and technicians over the year.

The way we work emulates pharmaceutical industry standards and the draft guidance on MRTPA issued by the FDA's Center for Tobacco Products in 2012. Our research aligns with international standards and practices that assure the quality and integrity of clinical and non-clinical laboratory processes and include the Good Laboratory Practice, Good Clinical Practice, and Good Epidemiological Practice standards.

We restrict animal studies to situations where no alternatives are available, and perform all activities in accordance with applicable laws and regulations, as well as internationally established best practices in laboratory-animal care. We always follow the widely

recognized principles known as the "3Rs" of animal research: Replace, Reduce, and Refine.²⁶ We hope that in time we will be able to replace much or all animal testing with non-animal alternatives. In 2018, PMI and 24 other organizations collaborated on non-animal assessment of acute inhalation toxicity.²⁷

We recognize that scientific assertions from tobacco companies may be met with skepticism. Sharing our science and listening to feedback are therefore fundamental parts of encouraging debate with scientific experts, regulators, and the public on important questions about our innovative products.

Since 2008, we have published over 340 papers on smoke-free products in peer-reviewed publications. In 2018, we presented our results at an additional 150 scientific conferences

(2017-76). Since 2018, the data from our non-clinical and clinical studies about our smoke-free products has become open-source, freely available to the public.

Further, we open our systems biology methods and processes for quality verification via a scientific crowd-sourced platform called sbvIMPROVER. This state-of-the-art approach allows us to peer-review and scientifically verify our results. Since 2011, around 200 institutions have taken part in the program; they have developed parallel methods to effectively challenge us, but ultimately they verified our research. The results are publicly available.

Additionally, to secure trust with specialist stakeholders, we share detailed product data on a specialist platform called Intervals to facilitate dialogue and reproduction of the science. By the end of 2018, 20 studies, 57 protocols and 144 data sets were published. Our own dedicated science website (PMI Science) provides a wealth of information which feeds our regular bulletin.

In an additional step to promote independent research in the domain of tobacco harm reduction, we made a commitment in 2017 to contribute USD 80 million per year to the Foundation for a Smoke-Free World, up to 2030, on terms specified in the agreement. The Foundation has U.S. non-profit status and is an independent body governed by its own board of directors. It operates completely independently from PMI. The Foundation's role, as set out in its corporate charter, includes funding research in the field of tobacco harm reduction, encouraging measures that reduce the harm caused by smoking, and assessing the effect of reduced cigarette consumption on the industry value chain.



LEARN MORE ON TRANSFORMING OUR BUSINESS:

- Peer-reviewed publications ▶
- The Tobacco and Nicotine Database ▶
- PMI's views on regulation ▶
- PMI's views on the health effects of smoking ▶
- PMI's standards for animal testing ▶
- on www.pmi.com and www.pmisience.com

ADDITIONAL RESOURCES ON:

www.sbvimprover.com
www.intervalscience.com



Above: A scientist in PMI's R&D center in Neuchâtel, Switzerland

PILLAR 2

Driving operational excellence

Our efforts to drive operational excellence are reflected through established programs on ethics and compliance, responsible marketing, and prevention of illicit tobacco trade. As we progress on our transition, we are strengthening risk management in our supply chain and further developing human rights due diligence activities. In this section, we provide an update on our performance and key developments in 2018 for each of these topics.

IN THIS SECTION

- Responsible commercialization, and youth access and usage prevention **40**
- Maintaining a strong ethics and compliance culture **43**
- Delivering on our commitment to human rights **47**
- Case study **49**
- Human rights due diligence in Mexico**
- Sourcing raw materials and other supplies responsibly **52**
- Case study **54**
- Addressing social impacts in our electronics supply chain**
- Maintaining data privacy **59**
- Tackling the illicit tobacco trade **60**



Our human rights efforts cover all SDGs. Please see page 5



86.9%

Of employees participated in training sessions pertaining to our Guidebook for Success in 2018



1st

Pilot human rights impact assessments conducted in 2018

Responsible commercialization, and youth access and usage prevention



Above: A customer in an IQOS store in Bologna, Italy

Foreword

Tobacco product marketing is subject to extensive restrictions, including outright bans, throughout the world. We have robust internal policies and procedures in place intended to ensure that our marketing and advertising are directed only towards adult smokers. In some countries, our own standards are stricter than local laws and regulations.

We aim to market our products responsibly while providing adult consumers with meaningful information on the risks relating to our products. Our four core principles, which are applicable across the world without exception, are:

- We only market and sell our products to adult smokers;
- We warn consumers about the health effects of our products;
- Our marketing is honest, transparent, and accurate; and
- We respect the law and our high standards.

Responsible commercialization is an area where many stakeholders have expressed concerns, especially about how we communicate to adult consumers; whether we target non-smokers or minors; and whether we apply lower marketing standards in developing countries. The above four core principles drive our approach in all the countries where we sell our products and we welcome opportunities to discuss and improve this approach as part of our commitment to market our products responsibly.

Progress in 2018

The well-known health risks of smoking have led regulators to impose significant restrictions on cigarette marketing. We are clear that nicotine-containing products should be subject to strict regulations and robust enforcement to dissuade non-smokers from starting to smoke; and to encourage smokers to quit. But it is equally clear that the millions of men and women who wish to continue to smoke should have the choice and appropriate information to switch to better alternatives.

Conventional and smoke-free tobacco products are fundamentally different. While our four basic marketing principles apply to all products, this difference means that we apply some specific rules and processes to conventional and smoke-free products.

An overview of our marketing principles for combustible products is available online. The Good Conversion Practices serve as the bedrock for our engagement with adult smokers to support them in switching to smoke-free products while discouraging unintended use; these products are not for people who have never smoked or for those who have quit smoking. We are also clear that smoke-free products are not risk-free nor are they a safe alternative to cigarettes.

Underpinning our marketing practices is PMI's Guidebook for Success – our Code of Conduct (see page 43 for more). In 2018, we provided approximately 23,440 training sessions on our Marketing Code through different channels to employees and relevant third parties. Marketing initiatives across markets are subject to reviews and approvals as required by our strict standards. Our Senior VP, Commercial, is the owner of the Marketing Code and our VP and Chief Ethics and Compliance Officer oversees our Ethics & Compliance (E&C) program. Adherence to our Marketing Code and to all our Principles & Practices is monitored by the Internal Controls function along with the independent Corporate Audit department, which reports directly to the Board's Audit Committee.

Youth access prevention

We know that great care must be taken when it comes to preventing youth access to and usage of our products. Nicotine is addictive. It is not risk-free, and it poses particular risks for adolescents; youth should not use any nicotine-containing product.

We took this aspect into consideration right from the start, as we were developing our new products, and continue to do so as we expand our portfolio. We do not conduct studies on youth; however, studies that we have conducted among young adult never smokers between legal smoking age and 25 years of age suggest that our smoke-free products are not attractive to them, as evidenced by the very low levels of intention to try and intention to use reported when they were exposed to various forms of IQOS branded communications. In particular, young adult never smokers, between legal smoking age and 25 years of age expressed particularly low levels of positive intention

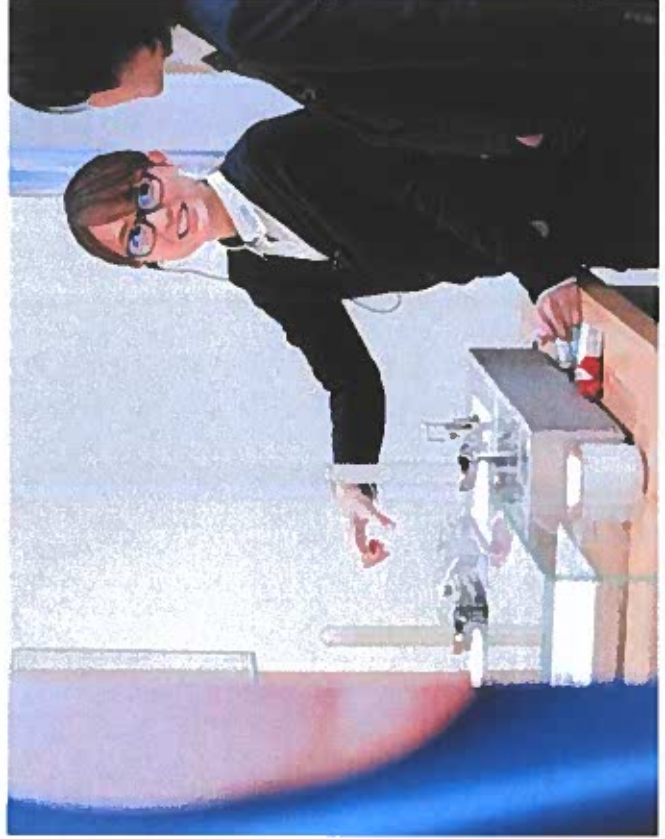
to use IQOS, which varied between 0% and 1.1%. These results are consistent with two recent independent studies in Japan and Switzerland that show that the use of heated tobacco products among middle- and high-school students is extremely low (see page 77). Our marketing must be honest, accurate, and transparent, and our principles must be understood and properly implemented. All our marketing and sales activities must respect applicable laws, global standards of decency, and the local culture and practices prevailing in the country where the activities will be conducted. To ensure that our Marketing Code is implemented as intended, each PMI affiliate head aims to ensure that the affiliate uses a robust, and substantive review and approval process, such as a brand marketing review, coupled with an auditable documentation trail.

In addition to principles requiring compliance with all applicable laws and regulations, we also have internal policies and procedures in place to ensure that all marketing and advertising are directed only towards adult smokers or users of nicotine-containing products. Examples of this in action are: the complete absence of cartoons, youth-oriented celebrities, or models who are or appear to be under the age of 25; and no names or logos of our brands on any promotional items likely to be used or seen by minors.

We support regulation that ensures that only adults can buy tobacco and other nicotine-containing products as well as the strict enforcement of minimum-age laws and penalties for adults who provide tobacco products to minors. We also provide guidance to retailers to ensure that they are aware of underage regulations and that they understand their role, even in the absence of relevant regulations, in preventing sales of tobacco and other nicotine-containing products to minors.

Our Good Conversion Practices – a summary

1. Smoke-free products are for adult smokers who want to continue enjoying tobacco or nicotine;
2. We do not offer smoke-free products to people who have never smoked or who have quit smoking;
3. Our goal is to switch every adult smoker who would otherwise keep smoking combustible products to smoke-free products, such as IQOS. We are committed to supporting adult smokers in their switching journey through education and guidance;
4. Smoke-free products are not an alternative to quitting. The best choice for consumers concerned about the health risks of smoking is to quit altogether;
5. To experience the benefit of smoke-free products, adult smokers should switch completely and abandon smoking permanently; and
6. Smoke-free products are not risk-free or a safe alternative to cigarettes, but they are a much better consumer choice for smokers who wish to continue to use tobacco and nicotine.



Above: A customer in an IQOS store in Ginza, Japan

Responsible commercialization, and youth access and usage prevention continued

PERFORMANCE AND NEXT STEPS

PMI has a heightened level of openness as our transformation expands. We monitor stakeholder feedback and track any complaints.

Our Marketing Code is strong and enforced globally. Nevertheless, responding to stakeholders' concerns, we are reviewing our business activities to ensure that youth are not targeted or encouraged to use any of our products. We will publicly report the results of that review by the end of 2019.

This will further inform our work on responsible commercialization, which is one of the priority outcomes of our 2018 sustainability materiality analysis.

We comply with all legal requirements for product and service information, labelling, and marketing communications. We report on label-related class actions and individual cases in our 10-K disclosure, which can be found on the U.S. Securities and Exchange Commission website, www.sec.gov.

