



PHILIP MORRIS INTERNATIONAL

Sustainability Report 2017

About PMI

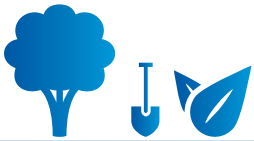
Philip Morris International Inc. (PMI) is a leading international tobacco company with a diverse workforce of 80,600 people across the globe.

In 2017, our products were sold in over 180 markets, and we operated 46 production facilities globally. We are building our future on smoke-free products that are a much better consumer choice than continuing to smoke cigarettes. Through our multidisciplinary, state-of-the-art capabilities in product development and scientific

substantiation of the reduced harm potential of our new products, we aim to ensure that our smoke-free products meet adult consumer preferences and rigorous regulatory requirements. Our vision is that these products replace cigarettes as soon as possible, to the benefit of adult smokers, society, our company and our shareholders.



For more information, see www.pmi.com and www.pmiscience.com.



Raw materials and other supplies

Leaf	Other
<p>+350,000 Farmers contracted by PMI and our suppliers in 28 countries</p> <p>90% Of the tobacco we purchase is through direct contracts (by our leaf operations or our tobacco suppliers)</p> <p>2,800 Field technicians providing support to contracted tobacco farmers for GAP implementation</p>	<p>50,000 Suppliers worldwide</p> <p>13 Number of languages in which PMI's Responsible Sourcing Principles are available</p>



R&D

<p>2 Research facilities</p> <p>+400 World-class scientists, engineers and technicians hired to support our best-in-class R&D capability since 2008</p>	<p>74% Of our total R&D expenditure is dedicated to our smoke-free vision</p> <p>+2,900 Patents granted worldwide related to our smoke-free products</p>
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Manufacturing and business facilities

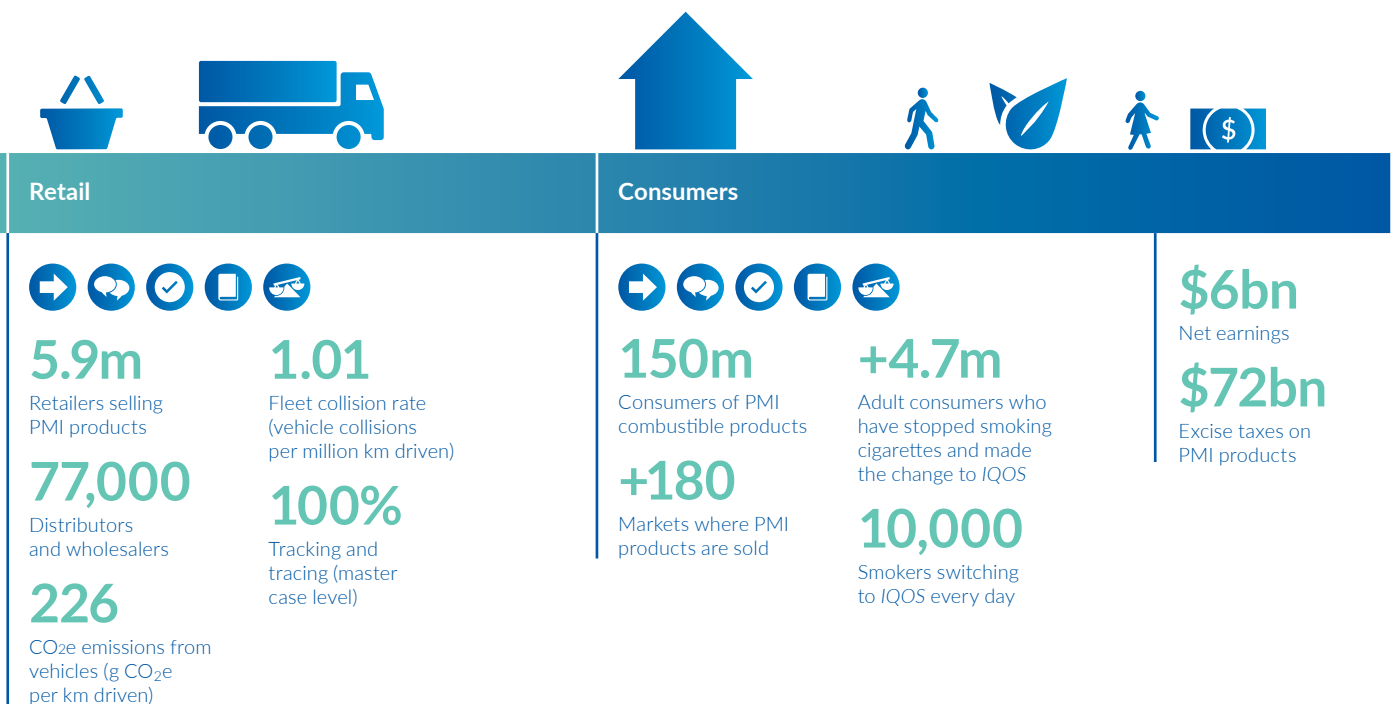
<p>80,600 Employees worldwide</p> <p>34.4% Employees at managerial level are women</p> <p>67% Employees covered by collective labor agreements</p> <p>4.9% Employee voluntary turnover</p>	<p>46 Manufacturing facilities globally</p> <p>31% CO₂e scope 1+2 reduction since 2010</p>
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Creating value at PMI

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

From the more than 350,000 farmers from which we source tobacco right up to the approximately 150 million consumers of PMI products, we have an important impact on the communities and the environment around us, which we are committed to address. We cannot achieve this alone.

The engagement beyond our own operations is key, as this is where the most significant impacts take place. While operating in a highly regulated environment, we strive to go beyond mere compliance to achieve a sustainable smoke-free future.



The policies and practices driving operational excellence across our value chain

- Good Agricultural Practices (GAP) & Agricultural Labor Practices (ALP)
- Animal welfare
- Marketing Principles Good Conversion Practices
- Responsible Sourcing Principles
- Conflict minerals
- Anti-diversion practices and tools
- Guidebook for Success (PMI Code of Conduct)
- Human Rights Commitment
- Engagement Principles

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About this report

We are happy to share our third Sustainability Report. By publishing this report closer to the release of our Annual Report 2017, we aim to provide a more comprehensive overview of our company and sustainability efforts earlier in the calendar year. This report builds on the PMI Sustainability Report 2016, issued in September 2017. As we progress on our sustainability reporting journey, we will provide deeper insights into our performance.


The report is structured around the important topics of our sustainability efforts, and our disclosures are mapped against the Ten Principles of the United Nations Global Compact (UNGC) and the United Nations Sustainable Development Goals (SDGs). See page 10

The data and information, including the infographics, cover the full year 2017 and all our operations, unless explicitly mentioned.

This report has been reviewed by PMI's Senior Management team, including our Chief Executive Officer, Chief Financial Officer, Chief Operating Officer and our President, External Affairs & General Counsel.

PricewaterhouseCoopers SA (PWC) has assured our transformation metrics on page 25.

We welcome your feedback on this report by emailing us at: sustainability@pmi.com

 This blue tint indicates the stories that relate to our business transformation.

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Letter from the CEO

Dear reader,

In my mind, sustainability encompasses four aspects. First, companies need to reduce to the largest extent possible any harm associated with their products. Being respectful of people throughout the value chain and preserving the environment are the next two pillars. Last, but not least, sustainability requires operational excellence.

My ambition is to make PMI a true leader in sustainable business practices. We therefore need to excel in all of these four areas, starting first and foremost with our products.

Smoking cigarettes causes serious disease, and the best way to avoid the harm of smoking is never to start, or to quit. But much more can be done to reduce health risks for the world's 1.1 billion men and women who would otherwise continue to smoke. While nicotine is addictive, it is the smoke generated by burning tobacco that is the principal problem. Through groundbreaking research, we have developed a range of smoke-free products that are enjoyable for smokers and have the potential to significantly reduce health risks when compared to smoking.

I am often asked when we will stop selling cigarettes. Our objective is to reach this moment as soon as possible by replacing cigarettes with smoke-free products. Last year, smoke-free products already represented over 4% of our shipment volume and around 13% of our net revenues, excluding excise taxes, in just two years since commercialization. To further accelerate this transformation, we continue to shift resources towards smoke-free products. In 2017, 39% of our global commercial expenditure and 74% of our global R&D expenditure were spent on reduced-risk products.¹ The results of our efforts exceeded our own expectations: By year-end 2017, over 4.7 million adult smokers had stopped smoking cigarettes and made the change to IQOS, our main smoke-free product. And 10,000 more are switching every day.

Clearly, we cannot achieve a smoke-free future alone. It depends on a number of factors out of our direct control, mainly support from regulatory and public health authorities, that will influence the pace and scale of switching away from combustible products. We are committed to continue leading the industry in this massive transformation, and we call on all stakeholders to work together towards a smoke-free future.

I am also pleased with the way we continue making progress on our social sustainability agenda. For example, with 34.4% of management positions held by women, we are on track to reach our goal of 40% by 2022. Another example is the roll-out of our Responsible Sourcing Principles that will help to identify and manage labor issues in our non-agricultural supply chain, which is becoming increasingly important as we transform our company from a cigarette maker to a smoke-free technology leader. But challenges remain, in particular on complex social issues such as child labor and living conditions for migrant workers in our tobacco supply chain. We are determined to continue to address these issues in cooperation with civil society partners and governments, as you can read about in our case study on Mexico.

Last year's environmental milestones include the fourth consecutive year in which PMI was recognized in CDP's Climate A-List and the first time that our water programs achieved CDP A-list ranking. PMI is one of 25 companies to be A-listed for both climate and water, placing us in the top 1% of the 3,000 corporations participating. We acknowledge that the transformation of our company towards smoke-free products invariably brings along new challenges we need to address, in particular increased use of water and energy at the manufacturing level, and the management of electronic waste.

As for operational excellence, we remain focused on securing the integrity of our supply chain through our efforts to tackle illicit trade in tobacco products. We also pushed transparency further by publishing our approach to corporate tax and data privacy, as well as an overview of our Marketing Principles and our Principles for Engagement with third-parties. These last two policies relate to business practices for which we receive frequent criticism from tobacco control advocates and others. We therefore urge concerned stakeholders to provide us objective feedback on these policies and examples of practices that they feel we need to change.

To benchmark ourselves and learn from other companies, PMI joined the United Nations Global Compact (UNGC) in 2015. We participated in many of the UNGC Local Networks, not only to learn, but also to contribute and share our experiences, talents and resources on joint initiatives. We were encouraged by the positive reactions in many Local Networks to our active participation, once initial skepticism towards our company was overcome. I was therefore disappointed by the UNGC's decision last year to exclude all tobacco companies from its membership.

The UNGC's decision does not change our commitment to implement its principles. Nor does it alter my conviction that a smoke-free world is achievable and, indeed, a better world. However, in my mind, recognizing and encouraging those willing to disrupt their existing business to replace it with a more sustainable one, and thus lead sector transformation, is the fastest way to meet global societal expectations, rather than practicing exclusion.

I am pleased to share with you this report outlining our work to transform our company. We are committed to continue operating responsibly, while successfully delivering solutions not only to our consumers, employees and shareholders, but also to society in general.

I cordially invite you to comment, challenge, and guide us as we continuously seek to improve the sustainability of our business and contribute to the UN Sustainable Development Goals.



André Calantzopoulos
Chief Executive Officer



My ambition is to make PMI a true leader in sustainable business practices. We therefore need to excel in many areas, starting first and foremost with our products.



Sustainability at PMI

Our approach to sustainability

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

Our sustainability strategy is a key element of PMI's overall business strategy and is structured around four pillars which enable our vision of a smoke-free future:

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

Each pillar encompasses key topics addressed in this report. They cover specific programs, management approaches, activities, processes, goals and Key Performance Indicators (KPIs), which are managed throughout the company by the relevant functions and business operations.



Sustainability governance and management

PMI's Board of Directors believes that environmental, social, and governance (ESG) factors relevant to the company's business are critical to PMI's long-term success.

The Board's sustainability oversight was more formally established at the beginning of 2018 when its Nominating and Corporate Governance Committee was given the mandate to oversee the sustainability strategy and performance, and to advise the Board on sustainability matters. Part of the Board's oversight is a focus on management's efforts to enhance shareholder value responsibly and sustainably.

Our Senior Management Team (Management Board) is regularly reviewing sustainability matters – strategy, key programs, and budget – through a cross-functional representation, coordinated by the Sustainability Team.

From an operational perspective, the Sustainability Team manages and coordinates our sustainability work across PMI functions and regions seeking to ensure it is embedded at all levels of the organization. Finally, we are creating three cross-functional working groups to manage environmental, social and reporting matters that are overseen by committees composed of senior function heads.

Led by the Vice President, Social & Economic Affairs, who reports to the President, External Affairs & General Counsel, a member of PMI's Senior Management Team, the Sustainability Team has evolved over the past years to ensure our company is equipped with the relevant know-how and expertise in view of the changing nature of our business.

Defining our focus

In 2016, we worked with Business for Social Responsibility (BSR) to identify the areas that are most significant to both our business sustainability and to our stakeholders and prioritized them. That analysis also highlighted areas of opportunity and risk, emerging themes, and gaps for management action. The analysis consisted of a structured review and engagement process, carried out by BSR and involving PMI's functional leaders and subject matter experts as well as external stakeholders. It considered both our current business and changes driven by our vision of a smoke-free future.

The analysis helped us to focus on where we need to prioritize and allocate resources to mitigate negative impacts and create opportunities for wider societal value, with product harm reduction the fundamental premise of our strategy.

We plan to update this analysis in 2018 and share the results in our 2018 Sustainability Report.

The results of the 2016 analysis were sorted into four categories as follows:

Fundamental to our business strategy

Three areas are fundamental to the sustainability of PMI's business strategy:

- Product Innovation for Substantial Harm Reduction: Continued recognition of the health impacts of our products and the prioritization and investment in reducing or eliminating those impacts through innovation and development of products that can substantially reduce individual risk and population harm when compared to cigarettes;
- Public Health Policy and Research: Our role and proactive approach in supporting public health and harm reduction policies and research; and
- Respect for Human Rights: Understanding, due diligence, and actions to respect human rights throughout our global operations and value chain.

Credibility and responsibility

The analysis also identified aspects that are critical to building the credibility and engagement with our stakeholders required for our business transformation, particularly the need to substantiate our commitments, demonstrate transparency and consistency in our approach, and maintain the highest standards in our policies, practices and actions. This also includes ensuring that we continue to market our products in a responsible way – and only to adult consumers – and being even more transparent in how we advocate on policy issues related to our products, including taxation and regulation.

- Corporate Governance and Ethics: Promotion of the highest standards of compliance and integrity across our global operations and value chain. Clear alignment of our public policy advocacy with our core strategy and commitment to stakeholders;
- Responsible Marketing and Youth Smoking Prevention: Strive to ensure that we continue to market our products responsibly and only to adult consumers; and
- Transparency and Reporting: Disclosure of our significant sustainability performance risks and opportunities in a clear, comparable and accessible manner.

Turning strategic risks into opportunities

We identified additional areas from a risk management perspective, including good agricultural and labor practices in tobacco farming and the need for climate change mitigation and related action throughout the value chain. We also need to anticipate and manage the supply chain risks related to our non-tobacco materials, especially as our product portfolio now increasingly includes electronic devices. Our ambition is to turn these strategic risks into opportunities to add value.

- Responsible Sourcing of Non-Tobacco Materials: Actions to identify and trace non-tobacco materials to origin, and source them in a responsible and sustainable manner (including electronics);
- Agricultural Labor Practices: Actions to eliminate all forms of labor abuses and to achieve safe and fair working conditions on tobacco farms;

- Good Agricultural Practices: Actions to ensure tobacco farmers have access to the information, systems and tools needed to be successful business owners who minimize the environmental impacts of their activities and provide good working conditions on their farms;
- Climate Change Mitigation and Adaptation: Efforts to reduce greenhouse gas emissions and prepare for the effects of climate change in our operations and supply chain, including water stewardship actions; and
- Post-Consumer Waste: Actions to minimize impacts through product design, waste management programs and recycling where possible. Increasing our efforts to prevent littering through consumer education.

Underpinning our approach

Governance, product, environmental and employee-related aspects were identified as being important for our continuous improvement efforts. Many are described in this report and include:

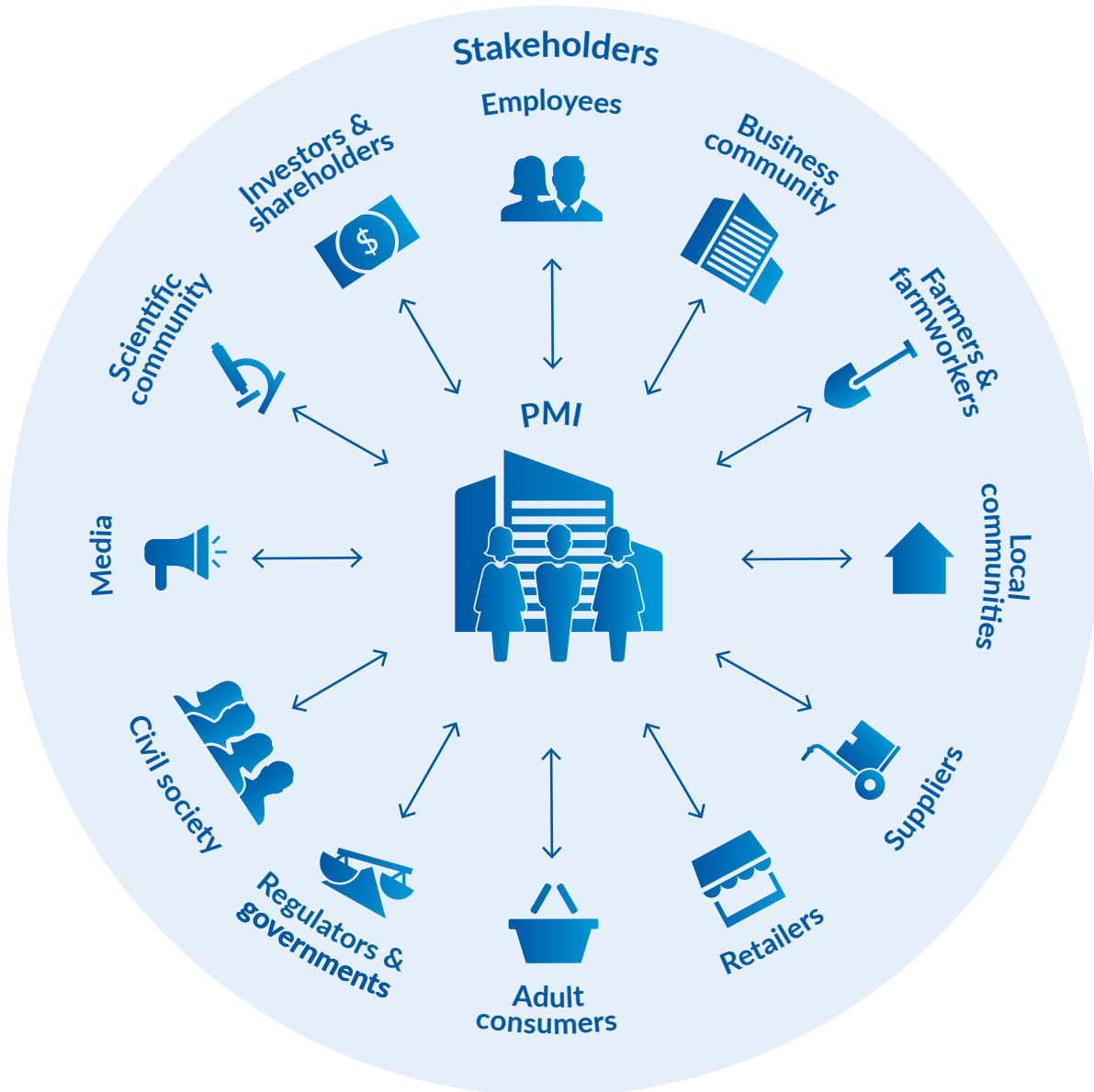
- Employee engagement and well-being, labor relations, workplace health and safety, inclusion and diversity, and talent recruitment and management;
- Fighting illicit trade in tobacco products;
- Good laboratory and clinical practices in our R&D efforts; and
- Good environmental management of our operations.

Stakeholder engagement

As we progress towards a smoke-free future, the trust of our stakeholders is key to our success. We engage with stakeholders on an ongoing basis in a number of ways. In doing so, we will be

guided by AccountAbility's Stakeholder Engagement Standard: AA1000. Due to the highly regulated nature of our business, we have also implemented Engagement Principles found on page 68 of this report.

The graph below highlights our main stakeholders per category.



Our work and the UN Sustainable Development Goals (SDGs)

We are committed to the SDGs and have adopted a three-pronged approach to help make them a reality. We have prioritized our work where we can have the greatest impact. As stakeholder expectations around the SDGs evolve, we will further refine our work and reporting on how we contribute to the goals through our business vision and across our operations and value chain.

Taking decisive action where we have the greatest impact



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

This report's section on "Transforming our business" describes in detail how our business vision aligns with this SDG.

Taking ownership where we can provide a substantial contribution



SDG 2: Through good agricultural practices and crop diversification we can help to improve the productivity and food security of smallholder farmers.



SDG 8: We ensure good working conditions for all our employees and can play a role in promoting good working conditions for thousands of workers throughout our supply chain.



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



SDG 16: Our efforts to combat illicit trade in tobacco products challenge the perception that illegal tobacco trade is a victimless crime without links to funding terrorism and other serious offences.
























Aligning our practices with the overall goals, even where our business has less impact



We certainly care about all other SDGs. Nevertheless, our business has very little impact on certain SDGs, and therefore we can only make a relatively modest contribution to these global objectives at this stage.

The table on the next page provides an overview of how our activities and programs relate to the 17 Sustainable Development Goals and the 10 principles of the UN Global Compact.

SDGs and UNGC cross-reference index

	Page reference					
Transforming our business						
Replacing cigarettes with smoke-free products	See pages 12 to 25					
Driving business excellence						
Ethics and compliance	See pages 26 to 27					
Responsible marketing	See page 28					
Interacting with governments	See page 29					
Our approach to corporate tax	See page 29					
Data protection	See page 29					
Human rights	See page 31					
Tackling illicit tobacco trade and related crimes	See pages 32 to 35					
Responsible Sourcing Principles (RSP)	See pages 36 to 37					
Good Agricultural Practices (GAP)	See pages 38 to 39					
Managing our social impact						
Working at PMI	See page 40					
Inclusion and diversity	See pages 41 to 42					
Labor relations & living wage	See page 43					
Safety, health and well-being	See page 43					
Reducing our environmental footprint						
Climate change	See pages 54 to 57					
Water	See page 58					
Conserving biodiversity and combatting deforestation	See pages 59 to 60					
Waste management	See pages 60 to 61					

6 CLEAN WATER AND SANITATION	7 AFFORDABLE AND CLEAN ENERGY	8 DECENT WORK AND ECONOMIC GROWTH	9 INDUSTRY INNOVATION AND INFRASTRUCTURE	10 REDUCED INEQUALITIES	11 SUSTAINABLE CITIES AND COMMUNITIES	12 RESPONSIBLE CONSUMPTION AND PRODUCTION	13 CLIMATE ACTION	14 LIFE BELOW WATER	15 LIFE ON LAND	16 PEACE, JUSTICE AND STRONG INSTITUTIONS	17 PARTNERSHIPS FOR THE GOALS	UNGC Principles
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Transforming our business



A cigarette manufacturing line (on the left-hand side) and a heated tobacco unit manufacturing line (on the right-hand side) at our factory in Neuchâtel, Switzerland

Replacing cigarettes with smoke-free products

In 2017, PMI manufactured and shipped 791 billion cigarettes and other combustible tobacco products and 36 billion smoke-free products, reaching approximately 150 million adult consumers in more than 180 countries.

Smoking cigarettes causes serious disease. Smokers are far more likely than non-smokers to get heart disease, lung cancer, emphysema, and other diseases. Smoking is addictive, and it can be very difficult to stop.

The best way to avoid the harms of smoking is never to start, or to quit. But much more can be done to improve the health and quality of life of those who continue to use nicotine products, through science and innovation.

For over a century, the basic design and use of cigarettes have not changed. A smoker lights the cigarette, shredded tobacco leaves are burned, and the smoker inhales nicotine, flavors, and various other substances present in the smoke. While nicotine is addictive and not risk-free, experts agree that the primary cause of smoking-related diseases is found in toxicants generated by combustion and inhaled in cigarette smoke.

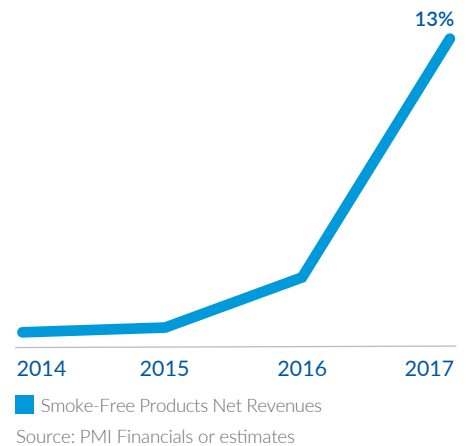
While several attempts have been made to develop better alternatives to smoking, drawbacks in the technological capability of these products and a lack of consumer acceptance rendered them unsuccessful. Recent advances in science and technology have made it possible to develop innovative products that consumers accept and that are less harmful alternatives to continued smoking.

PMI has developed a portfolio of smoke-free products, including heated tobacco products and nicotine-containing e-vapor products that have the potential to significantly reduce individual risk and population harm compared to cigarettes.

Many stakeholders have asked us about the role of these innovative smoke-free products in the context of our business vision. Are these products an extension of our cigarette product portfolio? Are they intended for developed countries only? Are they aimed at compensating a decline in cigarette sales? In 2016, we made a bold announcement: **Our business vision is to replace cigarettes with less harmful, smoke-free products as soon as possible.**



Contribution of Smoke-Free Products to PMI's Total Net Revenues



Smoke-free products: our product Platforms

Heated tobacco products

Platform 1



IQOS, using the consumables *HeatSticks* or *HEETS*, features an electronic holder that heats tobacco rather than burning it, thereby creating a nicotine-containing vapor with significantly fewer harmful toxicants compared to cigarette smoke.

Platform 2



TEEPS uses a pressed carbon heat source that, once ignited, heats the tobacco without burning it, to generate a nicotine-containing vapor with a reduction in harmful toxicants similar to *IQOS*. A small-scale city test of the product was initiated in 2017.

Products without tobacco

Platform 3



Platform 3 is based on acquired technology that uses a chemical process to create a nicotine-containing vapor. We are exploring two routes for this platform: one with electronics and one without.

Platform 4



Products under this platform are e-vapor products: battery-powered devices that produce an aerosol by vaporizing a nicotine solution. One of these – *MESH* – uses new proprietary vaporization technology.

Our ambition for a smoke-free future

Projection of smoking prevalence

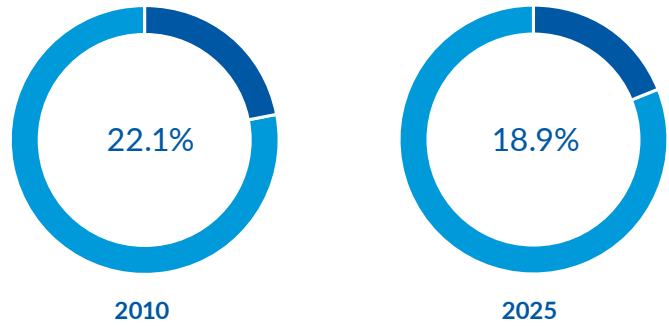
Today an estimated 1.1 billion men and women around the world smoke cigarettes or other combustible tobacco products such as cigars, bidis, and pipe tobacco. Smoking prevalence, which was estimated at 22.1% in 2010 (age 15+), has been in constant decline for several decades, and the World Health Organization (WHO) projects it will continue declining by 0.21 percentage points per year.² At that pace, it will take almost 100 years until the world is smoke free.

At the same time, 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 projected 1.16 billion smokers by 2025. These WHO projections assume current tobacco control policies and do not consider the potential of smoke-free products.

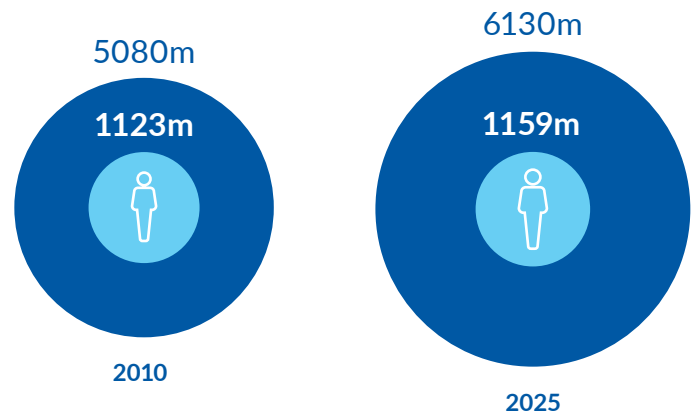
Member states of WHO are rightly dissatisfied with the slow pace at which smoking is declining and have established a 2025 target to reduce the prevalence of tobacco use by 30% compared to 2010, aiming to achieve a smoking prevalence of 15.5%.³

As population growth partially offsets the impact of this prevalence target, there will still be approximately 950 million smokers by the year 2025 if the WHO objective is achieved.

Projected smoking prevalence



Projected number of smokers



- Global population
- Projected number of smokers

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

PMI's ambition

We believe smoking prevalence can be reduced much faster by supplementing measures that governments take to discourage smoking initiation and encourage cessation with efforts to encourage smokers who would otherwise continue smoking to switch to smoke-free products. To illustrate the opportunity for public health, we project the number of consumers of PMI products for the year 2025. These calculations are consistent with the WHO projections, PMI's Business Transformation Metrics shown on page 25, and assume a constant global market share for PMI (excluding China and the U.S., where we do not have a material presence).

In the base case scenario, and without smoke-free products, the number of smokers buying PMI products is projected to increase slightly to an estimated 152 million by 2025. The WHO target to reduce the prevalence of tobacco use – assuming a proportionate effect on smokers using PMI products – implies a 19 million reduction to 133 million smokers of PMI products by 2025.

It is our ambition that at least 30% of our consumers who would otherwise continue smoking switch to our smoke-free products by 2025 versus 2010. Based on that ambition, we project that by 2025 at least 40 million PMI cigarette smokers will have switched to smoke-free products.

The combination of measures to discourage tobacco initiation and encourage cessation and our full-scale effort to replace cigarettes with smoke-free products could reduce smoking of PMI products by 40% within a decade – a major acceleration towards a smoke-free world.

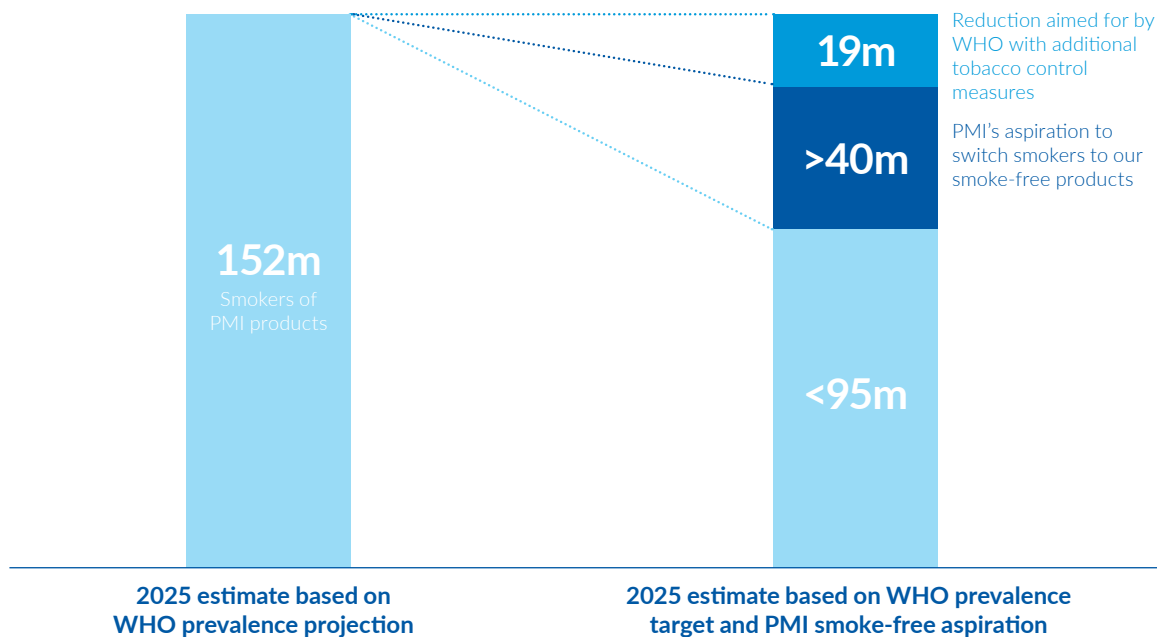
These are illustrative calculations, as we left out the potential for PMI to grow market share by switching consumers of competing cigarette brands to our smoke-free products. We also excluded the possible positive interventions by governments to regulate products proportionate to the harm they cause.

Clearly, governments and civil society, especially leading scientists and public health professionals, and ideally the WHO, can play a decisive role in encouraging the use of smoke-free products to replace cigarettes for people who would otherwise keep smoking.

Our competitors are also increasing their efforts to develop and commercialize their own smoke-free products. As a result, we expect a positive acceleration of innovation, competition, and consumer adoption that could reduce global smoking prevalence at a pace significantly beyond past reductions and future goals set by the WHO.

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

- People who quit or less people starting
- People who switch to PMI smoke-free products
- Smokers of PMI products



The rationale for our business vision

We understand that our vision of replacing cigarettes with smoke-free products is unprecedented for a tobacco company. Some will question our motives, and others will question why PMI would seek to transform a very profitable market for cigarettes. The answer is simple: Our goal of developing and commercializing less harmful products to replace cigarettes is completely aligned with the expectations of smokers, society, and our shareholders.

Our success as a business was primarily built on offering the best smoking experience through our top-quality cigarette brands, including *Marlboro*, *L&M* and *Chesterfield*. We are convinced that our continued success will depend, above all, on our ability to offer men and women who smoke less-harmful alternative products.

The business case is straightforward. PMI leads the smoke-free category, thanks to sustained R&D investments. We are therefore in an excellent position to not only switch consumers who smoke PMI cigarettes, but also those who smoke competing cigarette brands.

We are observing this in Japan, where many *IQOS* users previously smoked cigarettes made by our competitors. We are thus increasing market share, thereby enhancing business results. In addition, the profit margins of smoke-free products are similar to or exceed those of cigarettes helped by differentiated excise tax, as many governments recognize that products such as *IQOS* are not cigarettes and require a different tax system and yield.

A smoke-free world can be achieved faster if the industry as a whole, including new entrants, are incentivized for efforts in this direction. A wide variety of companies – from small start-ups to multinational tobacco companies – is increasingly active in the smoke-free category. All multinational tobacco companies are commercializing at least one smoke-free product, and the category is undergoing rapid change. This is a positive development, provided that all companies show the same commitment to scientific rigor and transparency.

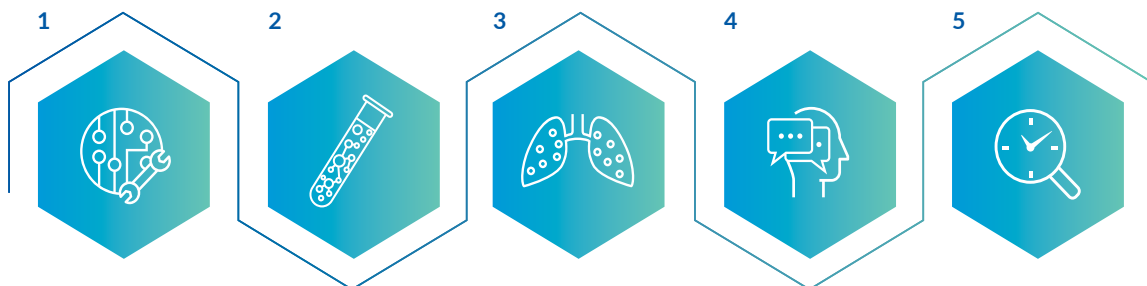
Technological innovation is transforming our industry. Developing, assessing, and commercializing novel, less-harmful alternatives to cigarettes should, in our view, become the focus of competition. PMI has been, and will continue to be, a driving force of this transformation.

We are often asked about our willingness to license our technology to other tobacco companies. PMI has granted Altria an exclusive license to commercialize *IQOS* in the United States, and we are in principle open to other partnerships where it makes business sense and helps to advance a smoke-free world.

Scientific assessment of our smoke-free products

The catalyst for our transformation is the science behind our smoke-free products. We knew from the outset that our science would be met with skepticism. Since 2008, we have hired over 400 scientists and engineers who are working in state-of-the-art facilities and use cutting-edge technologies to develop and assess our smoke-free products. Our scientific assessment program follows a stepwise approach inspired by pharmaceutical industry standards and in line with draft guidance issued by the U.S. Food and Drug Administration's (FDA) Center for Tobacco Products in 2012. We conduct our research in accordance with international standards and practices, such as internationally accepted Good Laboratory Practices (GLPs) and Good Clinical Practices (GCPs).

Our five-step approach to assess individual risk and population harm



1. Developing the product

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 eliminate combustion and ensure that the product delivers less Harmful and Potentially Harmful Constituents (HPHCs). In this initial phase of designing 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.

2. Laboratory studies

Our next step is to verify the potential of a smoke-free product's aerosol to reduce risk compared to cigarette smoke by measuring a reduction in toxicity as well as a reduction in risk using laboratory models. If they are reduced significantly, we move on to clinical studies.

3. Clinical studies

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 toxic 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 and smokers who quit using any tobacco and nicotine product for the duration of the study.

4. Consumer use research

We also conduct several types of perception and behavioral studies to better understand a smoke-free product's potential to benefit public health. These studies include research into how smokers perceive a product's risk and how they adopt and use a smoke-free product under real-life conditions. We also verify that never smokers and former smokers understand that smoke-free products are not intended for them.

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. We are undertaking post-market surveillance studies, starting in Japan, where our objective is to assess the marketed product in order to further substantiate the results collected in the pre-market clinical assessment and perception and behavioral assessment programs. This is done by collecting a set of qualitative and quantitative data on the use of the smoke-free product in real world conditions.

Developing and assessing a smoke-free product is a rigorous process⁴ that starts with the initial design of the product platform, a fundamental step for quality and consistency. Laboratory and clinical studies are then used to evaluate exposure and risk reduction potential. In addition, we also conduct research on how people understand communications about a product's risk profile and on how the product is actually used. Finally, we monitor the long-term use of all our products once they are in the marketplace. To see if our products fulfill their potential to have a positive impact on public health in the real world, it is important for us to follow the products even after they have been launched on the market. We combine a number of approaches, including safety surveillance, clinical studies and epidemiological studies, in order to progressively obtain a clearer picture of the risk-reduction potential of our products.