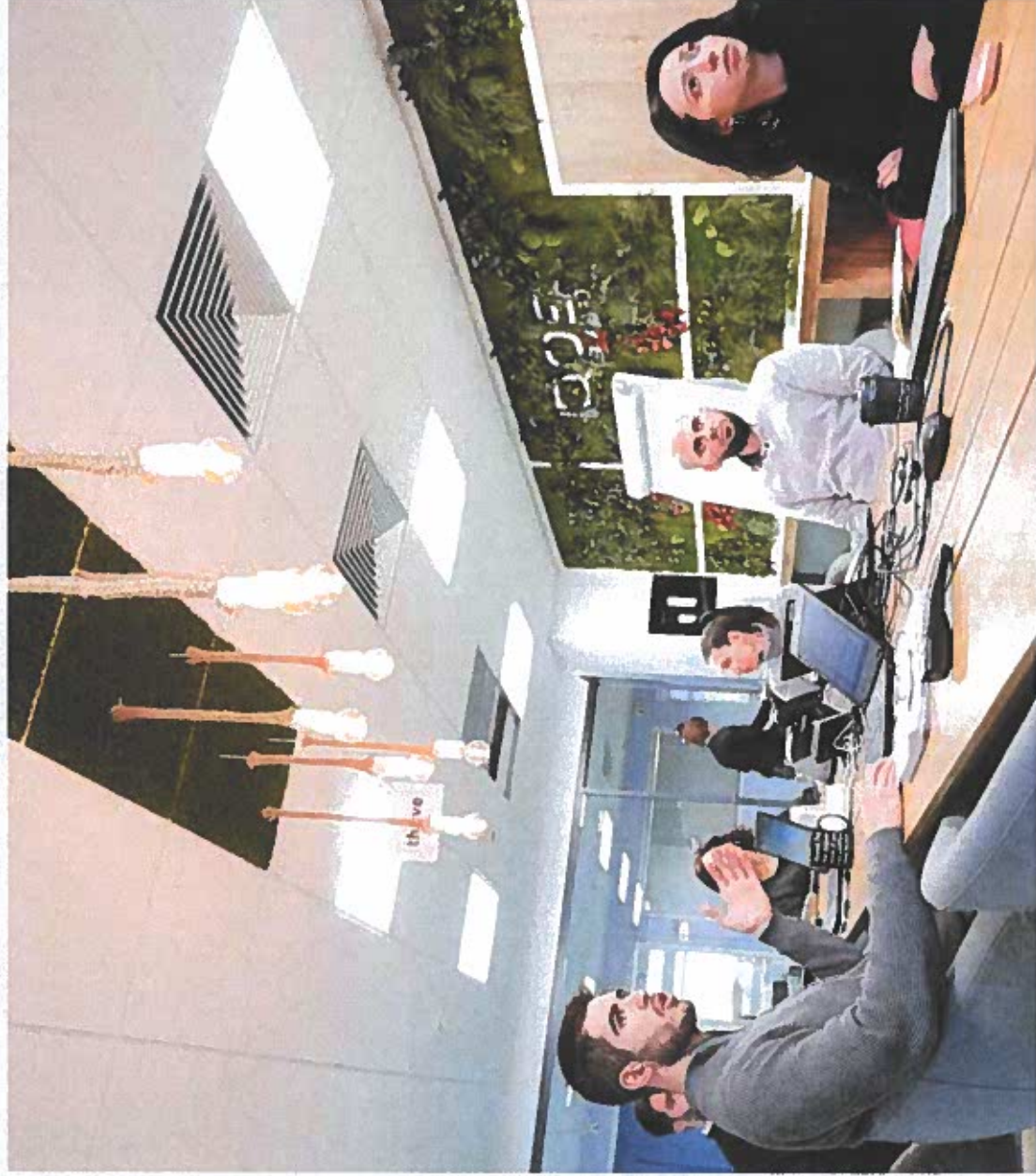
23,438

Training sessions on our Marketing Code completed by employees and relevant third parties in 2018



Above: An iQOO store in Ginza, Japan

Maintaining a strong ethics and compliance culture



Above: Employees in PMI's office in Bogotá, Colombia

Foreword

The business transformation necessary to achieve a smoke-free future depends on a strong foundation of principles and values delivered through actions on the ground. We want to demonstrate seriousness and professionalism through transparent and professional communication, coherent regulatory engagement, and a culture of respect, honesty, and fairness.

The ethics and compliance (E&C) program at PMI is the foundation for these elements of our transformation. At the core is our Code of Conduct. We strive to maintain a strong ethics and compliance culture through a combination of elements: Principles & Practices, which provide specific guidance on key topics; training and communications, which build understanding and commitment; and a diligent and fair investigation process for suspected misconduct combined with proportionate disciplinary action, which together reinforce a speaking-up culture and confidence in organizational justice.

We have developed and continue to improve each of these elements, informed by empirical research and insights gained from our own cases on how and why people behave as they do.

The E&C program aims to enable employees to take courageous decisions on difficult questions, and to help PMI achieve commercial success and operational excellence while adhering to responsible business practices.

Maintaining a strong ethics and compliance culture continued

Progress in 2018

A stronger compliance culture every day

Our Guidebook for Success, together with its supporting Principles & Practices, covers the following core risk areas: anti-competitive behavior; marketing and sales; conflicts of interest; workplace and labor practices; environment; health, safety and security; trade, and information security. It also covers a range of risk areas: prohibiting bribery and corruption, regulating gifts and entertainment, prohibiting facilitating payments, and regulating political contributions and advocacy activities. The Guidebook is available in 45 languages on the PMI website and employees can access it at all times on their company mobile devices.

In times of transformation, when legal frameworks are often still developing to take into account rapid change, using good ethical judgement is critical. While codes and training help promote the culture and behaviors desired, we aim to build and reinforce a culture in which employees own the sense of corporate integrity, where they are accountable (and hold others to account), and where PMI values guide everyday business decisions. We promote a way of working where we pause before taking action, we ask for help when we need it, and we speak up about things that do not seem quite right.

Our VP and Chief Ethics and Compliance Officer, who has a reporting line to PMI's President, External Affairs, and General Counsel, and reports regularly to the Board and its Audit Committee, oversees our E&C program. Adherence to our Guidebook for Success is monitored by the Internal Controls function and the independent Corporate Audit department, which reports directly to the Board's Audit Committee. Suspected violations of the Guidebook or other misconduct are investigated by the E&C department.

Preventing bribery, corruption, and anti-competitive practices

Corruption, bribery, influence trafficking, misleading information, secrecy about issues that are material to a decision, and dishonesty in general are not acceptable forms of doing business at PMI. Our Guidebook for Success, together with its supporting Principles & Practices, govern our interactions with government officials, which are conducted transparently, with integrity, and in adherence to local laws.

In particular, our Guidebook for Success and Principles & Practices cover a range of anti-bribery topics, including giving and receiving gifts and entertainment, facilitating payments (prohibited), contributions involving or connected with government officials, third parties who interact with government officials on our behalf, membership of organizations, advocacy activities, and reporting and record keeping. We also publicly disclose the limited political contributions we make on our corporate website.

We comply with advocacy rules, report on our activities as required in several jurisdictions, and are transparent when others engage on our behalf. We also prohibit third parties from interacting with governments, public institutions, or other audiences on our behalf from engaging in bribery or in other forms of inappropriate influence. We make our internal standards known to them, integrate such standards in our agreements with them and monitor their compliance.

In addition, leveraging our values, cross-functional knowledge, and experience, we connect with international organizations and global experts, such as Transparency International, Business 20 (B20), and the International Anti-Corruption Academy, to contribute to the fight against corruption, seek broad public-private cooperation, and support collective action in building effective, accountable institutions at all levels.



Above: Employees at Philip Morris Operations Center in Lausanne, Switzerland

Workplace integrity

Our Guidebook for Success and the related Principles & Practices establish our standards for a work environment that is respectful, inclusive, and safe. We are committed to maintaining an environment in which all PMI employees have an equal chance to contribute and succeed based on the merits of their work. We strive to eliminate discrimination, harassment, and unsafe conditions in the workplace.

We perform an ethics and compliance “health check” of our organization every few years using a global ethics and compliance census. We completed the last one in December 2018, in order to “check the pulse” of employees during this time of fundamental change and transformation. We provided the online assessment tool to nearly 40,000 employees and achieved a 70% response rate.

The results of our 2018 ethics and compliance census confirmed that the fundamentals of our E&C program remain strong. More than 90% of respondents agreed that PMI, the head of their business affiliate, and the CEO of PMI are each committed to doing business ethically. More than 90% of respondents also confirmed that they are aware of the E&C department and their duty to speak up about suspected misconduct, and that an investigation would take place if they were to speak up about a potential ethics and compliance violation.

Nevertheless, we saw early warnings that some employees may be increasingly concerned about retaliation, even though 70% of respondents still agreed that they would not face retaliation in any form for speaking up about potential misconduct. This represents a six-point drop on previous research completed in 2015. To address this and some other points raised by the census results, we are currently working to develop action plans that we will execute during 2019.



Above: Employees in PMI's manufacturing facility in Dakar, Senegal

Risk management at PMI

Our governance and technical procedures for risk management align with the Sarbanes-Oxley Act. Our Chief Strategy Officer reports to our CEO directly on strategic group risk. Strategic and operational risks are managed in an integrated way that accounts for functional, market, and product risks.

PMI's integrated risk assessment process, in place since 2015, brings together the functions of Corporate Audit, Internal Controls, and Ethics & Compliance. These groups collaborate to understand, assess, and advise on risk and its potential consequences for PMI. The work is based on feedback from the markets as well as on top-down strategic analysis. When a risk assessment requires a formal follow-up, PMI nominates an accountable person who follows up with an action plan and reports it up to Board level.

Operational and strategic risks, such as safety, leaf supply, climate change, electronic waste, or labor conditions, are well covered by our risk teams and management processes through which, increasingly, more complex sustainability and human rights risks and opportunities are being embraced at PMI. This is being done in parallel to the challenging work to transform to a smoke-free future: for example, by assessing diverse risks relating to the shift from a business-to-business model to a business-to-consumer model.

Maintaining a strong ethics and compliance culture continued

PERFORMANCE AND NEXT STEPS

In 2018, 86.9% of employees participated in training sessions pertaining to our Guidebook for Success. A total of 193,000 training sessions were completed across PMI, all of which helped our employees and relevant third parties to build their awareness about risks to the business, good ethical judgement, and how to speak up should they notice something wrong or something that could be improved.

We received 872 reports of suspected misconduct in 2018, of which approximately 40% were substantiated (2017: 714 received, 40% substantiated). None of the substantiated misconduct resulted in a material consequence for PMI.

A third-party-operated Compliance Helpline is available 24 hours a day, seven days a week, in all languages spoken at PMI. Although anonymous reporting is available, approximately four out of five people who used one of the many channels available to report suspected misconduct gave their name.

The principal categories of reported misconduct were: "I felt it" and "I heard" and "Workplace Integrity," accounting for approximately 60% of the cases. Over half of the employees whose misconduct was substantiated left the company, while the other half received written or verbal warnings, sometimes with financial penalties.

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

86.9%

Of employees participated in training sessions pertaining to our Guidebook for Success in 2018



Above: Employees in PMI's office in Tokyo, Japan

Delivering on our commitment to human rights



Above: Hand rollers of K. areh cigarettes in PMI's Indonesian affiliate, Sampoerna

Foreword

Respect for human rights is fundamental to operating a sustainable global business. At PMI, we embed respect for human rights in our culture, so that human rights principles govern the way we work with employees, suppliers, consumers, and the communities where we operate.

Different policy instruments set out how we want to achieve this aim: our Commitment to Human Rights, our Guidebook for Success, our Responsible Sourcing Principles, and our Agricultural Labor Practices Code. They align with our core values, and commit us to managing our human rights impacts in a systematic way, in accordance with the United Nations Guiding Principles on Business and Human Rights (UNGPs).

To ensure that we uphold our corporate responsibility to respect human rights in line with the UNGPs, in the diverse and challenging environments where we operate and from which we supply, we must focus on where we have the greatest potential human rights risk. We are continuously striving to improve our practices with respect to identifying risks to "rights holders" and we are strengthening our due diligence processes helping to drive continuous improvement and raise standards across our value chain.

Delivering on our commitment to human rights continued

Progress in 2018

Our human rights commitment is delivered by practical actions across our operations, and our supply chain. Our Human Rights Roadmap directs the actions across functions which are targeted to be delivered by the end of 2020. Actions fall under four broad aims, and typically range from capacity building and due diligence processes to grievance mechanisms and clear reporting.

The Roadmap one year on

The Roadmap is built on extensive internal engagement and consultation with experts in human rights, business partners, and other stakeholders. Its development included a high-level, company-wide human rights risk mapping, data collection and analysis of PMI's group-level policies, procedures, and practices. Periodically, we will share our progress in implementing the Roadmap.



Embedding a culture of respect

Top-down senior commitment counts. That PMI's senior management is instilling a culture of respect for human rights throughout our operations provides the ground for meaningful actions down the road. This sends an important message to employees and business partners about the need for practical understanding of human rights risks and of PMI's commitment.

Embedding an ethos in a corporate culture starts with awareness raising and training. We have provided tailored training programs to our corporate auditors and the regional security personnel, and specific training on modern slavery and human trafficking for relevant supply chain employees. We also started raising awareness on the foundations of human rights for new employees in our External Affairs department and at our Operations Center. In parallel, we continue engaging with our suppliers to build their understanding of PMI's Responsible Sourcing Principles (RSP) and comprehensive Implementation Guidelines.

As per our commitment in the Human Rights Roadmap, we started benchmarking and reviewing key Principles & Practices to include, where needed, relevant human rights considerations, starting with the PMI Marketing Code, and the employment (including all relevant labor rights) and anti-bribery policies. We also worked on a new security policy and a human rights guideline, to reinforce our security service suppliers' due diligence process, especially for those who carry weapons to fulfil their duty; both documents will be rolled out in 2019.



Human rights due diligence

Human rights due diligence is the cornerstone of our human rights program. Over the last years, we have developed due diligence processes for labor rights in our tobacco supply chain; environmental, health, safety, and security risks throughout our operations; and business integrity risks across our value chain.