Our studies on *IQOS* are very advanced and point towards risk reduction. Our findings to date show that:

- *IQOS* does not generate combustion or smoke;⁵
- *IQOS* vapor contains on average 90-95% lower levels of toxicants compared to the smoke from a reference cigarette designed for scientific research, with nicotine at similar levels to cigarette smoke;⁶

IQOS: Scientific substantiation progress

Totality of scientific evidence supporting reduced risk potential	Reduced impact on users and those around them	Improved oral hygiene
No combustion Reduced HPHC formation Reduced toxicity Reduced exposure Reversal of clinical risk markers Pre-market perception and behavior assessment Post-market surveillance Japan	Less smell No ash No risk of burning No negative impact on indoor air quality	Better breath Less unpleasant aftertaste Reduced tooth discoloration

- Laboratory studies conducted in animal models of disease confirm that these lower levels of toxicants result in *IQOS* vapor being significantly less toxic than cigarette smoke;⁷
- Laboratory studies confirm that switching to *IQOS*, conducted in animal model of diseases, led to a reduction in key smoking-related diseases and their associated mechanisms. These reductions approached those observed in the cessation group;⁸
- Clinical studies conducted to date confirm the results of our laboratory studies. Smokers who switched completely to *IQOS* in two one-week and two three-month clinical studies significantly reduced their exposure to 15 toxicants. These reductions

approached levels observed in the cessation groups;⁹ and

- *IQOS* use does not adversely affect indoor air quality based on indoor air quality exposure limits and is not a source of second-hand smoke.⁸

These results give us confidence that switching fully to *IQOS* is likely to present less risk of harm than continuing to smoke. We are convinced its introduction will benefit public health.

Our research efforts will continue to seek ways to further reduce the risk of harm and to broaden our smoke-free product portfolio such that we have products that are acceptable and affordable alternatives to all smokers.



Two scientists conduct studies to understand the aerosol of PMI's main smoke-free product, *IQOS*, at our R&D center in Neuchâtel, Switzerland

Encouraging scrutiny of our science through transparency and engagement

Ideological rhetoric is often fierce when tobacco is the topic, preventing the public from understanding factual information and undermining sound public policy. Confusion can be exacerbated by headlines and media stories. We understand that harsh media coverage or biased scientific studies are inevitable, and certainly take great care in our consumer information and our public statements because the public and consumers expect it – and deserve no less. We recognize these hurdles but are doing our best to counter and correct inaccuracies that erode the information environment in which consumers, policy makers, and investors are making important decisions.

Sharing our science, gathering feedback, and participating in robust scientific debate help answer important questions we receive about our innovative products from the public, scientific experts, and regulators. Since 2008, we have published more than 200 smoke-free-product-related studies and book chapters in peer-reviewed publications, such as the American Journal of Physiology, Nature Biotechnology and Regulatory Toxicology and Pharmacology. Over the last two years, we presented our results at over 150 scientific conferences around the world. In 2017, our scientists presented research results at 76 leading scientific conferences and published over 45 book chapters and articles in peer-reviewed journals.

In 2018, we are going one step further in our scientific transparency by making the data from our non-clinical and clinical studies about our smoke-free products available to the public.

Our systems toxicology program uses large datasets to build an understanding of disease mechanisms, predict the extent of damage to the body from exposure to toxic substances, and estimate improvements if those exposures are reduced. In 2011, we launched our sbvIMPROVER platform, a crowd-sourcing initiative developed with IBM, to enable independent scientific experts to review and validate our scientific methods and conclusions. It does so through the publication of Challenges and defined criteria by which scientific institutions

can independently develop methodologies and draw their own conclusions. Through this robust, 21st-century approach to peer review and scientific verification, we can gauge the extent to which our own research is in line with these crowd-sourced results. Since the inception of the sbvIMPROVER platform, nearly 200 institutions across the globe have taken part in the program, and the Challenges have verified our research. The Challenges and all publications and news articles related to this platform are available online.¹⁰

We use various print and online communication tools to share our science and encourage further debate and understanding about our smoke-free products. We have a dedicated website (www.PMScience.com) to share the latest information about our ongoing research, peer-reviewed publications, and we issue a regular “Scientific Update for Smoke-Free Products.”

We have created an infrastructure and website, Intervals.science,¹¹ to share more detail on the methods we use to assess products and the data we generate to support our results. With this platform, we also aim to foster increased reproducibility and trust in the science relevant for tobacco harm reduction and a dialogue among all relevant stakeholders.

Lastly, on September 12, 2017, we announced our support of the Foundation for a Smoke-Free World. We agreed to contribute \$80 million per year over the next 12 years, as specified in the agreement. We made an initial contribution of \$4.5 million in 2017 and the first annual contribution of \$80 million in the beginning of 2018. The Foundation is an independent body and is governed by its independent Board of Directors. 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.

Investing in production capacity for smoke-free products

Our company's shift toward a smoke-free future means going beyond developing the products and science. It also means supplying the demand. The case of IQOS in Japan illustrates the need to anticipate demand. Despite optimistic projections for a nationwide roll-out of IQOS in Japan, in 2016, consumer demand exceeded our expectations. We were surprised by the rapid pace of adult smoker conversion to the product once we hit a critical mass of 2-3% market share nationwide. By June 2016, we had to ration the number of IQOS devices sold across the country to avoid a situation where smokers who had switched to IQOS would be unable to find heated tobacco units. At the same time, we accelerated investment in the manufacturing capacity for heated tobacco units.

Our factory in Neuchâtel, Switzerland, was the first to produce the heated tobacco units used with the IQOS device. In 2015, our factory in Bologna became the first site fully dedicated to heated tobacco unit production. We are also converting some existing cigarette factories such as in Greece and Romania.

Milestones and investments



+\$4.5bn

Since 2008, we have invested more than USD 4.5bn in fundamental research, product and commercial development, production capacity, scientific substantiation, and studies on adult smoker understanding



+400

World-class scientists, engineers, and technicians hired since 2008 to support our best-in-class R&D capability in our two R&D facilities in Neuchâtel (Switzerland) and Singapore



+2,900

Patents granted worldwide related to smoke-free products



PMI's factory in Greece, its first cigarette factory fully converted to the manufacture of HeatSticks, used with IQOS

Our commercialization efforts behind smoke-free products

Developing and manufacturing scientifically substantiated smoke-free products is only the start: The next challenge is to convince smokers to switch. We have learned a great deal about the consumer conversion journey since our city tests of IQOS in Milan, Italy, and Nagoya, Japan, in late 2014.

The regulatory environment in which we commercialize our smoke-free products varies substantially around the world. As a result, it is easier in some countries than others to make smokers aware of smoke-free products and how they should use them. The differences in the regulatory environment explain, to a large extent, why switching rates to smoke-free products vary from one geography to another.

As the heated tobacco category is new, we face several challenges unseen before: increased time to communicate product benefits; consumer acceptance of a different ritual; and a willingness to stay with the product throughout the conversion process. We know that it usually takes one to two weeks for someone to fully stop smoking cigarettes and switch to IQOS. We also know that those who smoke are reluctant to change their behaviors. For these reasons, we are

shifting from a business-to-business model to a consumer-centric model to assist smokers with this transition.

This effort includes the deployment of specialized field personnel, or “coaches,” who have been rigorously trained to perform quality guided trials with adult smokers and explain the fundamental differences between cigarettes and IQOS.

For adult smokers, a successful guided trial – a truly personalized experience – leads to the purchase of an IQOS kit and the start of their conversion journey. Customer care services, including digital tools, are then available to follow up and to encourage smokers not to fall back to cigarettes, as well as to address any questions or issues.

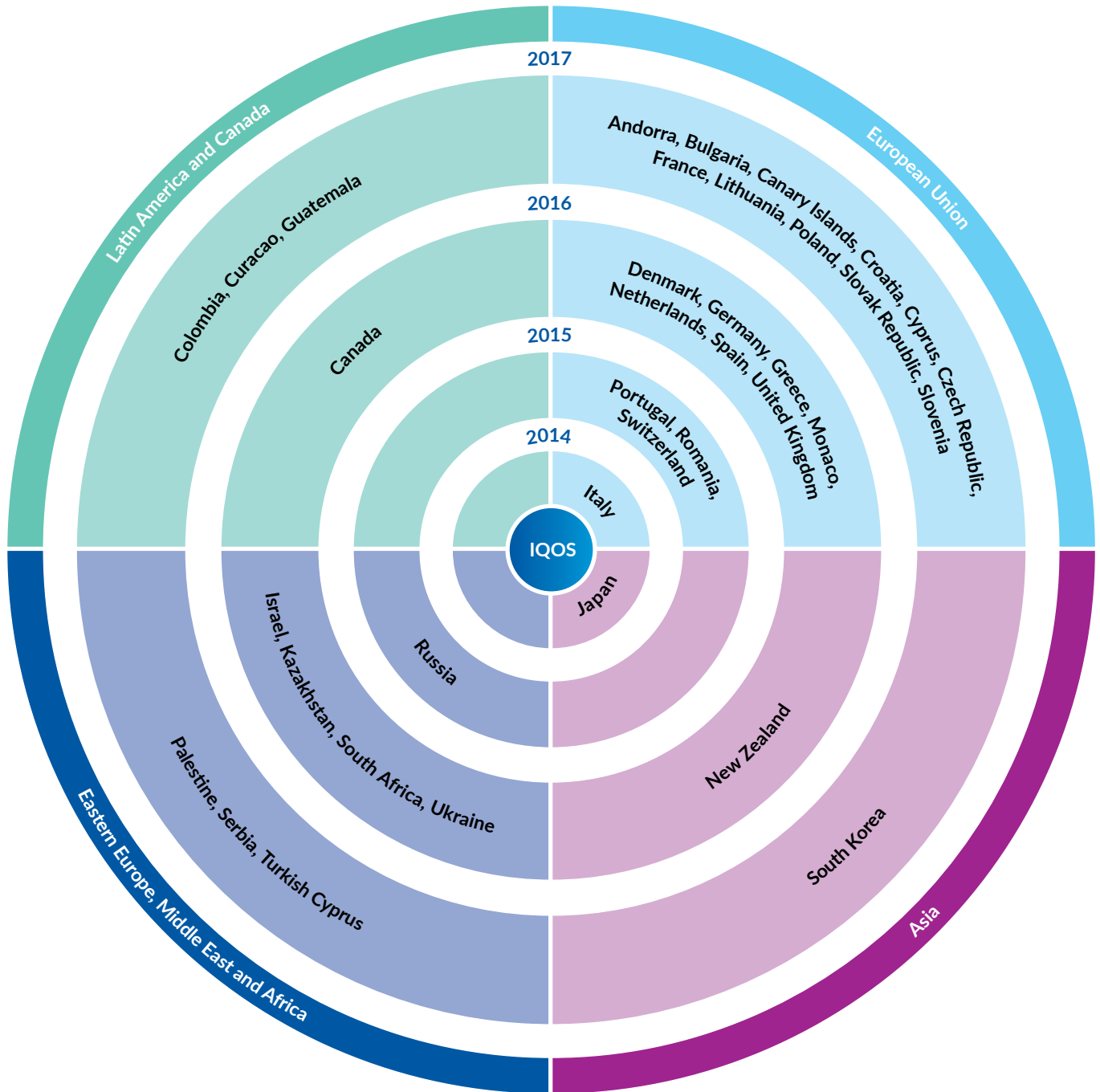
Smoke-free products contain nicotine, are addictive, and are not risk-free. We understand that any communication with adult smokers about these products must be carried out responsibly, attuned to the local environment and, observing regulatory obligations. Our employees and third parties acting on our behalf must follow strict principles in the commercialization of smoke-free products, which are formalized in our Good Conversion Practices (GCPs) which are being implemented as smoke-free products are launched. See page 28.

A substantial part of our marketing and sales budget in countries where we have launched IQOS has been re-allocated from cigarettes to IQOS. Clearly, to promote our smoke-free vision we must allocate our budget and headcount accordingly.

Our goal to replace cigarettes with smoke-free products extends to all countries where we operate, regardless of development status. We are only at the beginning of commercializing a fully fledged portfolio of smoke-free products and realize that additional efforts are necessary in finding products that are affordable and acceptable for consumers in different parts of the world. We acknowledge the need to continue working to develop different product platforms that can 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 if permitted by local legislation.

Our global progress overview

IQOS is available in key cities in 37 markets and nationally in Japan in 2017.





PMI's R&D facility in Neuchâtel, Switzerland, where those interested in our science can visit to find out more about our scientific work

Our view on tobacco regulation

The well-known risks of smoking have led regulators to impose more restrictions and higher excise taxes on cigarettes than on any other consumer product – while allowing cigarettes to remain available to adults. There's absolutely no doubt that nicotine-containing products should be subject to strict rules and enforcement.

Comprehensive requirements were put in place to control nearly every aspect of the cigarette business. The question then becomes: What's the plan to address the needs of men and women who are looking for less harmful, yet satisfying, alternatives to smoking?

The answer, in our view, is innovation – in products and in policies. As we work to design a smoke-free future, our priorities are changing. Technology that we and others have developed makes it possible to shift the tobacco and nicotine market towards a future in which cigarettes are replaced by less harmful, yet satisfying, smoke-free alternatives.

Not all regulatory and fiscal rules that apply to cigarettes are relevant and justified for smoke-free products. Regulators must differentiate supply and demand measures – for example, product, communication, and fiscal policies – based on product attributes and risk profiles. This is of critical importance for the people who smoke and who deserve policy choices that respect them and their ability to decide. And policies should be sensible, and based on principled pragmatism rather than influenced by ideology.

Many regulators, including the U.S. FDA and Public Health England, have included tobacco harm reduction as a complementary pillar of their comprehensive tobacco control plans, complementing cessation and prevention programs.

To be clear, regulations should continue to dissuade people from starting to smoke and encourage cessation, and we support regulatory measures to this end. But it is equally clear that millions of men and women will continue to smoke, and they should have the opportunity and information to switch to better alternatives.

Nagoya, Japan, was selected as the world's first pilot market for IQOS in November 2014. We found that adult Japanese smokers readily accepted IQOS, as it allowed them to enjoy a satisfying tobacco experience with no fire, no ash, less smell, and without negatively impacting indoor air quality. By the end of the Nagoya pilot launch in August 2015, the offtake share of IQOS had grown to 0.8% for the city of Nagoya. In September 2015, Philip Morris Japan (PMJ) expanded the IQOS sales area to include 12 major Prefectures, followed by nationwide expansion in April 2016.

IQOS continued to grow in popularity, and production was soon unable to meet demand. It was not an uncommon sight to see lines in front of IQOS stores where customers would patiently queue in the mornings for a chance to purchase an IQOS device. In addition, the competition was quickly entering the category with pilot launches of heated tobacco products in Fukuoka and Sendai, in May and December 2016.

Despite the limited supply of both IQOS devices and HeatSticks, the market share in Japan continued to grow and by October 2017, three million smokers had quit smoking and converted to IQOS. As of the fourth quarter of 2017, HeatSticks represented 13.9% of the nationwide tobacco market in Japan.

While the total tobacco industry volume continues to decline in line with long-term trends, the decline of combustible products has accelerated with the introduction of heated tobacco

products. As the market leader of this new category, PMJ increased its total tobacco market share. In fact, around 70% of IQOS users have switched from competitive brands of combustible cigarettes.

Transforming our business

In July 2016, PMJ undertook a massive organizational change wherein the number of sales staff were significantly reduced, and a new IQOS development team was created. Over the last two years, 30% of PMJ staff have been fully reallocated from combustible products to smoke-free products, with the other 70% supporting both portfolios. On top of that reorganization, more than half of PMJ marketing and sales budgets were shifted to smoke-free products.

PMJ continues to transform the business model to address new challenges with innovative solutions, such as guided trials, a dedicated customer care call center, improved logistics chain, IQOS stores, and digital platforms.

Guided trials

PMJ sales staff meet face-to-face with legal-age smokers interested in switching to IQOS to explain the scientific evidence behind IQOS and how to properly use and maintain the device. During these guided trials, the staff can directly address questions by interested smokers and seek to ensure that smokers switch to IQOS with a correct understanding of the product proposition and device usage. In 2017 alone, 871,000 guided trials were conducted in Japan.

Customer care call center

With the introduction of IQOS, PMJ established a dedicated call center with staff trained to respond to a wide variety of questions ranging from scientific evidence to technical support. In 2017, the Customer Care Call Center responded to an average of 15,000 daily contacts through an omni-channel approach, including phone calls, e-mail, and online self-service support.

Logistics chain

To return and repair devices with technical issues, PMJ has created a bi-directional logistics network that allows for the return of defective devices and the delivery of a new device nationwide within 24 hours.

PMJ is also undertaking efforts to recycle the metal from devices that were returned, and we are considering how to expand and improve this program in the future.

IQOS stores

PMJ has a network of nine dedicated IQOS stores across Japan. They serve as a touchpoint for adult smokers interested in switching to IQOS to learn about the device through guided trials, as well as provide current users with customer service, IQOS devices, and accessories.

Digital platforms

PMJ has several innovative digital initiatives that support smokers on their conversion journey and provide up-to-date content to IQOS users. Smokers switching to IQOS are supported by a "30-Day Challenge" program that sends information to registered users at regular intervals either by e-mail or through a social networking service platform to support them in their lifestyle change. Also, the IQOSphere user community provides a wealth of content to registered users to enrich their IQOS experience.

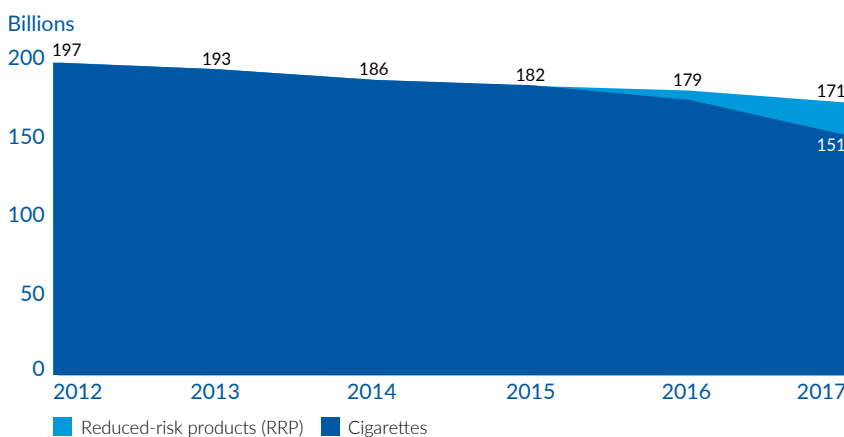
Challenges

With any new product, there are new challenges that need to be addressed. PMJ is on the forefront of PMI's transformation and is striving diligently to address these new challenges.

Accidental ingestion

According to the Japan Poison Center (JPC), an average of 97 cases of accidental or unintended HeatStick ingestion per month were reported in 2017. As PMI became aware of such cases, to prevent accidental ingestion by children, PMJ partnered with JPC to share information

Total Market - In Market Sales Volume, Annual 2012-2017



Source: Tobacco Institute of Japan IMS and PMJ Estimate/RRP includes competitive RRP IMS

and prompt consumers calling PMJ call centers to contact JPC. Additionally, PMJ started an awareness campaign through the IQOS website and leaflets. PMJ will continue to find new ways to communicate with consumers regarding the prevention of accidental *HeatStick* ingestion by children.

IQOS manners

Although IQOS offers many convenience benefits, IQOS users still need to be considerate of those around them. PMJ launched a campaign to remind users to pay attention to their surroundings when using IQOS. With regard to indoor use of IQOS, PMJ is aiming to create space for users of smoke-free products without bothering people who do not use nicotine products, for instance by transforming existing smoking areas into IQOS areas.



An IQOS store in Ginza, Japan.

Transforming society

IQOS can truly transform the way smokers enjoy tobacco products, but to achieve a smoke-free Japan, it is important for the society as a whole to understand the potential of smoke-free products.

Mitsubishi Estate Co., Ltd. is a market-leading comprehensive real estate developer operating a wide range of real estate-related businesses. Mitsubishi Estate established 10 *IQOS* lounges in common areas of office buildings which have become very popular with tenants as they meet the needs of the rapidly growing number of *IQOS* users without the smell and high maintenance fees of traditional smoking rooms.

Goshobo is a traditional Japanese ryokan (inn) operating in the Arima hot spring resort since 1191. The management of

the inn wanted to find a way to remove the potential fire hazard of combustible cigarettes while accommodating guests who wished to enjoy tobacco during their stay. Learning of *IQOS*, the management decided to make the inn completely non-smoking and offer guests the option of renting an *IQOS* device for the duration of their stay.

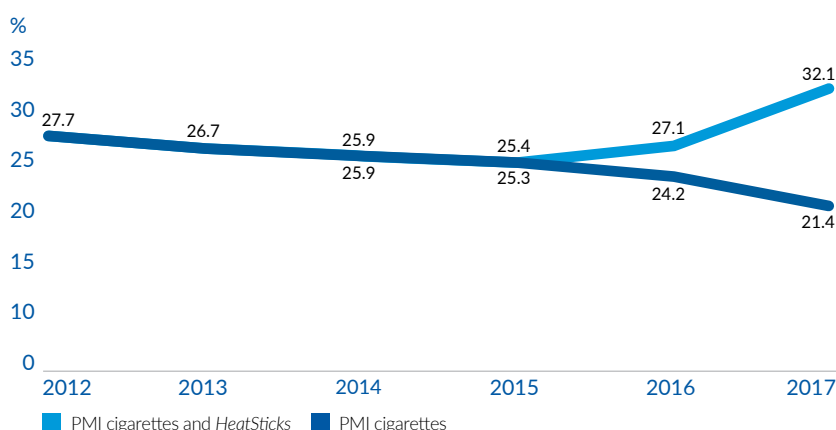
As another example, employees of a major telecommunications company were complaining about the bad smell of the smoking room. The company met with PMJ to learn more about *IQOS* and the product's scientific substantiation, especially the impact on indoor air quality. Based on these discussions, the management decided to remodel the smoking room to an *IQOS* lounge where smoking is not allowed, but *IQOS* use is permitted. Tests were performed on the

air quality of the lounge, and an employee satisfaction survey was conducted to gauge the results of the new initiative. The results show that there is no negative impact on indoor air quality, and employees who switched from cigarette smoking to *IQOS* now enjoy relaxing in this *IQOS* lounge.

Realizing a smoke-free future

In the last quarter of 2017, smoke-free products from PMJ and its competitors comprised 17% of the tobacco market, up from 5% in the same quarter of 2016. As a result of this phenomenal growth – never before seen in the tobacco category – cigarette sales in Japan have been declining at record pace, dropping by 16% over the same period. Smoke-free products already represent over 40% of PMJ's 2017 sales volume. Our ambition is to realize a smoke-free Japan by completely replacing cigarettes with smoke-free products in Japan as soon as possible.

PMJ Share of Market, Annual 2012-2017



Source: Tobacco Institute of Japan IMS and PMJ Estimate/Note: Denominator = Cigarettes + RRP including Japan Tobacco's PloomTECH and British American Tobacco's glo consumables IMS

Business transformation metrics

Last year, we introduced a set of business transformation metrics to make the actions we are taking to pursue our smoke-free vision measurable and verifiable. The first two metrics show our resource allocation between combustible products and smoke-free products, while the following four show progress in making smoke-free products the core of our business. We will continue to publish updates on our performance on a regular basis.

The first metric – **R&D expenditure** – shows how much of our total spend on research and development is dedicated to smoke-free products.

It includes the costs related to clinical studies, the development of new machinery, prototype, 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.

The second metric – **commercial expenditure** – shows how much of our total spend on the commercialization of our products is dedicated to smoke-free products. Commercial expenditure includes costs for marketing, consumer engagement, and trade promotions. As with the other metrics these refer to our global business, and therefore, the total includes commercial expenditures related to cigarettes in the many markets where we have not yet launched smoke-free products. For markets where we are commercializing new products, this percentage is and will be significantly higher. Last year, approximately 39% of our global commercial expenditure was dedicated to smoke-free products. The shift in resource allocation will continue in the years ahead.

The third metric – **net revenues** (operating revenues net of sales and promotional incentives) – shows the portion of our revenues that is generated by the sales of smoke-free products (including electronic devices and accessories). Excise taxes are excluded from the net revenue figures.

The next 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 comes from smoke-free products.

As for previous years, our business transformation metrics have also been assured.



PMI's first purpose-built factory for manufacturing HeatSticks, near Bologna, Italy

Our performance: Transforming our business	Actuals			Aspiration	
	2015	2016	2017	2018	2025 ¹
R&D expenditure (Smoke-free/Total)	70%	72%	74%	>80%	
Commercial expenditure (Smoke-free/Total)	8%	15%	39%	>55%	
Net Revenues ² (Smoke-free/Total)	0.2%	2.7%	13%	>16%	>38%
Smoke-free product ³ shipment volume (billion units)	0.8	7.7	36	>46	>250
Combustible product ⁴ shipment volume (billion units)	881	845	791	<755	<550
Smoke-free product shipment ratio (Smoke free/Total)	0.1%	0.9%	4.4%	>6%	>30%

1 Assuming constant PMI market share. We do not set aspirational targets for R&D and commercial expenditure but we expect both ratios to continue increasing to enable the stated outcome in terms of shipment volume.

2 Excluding excise taxes. For future periods, at today's pricing and excise tax assumptions.

3 Includes heated tobacco units and e-cigarettes. The 2018 aspiration pertains to in-market sales.

4 Includes cigarettes and other combustible tobacco products.

The 2017 metrics are subject to PwC's Assurance Report. See page 75.



Driving operational excellence

We believe that acting with integrity and preventing unlawful and unethical behavior is essential to our long-term success. We strive to go beyond mere compliance in our operations and across our value chain. Our efforts to drive operational excellence are reflected in the way we manage our ethics and compliance program, market our products responsibly, engage with stakeholders, approach corporate tax and data privacy, uphold human rights, tackle illicit tobacco trading, and implement responsible business practices in our supply chain. In this section we provide an update on our performance and key developments in 2017 for each of these topics.

Ethics & Compliance

Our Ethics & Compliance program and our culture of ethical business conduct provide a strong foundation as we transform our business. Honesty, respect, and fairness are core values which unite and guide us at PMI. They are integral to our company culture and the basis of our Code of Conduct (also referred to internally as our Guidebook for Success).

We believe that a strong compliance culture is achieved through a combination of elements: the right Code of Conduct and Principles & Practices, the required level of awareness, training and commitment to our values from all employees, a working environment that fosters appropriate conduct, an understanding of how and why people behave in certain ways, followed by a diligent and fair investigation process for suspected misconduct and proportionate disciplinary action.

The Guidebook for Success, together with its supporting Principles & Practices, covers the following core risk areas: competition law; conflicts of interest; environment, health, safety, and security (EHS&S); fiscal and trade (including anti-illicit trade); protection of information; marketing and sales; and workplace and labor practices. It also covers 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.

Last year, we revised our Code of Conduct and related Principles & Practices to provide even more clarity and guidance to employees, especially as smoke-free products become core to our business. We outlined specific requirements for scientific integrity and for marketing reduced-risk products, reflecting the transformation of our company.

Awareness of, and commitment to, our Guidebook for Success is implemented through training for employees and relevant third parties (in the form of classroom and online training, town halls, leadership communications, and team discussions), and the promotion of a working environment where employees feel comfortable and safe speaking up when things don't seem right or can be improved. We have a third-party-operated

Compliance training ('000)	2015	2016	2017
Competition law	7.79	6.54	5.98
Compliance overview	51.00	112.15	53.16
EHS&S	7.57	9.39	7.50
Employment	11.52	10.59	11.37
Fiscal & trade	22.71	14.35	5.87
Government relations	19.00	12.22	12.31
Information protection	8.96	7.57	42.82
Intellectual property	10.26	4.48	3.26
Marketing	44.27	45.00	33.16
Records management	9.61	15.23	9.94
Other compliance	0.85	0.84	0.63
Total number of training¹	193.54	238.36	186.00

¹ 2015 and 2016 training numbers have been updated to include live trainings that were conducted during these years but reported late, after the publication of our 2016 Sustainability Report.

Compliance Helpline available 24 hours a day, seven days a week, in all languages spoken at PMI. Although anonymous reporting is available, approximately two-thirds of the people who reported suspected misconduct gave their name.

In 2017, we reviewed 714 allegations of which approximately 30% were referred to other departments, and 40% were substantiated as misconduct across all areas of our Code of Conduct. Of these, the top two categories were theft and fraud against the company, representing approximately half of the cases, and workplace integrity and employment, representing approximately one quarter of the cases. Nearly two-thirds of employees whose misconduct was substantiated left the company, approximately one-third received written or verbal warnings or financial penalties.

In 2017, we provided around 186,000 Ethics & Compliance-related training through different channels to employees and relevant third parties. Approximately half of the training was live and half was online. Three-quarters was given to employees and one quarter to third parties. As our Code of Conduct refresher training is conducted in even years, the number of trainings decreased in 2017.

Our VP and Chief Ethics & Compliance Officer oversees our Ethics & Compliance program. Adherence to 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.

The Ethics & Compliance function runs annually an integrated risk assessment together with our Corporate Audit and Internal Controls teams, which look at risks across the company.¹²

Looking ahead: Maintaining a strong compliance culture

As our company transforms, we must be mindful of new challenges. A continued commitment to a strong culture of ethical business conduct, including anti-corruption, is essential. In particular, we plan:

- A company-wide employee survey on our compliance culture in 2018 to gain insights into areas for further improvement; and
- The global roll-out of our revised Code of Conduct.



Employees attend a training session at PMI's Operations Center in Lausanne, Switzerland

Driving operational excellence

Our performance: Ethics and compliance	2015	2016	2017
Number of compliance trainings ('000) ¹	193.54	238.36	186.00
Ratio of employees trained versus third parties trained (%)	77/23	76/24	75/25
Number of reports of suspected misconduct	753	792	714
Number of substantiated claims	279	292	317

¹ 2015 and 2016 training numbers have been updated to include live trainings that were conducted during these years but reported late, after the publication of our 2016 report.

Responsible marketing

One area where many express concern relates to our marketing principles and practices. Some of the concerns raised include whether our communications to adult consumers are appropriate, whether we target non-smokers or minors, and whether we have lower marketing standards in developing countries than in developed countries.

Our Marketing Code for combustible products is based on the following key principles, which are applied across the world without exception:

1. We market and sell our combustible products to adult smokers (not to minors or non-smokers);
2. We warn consumers about the health effects of combustible products;
3. Our marketing must be honest, accurate, and transparent; and
4. We respect the law and our high standards.

To proactively invite discussion with stakeholders about opportunities to improve our approach, we have provided a complete overview of our marketing principles for combustible products with this report. See Annex 1.

We have also developed marketing practices for our smoke-free products portfolio: our Good Conversion Practices (GCPs) for Smoke-Free Products, which are summarized to the right.



Good Conversion Practices (GCPs) for Smoke-Free Products

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.
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.



A pack of Marlboro with a graphic health warning in Germany

Interacting with governments

Some of our critics have voiced concerns about the way we interact with governments. Our Code of Conduct and Compliance Principles & Practices govern these interactions, which are conducted transparently, with integrity, and in adherence with local laws. We strive to comply with rules for advocacy, report on our activities as required in several jurisdictions, and we are transparent when others engage on our behalf. We also publicly disclose the limited political contributions we make.¹³

While confident about our practices, we want to be more proactive in addressing concerns raised. With this report we are making available and inviting feedback on our principles for engagement with governments and public organizations. See Annex 2.

Our approach to corporate tax

PMI is committed to conducting business in compliance with all applicable tax laws, and it has established tax standards intended to ensure compliance with those laws. Legal obligations and societal expectations require that our transactions are based on sound tax strategies and that we act in good faith in all dealings with tax authorities and other stakeholders.

Our approach to tax is based on the following:

- We comply with local rules and regulations;
- Business decisions are not determined by tax considerations alone;
- We pay tax commensurate with the activities we perform and substance we have in a particular country;
- We are open and transparent with tax authorities in the countries where we do business;
- We do not engage in aggressive tax planning, and we do not have in place any contrived tax structures; and
- We do not operate “letter box” companies.

PMI has implemented governance arrangements which set out clear accountabilities for the management of tax compliance risks and tax planning. PMI's tax strategy is to maintain a comprehensive, effective, and practical risk management program, shared best practices, a structured and documented control framework, appropriate planning, and coordinated decision making.

To achieve this objective, we have developed mandatory practices which include:

- Roles and responsibilities: Clear definition of roles and responsibilities are formalized in each PMI affiliate in accordance with PMI's Tax Compliance Program.
- Escalation and involvement of PMI Tax Department: In accordance with PMI's policies, PMI affiliates consult with the PMI Tax Department on all important transactions, including recurring or new transactions, business structures or operations with other PMI affiliates or unrelated parties, and determine positions, exposures or actions regarding material, non-routine tax or customs matters. Where there is sufficient uncertainty over the tax treatment of a particular transaction or there is a potentially significant impact, external advice is obtained.
- Tax reporting and procedures: PMI's Tax Standards and Guidelines are designed to ensure that effective and predictable tax compliance and control measures are in place. In accordance with these policies, all tax filing obligations must be accurately completed on a timely basis and in accordance with applicable laws and regulations.
- Documentation and tax records: In accordance with PMI's policies, PMI affiliates are responsible for the appropriate creation and retention of all relevant tax records.
- Monitoring and reviewing business activities: Business structures and transactions are continually monitored and reviewed by all PMI affiliates for tax compliance.

Dealing with tax authorities

PMI conducts all transactions on an arm's-length basis in accordance with current OECD principles, and we support greater transparency between tax payers and tax authorities.

When it is relevant and feasible, we have upfront conversations with tax authorities in the countries where we operate to minimize uncertainty on both sides. For example, tax rulings do provide a higher level of certainty not just for us but also for the tax authorities.

However, tax rulings are not the only means of securing transparency and certainty. For example, in Australia we are part of the Lead Relationship Manager Program, and in the Netherlands we joined the Horizontal Monitoring Program. Both programs promote ongoing and transparent relations between tax payers

and tax authorities. In the U.K., PMI interacts in an open and real time manner with Her Majesty's Revenue and Customs (HMRC), and we conduct an annual Business Risk Review with HMRC at which key tax issues and business changes with a potential U.K. tax impact are discussed.

Data protection

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. In anticipation of the new EU General Data Protection Regulation (GDPR), PMI has developed its Global Privacy Program (GPP) to establish a new global standard for data privacy across markets and functions throughout PMI. The GPP has been developed over a period of 18 months by a multidisciplinary PMI team and is based on an internationally recognized and established privacy management system. The program is designed to support PMI functions and affiliates within the EU to achieve GDPR compliance and to embed policies and practices that facilitate a fully compliant approach to data privacy. 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.

One of the key elements of the GPP is the introduction of greater central governance for data privacy, through data privacy leads (for markets and functions), a central privacy office team (a collaboration of External Affairs and the Information Protection & Governance group (IPG)) and the Data Protection Governance Board, which reports twice per year into 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.



A contract farmer
in Santa Catarina, Brazil

Human rights

Our Commitment

In 2017, we published PMI's Human Rights Commitment,¹⁴ which is the basis of our Human Rights program. Our Commitment is the result of internal cross-functional consultations and external stakeholder dialog, and it reflects our commitment to the United Nations Guiding Principles on Business and Human Rights.

In addition, a range of policies and programs addresses our value chain or specific groups, such as tobacco workers and children. Amongst those, our Responsible Sourcing Principles (RSP)¹⁵ and Implementation Guidance apply to all suppliers doing business with PMI and establish our expectations in the areas of human rights and labor rights, the environment, and business integrity.

Our Good Agricultural Practices (GAP) program¹⁶ applies to farmers contracting with PMI or our suppliers and includes Agricultural Labor Practices (ALP) covering the topics of child labor, fair treatment, income and work hours, forced labor, safe work environment, freedom of association, and compliance with the law. Affiliates and suppliers contracting tobacco farmers are committed to implementing the ALP program and the ALP Code¹⁷ and to working with us and our tobacco farmers on continuously improving living and working conditions on farms.

Human Rights Roadmap to implement our commitment

In 2017, we developed our Human Rights Roadmap to identify the practical steps required to integrate our Human Rights Commitment throughout our global operations and value chain. As part of this exercise, each functional area has developed a human rights action plan focused on the most salient risks to rights-holders.

Our Commitment to respect human rights

We are committed to business practices that respect internationally recognized human rights in line with the United Nations Guiding Principles on Business and Human Rights. We base our Commitment on the International Bill of Human Rights and the International Labor Organization's 1998 Declaration

on Fundamental Principles and Rights at Work. We will talk with and listen to people whose human rights we might affect. We will look closely at our practices, continuously strive to improve them, and operate systems to implement this commitment from supplier to consumer.

The Roadmap includes three core elements:

Embedding a culture of respect

The foundation of our Human Rights program is the commitment of PMI's senior management to instilling a culture of respect for human rights throughout our operations. Our employees and business partners need to have a practical understanding of human rights risks and of our expectation to have PMI's Commitment embedded throughout our operations and value chain. We aim to achieve this through ongoing training on business and human rights. Last year, we developed a Human Rights e-learning module, available to all our employees. In addition, we are developing tailored functional training sessions to ensure a more in-depth understanding of what human rights mean for individual functions, as well as concrete steps and actions expected from them.

Human rights due diligence

Human rights due diligence is the cornerstone of our human rights program. Over the last several years, we have developed due diligence processes for labor rights in our tobacco supply chain, EHS&S risks throughout our operations, and integrity risks across our value chain. Our ambition is to scale up these processes in the years to come and develop new ones as needed to integrate due diligence processes covering all human rights risks across our entire value chain. This is a vast undertaking, and we will build on the existing foundations already put in place across our organization.

As part of the ALP program, we disclose detailed reports of country-specific external assessments¹⁸ conducted by an independent third party (Control Union Certifications) trained and overseen by Verité, a not-for-profit organization specializing in labor and human rights issues, with action plans to address findings.

We also intend to conduct a pilot human rights impact assessment (HRIA) in collaboration with experts and in consultation with relevant stakeholders. Through our HRIA, we expect to gain a better understanding of the actual and potential human rights impacts at site level. The results will inform our approach moving forward as well as our program design and implementation.

Human rights grievance mechanisms

Providing access to effective grievance mechanisms in line with the Guiding Principles is a core element of our approach. We believe that everyone in our supply chain should have the appropriate means to voice concerns and seek help when needed. That's why we strongly support a culture of speaking up and ask suppliers, in our RSP, to provide workers with easily accessible means to raise concerns and to protect them from retaliation. Properly implemented, such mechanisms are one of the most efficient methods for ongoing due diligence and effective remediation.

As we move forward, we will continue looking into ways to provide access to grievance mechanisms throughout our operations and supply chain.

Between 2011 and 2016, approximately 630,000 migrants arrived in Italy by sea.¹⁹ Many stayed in the south of the country to work in the agricultural sector, which is labor intensive. Given the imbalance in demand and supply of labor in that sector, employment costs are low. The competition among migrant workers for jobs increases their vulnerability to labor rights abuses.