Building on our early work, we continue undertaking due diligence activities in line with the UNGPs to identify, prevent, and mitigate adverse human rights impacts of our global operations and supply chain. In 2018, we performed a corporate human rights risk assessment to identify our potential human rights risks at a global level, confirming that we are focusing on the right issues in line with our Human Rights Roadmap. We also integrated sustainability and human rights considerations in our ethics and compliance risk briefs included in PMI's integrated risk assessment.

ask our suppliers to provide their workers with easily accessible ways to raise concerns, free from any retaliation. An effective grievance mechanism is a strong element of due diligence and remediation.

In our tobacco supply chain, our Agricultural Labor Practices (ALP) Code states that

"Workers should have access to a fair, transparent, and anonymous grievance mechanism." Such mechanisms are available in several countries where we source tobacco. The most common form is a free helpline that is supported by working with local authorities, professional agents, and NGOs. Concerns can also be raised with field technicians at any time. As we move forward, we will continue looking into ways to provide better access to grievance mechanisms throughout our operations and supply chain.



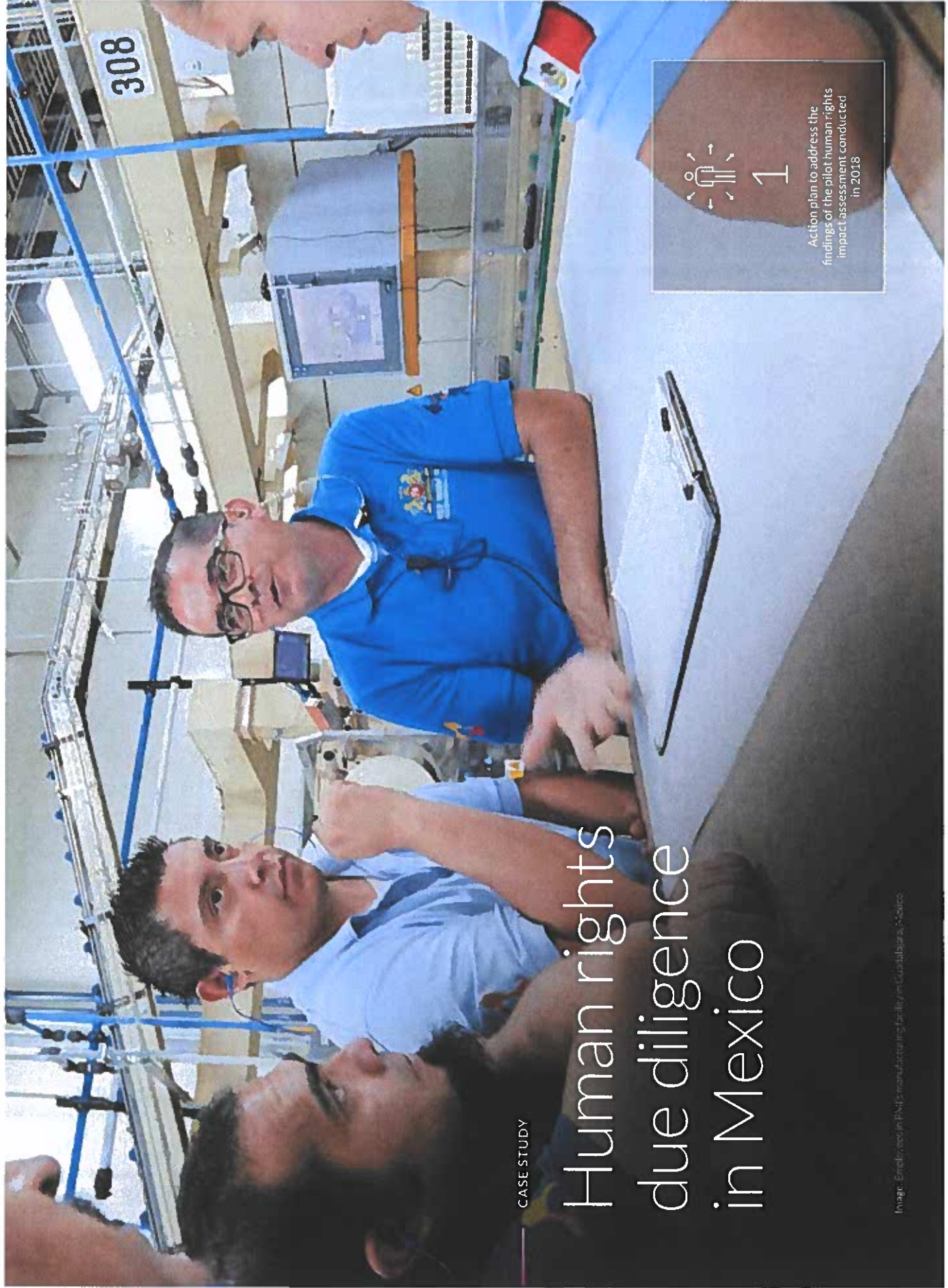
Reporting on our progress

This report serves as a means to share our progress and challenges as we advance on our Human Rights Roadmap.



Human rights grievance mechanisms

Providing access to effective grievance mechanisms in our operations and across our supply chain is a key requirement of the UNGPs and a core element of our due diligence approach. Internally, we have clear policies, run regular training and ensure robust processes are in place to encourage employees to speak up if things don't seem right or can be improved. The same applies to our supply chain where we believe that everyone should be able to have a voice and seek help. In our RSP, we specifically



CASE STUDY

Human rights due diligence in Mexico

Action plan to address the findings of the pilot human rights impact assessment conducted in 2018

Image: Employees in PwJ's manufacturing facility in Guadalupe, Mexico

CASE STUDY

Human rights due diligence in Mexico

In accordance with the commitment in our last report, we reinforced our due diligence processes by conducting a pilot human rights impact assessment in 2018 with the support of Article One, a specialist human rights consultant. Its scope was limited to our manufacturing operations, non-tobacco leaf supply chain, security operators, and communities impacted by our operations in the country. Our tobacco supply chain and marketing practices were not in scope of this first pilot exercise. The former is largely covered by our Agricultural Labor Practices (ALP) program and will be included in the 2019 impact assessment, which will also include our marketing activities and related internal reviews and control processes. In parallel, a cross-functional working group will conduct a comprehensive review of the steps PMI takes across its business activities to market its products responsibly.

Our pilot assessment comprised five steps:

1. Preparation

Review by the consultant of PMI policies, procedures, and controls, including interviews with functional heads at the Operations Center (including People & Culture, Health and Safety, Supply Chain, Security, E&C, Procurement and External Affairs).

2. Methodology and research

Definition of the method and scope of the assessment, based on country risk briefs and scoping questionnaires, to identify the "rights holders" to be interviewed, the PMI facilities to visit, and the external stakeholders with whom to engage.

3. Assessment
In-country interviews and visits by the consultant with PMI local management and several "rights holders," such as factory workers, contracted employees, trade union representatives, suppliers, third-party staff, as well as external stakeholders, such as non-governmental organizations (NGOs), local authorities, trade associations, and international human rights organizations.

4. Integration

Based on the findings, recommendations and a corresponding action plan, timeline and accountability program were developed for the Mexico-based team to implement. The corporate human rights team monitors the follow-up of the actions at the country operation level.

5. Reporting

Reporting on the action plan and learning from this exercise.

The pilot assessment in Mexico revealed strengths in safety, employee loyalty, diversity and inclusion policies and practices, and parental leave, and a high awareness of the internal grievance process. In parallel, it substantially improved awareness of human rights impacts in PMI Mexico. It also led to an action plan to address the following areas:

- Working time: even though in compliance with Mexican labor law, some PMI workers in Mexico sometimes work excessive over time especially during peak season. This may pose a potential human rights risk related to factory workers' safety;
- Although evening and night transport is provided for all factory workers to and from the workplace, some workers expressed the need to review the city areas covered by this service;

- Long shifts for certain vendor-employed drivers and security guards in retail delivery may pose a risk of road safety-related accidents among PMI suppliers' drivers;
- Risk to personal security and life of truck drivers and guards from robberies;
- Risk of wages below living wage level for some suppliers' staff; and
- Risk of substandard working conditions for some suppliers' workers in low-skill manufacturing and services. Identifying and addressing human rights impacts on the ground is a complex task involving many different issues, functions, and segments of the value chain. Even though limited in scope, this exercise raised awareness of human rights at the country level and further developed employee competencies and skills to address human rights issues. From a corporate perspective, we aim to use local learnings to enhance our global understanding and management of human rights impacts.



Above: An employee in PMI's manufacturing facility in Guadaluajara, Mexico

PERFORMANCE AND NEXT STEPS

In 2019, all relevant functions will continue implementing their action plan as per our Human Rights Roadmap. A key focus will still be raising awareness of human rights across the organization. To go further, and to reach our employees in all markets, we will be reviewing our human rights e-learning tool to ensure that practical training content is accessible and relevant to all employees. We will further review and integrate human rights considerations into our Principles & Practices, our integrated risk assessments and our Corporate Audit protocols.

Following the pilot assessment in Mexico, we will focus on implementing its findings and will conduct a second human rights impact assessment in 2019 elsewhere. We expect to gain an even better understanding of the actual and potential human rights impacts at site level and to use feedback through our due diligence program. We will report the findings in next year's Sustainability Report.



Above: Hand rollers of kretek cigarettes in PMI's Indonesian affiliate, Sumbawa

2nd

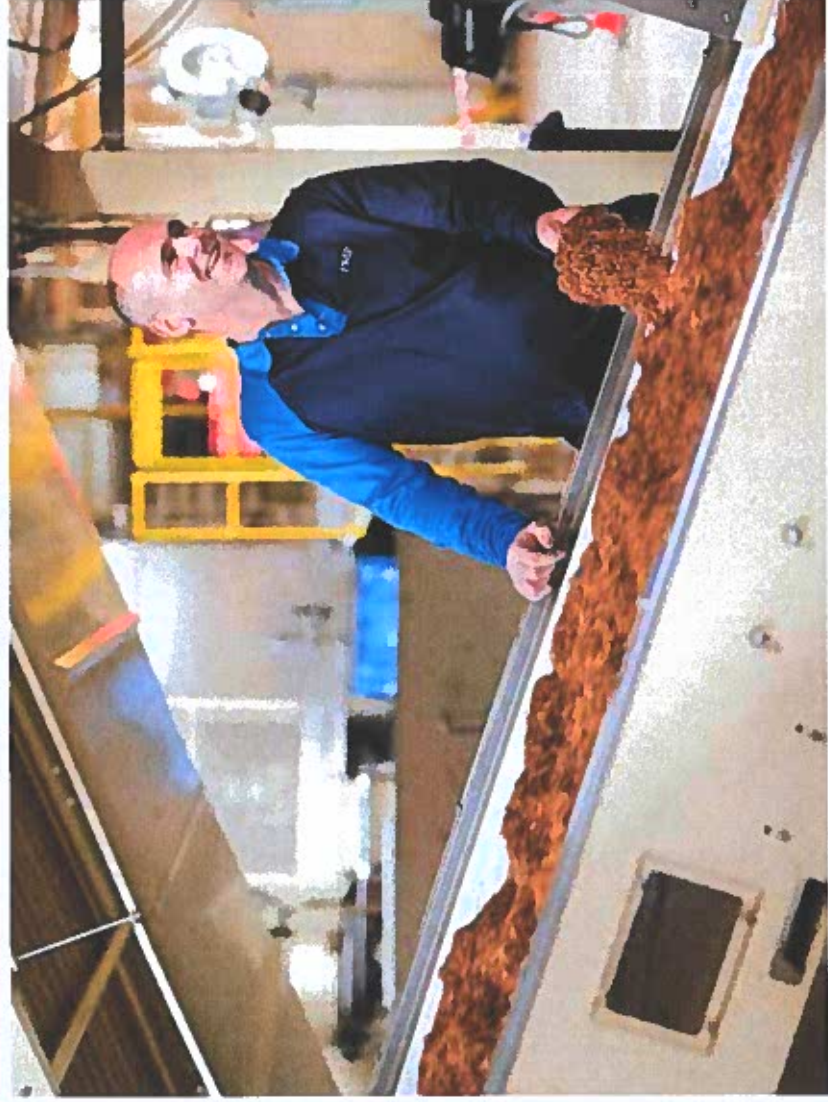
Human rights impact assessment
to be conducted in 2019

Sourcing raw materials and other supplies responsibly

— TARGET —

2,000

Suppliers assessed through the supplier due diligence platform (STEP - Sustainable Transformation Enables Performance) by the end of 2020



Above: An employee in PMI's manufacturing facility in Neuchâtel, Switzerland

Foreword

A central pillar to becoming a leader in sustainable business practices is engaging with our suppliers to achieve responsible, sustainable supply chain practices.