Against this backdrop and considering the company's sourcing of tobacco from this part of Italy, PMI began working with the International Organization for Migration (IOM) in 2015. Since then, PMI has been supporting a project entitled "Terra Munda",²⁰ which focuses on gaining insights into labor rights abuses and the various challenges facing migrant workers in agriculture in Southern Italy.

A preliminary assessment was conducted in 2016 to establish the most pressing needs of migrants living in informal settlements in the regions of Campania and Apulia. It identified shortcomings in four priority areas:

- Decent accommodation and housing;
- Vocational training and job placement opportunities;

- Legal counseling and awareness of existing social services; and
- Italian language classes.

As a result of the findings, IOM developed two sets of interventions to address the exploitation of migrant workers and to protect their rights under the umbrella of the Terra Munda program.

Firstly, two teams of dedicated IOM staff were established on the ground and assisted migrants living in informal settlements by:

- Providing social orientation and legal counseling to vulnerable migrant workers living within informal settlements;
- Identifying the most vulnerable cases (including victims of trafficking or exploitation, unaccompanied children, etc.) and referring them to relevant authorities for necessary assistance;
- Gaining the trust of the local migrant communities and monitoring their emerging needs; and
- Providing cultural and linguistic support.

By December 31, 2017, these teams had supported over 5,200 individuals in 14 months.

Secondly, a comprehensive vocational training program was developed in collaboration with PMI Italy, its partners and suppliers as well as a number of local NGOs and institutions to support the integration of 19 migrants. Over a six-month period, these individuals participated in a remunerated training program, which included accommodation and transport to and from the workplace, counseling, Italian language courses, and workplace safety and security training.



I had never grown tobacco before, maybe it exists in Africa but I didn't know. I was excited to learn new ways of growing crops. I am also grateful because I have learned how to interact with Italians in the workplace, in the city, and in public places. Now I feel that I can fight for my rights and look for a job on my own.

– A beneficiary from Senegal

Tackling illicit tobacco trade and related crimes

According to the United Nations Office on Drugs and Crime, transnational organized crime is an annual business of USD 870 billion.²¹ It is not just luxury goods that are counterfeited or smuggled and sold illegally. Cigarettes are among the most illegally trafficked goods in the world. Criminals are increasingly attracted to the high profits and minimal risks associated with illegally trafficking tobacco products.

Fighting illicit trade in tobacco products, including preventing the diversion of our own products, is a key component of our sustainability program. It is within our best interest, that of our customers and shareholders, but also of governments to safeguard the legitimate supply and purchase of tobacco products.

Yes, the problem of illegal trade impacts our business, but the effects stretch far beyond our bottom line. Fighting illicit trade links directly to combating corruption, contributing to improving human rights, labor rights, and environmental standards, principles that organizations involved in illicit trade ignore or violate.

Awareness continued to increase in 2017 that illegal tobacco trade is not a victimless crime and that it links to the funding of terrorism and other serious crimes. This was reflected in many forums including some in which PMI participated, such as the Helsinki Commission hearing held in the U.S.,²² an event held by the Business Council for International Understanding in Panama²³ and the Financial Times round-table discussion on Combating Illicit Trade in the United Kingdom.²⁴

For us, this challenge means continuing to invest time, effort, and resources in maintaining the integrity of our supply chain, protecting our consumers, and working with governments and other partners to tackle the systemic causes of illicit trade.

Our efforts focus on three main objectives:

- Effective measures to secure our supply chain and prevent the illegal diversion of our products;
- Support for regulation and public-private partnerships to stop illicit trade; and
- Investment in research, training, and education to raise awareness and tackle the issue.

The categories of illegal tobacco trade



Contraband

Genuine tobacco products that are produced for lawful distribution in their market of intended destination but illegally diverted into a different market



Illicit whites

Tobacco products that are generally legally produced in a market and which are smuggled into another market where they have limited or no legal distribution

FAKE

Counterfeit

Tobacco products that have been manufactured without the permission of the trademark rights holder



Under declaration

Tobacco products that are produced and distributed in the same country, a portion of which is not declared to the domestic tax authorities



Smuggling is a much more diffuse and difficult criminal activity to tackle – and this is where many criminals have found safe haven. Cross-border smuggling, by definition, introduces jurisdictional challenges. The capacity to operate beyond national borders is an important advantage for organized criminal groups, which can quickly change their modus operandi or trafficking routes.

– Marc Firestone, President External Affairs & General Counsel – U.S. Congressional hearing, July 2017

Effective measures to secure our supply chain and prevent the illegal diversion of our products

We are committed to ensuring that our products are sold legally in the markets for which they are intended. Collaboration and market-responsible actions, such as tracking and tracing or volume monitoring, are key to fighting the diversion of our products. Given the fast-evolving nature of criminal activity in this area, our tools and processes are continuously refined and updated to help address new areas of risk.

Under the guidance of our Anti-Diversion Governance Committee, we continuously refine our Principles & Practices to ensure our tools are applied systematically across PMI.²⁵

In 2017, we also adopted a risk-based approach and classified markets into risk categories to focus our resources and controls where they are most needed. Our updated Know Your Customer policy includes mandatory actions for markets exposed to higher risk of product diversion, such as yearly customer due diligence and monthly volume monitoring, or an assessment of tracking and tracing controls. For example, our affiliate in Ukraine introduced the monitoring of retailer purchases for specific brands and compared volume requested versus market-specific dynamics, ensuring that deliveries of our brands are continuously assessed.

Tracking and tracing keeps track of product shipments. It helps determine where products have been diverted from their legitimate supply chain. In our business environment, we deploy tracking and tracing at the master case (10,000 cigarettes, 500 packs), carton (200 cigarettes, 10 packs) and pack levels.

Further details can be found in our Anti-Diversion Governance Committee Progress and Outlook Report 2016-2017.²⁶

Tracking and tracing to prevent the illegal diversion of PMI legal products in the supply chain

Tracking



Tracing

Support for regulation and public-private partnerships to stop illicit trade

PMI welcomes regulation and partnerships to help address illicit trade. Over the years, our supply chain controls have been improved through cooperation with regulators and governmental agencies with whom we have specific commitments and obligations.

In addition to supporting the ratification of the World Health Organization's Framework Convention for Tobacco Control (FCTC) Protocol to Eliminate Illicit Trade in Tobacco Products, we also support regulations which extend beyond national borders covering regional organizations such as the European Union (EU). With much of the illicit tobacco trade entering the EU from outside its borders, we know that concerted action is needed to have a real impact.

PMI remains committed to anti-diversion practices through bilateral cooperation agreements with governments and local customs authorities in the form of Memoranda of Understanding (MoU). These MoUs have resulted in the continued exchange of information and technical training for law enforcement officers. In 2017, PMI signed 10 MoUs, bringing the total to more than 50 MoUs, with governments in 48 countries.²⁷

Thanks to the framework set by our MoUs and the exchange of information with authorities, 76 illegal factories producing counterfeit PMI brands were dismantled in 2017 by law enforcement agencies, of which 48 were based in Poland. We estimate that in Poland alone we helped to avoid the sale of four billion counterfeit cigarettes. Had the illegal factories not been dismantled, the estimated tax loss in the EU markets would have been around EUR 1 billion.²⁸



The key to combating illicit trade is sharing information between different agencies, whether they be border guards, coast guards, police, customs, security services or tobacco manufacturers.

– Howard Pugh, Europol – Stopillegal, January 2017

Investment in research, training, and education to raise awareness and tackle the issue

A key element of our strategy includes increasing awareness of the illicit tobacco trade and its drivers. By assessing these aspects, PMI and others can provide insights to governments and local authorities to inform future actions and combat illicit trade more effectively.

To gain a better understanding of the size, nature, trends, and actors typifying the illicit tobacco trade, PMI applies a research methodology based on the collection of empty cigarette packs (Empty Pack Survey or EPS).

In 2017, Empty Pack Surveys were conducted in 79 countries. In total, 117 surveys were commissioned to external parties, around 70% thereof with other tobacco manufacturers.²⁹

Maghreb report 2016

In 2017, for the first time, we studied the illicit tobacco trends in the Maghreb region in cooperation with KPMG. In addition to KPMG's proprietary analysis of the magnitude of the illicit tobacco trade, the report also includes a more

qualitative analysis by the Royal United Services Institute for Defense Studies (RUSI), which highlighted the dynamics behind the illicit trade in cigarettes and other diverted products in this region.



Raising awareness among the general public

Accessible and transparent communication on the illicit trade of tobacco products is key for PMI. In 2017, we launched stopillegal.com. The objective of this site is to inform the general public on the magnitude of illicit trade, its drivers and consequences, as well as to share PMI's Principles & Practices on this issue.

Education and training to authenticate PMI legal products

PMI works with law enforcement agencies in countries worldwide, investing in education and technical training as another key part of our anti-illicit strategy. In 2017, we trained more than 700 members of law enforcement agencies in 15 countries on how to differentiate between counterfeit and authentic packs of PMI cigarettes.

PMI IMPACT: Combating illegal trade together

Launched in 2016, PMI IMPACT is the first-of-its-kind global funding initiative to support public, private, and non-governmental organizations in implementing effective solutions against illegal trade and related crimes. PMI has committed USD 100 million for this program. In the initiative's

first round, a total of 32 projects from 18 countries was selected. The implementation of all these projects is now underway and will be reported upon at www.PMI-Impact.com.

The second funding round of PMI IMPACT, which opened in September 2017, called for projects that address different forms of illegal trade and

related crimes, such as money laundering, corruption, and organized crime. PMI IMPACT has received 157 applications across 56 countries globally, which are currently being assessed by an independent Expert Council.

Our performance: Tackling illicit tobacco trade	2015	2016	2017	2018 goal
Keeping full coverage for tracking and tracing – master case level ¹	100%	100%	100%	100%
Tracking and tracing – % of sold packs with unique code applied	53%	67%	75%	85%
Extending Memoranda of Understanding (MoU) with law enforcement agencies/governments – number of countries	6 additional	5 additional inclusive of SELEC (11 countries)	10 additional	5 additional
Regional studies and country analysis to improve awareness of illicit trade – % of global cigarette consumption covered	25%	25%	25%	27%
Training for law enforcement agencies to monitor diversion of PMI products – number of law enforcement officers trained	507 across 15 countries	2,176 across 14 countries	717 across 15 countries	At least 500 across 10 countries
Number of views on stopillegal.com ('000) ²	n/a	n/a	18	90

- 1 Full coverage equates to 95% tracking and tracing in our supply chain (excluding Kretek business). There are 5% of master cases not covered – these are destined to countries which are not identified as a source of potential diversion or where PMI sells to a single customer in the country.
- 2 Data for period July 16, 2017 – December 31, 2017 (the website was launched in 2017).



PMI employee scans a master case as part of our tracking and tracing system

Responsible supply chain

Our business has a significant, global supply chain organized by five main categories. We have a large agricultural supply chain, ranging from tobacco growers – in both developed and developing countries – to producers of other agricultural products, 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 tow (for cigarette filters) and paper (both cigarette paper and packaging materials). Key to our business are also the manufacturers of machines for our cigarette and heated tobacco products factories, a highly specialized industry. A recently added part of our supply chain consists of the 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 for any business, such as office equipment, company cars, and consultancy.

As a responsible business, we want to understand and continuously address potential sustainability issues in our global supply chain, ranging from environmental impacts to labor abuses or corruption. We are working with business partners to proactively identify, manage, and reduce risks, and create shared value. We see this as a fundamental part of upholding our commitment to sustainability and, in particular, to the UN Guiding Principles on Business and Human Rights.

Responsible Sourcing Principles (RSP)

Initially, in the wake of stakeholder concerns, we focused on addressing labor and other risks in the places where we source tobacco. In 2011, we developed the Agricultural Labor Practices (ALP) program – a key pillar of our broader Good Agricultural Practices (GAP) program – with the help of Verité, a leading not-for-profit organization specializing in labor and human rights issues.³⁰ This program has been rolled out globally: Every farmer with whom PMI or our leaf suppliers have a direct contract has a contractual obligation to implement the ALP program.

In 2017, we released our Responsible Sourcing Principles³¹ and Implementation Guidelines, which established the foundation for a more comprehensive and systematic approach to addressing supply chain sustainability beyond our agricultural supply chain. The RSP provides PMI's expectations in the areas of human rights and labor rights, the environment, and business integrity, and applies to all suppliers doing business with PMI, except for tobacco farmers, who must follow our GAP/ALP program. The RSP program was developed in consultation with external stakeholders, who are experts on human rights and sustainability, and with a selected group of key suppliers.

Ensuring our Responsible Sourcing Program starts on the right foot

In 2017, we started to roll out the RSP, communicating directly with global partners covering 99% of our total spend on global vendors by December 2017. We also engaged with a number of suppliers to clarify questions related mainly to the implementation of these principles.

We launched the RSP in three of our five regional procurement clusters, starting with Sustainability and RSP Awareness sessions with regional and country procurement management, followed by the development of comprehensive supplier communication plans. During 2017, we translated the RSP into 13 languages to accommodate local requirements.

To further foster engagement with supply chain partners, we regularly reach out to groups of suppliers to discuss topics that are of common interest, and sustainability is now firmly on the agenda of these events. For example, with our Turkish affiliate we organized a supplier sustainability day with the participation of the managing director and senior management. The coverage of the workshop represented over 60% of our direct and indirect procurement spent in the country.



It was a great pleasure for me to meet with you and your colleagues at such a meaningful seminar. I honestly believe and see that both companies, PMI and BillerudKorsnas, are in the same lane to achieve sustainability targets and it is very nice to see both companies are having full focus on this critical and responsive issue.

– A workshop participant

PMI business partners attend a Sustainability Day organized by our Turkish affiliate

Governance

During 2017, we strengthened our governance model. In addition to the existing Supply Chain Sustainability Coordinators for Global Suppliers, we extended the network to include regional Sustainability Coordinators in each of our five procurement clusters. We also increased operational support for sustainability with dedicated resources at our European Service Center.

Organizational training

The integration of the RSP into our organization is fundamental to achieving buy-in and understanding. During 2017, a comprehensive e-learning was developed in consultation with external experts in human rights, the environment, and business integrity. We plan to roll out the e-learning in 2018 to various target groups worldwide. Our objective is to train procurement personnel as well as other relevant functions within our company.

Conflict minerals due diligence

During 2017, we continued to strengthen our conflict minerals due diligence process related to 3TG minerals (tungsten, tantalum, tin, and gold) that are mined in the Democratic Republic of the Congo and adjoining countries. We included Conflict Minerals as one of the principles in our RSP.³¹ We communicated to both EMS suppliers for IQOS about our expectation that they should increasingly source minerals from smelters or refiners that are certified as “conflict free” by available third-party sources.³²

Managing risk as we develop our electronics supply chain

We are increasingly expanding a new and complex supply chain that includes electronics manufacturing. Electronics suppliers are new partners to PMI and are often in geographies where we have not previously done significant procurement of direct materials (mainly China and Southeast Asia) and where human rights issues have been flagged. Further, the fast-growing nature of this novel part of our business means that new suppliers are continuously being added to our electronics supply chain, particularly for tier 2 suppliers and below.

Our focus so far has been on our main smoke-free product IQOS. In 2016, PMI worked with Verité to carry out a comprehensive assessment of the labor management systems, starting with one of our electronics manufacturing services (EMS) supplier. The purpose of the assessment was to identify strengths and gaps in the supplier's systems and

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, PMI and Verité worked together with the EMS supplier to address the gaps that had been identified. In addition to regular reporting, the assessment team conducted a further on-site visit to discuss and validate the improvement measures; the supplier has made progress in addressing the gaps and topics like recruitment fees, and working conditions have been addressed.

In addition, we started to map out the IQOS supply chain to identify human rights risks down to third-tier suppliers. We have now identified the suppliers with the highest inherent risk, and during 2018 we will start to work towards getting a better understanding of these suppliers and how to manage risks.

We also took steps to integrate sustainability criteria into the assessment of new EMS suppliers for PMI. To select PMI's second EMS supplier, we established specific qualifying criteria (e.g., regarding labor/human rights risks, preference to suppliers contracting and managing workers directly) and conducted a one-day assessment with an on-site visit and management interviews for each of the three finalists in the bidding process. Subsequently, we also conducted a full sustainability review, led by Verité, of the selected supplier to gain a more in-depth understanding of its status and seek alignment with our RSP early on. The results of the review showed that the supplier was very well aligned with our RSP, and minor gaps identified are being addressed.

Good Agricultural Practices (GAP)

We source around 90% of our tobacco through direct contracts with over 350,000 tobacco farmers in 28 countries worldwide. PMI has direct contracts with 23,000 of these farmers. The other 332,000 have direct contracts with over 20 third-party suppliers with whom PMI has direct contractual relationships. Around 2,800 trained agronomists, employed by PMI and our suppliers, provide support to contracted farmers throughout the tobacco-growing season to improve overall conditions and production, visiting farms regularly throughout the crop season.

Direct contracting is critical to enable us and our tobacco suppliers to work collaboratively with farmers and to drive the systematic implementation and monitoring of our standards. It also benefits the farmer in a number of ways:

- Ahead of the growing season, the contractual agreement on the volume and price of the tobacco protects the farmer from market fluctuations and provides better assurance that there is a buyer for the crop;
- Farmers can access crop inputs, such as seeds, at a lower cost than market price;
- Removing middlemen reduces transportation costs or other non value-added fees charged to farmers; and
- The contract can be used by the farmer as collateral for credit or other financing arrangements.

Since 2016, we have assessed conformity of our tobacco leaf suppliers, as well as of our own tobacco leaf operations, to our GAP standards through the industry-wide Sustainable Tobacco Program (STP) that is independently managed by AB Sustain, an independent supply chain management company, and includes:³³

- Annual self-assessments performed by tobacco suppliers via the online STP portal and reviewed by AB Sustain; and
- On-site reviews conducted by AB Sustain auditors with visits to a sample of contracted farmers, as well as a thorough review of tobacco suppliers' policies, procedures, and documentation demonstrating the level of STP implementation. One of the outcomes of the formal assessment is an independent performance rating against all STP criteria.

In 2017, on-site reviews were conducted in eight countries, making a total of 16 countries reviewed over two years.

Our GAP program focuses on three areas, with mandatory implementation for all tobacco farmers with whom PMI or our leaf suppliers have direct contracts:

1. Improving working conditions on the farm (see pages 48-53)

The Agricultural Labor Practices (ALP) program focuses on promoting and monitoring good labor practices, including health and safety conditions, terms of employment, and preventing and eliminating child and other labor abuses.

2. Minimizing the impact of tobacco farming on the environment (see pages 56-60)

GAP promotes environmentally sustainable practices, including curing barn improvements, the use of more sustainable tobacco-curing fuel sources to reduce greenhouse gas emissions, the elimination of highly hazardous Crop Protective Agents (CPA), the promotion of bio-pesticides and the overall reduction of CPA use, biodiversity management and reforestation, as well as water, soil, and waste management.

3. Making tobacco farming more profitable

Tobacco is a valuable crop that helps strengthen food security and nutrition and allows farmers to generate significant income, particularly in the case of smallholder farms. Promoting practices and technologies to improve farmers' yields and crop quality, and to reduce labor requirements, leads to a higher income for the farmer. It also frees up land for alternative crops, thereby helping to create an additional source of income. Our program also includes assistance to farmers in growing these alternative crops.

Reducing hardship at work and improving efficiency in Greece

Tobacco growing is labor intensive. As such, efficiency improvements are crucial for optimal production. Initiatives to reduce the number of working hours required to grow the crop range from mechanization, curing preparation, to packing simplification. While this is a global effort, the specific initiatives depend on the particular characteristics of the crop and the farms in each country.