Our business has a significant, global supply chain. We have a large agricultural supply chain, ranging from tobacco growers to producers of other agricultural raw materials, such as clove, menthol, and guar gum. Another part of the supply chain consists of manufacturers of direct materials used to produce cigarettes and other tobacco products, such as acetate (low for filters) and paper (both cigarette paper and packaging materials). Also key to our business are the manufacturers of machines for our cigarette and heated tobacco products factories, a highly specialized industry. A recently added part of our supply chain includes manufacturers of electronic devices for heated tobacco products and e-cigarettes. Finally, we work with thousands of suppliers of goods and services that are not specific to the tobacco business, but essential to any business, such as office equipment, company cars, and consultancy.

In our tobacco leaf supply chain, PMI has direct contracts with approximately 21,000 tobacco farmers and direct contractual relationships with more than 20 third-party suppliers contracting over 329,000 tobacco farmers (excluding China). Beyond tobacco, our supply chain comprises more than 36,000 suppliers across 180 markets with an annual spend of around USD 10 billion.

Our total supply chain has a significant environmental, social, and economic footprint that calls for comprehensive programs to address risks and achieve improvements.

PMI's approach to sustainable supply chain management includes a set of Responsible Sourcing Principles (RSP) which define the expectations for our suppliers, and their supplier's too. Our supply chain due diligence system aligns with the UNGPs. The specific sustainability risks of our agricultural supply chain are addressed through our Good Agricultural Practices (GAP) and the Agricultural Labor Practices (ALP) program.

We aim to anticipate and respond to sustainability issues arising in our supply chains through our management approach and by working with our suppliers and other stakeholders.

Progress in 2018

We formally assess where our supply chain risks are and how to manage them. We do this by considering the risks (social, environmental, and governance) of the material or service supplied, as well as the country in which the material is produced or the service is delivered. The materials with the most significant sustainability risks in our supply chain are:

- Tobacco leaf;
- Other agricultural products such as clove, menthol, and guar gum;
- Acetate tow (filters);
- Wood-based products used in packaging; and
- Electronic devices and components (for products such as IQOS).

Assessing suppliers against our Responsible Sourcing Principles (RSP)

We published our RSP in 2017 along with the RSP Implementation Guidelines to set the requirements for responsible approach to the sourcing of our materials and services. The RSP has been translated into 26 languages and covers environmental, social, and governance topics. We provide suppliers with information and engage with them on the need, over time, to align their business practices with our RSP. A major focus in 2018 was delivering training and workshops for PMI procurement teams as part of the capacity-building process with suppliers.

In parallel, we have designed a Supplier Due Diligence Framework which is currently being developed in line with international best practices.

The Framework aims to regularly evaluate suppliers' status in social, environmental, and business integrity compliance and to address gaps within our RSP or other commitments. This

means an initial screening of suppliers according to geography and industry. This screening will identify the suppliers that need to be more closely monitored and assessed. Monitoring may range from self-assessments, to desktop reviews, and up to supplier's on-site audit.

Our objective is, of course, to support suppliers in a continuous improvement approach to align their practices with our requirements, improving the overall working and living conditions in our supply chain. An integral part of the Supplier Due Diligence Framework is a process to ensure that suppliers have established action plans for potential gaps and that they rigorously and timely implement them. Tracking and reporting on our suppliers' performance, both internally and externally will drive transparency. In addition, we will continue to look for further opportunities to collaborate with our suppliers in specific projects to improve social and environmental sustainability.

We are setting up an online supplier platform (based on information collection and data exchange) to deliver the Supplier Due Diligence Framework in practice.

During 2019, we intend to invite the first wave of suppliers to join the platform as the core part of their assessment against our RSP. The target is to assess 100% of global suppliers of direct materials and devices using the platform. Suppliers of technical and indirect materials will be the next target group.

We plan to expand the assessment and engagement work over the next two years. To push sustainability in the smoke-free product supply chain in 2018, we launched initiatives with tier 1 and tier 2 electronic component suppliers, for example:

- Written commitment to the RSP by all tier 1 and tier 2 suppliers directly managed by PMI;
- Audits with Verité, our supply chain assessment partner, of the key tier 1 suppliers in Asia;
- Pilot project to promote better recruitment and employment practices for foreign workers in Asia; and
- A review of tier 2 electronics suppliers directly managed by PMI, including visits and preliminary risk mapping.

The 2018 conflict minerals submission to the U.S. Securities and Exchange Commission (fiscal year 2017) reported that all 259 smelters, except one, in our electronics supply chain covered in that report are certified conflict-free.²⁸ To continue to build internal capabilities, we introduced a conflict minerals e-learning for procurement employees.

Additionally, part of our procurement work in 2018 was to focus on the strategy for carbon emissions and deforestation in our non-leaf direct materials supply chains. We engaged a specialist organization to collect and analyze data on the carbon emissions of our paper, board, and acetate tow supply chains, in order to better understand the opportunities and set targets for suppliers during 2019.

We also worked with our principal paper and board suppliers on deforestation and traceability of wood-based products. An initial analysis of the deforestation risk identified acetate tow as a top priority area for engagement in 2019, followed by board and paper. Our strategy for assessing deforestation risk is described on page 97.

Engaging with direct materials and electronics suppliers

In 2018, we specifically looked at risks in our IQOS supply chain. As illustrated by the case study on the next page, the way we work comprises on-site engagement, assessments, establishment of action plans, and improvement tracking. Where required, we also conduct conflict minerals reporting.

Our Supplier Due Diligence Framework

Approach

- Risk-based
- Data-driven
- Systematic
- Scalable

Objectives

- Assess performance of suppliers against the Responsible Sourcing Principles
- Define corrective action plans to address gaps
- Monitor progress against plans
- Report



CASE STUDY

Addressing social impacts in our electronics supply chain



>1,000

Workers surveyed by our supplier to better understand issues in the recruitment process



\$2.7m

Reimbursed by the supplier to workers after the establishment of an average recruitment cost per country of origin

CASE STUDY

Addressing social impacts in our electronics supply chain

We are still new to the world of electronics supply chains but we are not new to engaging with stakeholders to promote high standards for work conditions in our supply chains. Since 2010, we have partnered with an international fair labor NGO, Verité, to improve labor practices on the farms from which we source tobacco. Since 2016, our collaboration has embraced efforts to improve human rights in our electronics supply chain too.

Our work so far has focused on understanding our exposure to social sustainability risk. Our due diligence work started with formal assessments of our tier 1 suppliers. We found that most supplier's aligned with our RSP, although some had issues that needed to be resolved, primarily recruitment practices and the living and working conditions of migrant workers.

With one of our major electronics suppliers in Asia, our journey started in late 2016, where PMI worked with Verité to carry out a comprehensive assessment of the labor management systems to understand the living and working conditions of workers, particularly migrant workers, who make up a significant percentage of the supplier's labor force. During 2017, we worked with this supplier to establish a labor management system at the manufacturing site and to eliminate some of the more serious issues, like retention of passports and excessive working hours.

In 2018, we undertook a full follow-up audit that included interviews with 40 workers in their native languages, as well as interviews with management and third-party service providers. We cross-checked our findings against the supplier's policies and procedures and our RSP.

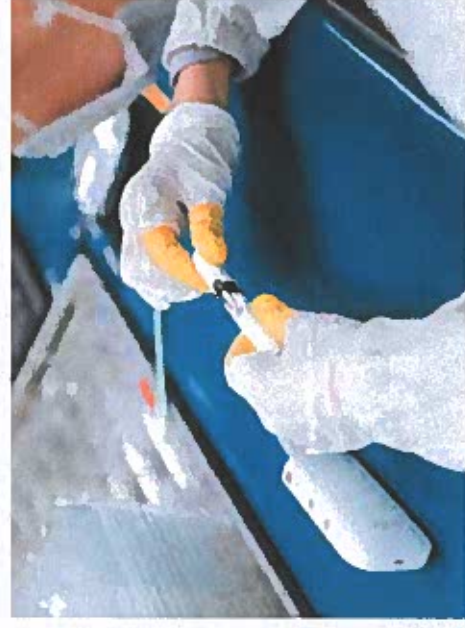
Health and safety management was good, working hours were within the RSP limits, and workers were in possession of their passports. However, the interviews, the review of internal documents such as worker contracts, and the analysis of supplier agreements identified important gaps. Recruitment fees were being charged to migrant workers, the living conditions needed improvement, deductions from wages were unclear, and the grievance mechanism was not effective. A prompt response was needed to address these findings.

With support from senior management at the supplier, we established an ambitious action plan that required the supplier to close the major gaps swiftly. We also undertook a benchmarking exercise to understand better how other manufacturers in the region have managed similar issues.

At the end of 2018, the supplier surveyed over 1,000 workers at the site to better understand issues in the recruitment process. As a result, the supplier established an average recruitment cost per country of origin, and then reimbursed all workers at the site, not only those working on

our products. Total reimbursements amounted to the equivalent of more than USD 2.7 million. The supplier also decided to stop outsourcing its worker recruitment process and to develop a training and audit process for its own recruitment service providers. Additionally, the supplier informed PMI that it would no longer recruit from those countries of origin where there is known to be a very high risk of worker exploitation. The supplier further committed to improve grievance mechanisms, factory manager training, and communication with candidate workers in their home countries before they migrate. Moreover, the workers will move to new dormitories in 2019.

Following our recommendations, the supplier joined a program that aims to promote ethical recruitment practices. The program includes an external worker helpline, multiple rounds of in-depth worker surveys to help improve working conditions, worker-management communication training, and effective pre-departure orientation training, along with other measures. The program should extend until early 2020.



Above and right: IQOS device manufacturing in Asia

Sourcing raw materials and other supplies responsibly continued

Implementing Good Agricultural Practices (GAP) for tobacco suppliers and farmers

Sustainable tobacco production is the efficient and competitive production of quality tobacco in conditions that limit, as much as possible, the impact on the natural environment, and that improves the socio-economic conditions of the people and communities involved in its production. Sustainable tobacco production is the desirable outcome when GAP is properly applied.

GAP has been in place since 2002, and since 2016 we have been assessing conformity of tobacco suppliers and farmers with our GAP standards through the industry-wide Sustainable Tobacco Program (STP) managed by AB Sustain, an independent supply chain management specialist. One of the outcomes of the assessment is an independent performance rating against all STP criteria. AB Sustain conducted STP assessments in all supplier locations over the last three years. In 2018, they assessed suppliers in 14 countries (2017: 8). The STP process includes:

- Annual self-assessments completed by tobacco suppliers (reviewed by AB Sustain);
- On-site audits conducted by AB Sustain to a sample of contracted farmers; and
- Comprehensive review of tobacco suppliers' policies, procedures, and documentation, and demonstrat[ing] the level of STP/GAP implementation.

GAP at PMI: a mature system with demanding requirements

- Our GAP program is structured around four key pillars: Governance, Crop, Environment and People. Under each one of them are principles and measurable standards that we expect all those who grow and supply tobacco to PMI to meet.
- **Governance:** PMI expects leaf suppliers to embed the necessary processes in their business practices to ensure its successful implementation. Good business practices may include contracting arrangements with farmers, sufficient field technicians for an effective GAP implementation, regular visits and training for farmers.
 - **Crop:** GAP promotes the adoption of growing practices that result in tobacco produced with the right quality, style and integrity, and meeting regulatory requirements. It includes considerations such as seed variety integrity, sound plant nutrition, integrated pest management, and crop profitability.
 - **Environment:** GAP enables PMI to help farmers minimize negative impacts on the environment by an appropriate usage of the natural resources such as water and energy; conserving ecosystems and biodiversity; ensuring soil fertility in the long term; and managing waste properly.
 - **People:** PMI is committed to eliminate child labor and other labor abuses and to achieve safe and fair working conditions on all farms from which we source tobacco. This pillar of GAP is supported by PMI's Agricultural Labor Practices (ALP) program (see page 65 for more).

GAP implementation by PMI and our tobacco suppliers



PMI has direct contracts with 21,000 farmers via our PMI leaf operations. We also contract over 20 third-party leaf suppliers who themselves have direct contracts with more than 329,000 farmers in the countries where we source tobacco.

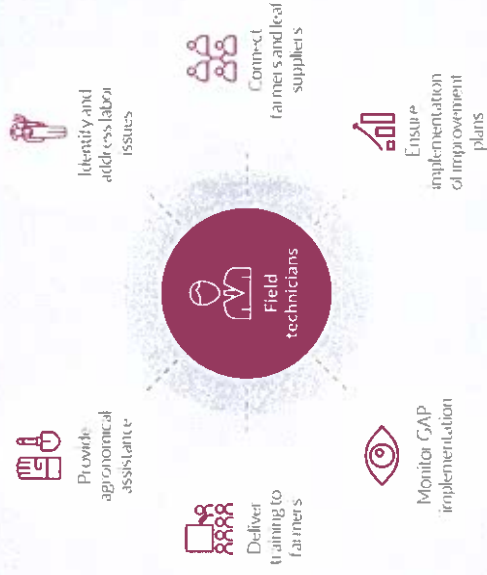
PMI adopts an inclusive farming approach called Integrated Production System (IPS) that requires leaf suppliers to be in a commercial partnership with farmers, enabling direct levels of support, such as the provision of recommended crop inputs, knowledge and technology transfer, financial loans or other extension services, aligning with the goals of the GAP standards. IPS farmers are provided with market information from suppliers that, alongside the contract, helps to protect them from market uncertainty to achieve a fair price for their crop, and to guarantee the sale of tobacco. IPS involves all farming practices, from crop planning until the tobacco is processed and packed.

Additionally, an important aspect of our GAP program is the systematic intervention and monitoring by field technicians. These men and women know the farmers they support and their community. They facilitate GAP implementation on the ground, and work to ensure good labor practices are upheld at the farm level. It is often a daunting task: in many countries most farms are small-scale family farms of less than two hectares, with perhaps no business procedures, and located in rural areas where basic infrastructure is poor or absent. Field technicians' visits are important for GAP and A.P. monitoring, training, and procedural support. They build trust with farmers to resolve issues together sensibly and overcome barriers to progress. They are vital to the whole monitoring system.



Above: A field technician and a tobacco farm worker in Mozambique

Role of field technicians



Mint: first steps towards responsible sourcing

Mint is used in heated tobacco units and conventional cigarettes. It is sourced mainly from small farmers in the Uttar Pradesh region of India. We recognize the potential for sustainability risks due to the long supply chain, with many intermediaries, no direct contracting, and challenging socio-economic conditions.

In 2018, with a key supplier, we surveyed 1,100 households in the region to evaluate how menthol mint farming is organized. Potential risks identified include safety, child labor, access to drinking water, and the use of firewood for cooking. A first step in 2019 is to establish 40 women's self-help groups as the backbone of a sustainability program (including approximately 400 women in 10 villages). The aim is to improve sustainability performance, increase household profitability, develop agricultural practices, and boost economic empowerment.

Sourcing raw materials and other supplies responsibly continued

PERFORMANCE AND NEXT STEPS

We report on steady progress in enforcing the requirements of our RSP, GAP and associated guidelines to source tobacco and other categories in a responsible manner.

Across our entire supply chain, the supplier due diligence platform, to be launched in 2019, will provide the data on the status of key suppliers on performance improvements. Our initial focus will be on 400 suppliers of raw materials, electronics, and selected categories of indirect materials. Through 2020, we plan to include an additional 1,600 suppliers, using a risk-based approach.

All our tier 1 electronics suppliers for smoke-free products aligned with our RSP and achieved performance improvements.

Over the next two years, we will extend our monitoring to tier 2 suppliers and we will further develop a process for monitoring tier 3 suppliers. We are integrating sustainability criteria and more detailed guidance in our contract tendering process, for further development in 2019.

Our RSP was signed by 100% of our tobacco leaf suppliers in 2018. The conformity of tobacco suppliers and farmers to our GAP standards has been audited in all countries from which we source by ABSustain through the SIP, between 2016 and 2018.

All

Our tobacco leaf suppliers signed our RSP in 2018



Above: Production technicians in Brazil, Brazil

Maintaining data privacy



Above: Anemelyce in PMI's office in Athens, Greece.

In recent years, there has been increasing public awareness of privacy issues and greater scrutiny by stakeholders of how companies approach data privacy. Global data protection laws have become more prevalent and rigorously enforced. Even before the EU General Data Protection Regulation (GDPR) became effective in May 2018, PMI had developed, and will maintain, its Global Privacy Program (GPP) to establish a new global standard for data privacy across our markets and functions. The GPP was developed and deployed using an internationally recognized privacy management system. The program is designed to support PMI functions and affiliates within the EU to achieve and demonstrate GDPR compliance and to embed policies and practices that facilitate data privacy compliance. Outside the EU, the GPP sets the GDPR as PMI's global standard, ensuring that the whole PMI organization is aligned to a high standard of privacy practice.

Core to GPP is greater central governance for data privacy, whereby specific people lead on data privacy for markets and functions. Our External Affairs and Information Protection and Governance group have come together to run a central privacy office. Meanwhile, our Data Protection Governance Board also reports twice per year to the Corporate Risk Governance Committee. The GPP also mandates practices that the GDPR introduces or enhances, in areas such as data privacy impact assessments, awareness and training, privacy compliance assessments, personal data inventories, and data subject rights. Additionally, many existing data protection approaches have been reviewed and strengthened, such as the principle of transparency and the management of third-party risks.

Tackling the illicit tobacco trade



Above: Training on prevention of illicit tobacco trade in Medellín, Colombia

Foreword

It is estimated that one in every ten cigarettes smoked globally is illicitly traded.²⁷

The illicit tobacco trade has a sustainability impact as it is often associated with organized crime and corruption, and can lead to abuses of human rights, labor rights, and environmental standards. It is a major economic problem for governments, which are losing a potential USD 40 billion in tax revenue each year.²⁸

We have long-standing preventive and protective measures to secure our supply chain. Tackling illicit trade requires cooperation from all affected parties; stakeholder engagement and cooperation with law enforcement agencies are therefore key.

PMI strongly supports the objectives and the principles of the WHO Framework Convention on Tobacco Control (FCTC) Protocol to Eliminate Illicit Trade in Tobacco Products and we are delighted to see a growing number of parties joining this international treaty. We support many countries through bilateral cooperation agreements in their fight against illicit trade.

Progress in 2018

We channel our efforts to:

1. Fight the diversion of our products by continuously improving measures to secure the supply chain with all stakeholders;
2. Share our knowledge with the impacted parties through continuous research, analysis, and communication of illicit trade issues and consequences, and
3. Pre-empt attempts to illegally divert our smoke-free products by assessing potential risks and by equipping our organization for this new challenge.

Fighting the diversion of our products

Work continued in 2018 on tools that prevent the illegal diversion of our products. Under PMI's Anti-Diversion Governance Committee, which oversees the continuous refinement process, and the update of our Principles & Practices, we implemented a risk-based approach with positive results that allowed

us to focus resources where needed, improving efficiency. Information on security and anti-diversion measures taken by our key markets can be found in the Anti-Diversion Governance Committee's Progress and Outlook Report 2018 available on our stop illegal website.

In 27 higher-risk markets for combustible products, we enhanced our Anti-Diversion tools such as "Know Your Customer", volume monitoring, and tracking and tracing technologies, to ensure that our products are sold legally in the markets for which they are intended.

As an example, following a large increase in excise taxes levied on tobacco products in Saudi Arabia in 2017, Kuwait witnessed a significant increase in demand from Saudi adult smokers. PMI and its distributor's closely monitored sales in Kuwait across all trade channels down to retailers to ensure legal product availability for Kuwaiti consumers while mitigating the outflow to Saudi Arabia.

Supply chain controls: our risk-based approach



We adapt tools to suit risk profile

- Volume monitoring
- Order controls
- Anti-diversion plans
- Tracking and tracing



Above: Operation to prevent illicit tobacco trade in Medellín, Colombia



Transforming our business

Driving operational excellence

Maximising our social impact

Reducing our environmental footprint

Reporting on sustainability

Philip Morris International Sustainability Report 2018

Tackling the illicit tobacco trade continued

Taking strong action with second- and third-level tracking and tracing

In Ukraine, cigarette taxes and prices reflect local economic conditions. Their price attractiveness, by European standards, makes them an attractive object for smuggling to other countries. For many years, PMI Ukraine has acted to prevent such smuggling by utilizing a comprehensive set of actions including volume monitoring and awareness raising. PMI operates a global tracking and tracing system, allowing us to monitor and trace product flows as they make their way down the supply chain. In a nutshell, it enables us to identify and address any supply chain "leaks", such as wholesalers selling our products to illegitimate retailers in the intended market, or to criminals smuggling our products into higher tax countries. In 2018, PMI Ukraine expanded the tracking and tracing system to the third layer for selected customers, improving the precision with which we can identify and resolve problems in our supply chain.

Sharing our knowledge with the impacted parties

PMI IMPACT I is our global initiative to support projects dedicated to fighting illicit trade and related crime. We invite public organizations, law enforcers, private entities, and NGOs from around the world to submit their project proposals for funding. Projects are selected through an open and defined evaluation process, led by a council of independent experts. PMI has committed USD 100 million for this program established in 2016. PMI IMPACT I has, to date, launched two funding rounds and received around 390 applications, with over 60 projects from 40 countries selected for funding. Projects include research, the development of technical solutions, the funding of equipment to support law enforcement operations, activities to enhance the capacity and proficiency of law enforcement agencies, awareness platforms, and communication initiatives to foster cross-sector and public-private collaboration. Substantially all grants under the second funding round were awarded in 2018.

In addition to PMI IMPACT I, we have a comprehensive research program in place looking into all types of illicit trade of tobacco products. Our base approach to assess the prevalence of illicit trade includes "Empty Packs" surveys, which help us monitor the nature, trends, and challenges in over 80 countries. This provides crucial data alongside other technical studies which we share with stakeholders with whom we align our priorities.

Pre-empting attempts to illegally divert our smoke-free products

It is paramount that we do everything we can to protect the integrity of our new product portfolio supply chain and to ensure that our consumers have access to products of uncompromised quality.

Securing our supply chain from raw materials to consumer and from consumer to product recycling and disposal is very important to prevent diversion of critical components and products. During the second half of 2018, we established a cross-functional team to deal with this matter. We currently focus on supplies distribution and reverse logistics processes. We are also setting up new operating standards with our partners at the beginning and the end of the life cycle of our products. At the same time, we continue to enhance our standards on product tracking requirements with a special focus on the tracking requirements for electronics in our supply chain.

Cooperating with law enforcement agencies in Colombia and Ecuador

Over the years, our teams in Colombia and Ecuador have established concrete information-sharing with law enforcement agencies and provided regular training sessions on illicit tobacco products prevention. With the launch of smoke-free products in Colombia in 2017, PMI teams have increased their efforts and trained 735 law enforcement officials in 2018, up by 160 attendees from the previous year.



Above: Operation to prevent illicit tobacco trade in Medellín, Colombia

PERFORMANCE AND NEXT STEPS

As of 2018, PMI has Memoranda of Understanding with customs authorities and governments in 49 countries as part of concerted efforts to take action against illicit trade.

In Poland, successful cooperation with law enforcement agencies led to the closure of 119 illegal factories in 2018.

We support enforcement actions led by authorities to destroy confiscated manufacturing equipment, materials used to make cigarettes, and illegal tobacco products. This is essential in order to prevent these items from finding their way back into the illicit trade.

In 2018, we worked continuously with law enforcement agencies and authorities worldwide and provided Anti-Illicit Trade Awareness and PMI Forensics Technical Training to more than 900 recipients during 41 sessions in 14 countries, helping them to understand illicit trade issues, consequences, and technical knowledge on PMI product authentication.

We continue to secure our supply chains and prevent the illegal diversion of products by investing our resources and aligning our organization towards our goal.