For example, labor scarcity and an aging farmer population in Greece are concerns for long-term sustainable tobacco production. PMI initiated a project to find a less-labor-intensive

method for harvesting oriental tobacco, which represents around 45-50% of total labor requirements in tobacco harvesting in Greece. In previous years, different prototypes of harvesting machines were tested, and in 2017, working with tobacco suppliers, we tested two row-harvesting machine prototypes in Greece operating on 40 hectares of a land. The feedback from both tobacco suppliers and their contracted farmers has been positive. In addition to increasing harvesting efficiency, we see mechanized harvesting of oriental tobacco as a way to mitigate labor-related issues, such as child labor.



A contract farmer in Greece harvests oriental tobacco using a two-row harvesting machine prototype



A tobacco farm worker in Nayarit, Mexico

Our performance: Agricultural supply chain ¹	2015	2016	2017	Goal
Tobacco purchased through direct contract by our leaf operations or our tobacco suppliers (%)	88	88	90	>90
Number of tobacco supplier locations (countries) assessed by AB Sustain	n/a	8 (22% of purchased tobacco)	8 (33% of purchased tobacco)	Every tobacco supplier every three years
Systematic monitoring of labor practices (% coverage) ^{2,3}	32.5	72.0	77.0	100
Cumulative number of tobacco supplier locations (countries) assessed by Control Union since 2013 (ALP topics) ³	13	15	19	24 countries by 2020
Number of contracted farms in the scope of Control Union assessments per year (ALP topics) ^{3,4}	11,043	7,508	6,433	

1 Data relate to our total tobacco supply chain, except when explicitly mentioned in footnotes.

2 Data relate to crop season, which may span over more than one calendar year.

3 Data cover approximately 90% of our sourced tobacco.

4 According to our methodology, these assessments cover different countries and tobacco suppliers every year. Depending on the geography and typical farm size in different countries, the number of farms covered by the assessments will vary. The variation in the number of farms assessed over the last three years does therefore not reflect a reduction in the scope of the assessments.

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 at PMI, the labor standards we expect from farmers and suppliers, and our shifting attitude towards consumer centrality. In this section, we provide an overview of what it is like to work at PMI: our company culture, our approach to inclusion and diversity, labor relations as a foundation for sustainable business, and ongoing efforts in the areas of employee safety, health and well-being. We also look to the future

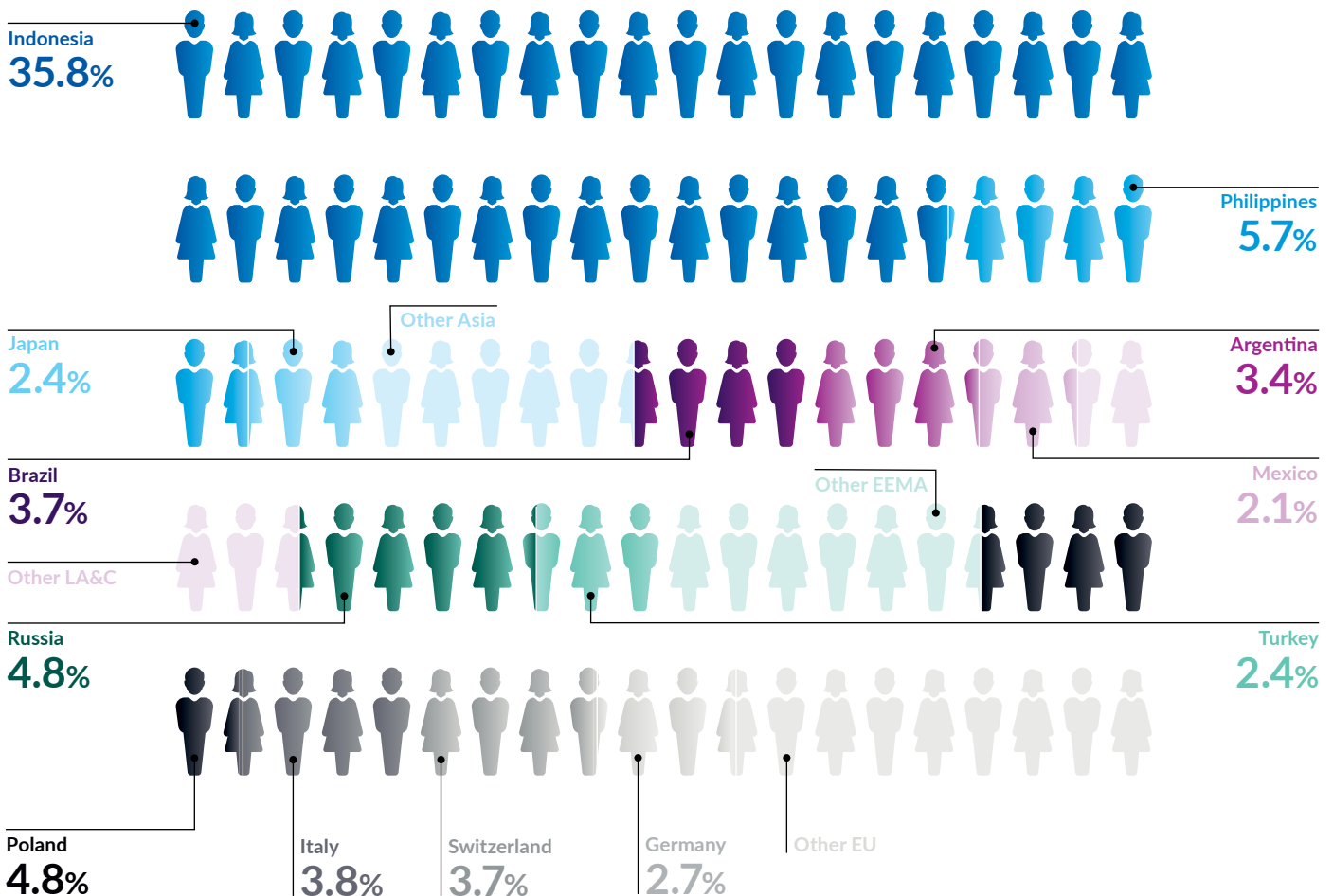
and the steps we are taking to equip our people to adapt and thrive as our company shifts towards smoke-free products. Social responsibility does not stop at our operations: We also discuss our Agricultural Labor Practices program.

Working at PMI

We are a multigenerational, diverse community of 80,600 employees worldwide, speaking over 80 languages and working together in a culture of honesty, respect, and fairness.

The transformation of our business goes hand in hand with evolving our ways of working, our mindset and behaviors, as well as our culture. PMI's People & Culture (P&C) Leadership Team is accountable for driving the internal transformation that will enable the success of our smoke-free vision. Defining the behaviors required to drive this vision and attracting, supporting, and retaining people from every part of the globe are key P&C priorities.

PMI employees around the world



Transforming our company culture

Converting our Human Resources function to People & Culture reflects the importance of developing a new culture within PMI that is focused on enabling a smoke-free future through insight and innovation, and on putting our consumer at the core of everything we do.

The P&C function is organized to deliver a new and exciting people agenda in line with our aspirations to continue making PMI a great place to work. The function has been designed so that it will maintain and grow the capabilities that have made PMI so successful in the past, while developing our people and equipping them to successfully transform the company.

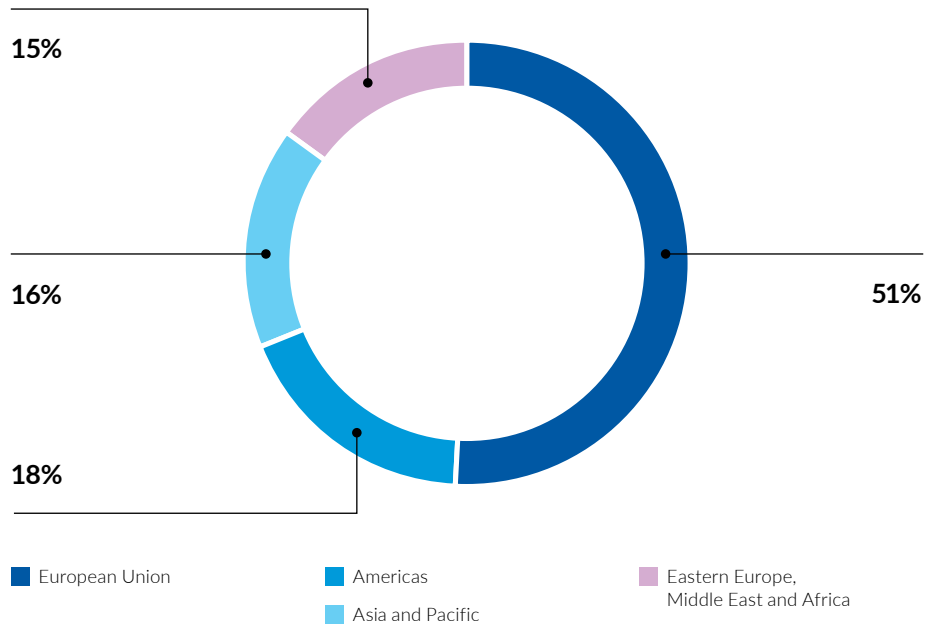
Inclusion and diversity

We believe the best way to spark innovation, solve problems, and make better decisions is to harness the power of different skills, ideas, and perspectives from diverse groups of people who are supported by an inclusive culture. We are a truly global and diverse organization.

Diversity is about differences. At PMI, we think about differences broadly, including, without limitation – gender, gender identity, ethnicity, nationality, age, sexual orientation, religious background, ability, education, and technical skills. All of these differences contribute to diversity of thought because they impact how we see the world. Inclusion is about treating people fairly and equitably so that they can contribute their personal best in every way. It is about mindsets, behaviors, and employment practices that value, respect, and accommodate differences, promote listening, and learning from others, and create space for constructive disagreement.

An essential element of our inclusion and diversity agenda is a focus on leveraging the full potential of women in the workplace. By closing 2017, with 34.4% women in management positions, up 1.6 point versus 2016, we continue to progress towards our 2022 goal of reaching 40% female representation at the managerial level. To support this goal, we aim for a 50:50 gender ratio in our recruitment pipeline. In 2017, women accounted for 43% of new hires at managerial levels and 47% of new hires at more junior levels. Career support and advancement are also critical for achieving this goal. In 2017, 38% of promotions at managerial levels were of women.

A diverse global leadership



Giving people autonomy over where and when they work and focusing on output instead of “being seen working” can increase productivity, provide environmental benefits from cutting business travel, and support employees in balancing business and personal priorities. Fifty-one markets now operate flexible work arrangements. While we have laid the foundation, we have more to do to fully leverage the benefits of flexible work.

We have launched parental support programs and initiatives designed to help employees achieve their ambitions to be both great parents and great professionals. These include the creation of a network group called “Parents@pmi” and workshops for pre- and post-maternity and for new fathers. We also continued to support the International Dual Career Network, a platform designed to support the careers of the partners and spouses of our internationally mobile employees.

To further enable our people to develop mindsets and capabilities to act and lead others inclusively, we continuously train People & Culture professionals and people managers on how to mitigate unconscious biases in recruitment, talent, and performance management. Over the past year, we completed 60 awareness-building workshops; in which:

- 1,552 employees participated; and
- 14,119 training hours were provided.

All PMI regions and affiliates have customized their Inclusion and Diversity (I&D) agenda and activities to focus on their own priorities. Here are some highlights:

Africa

Launched the AFRICAN CUP to further develop talent from diverse backgrounds and build new capabilities across the region. This project leverages PMI's talents to help solve business issues and fast-track capability building in Africa through international assignments in that region.

Algeria

Conducted a conference for all employees to raise awareness of I&D, including unconscious bias and challenging cultural and gender stereotypes.

Senegal

Participated in the very first women development forum in sub-Saharan Africa, attended by more than 200 top-level business executives from multiple sectors.

South Africa

Worked with organizations like the Global Fund for Women and local communities on initiatives relating to the abuse of women and children.

Americas

Argentina

Promoted flexible working arrangements with the #QuieroRemoteWork challenge. People were encouraged to work remotely and share their experiences via a knowledge-sharing platform including posts with pictures, comments, and "likes".

Canada

Continued to improve its disability agenda through ongoing training, implementing an accessibility plan, and removing barriers for people with disabilities.

Mexico

Implemented a program aligned with the Official Mexican Standards (NOM) 25 Local Bronze Certification, focusing on gender equality and non-discrimination, salary equity, prevention of workplace violence, work-life balance, and equal treatment and opportunities.

Asia and Pacific

Australia

Created innovative ways to engage employees on I&D issues by providing platforms to share views and perspectives. Examples: "Don't Argue" debate on pros and cons of flexible working arrangements and BAR-B-GRAS BBQ to raise awareness and support for the plebiscite of the Marriage Equality Act.

Indonesia

Launched the Sampoerna Inclusive Leadership Award (SILA) to engage managers and their people to "walk the talk" and recognize those showing exemplary inclusive behaviors. Aims to propagate inclusive leaders to help foster a more inclusive environment.

Malaysia

Promoted work-life balance practices and participated in the Life at Work Awards to recognize companies creating increasingly diverse, inclusive, and family-friendly workplaces.

Philippines

PRIDE month was celebrated for the second year in a row as part of affiliate-wide communication and awareness building programs.

Singapore & Taiwan

Embarked on efforts to better understand the needs and expectations of different generations in the workforce. A Generational Efficacy Workshop took place to gain insights into diverse generational needs and to map out priorities and actionable next steps.

Europe and Middle East

Italy

Implemented the Women in Development program for the Greenfield factory in Bologna. Offers opportunities for women without a technical background to pursue a career in a manufacturing environment.

Russia

Introduced flexible time and remote working arrangements to help foster an inclusive work environment as an enabler of transformation, and to support professional growth and work-life balance.

Switzerland

Participated at the Bern PRIDE parade in support of the Swiss LGBT+ community, launched unisex toilets in its premises, and conducted forums where senior PMI leaders spoke about LGBT+ inclusion.

Turkey

Collaborated with the Women Entrepreneurs Association of Turkey (KAGIDER) to help women achieve their career goals and aspirations through an external mentorship program.

United Arab Emirates

Increased its focus on gender diversity by targeting a balanced gender ratio in the talent acquisition pipeline, implementing contemporary onboarding programs, and promoting flexible working arrangements.

United Kingdom

The LGBT+ and allies group "PML Stripes" directed efforts to successfully celebrate "National Coming Out Day" and conducted a fundraising event for a local charity, the Terrence Higgins Trust, in commemoration of World AIDS Day.

Labor relations

Building and strengthening respect and trust are at the core of our labor relations principles. Today, with the efforts we are currently deploying to transform the business towards a smoke-free future, this becomes even more important.

Our Workplace Integrity Policy, which all PMI employees are expected to know and follow, speaks to our commitment to fundamental principles and rights at work. We respect the right of our employees to form or join trade unions and employee representative organizations of their own choice, and they should be able to make an informed decision free from coercion, thereby guaranteeing freedom of association. We recognize our employees' right to bargain collectively through employee representatives. We respect the terms of collective agreements and, where collective bargaining arrangements are in place, we ensure that PMI bargains in good faith. We make all efforts to conduct fair and cooperative negotiations, to overcome potential difficulties that may arise and reach sustainable and business responsible agreements, which will serve the parties in the long term. Overall, we maintain a strong commitment to promote cooperation on matters of mutual concern and observe high standards of employment and labor relations.

Collective Labor Agreements (CLAs) with trade unions and employee representatives demonstrate our commitment to meaningful engagement. CLAs govern many of our employees' terms and conditions at work and may include working hours, occupational health and safety, holidays, wages, and procedures for dispute resolution. In 2017, we had 80 CLAs in 35 countries, covering approximately 67% of our employees. We strengthened the labor relations capability within our People & Culture function by rolling out an e-learning tool for employees who lead labor relations at the country level. For 2018, we plan a progressive roll-out to line managers in other business areas.

Rewarding our employees

Our total reward programs enable us to attract the talent we need to successfully achieve our business strategy. We offer compelling programs in the areas of compensation and benefits, health and well-being, financial planning, and education.

We establish our programs considering all elements important to our existing and future employees. Our compensation programs are at, or above, market median in all countries where we do business. Along with the transformation of our business, we adapt our programs to be the most relevant to our diverse, multi-cultural and multi-generational workforce. We are committed to rewarding superior performance aligned with our short- and long-term transformation targets.

We are committed to pay men and women equally for equal work and seniority, wherever we operate around the world. We are proud to have been the first multi-national company to achieve Equal-Salary certification in Switzerland and Japan, and we aim to receive a global Equal-Salary certification by 2019.

Living wage

In 2016, we started a project with Business for Social Responsibility (BSR) to assess whether the lowest-paid people in our organization are able to maintain a fair standard of living. After defining the concept and methodology with BSR, we ran a living wage survey in countries where we had over 50 permanent employees in 2017. The results confirmed that, in the 58 countries³⁴ surveyed, no permanent employee was paid below the living wage rate.

In 2018, we will run a similar survey for temporary and seasonal employees. Our ambition is that none of our employees get paid below the living wage rate.

Living wage

According to our concept, a living wage:

- Is earned within normal working hours;
- Provides the means for an individual/family to purchase the goods and services necessary to attain a basic standard of living and to accumulate a minimum level of savings; and
- Is aligned with the social and cultural expectations of the community and/or country of which individuals are part.

Health and well-being

The health and well-being (H&WB) of our employees, both inside and outside the workplace, is a multifaceted topic touching on the physical, emotional, and behavioral aspects of living. It is understood differently from country to country and is influenced by personal preferences, local culture, behaviors, and demographics. With this in mind, we continue to roll out our program and minimum requirements on promoting H&WB initiatives through our *BalancedYou* program across affiliates worldwide. This covers four main areas:

- Illness and disease prevention;
- Encouraging physical activity;
- Promoting healthy eating; and
- Supporting stress management and work-life balance.

We encourage the establishment of local H&WB committees in our affiliates. In 2017, such committees existed in 36 of our markets. Composed of cross-functional team members and employee representatives, they foster the collaboration and dialogue necessary to tailor the activities according to the specific needs of local employees.

During the latter part of 2017, we initiated a global survey on health and well-being internally in collaboration with our Market Research team to collect feedback on what H&WB means across the globe. This allowed us to identify the top three areas of concern to our employees: stress, sleep, and work-life balance, and the activities of interest to employees inside and outside the workplace. This assisted us in forming the global strategy for health and well-being. We also launched a digital *BalancedYou* module to support our global approach toward H&WB. Aimed to define, inform, and support employee participation in health and well-being activities, it covers for example: articles written on contemporary topics, challenges to encourage cross-border participation and a sense of community, and coaching tips and support via live chat and personal support.

We plan to implement a smoking cessation program for employees, which is currently under development in order to enhance PMI's H&WB approach. Separately, we also envisage introducing smoke-free alternatives for employees who do not want to quit tobacco use, in local markets where such options are available.

PMI is undergoing a significant transformation which affects every part of our business and every employee. It is crucial that we put the necessary systems and processes in place to fully support people throughout this pivotal period and equip them for success. The year 2017 saw considerable efforts across the key pillars enabling our transformation: How we organize ourselves, how we lead and behave, and how we work.

1. The way we organize

To accelerate and enhance our ability to deliver on our vision, we have implemented a new Operating Model, which separates development from deployment to enable the company to better focus on both innovation and consumer centricity. To bring this Operating Model to life, building new capabilities (e.g., in science and in technology, to be equipped in today's digital era) and upskilling our employees will be the focus for 2018.

2. The way we lead and behave

Today's challenges differ from those we faced in the past. We need to change many of the ways we think and act, both as individuals and as a company. That is why we need a new approach to leadership within PMI and a new culture that helps ensure that our people have the mindset and behaviors necessary to drive the innovation, collaboration, and consumer – and stakeholder – centricity required to successfully operate our transformation. Through an innovative survey, we engaged over 10,000 employees to define the behaviors required to drive long-term success and ultimately create a smoke-free future.