+900

Recipients of Anti-Illicit Trade Awareness and PMI Forensics Technical Training in 2018



Above: An employee at PMI's Operations Center in Loussonne, Switzerland

LEARN MORE ON DRIVING OPERATIONAL EXCELLENCE:

- Our Guidebook for Success (PMI's Code of Conduct) ▶
- An overview of PMI's marketing principles for combustible products ▶
- PMI's Good Conversion Practices ▶
- An overview of PMI's engagement principles ▶
- PMI's Commitment to Human Rights ▶
- PMI's Human Rights Roadmap ▶
- PMI's Responsible Sourcing Principles (RSP) and RSP Implementation Guidelines ▶
- PMI's Agricultural Labor Practices (ALP) Code ▶
- PMI's Good Agricultural Practices (GAP) Principles and Measurable Standards ▶
- on www.pmi.com or www.pmi.com/transparency

ADDITIONAL RESOURCES ON:

www.stppillegal.com
www.pmi-impact.com

PILLAR 3

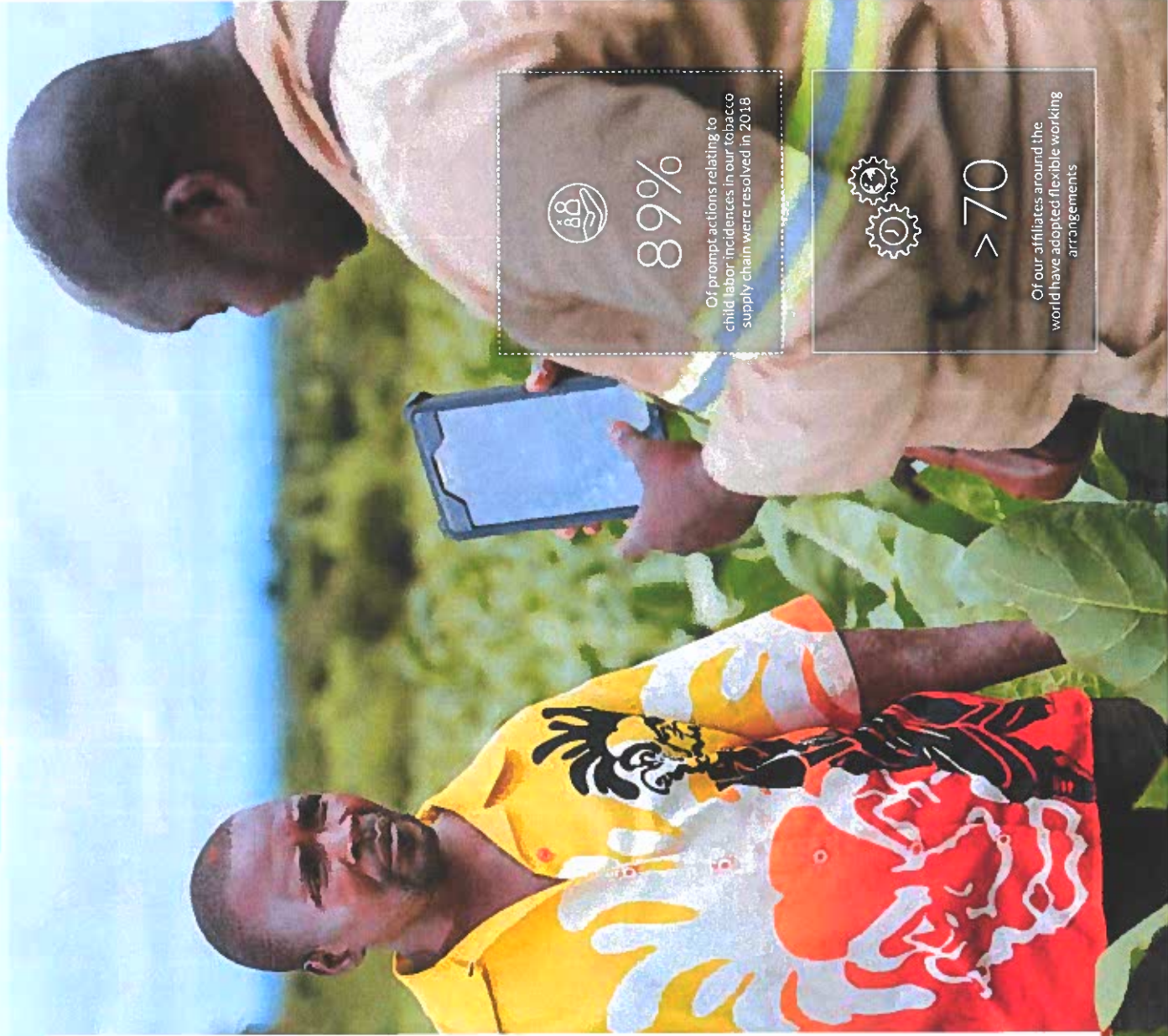
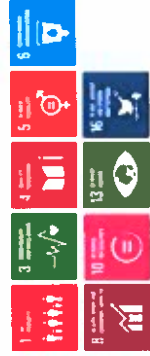
Managing our social impact

Continuously improving PMI's social impact within our operations and beyond is essential to our long-term success. This starts with how we attract and retain people and extends to the labor standards we expect from farmers and suppliers.

In this section, we provide an overview of what it is like to work at or with PMI, focusing on the main topics that emerged from our sustainability materiality assessment: our efforts to tackle child labor in tobacco growing; how we promote fair working conditions; our programs to promote health, safety, and well-being; our approach to diversity and inclusion; and our community engagement efforts.

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89%

Of prompt actions relating to child labor incidences in our tobacco supply chain were resolved in 2018



>70

Of our affiliates around the world have adopted flexible working arrangements

Image: PMU training and tobacco farmers in Mozambique

Eliminating child labor and improving labor conditions on tobacco farms

— TARGETS —

<p>Zero</p> <p>Child labor in our tobacco supply chain by 2025</p>	<p>100%</p> <p>Workers paid at least the minimum wage by 2022</p>	<p>100%</p> <p>Farmers and workers have access to personal protective equipment (PPE) for application of crop protection agents (CPAs) and prevention of green tobacco sickness (GTS) by 2020</p>
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Foreword³²

The informal, seasonal, and transactional nature of agricultural work makes farm workers vulnerable. Most child labor occurs in agriculture³³ and results from complex socio-economic challenges. Overcoming these challenges cannot be accomplished overnight, or by a single company, but we are committed to playing our part and making a difference. Since 2011, PMI has been implementing the Agricultural Labor Practices (ALP) program to eliminate child labor and to achieve safe and fair working conditions and a decent livelihood for all farmers contracted to supply tobacco. We co-developed the ALP program with Verité, our strategic partner and a leading global NGO in responsible supply chains. The ALP program comprises five elements:

- 1. The ALP Code**, based on International Labour Organization (ILO) conventions, with seven principles and 33 measurable standards, to be followed by over 350,000 farmers whom we source tobacco from. The seven principles of the Code are: no child labor; no forced labor or human trafficking; fair treatment; safe work environment; fair income and work hours; freedom of association; and terms of employment.
 - 2. Training** for PMI's Leaf Sustainable Agriculture teams, suppliers, farmers, and workers about the Code and how to address any gaps when applying it.
 - 3. Internal monitoring** by over 2,600 field technicians, the human face of monitoring, solving problems and communicating PMI's expectations during their regular visits to farms.
 - 4. External country-specific assessments** by Control Union, a specialist supply chain auditor, to independently evaluate the implementation of the ALP program.
 - 5. Collaboration** with civil society organizations, governments, and the private sector on initiatives to address systemic issues and to empower communities through new participatory processes, such as local ALP Committees.
- In order to take the ALP program to the next level, we initiated a 'Step Change' approach in 2018, to address the root causes of the main issues that keep surfacing year-on-year and to provide long-term solutions to prevent them. As part of this approach we have defined ambitious targets in key risk areas.



Above: A tobacco farm worker in Mozambique

Eliminating child labor and improving labor conditions on tobacco farms continued

Progress in 2018

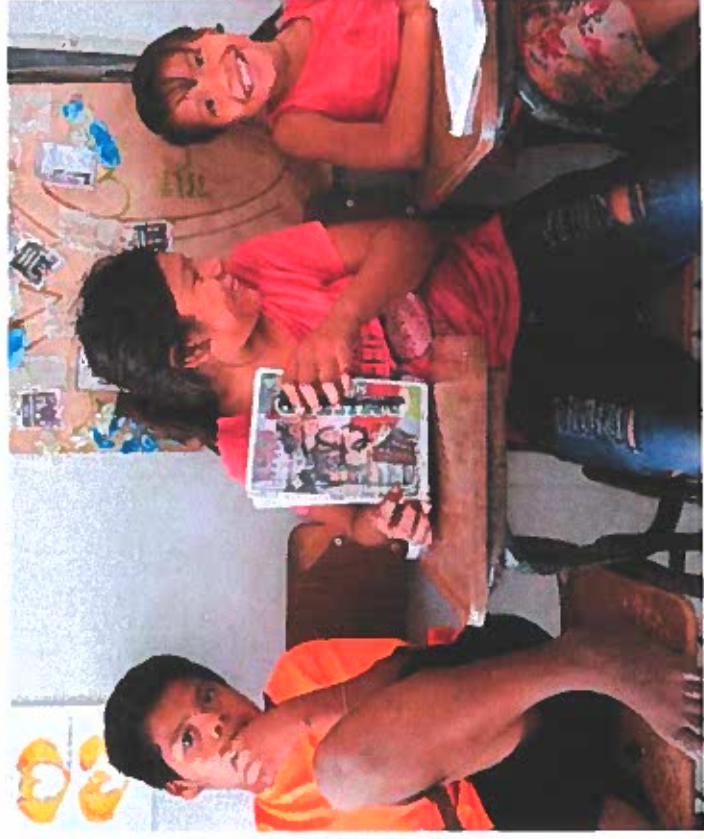
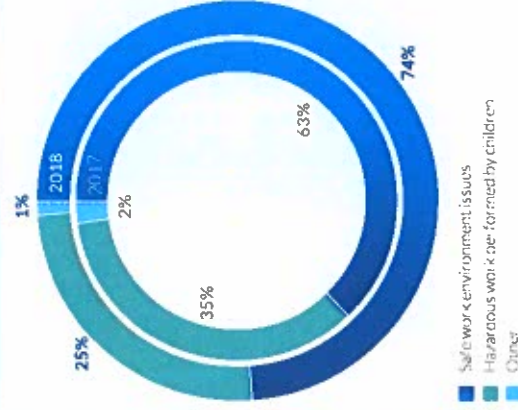
In 2018, we accounted for developments in the field of human rights, by amending our ALP Code to better reflect the tenets of the United Nations Guiding Principles on Business and Human Rights and to align it with our Responsible Sourcing Principles. The key changes relate to human trafficking risks, broadening the scope of a safe work environment, and precisions on terms of employment and compliance with the law.

In 2018, we continued to invest in improving and expanding the farm-by-farm ALP monitoring by updating and implementing our Prompt Action (PA) Guidelines as a standardized process in each country. Globally, we have expanded the geographic coverage of our monitoring from 77% in 2017 to 88% in 2018 and we have improved our data quality through better reporting guidance, further training for field technicians, and more farm visits, both planned and unannounced.

In 2018, a total of 18,543 prompt actions were recorded by field technicians, 74% of which were related to an unsafe work environment and 25% to child labor.

The data gathered point a more accurate picture of what is going on in each farm and allows the people involved with the ALP program management in each country to continue to develop their understanding of the challenges faced by tobacco farmers and workers. The global data consolidation enables a more thorough analysis and a better understanding of trends and patterns where the most prevalent and persistent issues occur in order to deploy targeted initiatives to solve these issues.

Overview of prompt actions recorded by field technicians (2017-2018)



Above: Child labor center in Nsabarit, Mozambique

A “Step Change” approach for our ALP program

Leveraging on efforts made so far, and having gained a more accurate sense of the program's overall performance, we took the decision in 2018 to deploy a “Step Change” approach to achieve significant improvements in areas with intensive and targeted needs.

Through 2018–2022, as part of a new “Step Change” approach, we will give additional focus to our work in Argentina, Indonesia, Malawi, Mozambique, South Africa, and Turkey.

The focus areas in each country differ but include at least one of the most recurrent and difficult issues listed here:

- Elimination of child labor. Currently, we identify and address over 4,000 child labor incidents every year. While we have seen a general decrease over the years, by 2025 we want to achieve a situation where no child labor occurs; if isolated incidents are identified, they will be addressed immediately;
- Payment of at least the legal minimum wage for workers. In formal, additional agreements in the agricultural sector mean that remuneration rates may fall below national minimum standards. By 2022, we want to ensure that all workers are receiving at least the minimum wage, regardless of local practices;
- Availability and usage of personal protective equipment (PPE) for the application of crop protection agents (CPAs) and the prevention of green tobacco sickness (GTS). By 2020, we want to ensure that everybody working on the farm has access to the appropriate PPE; and
- Adequate accommodation for workers. We have identified a few countries where the accommodation provided to workers was inappropriate. We are making the necessary investments to help farmers to fully address this issue by 2020.

Working with Verité, we are intensifying partnerships and engagement with local NGOs, governments and other stakeholders to tackle the social and economic root causes of child labor and other unacceptable labor practices. Over the next few years our action plans will consist of the following:

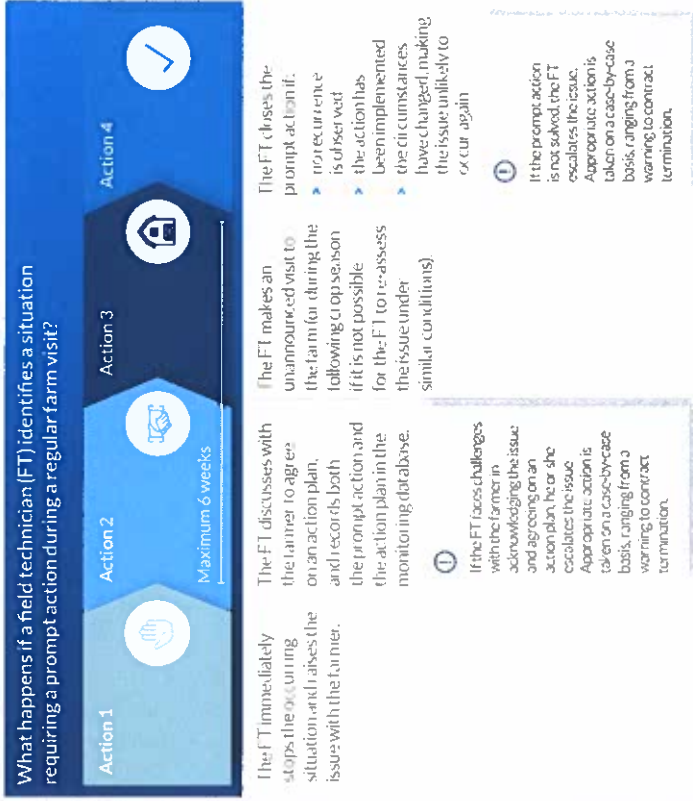
- More effective due diligence before contracting, and stronger consequence management in case of persistent A.P. Code violations;
 - Projects with farmers and suppliers to improve crop yields and quality and farm management aiming to achieve at least a living income;
 - Systematic sharing of best practice solutions between field technicians; and
 - Wider collaboration with other companies to explore solutions to complex social problems, such as child labor, for the benefit of the entire industry, farmer's families and farming communities.
- These action plans are currently being implemented and will be a fundamental part of our program in the coming years.

Prompt actions step-by-step process

Prompt actions arise from situations where somebody on the farm may face a risk or a danger and immediate action is required. Any incident of children carrying out age-inappropriate tasks or hazardous work is reported as a prompt action and addressed immediately.

The vast majority of child labor-related prompt actions arise in a family context on small-scale farms with two hectares or less. Typically, children are carrying out farming tasks alongside their parents who may not see this work as detrimental to the child because of local traditions and experience.

In any case, whenever a field technician witnesses a child labor incident they are obliged to stop it and raise a prompt action. The next step is to agree with farmers on a corrective action. An unannounced follow-up visit will check whether the situation has been resolved. If not, the matter is escalated and sanctions can lead up to contract termination.



Taking action to prevent and eliminate child labor

Based on our comprehensive and regular monitoring of tobacco farms (including through external third parties), we are confident that the vast majority of contracted farms supplying PMI do not use child labor. Our monitoring data (covering 88% of contracted farms) show that, out of the over 300,000 farms visited by field technicians, 98% were meeting the standards in this respect by the end of the crop season.

While this number is a positive sign of the efforts on the ground, we remain cautious as we acknowledge the limitations of our monitoring system (e.g. field technicians are present on the farms for a limited amount of time at various crop stages) and of course the seriousness and the complexity of the issues we face.

In 2018, the total number of child labor related prompt actions amounted to 4,587, a slight increase from 4,417 in 2017. The vast majority of child labor cases identified (92%) were children working with their own families. While there was a general decrease in most geographies and by most suppliers, this was offset by significant increases in Turkey and Malawi. Our analysis shows that the increase in these two countries does not necessarily reflect a higher prevalence of child labor on the ground, but rather an enhanced visibility at farm level attributed to better monitoring with increased coverage.

In 2018, we addressed 4,082 of these incidents, representing 89% of the prompt actions identified, up from 67% in 2017.

Eliminating child labor and improving labor conditions on tobacco farms continued

Detailed analysis of our 2018 data shows fewer incidents of children below 18 handling and stringing tobacco leaves for curing and harvesting. However, the data show a higher incidence of children carrying heavy loads and working with sharp tools. A stricter and more thorough application of our guidelines in Malawi has meant increased detection of such prompt actions.

In the geographic areas where the incidents persist, we are focusing on developing a better insight and understanding of the root causes. We are enhancing the remediation initiatives available and adapting them to the local socio-economic environment, so that we can work with farmers to directly address the root causes of each incident. We will monitor the remediation efforts and undertake external verification to validate the effectiveness of these initiatives.

In parallel, we plan to intensify awareness raising and training to farmers and workers, including local communities when possible. In addition, we support community initiatives that provide alternative educational opportunities for children or basic literacy and numeracy skills for mothers. We are also strengthening our due diligence and consequence management processes to address persistent non-compliance cases to ensure our efforts are effective.

In sum, child labor has no place in our supply chain. We have put in place the mechanisms to identify it and we are systematically addressing the cases that surface. Despite complex challenges, we want to reach a point where these issues are no longer happening.

Tackling child labor in Indonesia

The same scene plays out across rural Indonesia: the children finish school at around one o'clock, sometimes three. Typically, the head of the family expects the children to help out after school in some way because this is the common practice. The family farm is small, farm workers are not available, or may be too expensive for the household economics, and mechanized equipment is rare.

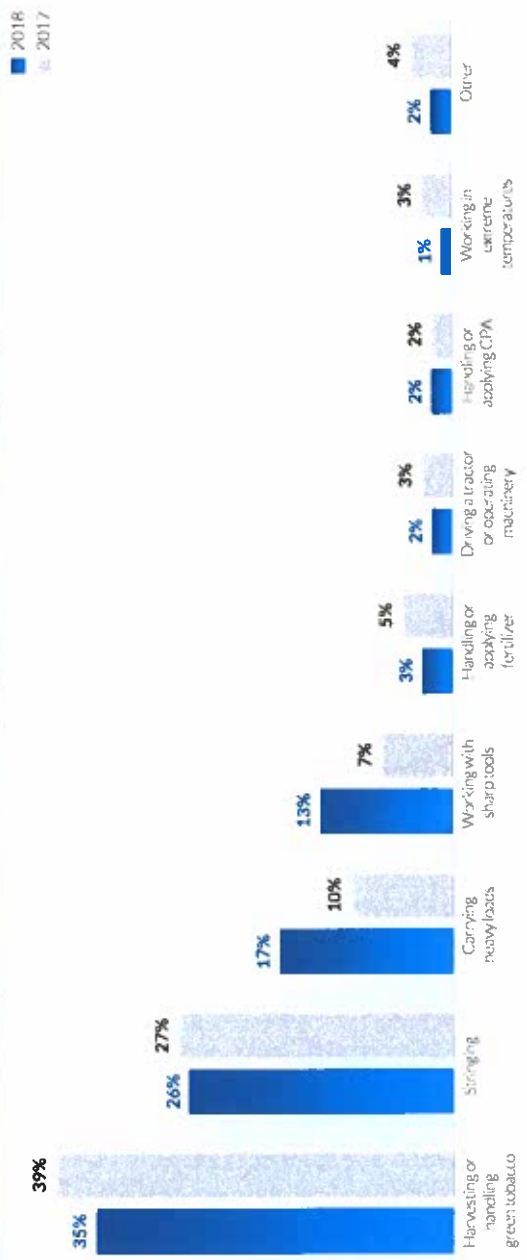
Against this general backdrop, child labor has been a persistent issue in tobacco-growing areas in Indonesia. PMI's monitoring data show that children are most likely to work in the tobacco fields during the peak season (August–November), starting straight after

school and working on stringing, harvesting, or handling green tobacco. Our strategy to draw children away from the fields involves monitoring by the field technicians, training and awareness for parents regarding hazardous work in tobacco, removing the need for children to help on the farm (by mechanizing the stringing process for instance) and offering after-school initiatives.

In addition to the above actions, in 2016, a community-based initiative known as Rumah Pintar ("Smart House") was introduced in Lombok and Java by PMI's Indonesian affiliate, its suppliers and local NGOs. Rumah Pintar are community facilities offering after-school

recreational and educational activities to the children of contracted farmers and workers. By 2018, the program had expanded to 34 villages and 14,561 children aged 7–18 years. In 2019, the plan is to expand to 73 units. Two external surveys undertaken by the local NGOs involved indicated a significant reduction in child labor as a result of the Rumah Pintar. Children removed from child labor increased on average from 47% before the program to 82% in 2018. This initiative has achieved widespread recognition, including from the government.

Child labor prompt actions reported, per type of activity (2017–2018)

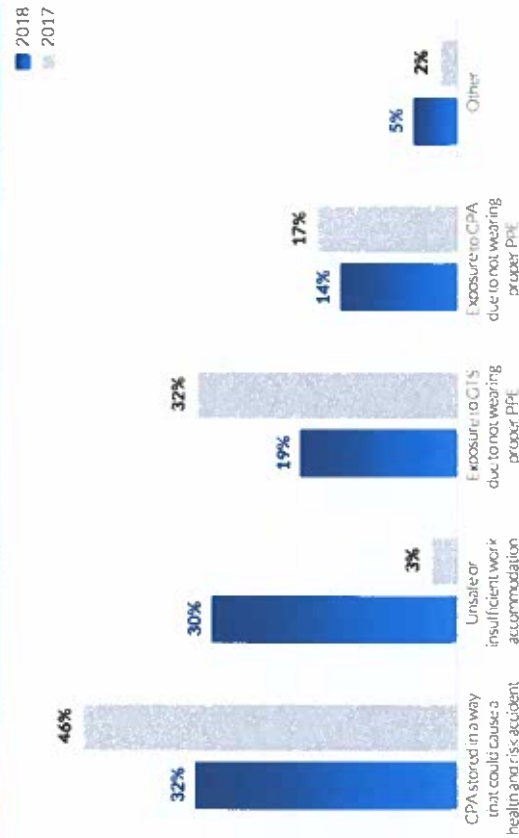


Focusing on safe working conditions

In 2018, among the over 300,000 farms visited by field technicians, a total of 13,780 prompt actions were related to an unsafe work environment, compared with 8,087 in 2017. Almost two-thirds of those were linked to inadequate CPA storage practices, CPA application, and handling of green tobacco without appropriate PPE. Unsafe or insufficient worker accommodation accounted for the second category of our prompt actions reported and represented by far the biggest increase in the reported prompt actions since 2017. This was particularly the case in Malawi, Mexico, and South Africa, where we strengthened our focus and monitoring of this issue. We have set ambitious plans to resolve the accommodation problems.

An example of this is the large-scale renovation of workers' accommodation in South Africa. The project covers all contracted tobacco farms in two areas: Limpopo, and the Eastern and Western Cape. In 2018, 174 houses were completed in Limpopo with the remaining 45 to be completed together with the 24 houses in the Eastern and Western Cape in 2019. Upon completion in 2019, we expect a total of 243 new rooms, 326 renovated rooms, 408 window replacements and 83 toilets to be built, benefiting over 560 workers.

Safe work environment prompt actions reported, per type (2017 - 2018)



OUR "STEP CHANGE" APPROACH IN ACTION: Addressing poor living conditions of migrant workers in Mexico

In our 2017 report, we shared our intensive efforts to address the poor living and working conditions of migrant workers in tobacco-growing areas in Nayarit, Mexico. Every year, these migrant workers come from Mexico's highlands and settle in tobacco-growing areas for the season. One year on, this provides a good illustration of our "Step Change" approach.

In the last quarter of 2017, PMI and its supplier Tabaco del Pacifico Norte (TPN – subsidiary of Universal Corporation) conducted an in-depth analysis of this complex and deep-rooted problem and developed a plan with the following objectives:

- Prevent workers from living on the tobacco fields;
- Prevent night work in the fields;
- Provide adequate accommodation to all migrant workers; and
- Provide workers with access to shade areas for rest and lunch, and to sanitation. To address the root causes of the issues in an effective and sustainable manner, PMI introduced a series of measures to reorganize labor schedules and activities and to prohibit field work after sunset to be implemented by TPN, including:
 - A 25% increase on the piece-rate paid to workers;
 - A sensitization campaign in the workers' communities of origin;

- Cost compensation for farmers that successfully provide adequate accommodation, transportation, as well as sanitation and clean water;
- No renewal of contracts with farmers that do not join the effort; and
- An extension of the opening hours and capacity of the five childcare centers providing education, nutrition, and medical services for the children of the migrant families.

By the end of the season, these measures benefited over 6,000 people (workers and their families). Only six farmers did not make an effort to align with our objectives and their contract was terminated at the end of the season. Additionally, the monitoring and external verification of the program undertaken by Fundación Mexicana de Apoyo Infantil in July 2018 showed significant progress had been made on the objectives:

- 93% of workers no longer lived on the tobacco fields or worked into the night;
- 87% of migrant workers had access to adequate accommodation; and
- 85% worked in adequate field conditions, and 94% were provided with rest areas and toilet facilities, and 98% with drinking water.

Eliminating child labor and improving labor conditions on tobacco farms continued

Ensuring fair working conditions

One of PMI's seven Principles outlined in the AI P Code is "income and work hours" – ensuring farm workers are treated fairly and are paid at least the minimum wage by the farmers from whom we buy tobacco. In 2018, roughly one-third of contracted farmer's hired workers at some point during the season. Contractual employment relations are typically informal and temporary – spanning from a few days to deliver a particular task to an entire growing season. Remuneration is often agreed either by piece-work (workers get paid a certain amount for a

given output, e.g. amount of leaves prepared for curing) or in the form of a lump sum for the services provided across the season. While we have been building awareness about national minimum wages as part of our AI P Code requirements, very often both farmer's and workers do not know how to apply these national standards to their agreements (e.g. converting traditional piece-work rates to a daily rate equivalent if benchmarked against the national minimum wages). In addition, the seasonal agreements on small-scale farms do not encompass in practice a full-time,

continuous occupation for the whole season (simply because there is not enough work). In this case, it is difficult to benchmark against the national minimum wage rates without a record of the number of days actually worked.