3. The way we work

To ensure no employee is left behind in our transformation journey, we have implemented various programs to help them understand different business challenges and equip them with the necessary knowledge to lead the transformation towards PMI's smoke-free vision:

- We have developed an online training program designed to give people the foundational information they need on our new product portfolio, that has been accessed by 27,000 users.
- We have developed the Transformation Academy – a 12-week training program for management teams worldwide, focusing on smoke-free products regulatory complexities, responsible marketing, and sustainability. In 2017, 250 leaders in 20 markets participated in this program.
- In our operations, we have introduced a manufacturing excellence program using new standardized routines, processes, and tools, which is deployed sequentially to develop the capabilities of our people. In 2017, 14 factories implemented this program and over 1,500 employees were trained.
- We have also introduced a different way of working based on consumer centricity, enabling employees to deliver faster while ensuring solutions meet the final consumer needs. This program covered over 3,000 employees in 2017.



Employees working together at PMI



A hand roller of kretek cigarettes in Indonesia

Our performance: Working at PMI	2015	2016	2017	Goal
Number of employees	80,200	79,500	80,600	
Women employees (%)	40.6	41.2	41.6	
Women in management positions (%)	31.0	32.8	34.4	40 by 2022
Number of women in Company Management (management board)	1 (out of 16)	1 (out of 17)	2 (out of 20)	
Number of women on Board of Directors	2 (out of 12)	2 (out of 13)	2 (out of 13)	
Employee turnover rate (%) ¹	13.8	11.2	11.0	
Employee voluntary turnover rate (%) ¹	4.3	4.3	4.9	
Employees covered by collective labor agreements (%)	67	68	67²	

1 The aggregated data cover approximately 70% of our employees.

2 As of October 1, 2017, approximately 74% of our workforce in non OECD countries was covered by collective labor agreements.

Looking ahead

- Our business vision to create a smoke-free future entails an organizational transformation, which calls for a new mindset and perspective. Consumer centricity, a multi-stakeholder approach, and continuous focus on inclusion and diversity are key enablers to achieve this.
- In the next few years, we will continue to work on our goal of increasing the representation of female employees

- in management positions to 40% by 2022, and we will pursue our goal to reach a global Equal-Salary certification by 2019 with the Equal-Salary Foundation, working in partnership with PricewaterhouseCoopers (PwC) for the 18-month audit and certification procedure.
- We believe that sound labor relations and a constructive dialogue with our employees and their representatives will help us to respond to the challenges and opportunities arising from our

- company transformation. We will continue building and reinforcing our labor relations capabilities across the globe.
- We want to ensure that none of our employees receive a salary below the living wage rate.
- We are studying best practices and looking at ways to define and embed evidence-based employee health and well-being metrics into our broader corporate reporting framework.

Safety in the workplace

PMI has 46 production facilities globally. We have developed and implemented a leading environmental and occupational health, safety, and security management system, which involves policies, standard practices, and procedures at all of our manufacturing centers. We have set minimum requirements based on PMI best practices and local regulations and have embedded these requirements into every level of our organization. Training and awareness programs support our ambitions, globally and at the affiliate level.

In 2017, we expanded the scope of our Mission Zero program beyond our manufacturing operations to reach our country sales and marketing organizations. We piloted safety cultural assessments in several markets that allowed us to build a systematic approach to improve safety performance. We launched new safety executive leadership workshops and tools, and undertook employee engagement activities across our affiliates.

We established PMI Markets Safety Awards for the first time, to recognize those markets that had already started applying the Mission Zero philosophy to their day-to-day work, and to encourage their further commitment to sustain PMI's safety culture and environmental commitments.

In 2017, our Lost Time Injury (LTI) rate, the most widely used benchmark to assess prevalence of serious work-related injuries, was the best in our industry and one of the lowest among our fast-moving consumer goods peer group.

In 2017, the LTI rate across the whole of PMI was 0.10 (injuries per 200,000 hours worked) and in our factories it stood at 0.05. Thirty-five of our factories achieved zero LTI for more than a year, and several sites have reached up to five years without LTIs.

We also conduct regular safety assessments at our offices, warehouses, and car fleet organizations. Additionally, we have engaged Bureau Veritas, an external certification body, to assess the management systems at our manufacturing centers around the world in accordance with internationally recognized standards for safety and environmental management.

In 2017, 42 (some 91%) of our factories were certified to OHSAS 18001, the international safety management standard. Newly acquired or built factories have begun the certification process. Because we have new onboarding factories we may not reach 100%, but that remains our goal. Due to a factory closure in the Dominican Republic and the geopolitical situation in Venezuela, where we could not have our site certified, our certification percentage decreased versus 2016.

Despite good results and low injury rates, we are committed to exploring more innovative and engaging ways to keep our performance world class. Managing change with safety in mind is essential as we convert existing factories or build new production sites for smoke-free products.

Safety across our fleet

With a fleet of more than 25,000 vehicles in more than 100 countries and over 500 million kilometers driven in 2017, road safety is a key concern. Despite our low injury rate, unfortunately in 2017, two PMI employees lost their lives in road accidents. We continue to make our best effort and invest in a safe fleet, fleet safety programs, and employee awareness. We manage our vehicle fleet with an integrated approach based on nine elements: leadership, baseline assessment, risk assessment, hiring of drivers and placement, training, performance recognition, vehicle selection and maintenance, incident reporting and investigation, and management reviews and communication.

In 2017, we made progress across our Fleet Safety program:

- We implemented our Fleet Safety program in all markets where we operate and involved our sales force organization;
- We focused on innovative technology solutions (gamification and telematics) to facilitate safe driving and accident prevention;
- Our collision rate (collisions per million km driven), which covers higher severity road accidents, has declined to 1.01 per million km driven (from 1.22 in 2016);
- We launched a new global online driver risk assessment tool complemented by local practical fleet driving programs;
- We established a working group with the top 12 biggest markets (covering approximately 18,000 vehicles) to govern global fleet safety development; and
- We have gained better understanding of safety dynamics in our fleet based on employee feedback and reporting.

Our performance: Safety in the workplace	2015	2016	2017	Goal
Lost Time Injury (LTI) rate (per 200,000 hours worked)	0.11	0.12	0.10	<0.10
Fatalities (PMI employees and contracted employees)	0	1	2	0
Fleet crash rate – vehicles crashes per million km driven ¹	5.3	6.8	6.2	<4.0
Fleet collision rate – vehicles collision per million km driven	1.24	1.22	1.01	<1.50
Manufacturing facilities with OHSAS 18001 certification (% of PMI factories)	93	93	91	100

¹ Regarding fleet safety, as of our 2018 Sustainability Report we will no longer report on Fleet crash rate (which includes cosmetic damage) as we believe collision rate (collisions per million km driven), which covers higher severity road accidents, is a better indication of our safety performance.



An employee at PMI's first purpose-built factory for manufacturing HeatSticks, near Bologna, Italy

Agricultural Labor Practices³⁵

According to the International Labor Organization (ILO), the largest share of child labor occurs in the agricultural sector: Around 108 million children are impacted worldwide, involved in different forms of hazardous work.³⁶

PMI's Agricultural Labor Practices (ALP) program aims to eliminate child labor and other labor abuses and to achieve safe and fair working conditions in all farms where our tobacco is sourced. Our over 350,000 contracted farmers, representing over 90% of the tobacco PMI buys, are required to comply with the ALP Code.³⁷

Our approach

The ALP Code sets out seven principles related to child labor, income and work hours, fair treatment, forced labor, safe work environment, freedom of association, and compliance with the law; and 32 standards to measure compliance with these principles. Training is provided to farmers, workers, agronomists, and field technicians on these topics.

Striving to ensure that our standards are met, field technicians working for PMI or our tobacco suppliers conduct regular farm visits to detect potential issues. The field technicians also provide additional support, such as distributing Personal Protective Equipment (PPE) to reduce labor-related risks, and more generally work with farmers on continuously improving living and working conditions on farms. We also collaborate with other stakeholders in the tobacco supply chain, including governments and NGOs, to tackle underlying systemic problems present in the agricultural sector.

In addition, external third-party assessments are conducted by Control Union (CU) certifications,³⁸ a certification agency specialized in sustainable supply chains across multiple industries. The results of these CU assessments, including the action plans to address identified issues, are disclosed publicly.³⁹ We also publish comprehensive progress reports of the ALP program.³⁹

Systematic monitoring

Systematic monitoring of farms implementing the ALP program begins with the collection of individual farm profile data. The farm profiles, updated each growing season, provide the field technicians with key information about the farm and the people working and living there (demographic information, size and nature of the farm, number and age of people present, categories of workers, housing arrangements, and school attendance).

The field technicians then visit the farms throughout the tobacco-growing season and evaluate how well labor practices align with the ALP Code principles. When they identify issues requiring immediate intervention, called "Prompt Actions", they immediately address them with the farmer and together develop an individual improvement plan against which progress is monitored. In those cases where a farmer consistently resists making the changes required, the contract is not renewed or may be terminated. In the 2016/2017 season, 36 contracts were terminated. In addition to Prompt Actions, less serious issues are also monitored and addressed.

The aggregation of data collected across over 350,000 farms is challenging. In 2015 and 2016, we made steady progress in standardizing our processes and systems by developing data templates and electronic records. This allowed us to create a global ALP monitoring dataset enabling analysis at market and regional levels. To gain a more complete and accurate overview of the risks and patterns of vulnerability of tobacco workers, we also compare the ALP monitoring data with information gained through CU third-party assessments.

Evaluating the impact of the ALP program

To assess the effectiveness of the ALP program, we focus on four questions:

- Is child labor being eliminated on farms supplying tobacco to PMI?
- Is the working environment safe?
- Are workers being paid enough to meet their basic needs?
- Is all farm labor voluntary?

The year 2017 is the first year that we were able to assess performance of the program based on the four questions above, establishing a baseline for future analysis.

In 2017, approximately 13,000 Prompt Actions were recorded by field technicians.

Almost two-thirds related to unsafe work environment, mainly linked to inadequate Crop Protection Agents (CPA) storage practices and application of CPA without appropriate personal protective equipment.

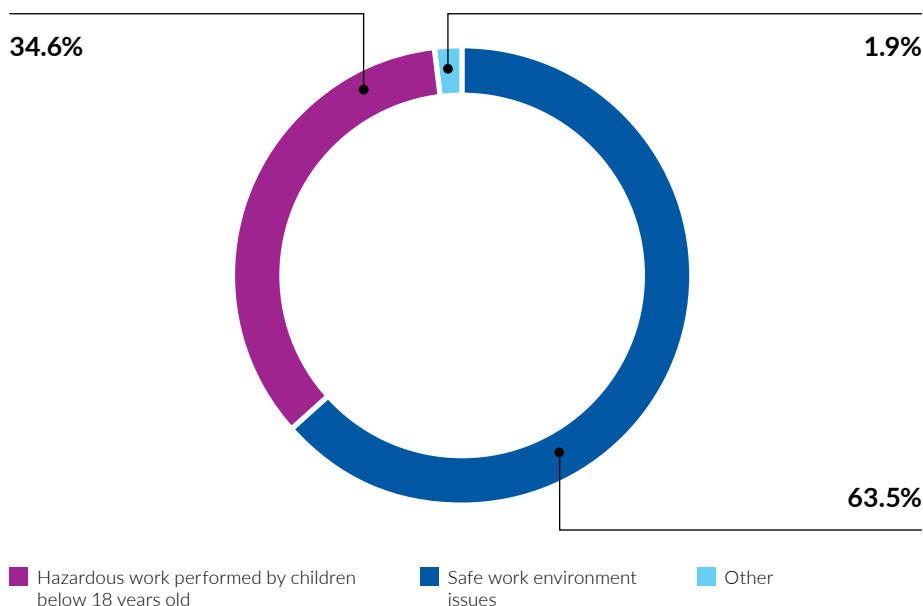
Approximately one-third of Prompt Actions related to hazardous tasks performed by children below 18 years old. The most common hazardous work performed relates to the contact with fresh tobacco leaves and the associated risk of exposure to nicotine, mainly during harvesting, and during the preparation of strings of tobacco leaves for curing.

The remaining 1.9% of Prompt Actions, representing 245 cases, were related to the following topics: income and work hours, fair treatment, or situations that could be related to forced labor.



A field technician in Malawi supports farmers in implementing good agricultural practices in tobacco

ALP Prompt Actions in 2017



Types of hazardous work performed by children below 18 years old

Harvesting or handling green tobacco	39%
Stringing	27%
Carrying heavy loads	10%
Working with sharp tools	7%
Handling or applying fertilizer	5%
Working in extreme temperatures	3%
Driving a tractor or operating machinery with moving parts	3%
Handling or applying CPA ¹	2%
Others	<4%

1 CPA: Crop Protection Agents
2 GTS: Green Tobacco Sickness



Types of safe work environment issues

CPA ¹ stored in a way that could cause a health and accident risk	46%
Exposure to CPA ¹ due to not wearing proper protective equipment	32%
Exposure to GTS ² due to not wearing proper protective equipment	17%
Unsafe or insufficient worker accommodation	3%
Others	<2%

In addition to this quantitative analysis, we have been gathering qualitative information on the impact of the ALP program on people's lives through interviews with farmers and workers. In a pilot exercise, conducted in 2017 in a community in Malawi with our suppliers' farmers growing tobacco, a new participatory method for impact evaluation was tested involving the collection of "Most Significant Change" stories from farmers and workers on farms enrolled in the ALP program. In that exercise, coordinated by third-party facilitators (unaffiliated with PMI's suppliers), participants expressed the most significant changes that have occurred in their lives as a result of the farm's participation in the ALP program. Although the sample was not statistically representative, the stories revealed a striking range of meaningful and often inter-connected impacts. Farmers often emphasized the increased economic security they and their families have been able to realize as a result of direct contracting and support from the PMI supplier.⁴⁰

Evaluating the overall impact of the ALP program is a complex exercise requiring multiple, complementary approaches. We will continue to explore new ways to evaluate the effectiveness of our program and make changes where necessary. We will continue to be fully transparent in disclosing the program's performance.

Focus on migrant workers

Data gathered on farm profiles show there are many seasonal workers on the tobacco farms supplying PMI, especially during the peak harvesting time. Their presence on farms is associated with many risks to the standards of the ALP Code, as illustrated in our case study on Mexico. These include inadequate accommodation, low pay, pay via a crew or group leader, lack of redress for harm, accidents or unfair treatment, and difficulties in ensuring effective training on work safety. Furthermore, migrant workers' families frequently bring their children, creating a risk of child labor.

In the State of Nayarit (Mexico), burley and sun-cured tobacco farmers rely on indigenous Cora and Wixáritari (or Huichol) workers for the harvesting season. These workers migrate with their families from Mexico's highlands and settle in tobacco-growing areas, where they live in very poor conditions throughout the harvesting period. While PMI previously reported on progress in addressing child labor among this community, attempts to improve living conditions for these workers and their families have had very limited success.⁴¹

In the last quarter of 2017, PMI did an in-depth analysis of this complex and deep-rooted problem and developed a plan aiming to:

- Provide adequate accommodation to all migrant workers;
- Provide workers access to shade area for rest and lunch, and to sanitation in the field;
- Prevent workers from living in the tobacco fields as of the current harvesting season; and
- Prevent night work in the fields.

The plan was developed together with our local supplier Tabaco del Pacifico Norte (TPN – a subsidiary of Universal Corporation) in consultation with all relevant stakeholders (workers, indigenous leaders, supplier's field staff, third-party NGOs, local authorities, companies from other sectors) and our ALP program partner Verité.

Typically, the four to five months of earnings during the tobacco season are the main source of annual income for the Cora and Wixáritari families. Maximizing the number of working hours and income is thus the key reason why they often prefer living in the field during the harvest period, as other possible accommodation options are generally at some distance from the fields and would imply loss of time and money due to commuting.

In the 2016-2017 season, TPN provided basic emergency shelters to 100% of contracted farmers. However, these did not fully provide a safe and sanitary solution for workers and their families, and further investments in more permanent and improved infrastructure was not a feasible solution, as most of the farmers' land is rented and may change year-on-year. Moreover, even if adequate accommodation in the field could be provided, there would still be issues with long working hours and children's

presence in the field when they return from daycare centers, with continued risk of child labor.

PMI concluded that any intervention to fully address the living conditions of workers and their families would involve changes in the traditional organization of work in Nayarit's burley and sun-cured crop. With that in mind, as of December 2017, PMI introduced a series of measures to reorganize labor schedules and activities and to prohibit field work after sunset.

To enable this change and assure workers income and buy-in, PMI agreed with TPN to a 25% increase on the piece-rate paid to workers, and TPN developed a sensitization campaign in the workers' communities of origin with support from the National Committee of Indigenous Peoples (CDI).

Farmers with contractual agreements with TPN agreed they would be responsible for ensuring adequate accommodation for workers, the transportation logistics to and from the field, and the provision of sanitation and clean water for washing in the fields. TPN also agreed with farmers that, provided these conditions were met, they would provide a monetary incentive to cover the farmers' costs.



A migrant worker in Nayarit, Mexico, with her three children as they wait for the school bus



A migrant worker in tobacco fields in Nayarit, Mexico

PMI supports five childcare centers, which provide education, nutrition, and medical services for the children of the migrant families, and are run by a local NGO (Desarrollo Rural de Nayarit – Dernay). For the 2017-2018 season (finishing in May-June 2018), Dernay extended the opening time of the centers and increased the accommodation capacity to welcome the maximum possible number of children.

TPN is implementing the measures agreed with PMI, providing the logistical support to farmers, monitoring their progress, and coordinating efforts with all stakeholders, including indigenous representatives. Furthermore, PMI engaged a third-party NGO (Fundación Mexicana de Apoyo Infantil – FAI), which independently monitors housing and working conditions provided by the farmers and collecting workers feedback. FAI regularly updates TPN on the results of their monitoring, and TPN field staff follow up on individual issues identified.

FAI's early monitoring data and feedback from workers and farmers is very encouraging. While there are many challenges to overcome in the implementation of this plan (e.g., improvements in the housing conditions offered to workers, preventing children accompanying their parents to the field from engaging in child labor) we believe that we have created the right conditions to address the critical issue of the working and living conditions of Cora and Wixáritari families working in tobacco. We estimate that by the end of the season we will have reached over 6,000 people (workers and respective families) covering every single burley and sun-cured tobacco farm contracted by TPN in the State of Nayarit.

PMI assumed the overall implementation costs of this program and informed our supplier that we would not be willing to purchase tobacco sourced from farmers who do not participate in this season's effort or who do not comply with the full range of conditions established.

The PCSD Partnership, facilitated by the OECD's Unit on Policy Coherence, was added to the UN's global registry of voluntary commitments and multi-stakeholder partnerships in 2016. It brings together governments, civil society, and the private sector from all regions of the world committed and working to enhance policy coherence for sustainable development as a key means to implement the Agenda 2030 for

Sustainable Development. Members of the Partnership work together to foster synergies across economic, social, and environmental policy areas, identify trade-offs and reconcile domestic policy objectives with internationally agreed objectives, and address the spillovers of domestic policies.

Philip Morris International joined the PCSD Partnership in late 2017 and is

committed to compile a comprehensive case study on sustainable agricultural transformation through a policy coherence lens and its sectoral implications in long-term economic development (2030-2063). The case study will identify the key barriers to this transition, document leading practices, and illustrate the most likely economic development scenarios in 2030 and 2063.

Smoke-free products and their impact on tobacco growing

The production of smoke-free products requires less tobacco compared to cigarettes. When large numbers of consumers eventually switch to smoke-free products, we expect a gradual decrease in tobacco leaf requirements, which will free up land and capacity for other uses.