In addition to the informal nature of the employment agreements and the challenges described, in some geographic, particularly in Indonesia and the Philippines, there are traditional community or organizations (involving farmer's and workers) that agree on the season's remuneration rates without taking into account the national minimum wages. Although tobacco workers are paid typically at or above the prevailing agricultural rates, given the specialized nature and complexity of the work involved, our monitoring data showed that in 13% of the cases, workers were paid below the national minimum wage rates. These issues have been identified in Malawi, Mozambique, the Philippines, and in one region in Argentina and one region in Indonesia.

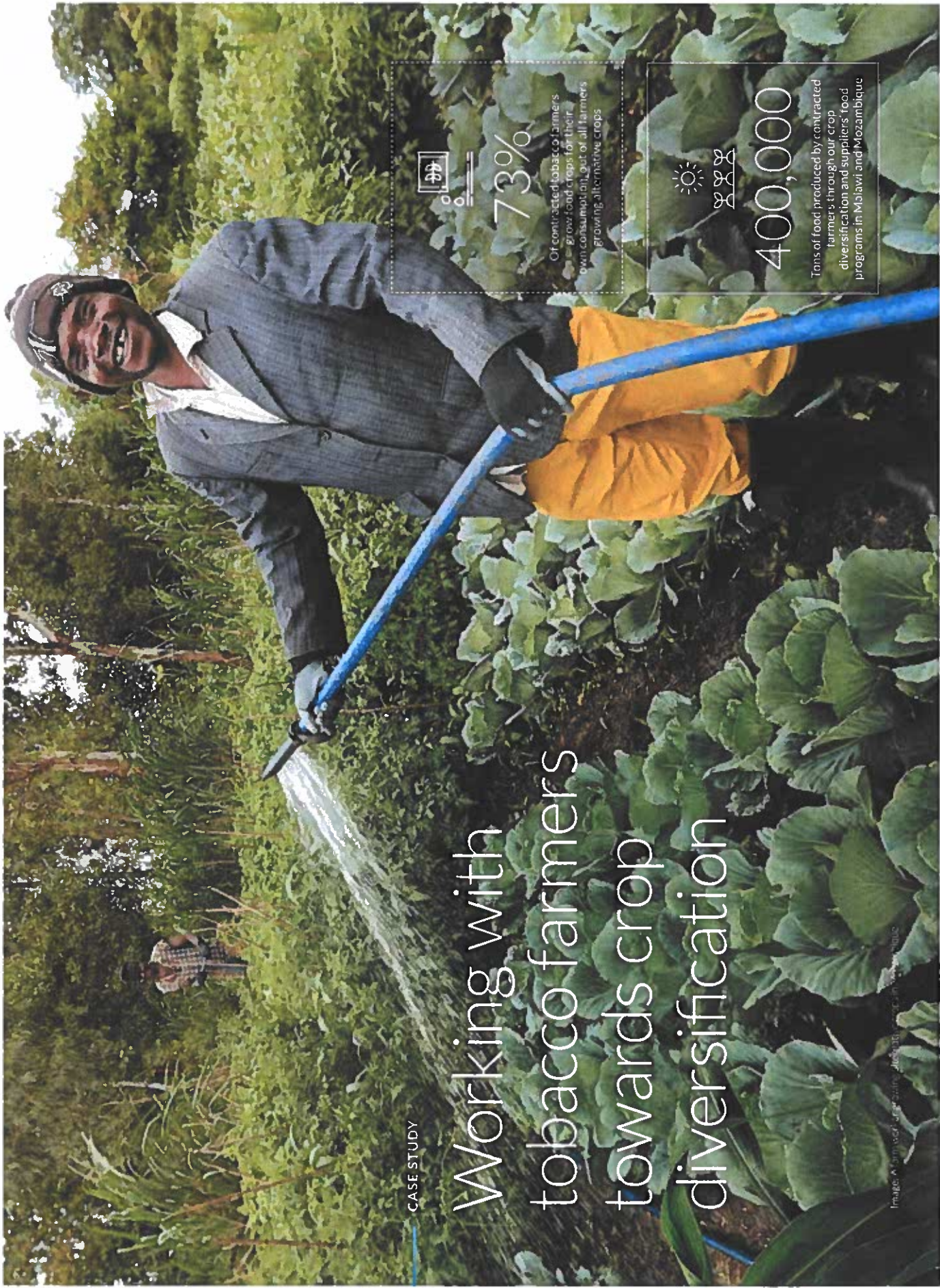
In 2018, as part of our "Step Change" approach, the above-mentioned markets undertook more in-depth surveys to better understand the issues and their root causes, and began developing ambitious plans to close the wage gap by changing practices in relation to the types of agreements established, including formalization of contracts and record keeping for work rendered.

An example of PMI's commitment to the adoption of minimum wage standards is the company's position on the tenancy system in Malawi. Tenancy farming is an agricultural production system in which landowner's contribute their land, while tenant farmer's contribute their labor. Tenancy agreements can take multiple forms but typically, in Malawi, landowners pay tenant farmer's an agreed cash amount for each kilogram of tobacco delivered at the end of the season (a per centage of the selling price to the final buyer) and provide the crop inputs, subsistence goods and accommodation. Historically, we have discouraged the tenancy practice because we cannot properly ensure the respect of our AI P Code. This tenancy system in Malawi has long been contentious among stakeholders and remains an unresolved issue. While the industry has taken some measures, this year PMI has gone a step further by asking our suppliers in Malawi that the tobacco supplied to us should not originate from farms with tenancy agreements.

We expect that our position will drive the general adoption and implementation in the country of the minimum wage, as well as other measures to mitigate the risks of exploitation of vulnerable tenant farmer's.



Above: A tobacco farm worker in Nayarit, Mexico



CASE STUDY

Working with tobacco farmers towards crop diversification



73%

Of contracted tobacco farmers grow food crops for their own consumption, out of all farmers growing alternative crops



400,000

Tons of food produced by contracted farmers through our crop diversification and suppliers' food programs in Malawi and Mozambique

Image: A. Simons/Agri-Forum, 2018

CASE STUDY

Working with tobacco farmers towards crop diversification

Transforming our business can lead to new challenges for farmers in certain geographies as we see a gradual decrease in our tobacco leaf requirements, smoke-free products requiring half the quantity of tobacco or less, compared with cigarettes. Consequently, we are expanding the support we provide to farmers. While we have focused on Malawi in our previous reports, we have also been busy in Brazil, Colombia, Mozambique, Pakistan, and the Philippines.



In Malawi, a priority country for our diversification program, we signed a Memorandum of Understanding with Palladium International LLC (Palladium) to work together on selected initiatives. Palladium is a global impact firm implementing USAID's "Feed the Future" program in Malawi. The aim is to create opportunities for smallholder farmers to diversify production away from tobacco and into other food crops, such as soybean or groundnuts. During 2018, we trialed various irrigation methods, including drips, sprinklers, and pivot systems fed from different water sources, such as dams, weirs, rivers, and boreholes pumped using solar or diesel pumps, to identify efficient, cost-effective solutions for farmers. To reduce post-harvest losses, 147,000 crop storage bags were distributed to all farmers in our food crop program to improve crop storage as a simple, low-cost way to reduce losses and insecticide use.

In Mozambique in late 2018, we, together with our supplier, initiated pilots of alternative crops with an international NGO, Business for Development, whose experience lies in assisting communities to rise out of poverty. In addition, 400 treadle pumps were distributed to smallholder farmers, providing them with a means to pump water from existing water sources to use on seedbeds and vegetable gardens. In addition, we distributed 6,000 crop storage bags.

In 2018, we launched our new Pakistan Diversification Program, where we initiated the Corn Support Program, providing hybrid corn seed and fertilizer to 200 farmers under our Integrated Production System (IPS). We expect yields of around 3,000 kg of corn on a 0.5-hectare plot, earning approximately USD 500 of additional income. In addition, Pea Support Program provides pea seeds to 64 farmers. A similar project is planned to help 75 farmers grow mung beans. PMI will provide raw materials and training, and the marketing will be sponsored by the Hashoo Foundation.

Our Philippines Tobacco Roadmap aims to improve the competitiveness of farming communities by reducing poverty, promoting sustainability and improving farmers' profitability and livelihood through diversified crops while enhancing the quality and competitiveness of Philippine tobacco. PMI is strengthening the Corn Support Program, launched in 2015 and annually supporting around 175 farmers. We are running a pilot to analyze the supply chain and identify inefficiencies related to transportation and post-harvest activities. Mobile threshers and grain dryers will be lent to farmers to potentially reduce post-harvest costs and generate additional income.

In Colombia, farmers are benefiting from diversification programs with food crops such as banana/plantain, corn, and garden vegetables. Approximately one-third of farmers inter-crop corn with tobacco, while we have distributed

banana/plantain seeds to 256 farmers and provided 375 home garden vegetable seed kits. Additionally, we have assisted 50 farmers in setting up micro-fisheries and 100 farmers in setting up chicken cooperatives as an alternative source of income.

In Brazil, PMI has helped to set up home allotment gardens for rural families in 201 municipalities to grow native and exotic fruits. The project in partnership with Embrapa (the Brazilian Agricultural Research Corporation) provides each beneficiary with fruit tree saplings and farming inputs while the beneficiary provides land and labor for implementation and maintenance of the gardens. The project aims to expand, reaching new beneficiaries including not only farmers supplying to PMI,

but also vulnerable communities. The project increases diversification activities, improves biodiversity in small farms through the planting of trees, improves family health by promoting healthier eating habits and generates additional income to the farmers, due to the possibility of selling surplus production.

As we expand our diversification efforts, monitoring and evaluation will allow us to assess the impact of the various initiatives on farmers and their families. We have compiled a household welfare survey, which was piloted in Malawi at the end of 2018 with a small sample of farmers. Rolling out this survey to a larger population will allow us to measure, on an annual basis, the impacts on household income, food security, and nutritional diversity.



Above: A farmer works growing alternative crops in Mozambique



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sustainability

Philip Morris International
Sustainability Report 2018

PERFORMANCE AND NEXT STEPS

The systematic monitoring of the ALP program implementation in 2018 increased to 88% (2017: 77%) of the 350,000 farmers from whom PMI or our leaf suppliers source tobacco, against a 2020 goal of 100%. Overall, our analyses show that child labor is decreasing in most geographies despite a higher number of recorded incidents in some countries, mainly attributable to improved monitoring.

In 2018, we resolved 13,687 issues raised through prompt actions representing 74% of the total prompt actions raised by field technicians. Of the prompt actions relating to child labor, 89% were resolved, up from 67% in 2017. In the 2017–2018 crop season, 50 contracts with farmers were not renewed or terminated for lack of compliance with our ALP program.

Our external verification partner Control Union further assessed four countries in 2018, bringing the cumulative total to 21, against a 2020 target of 24. The reports are published on PMI website.

Our biggest achievement in 2018 is that, together with our suppliers, we developed comprehensive and ambitious action plans taking into account the local, social, and economic drivers of the priority problems that we aim to eradicate. We are taking a strong stance and have ambitious targets, and will measure our progress and report it transparently. These plans are currently being implemented and will be a fundamental part of our program in the coming years.

In 2019, we will pilot a new business model in Malawi and other countries to better assess our approach to a living income for farmers.

89%

Of prompt actions relating to child labor incidents were resolved in 2018



Above: A field technician with farm workers in Mozambique

Supporting fair working conditions



Above: Employees in PMI's office in Dubai, Sharjah

Foreword

PMI's vision of creating a smoke-free future requires a full transformation of many other aspects of our company – the way we are organized, the way work is defined and allocated, and the way leaders are assessed and their performance is measured. That's a momentous challenge and to accomplish it we need the full array of skills and talents available to us.

Our intention is to strengthen our inclusive culture and boost how everyone can contribute their personal best through attitudes, behaviors, and employment practices that value, respect, and accommodate differences, that promote listening and learning from others, and that create space for constructive disagreement.

The era of transformation at PMI has ushered in new people, new skills, and new ways of working. We aim to harness the way transformation inspires and motivates our colleagues while mitigating the natural anxiety and stress that business transformation brings.

Progress in 2018

Attracting and retaining talent

Our new operating model, the way we organize ourselves, was a focus in 2018, and vital to realizing our business transformation. Essentially, it means we are blending old and new ways of working at PMI. The learnings from IQOS growth in Japan and the digital skills for a "consumer-centric" approach are examples of the new ways. New employee training is provided about smoke-free products, responsible marketing and sustainability.

Going smoke-free means a new leadership approach where openness, constant learning, collaboration and stakeholder engagement are demanded from our leaders.

We equip our teams with the right skills and encourage their development through our Thrive program, which helps connect people to the company purpose, stimulate behavior change and encourage leadership. In order to make learning and development accessible to all employees globally we have upgraded our learning platform in 2018 to make it more interactive with better content.