To proactively prepare for and enable this crop diversification in the most effective way, we are following a multi-stakeholder approach involving suppliers, NGOs, and other companies active in the agricultural sector. We are, for example, partnering with USAID Malawi Feed the Future Program to diversify smallholder farmers production away from tobacco and into other food crops such as soybean or groundnuts, and have joined the Global Agribusiness Alliance (GAA).⁴³

We are also working with our tobacco suppliers and their farmers to introduce additional varieties of alternative crops to smallholder farmers. This allows them to not only grow food crops for their own consumption, but also crops that can serve as additional sources of income.

Malawi has been selected as one of the priority markets for our diversification efforts as tobacco accounts for more than half of the country's export. At this initial stage, more than 7,600 farmers are growing 1,000 hectares of groundnuts, 267 farmers are growing 200 hectares of soya beans and 4,600 farmers are growing around 2,000 hectares of pigeon peas and more than 100 hectares of chuma beans.

As part of this work, farm trials are conducted to identify high-yielding, disease-resistant, and drought-tolerant varieties of groundnuts and soya beans that should ensure top performance for the Malawian climatic conditions. Our tobacco suppliers are supporting the selected farmers for this trial by providing and distributing crop inputs, helping with insurance and storage, as well as providing advice by their agronomists and support in the marketing of their production.

A key component for the success of these initiatives is ensuring the availability of water when required, regardless of whether the alternative crops are grown during the dry or rainy season. We are working with Netafim, a company specialized in precision irrigation, to

promote relevant solutions. Solar boreholes and storage tanks will be constructed and different irrigation systems will be tested. Finally, to reduce post-harvest losses, the more than 12,000 farmers involved in the food crop program are provided with Purdue Improved Crop Storage bags, which are specifically designed to reduce insect damage to crops in storage.



Food crops (maize and groundnuts) grown alongside tobacco on an IPS contracted farm in Malawi

Focus on supporting farmers to grow alternative crops

For several years, we have been supporting smallholder farmers to grow food crops alongside tobacco. In Malawi and Mozambique these efforts encompass technical assistance and financing for fertilizer and seeds, mainly for maize. In 2017, 117,000 contracted smallholder farmers produced 290,000 tons of food, with 110,000 farmers receiving financial support.

We have seen significant improvements in food crop yields, up nearly fourfold in the case of maize. This is strengthening food security and often results in a surplus for sale at local markets.

Together with our tobacco leaf suppliers, we are exploring with international food crop buyers and NGOs the possibilities to create a route to market for surplus food crops produced by tobacco growers in these countries, leveraging on the infrastructure and logistics already in place for tobacco production.

Although the proportion of farmers growing food crops for their own consumption remained stable globally, at approximately 70%, the number of tobacco farmers growing and selling food crops as an additional source of income rose from 35% in 2015, 41% in 2016 to 46% in 2017.

Looking ahead

Now that we have established a comprehensive and systematic way of evaluating the effectiveness of our ALP program, we will review and update the program as necessary in 2018, focusing on four critical areas:

- Children under 18 involved in hazardous work;
- Safe working conditions, including the availability of Personal Protective Equipment to prevent exposure to CPA and Green Tobacco Sickness (GTS);⁴⁴
- Accommodation for workers; and
- Minimum wage for workers.

Our performance: Agricultural Labor Practices ¹	2015	2016	2017	Goal
Systematic monitoring of labor practices (% coverage) ²	32.7	72.0	77.0	100
Cumulative number of tobacco supplier locations (countries) assessed by Control Union since 2013 (ALP topics)	13	15	19	24 countries by 2020
Number of contracted farms in scope of Control Union assessments by year (ALP topics) ³	11,043	7,508	6,433	

1 Data cover approximately 90% of our sourced tobacco.

2 Data relate to crop season, which may span over more than one calendar year.

3 According to our methodology, these assessments cover different countries and tobacco suppliers every year. Depending on the geography and typical farm size in different countries, the number of farms covered by the assessments will vary. The variation in the number of farms assessed over the last three years does therefore not reflect a reduction in the scope of the assessments.

Reducing our environmental footprint

Effective environmental management across our operations and value chain goes beyond compliance with applicable laws and regulations: It is central to the security of raw material supply, promotes efficiency and savings, and minimizes negative environmental impacts.

Our environmental management strategy follows a two-pronged approach:

- Minimizing our impact on the environment through carbon footprint and water use reduction, conserving biodiversity and combating deforestation, as well as waste minimization; and
- Understanding and adapting to potential future business impacts of major environmental trends, such as the impact of climate change on tobacco growing. We undertake risk assessments to quantify the impacts of these trends along our value chain. Based on the results, we develop management and adaptation strategies.

Through life-cycle and other assessments along our value chain we understand our main areas of impact and therefore where to set priorities. These areas include tobacco farming for carbon footprint reduction and water stewardship action and product end-of-use for action on litter and waste. We also need to manage new areas of impact due to the increasing use of electronics and batteries in our products.

In this section, we provide an update on our 2017 activities related to climate change, water use, biodiversity, deforestation, and waste. These efforts demonstrate how we are embedding SDGs 6-7 and 13-15 into our sustainability strategy and how these activities contribute towards advancing SDG 12 on Responsible Consumption and Production.

Climate change – a science-based approach

Climate change, one of the biggest challenges facing humanity today, requires collective global action. Following the adoption of the Paris Climate Agreement in 2015, there is widespread understanding of what needs to be done to protect the planet. PMI supports the Agreement, and we are playing our part in delivering on the necessary action.

In 2017, we continued to make progress in reducing our environmental impact across our value chain: in our factories where our carbon footprint is relatively small compared to other industries, as well as beyond the factory gates. That includes looking at both our upstream supply chain activities (currently focusing on tobacco farming) and downstream, following our product and packaging environmental impacts to end-of-use. We also work towards ambitious targets, based on climate science, which guide and inform our climate change programs as part of our culture of continuous improvement.

CDP Climate leadership for the fourth year in a row

Every year we report on the status of our activities and progress to CDP, the leading international not-for-profit organization assessing companies' efforts on climate change. Out of over a thousand of the world's largest companies assessed by CDP last year, PMI's operational carbon footprint is nearly 90% lower than the average, and PMI is one of only 25 companies recognized in CDP's 2017 "Climate A List," for consistently taking comprehensive action to reduce greenhouse gas (GHG) emissions and mitigate climate change, and for the transparency of our disclosures.

PMI also achieved CDP Supplier Engagement Leadership for our actions and strategies to reduce emissions and lower climate-related risks in our supply chain, making it onto CDP's Supplier Engagement leader board, and placing PMI within the top 2% of companies in 2017.

Science-based targets and renewables

PMI supported the call for a price on carbon in the Paris Climate Agreement and committed to developing science-based targets. Our targets, which were recognized by the Science-Based Targets initiative in 2017, demonstrate how PMI can contribute to keeping global warming below 2°C based on pre-industrial levels.

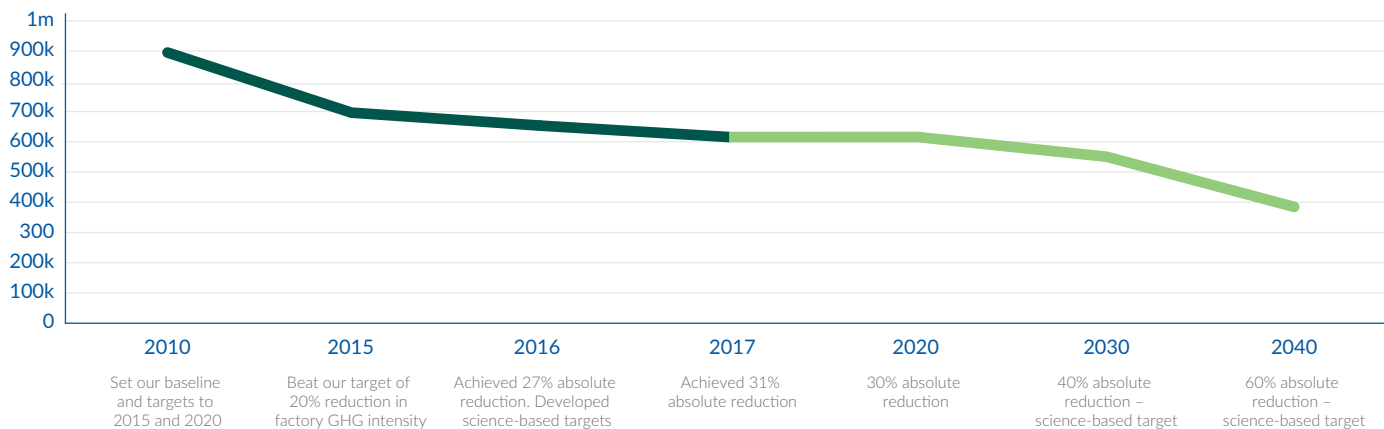
We have set our performance baseline as 2010. Against that baseline, we aim to reduce absolute CO₂e emissions from our own operations by 30% by 2020, 40% by 2030 and 60% by 2040. We are well on track in 2017, achieving an overall reduction of 31% for our GHG scopes 1 and 2 emissions, driven by the use of greener electricity, exceeding our 2020 target.

Across our value chain, we aim to reduce absolute CO₂e emissions by 40% by 2030. In 2017, we achieved a 30% reduction across scopes 1, 2 and 3, driven by gains in curing efficiency and use of greener fuels in tobacco agriculture. We also have a long-standing commitment to reduce the emissions intensity of our value chain (measured in CO₂e per million cigarettes equivalent) by 30% by 2020. In 2017, we remained on track to meet this target, reaching a 24% reduction since 2010.

Global greenhouse gas emissions scope 1, 2 and 3 ('000 metric tons CO₂e)



Absolute GHG Emissions: Scope 1 and 2 – Results and Targets



The programs for achieving our targets are comprehensive and include:

- eco-design in new facilities;
- fuel efficiency in our manufacturing processes;
- purchasing greener electricity;
- purchasing greener fuels;
- greening our fleet; and
- helping farmers improve fuel efficiency and use greener fuels in our tobacco supply chain.

We are continuing our Marginal Abatement Cost Curve (MACC) approach to identify where to act by comparing and ranking all our GHG reduction projects globally based on their cost-effectiveness in reducing emissions. We have also set an internal carbon price (USD 17 per ton CO₂e), necessary to drive the investments needed. On a day-to-day basis we use MACC to refresh and enhance our list of initiatives. As an example, in 2017 we installed three high-efficiency tri-generation power plants – systems which generate heat, cold, and power in one efficient combined process – coupled with solar photovoltaic energy generation in Indonesia and Turkey.

In order to support our science-based targets and green technology development, we set a target to source 80% of our production electricity needs from renewables by 2030. In 2017, with green electricity supplied to our facilities for the first time in Mexico, Colombia and Serbia, 53% of electricity was sourced from wind, solar or hydro plants. We will continue sourcing more as renewable electricity becomes available in the countries where we operate.

Greening our vehicle fleet

PMI operates a fleet of more than 25,000 vehicles across the world. In 2017, fleet emissions represented around 30% of our Scope 1 GHG emissions. Reducing those emissions must therefore form a core part of our carbon reduction strategy. In 2017, the absolute CO₂e emissions from our fleet decreased by approximately 16% versus our 2010 baseline.

Significant technological advancement in electric vehicles make them more commercially competitive for fleet managers, and a range of fully electric, hybrid, and other low carbon emissions vehicles are now available in many of the markets where we operate. We are therefore developing a global roadmap on how to move towards a more sustainable fleet, cutting carbon emissions, generating cost savings, and maximizing efficiency.

One example of how we have implemented this approach comes from our affiliate in Spain, where we replaced the entire diesel-powered fleet with hybrid electric cars (around 300 cars). As a result of this project, the fleet CO₂e emissions

were reduced by 21%, with an associated reduction in other pollutants typical of diesel vehicles. Beyond the environmental improvements, there was an outstanding engagement within our organization whereby our employees actively participated in the selection of hybrid vehicle models available from different manufacturers. We also recognize that having the correct vehicles is only the starting point and are now focusing on eco-driving initiatives with technical training for our employees on how to drive in the most efficient way.

Working with tobacco farmers to reduce greenhouse gas emissions

The environmental impact of tobacco farming can be significant, and the GAP program is therefore crucial for managing and reducing our overall environmental footprint.

Most GHG emissions related to the tobacco supply chain come from the curing process for Virginia flue-cured tobacco (Virginia). Our target is to lower the GHG emission intensity related to this curing process by 70% by 2020, compared to a 2010 baseline. We are well on track, with a 38% reduction achieved so far by 2017. To achieve this target we focus on improving curing barn efficiency and eliminating the use of coal and non-sustainable firewood.

Improving curing barn efficiency

One of the main tobacco types used in our products is Virginia tobacco, which is cured in heated barns and thus requires an energy source, such as wood. About five kilograms of wood are needed to cure one kilogram of Virginia tobacco. With Virginia tobacco representing approximately two-thirds of our global tobacco variety needs, and around 140 grams of tobacco to produce a carton of 200 cigarettes, approximately 0.5 kilogram of wood is required for the curing of 200 cigarettes.⁴⁵

Most tobacco growers around the world own their own curing barns. Our GAP program focuses on improving combustion efficiency, ventilation, and controls of the barns. In 2017 alone, approximately 23,000 barns were improved in Brazil, Indonesia, Italy, Malawi, Pakistan, the Philippines, Spain, and Tanzania, bringing the total number of barns improved since the beginning of the program in 2014 to approximately 45,000. We aim to improve a total of 60,000 barns by 2020.

To further improve curing efficiency, a trial has been carried out in Brazil and Pakistan involving the installation of fins on the heating pipes in flue-curing barns to increase the exposed surface area and hence the efficiency of the heat exchange. Based on initial results in Pakistan, this method can lead to savings of more than 10% of firewood-fuel.

Eliminating the use of coal and non-sustainable firewood

Based on current plans, more than 70% of our flue-cured tobacco purchases should be cured with renewable fuel sources by 2020. In 2017, 36% of the flue-cured tobacco we purchased was cured with renewable fuels (versus 29% in 2016) of which 29% was cured with sustainably sourced firewood and 7% with biomass. As a result, GHG emissions from curing activities were reduced by over 330,000 tCO₂e.

To increase the use of renewable and traceable curing fuel sources, PMI leaf operations and tobacco suppliers planted more than 26 million trees in Brazil, Indonesia, Malawi, Mozambique, Pakistan, the Philippines, and Tanzania. Natural forest regeneration practices were implemented in collaboration with our tobacco suppliers in the secondary Miombo woodland⁴⁶ in Malawi, Mozambique, and Tanzania.

To further improve the supply of sustainable firewood for both curing Virginia tobacco and for domestic requirements in tobacco farming communities, our tobacco supplier piloted two community management plans for the secondary Miombo woodlands in Mozambique. These were based on providing technical and financial support to the tobacco farming communities, which will gradually take up the management and ultimately harvest the firewood.

In 2018, we expect to review the first outcomes of the Miombo regeneration strategy and management plans to validate whether they provide a sustainable approach to the supply of firewood. If the practices are demonstrated as feasible and sustainable, we intend to establish more than 10,000 hectares of such managed forestry by 2020.

In 2017, approximately 23% of our Virginia purchases were still cured with coal. Plans have been developed to replace coal with agricultural waste pellets, green electricity produced by hydro-power plants, and sustainable firewood in countries still using coal to cure our Virginia purchases. Our objective is that by 2020, no coal will be used to cure our flue-cured tobacco purchases.

In 2018 and 2019, our GHG emissions related to tobacco flue-curing are expected to decrease further through a significant increase in the usage of traceable firewood coming from sustainably managed tree plantations (more than 200 million trees were planted between 2000 and 2017). As part of our precautionary approach, we do not assume that fuelwood is from sustainable sources unless we have proof – and we calculate our carbon footprint accordingly, using a “full carbon” emission factor for fuel wood that we are not sure is renewable.



Sustainably sourced wood chips used as fuel in tobacco curing

CO₂e reductions in our tobacco supply chain

A monitoring and verification framework has been launched in 2017 across our leaf supply chain to monitor and verify the impact of the more than 40 initiatives being implemented. These initiatives support the achievement of our 70% carbon footprint reduction goal for 2020 by eliminating the use of coal and non-sustainable firewood, promoting the use of alternative biomass fuels and improving curing efficiency.

PMI targets for 2020 to improve environmental performance in our tobacco supply chain

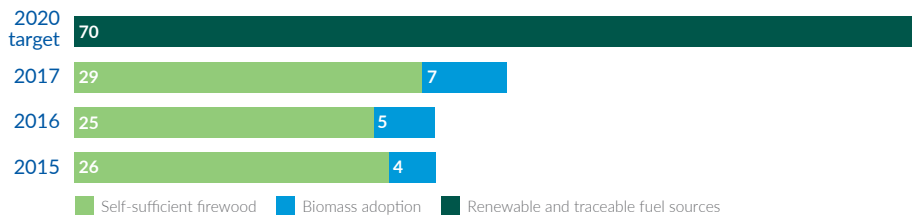
CO₂e reduction (%)



Tobacco purchased at no risk of deforestation of old growth forest (%)



Renewable and traceable fuel sources (%)



■ Self-sufficient firewood ■ Biomass adoption ■ Renewable and traceable fuel sources

Water: stewardship across and beyond our operations

In comparison to other products, tobacco is not particularly water intensive. Water is used in our factories, in the manufacture of raw materials such as filters, paper and packaging materials, and in agriculture, even though more than half of the tobacco grown is rain-fed and does not require irrigation.

In our environmental programs, we do not just seek to reduce what we use but also to act as a water steward. That means responsibly using the water we need without negatively affecting the needs of others by:

- Understanding how much water we need and using it optimally;
- Not negatively impacting the quality of water resources;
- Striving to ensure access to safe Water, Sanitation and Hygiene (WASH) in all our facilities and increase availability of WASH services on our contracted farms;
- Respecting the vulnerability of water resources we use and the role of those resources in the wider community;
- Seeking partnerships to improve our water management practices; and
- Continuously improving these practices through our Good Agricultural Practices program in our tobacco supply chain.

In 2017, we achieved A-List status for CDP Water, which recognizes our water stewardship initiatives.

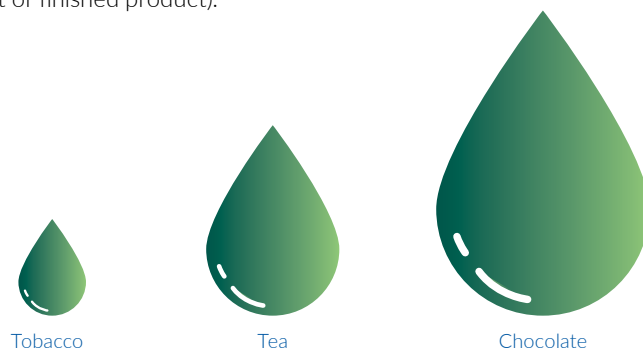
Water is not a major input to conventional tobacco product manufacturing, but we seek continual water use reduction across manufacturing facilities and focus on achieving improvements in water efficiency, conservation, and reusing or recycling water where possible.

In 2017, the process to manufacture our new smoke-free products required approximately four times more water per unit of product than for conventional cigarettes. Our efforts are geared towards improving water efficiency throughout that process by implementing new process designs, reusing or recycling water, and by using rainwater harvesting where feasible, with a view to minimum water discharge.

In 2017, PMI implemented other initiatives to reduce water use and increase water recovery; however, due to our new manufacturing process, our average water consumption increased from our lowest level of 4.0m³ in 2016 to 4.8m³ of water for every million units of product equivalent (cigarettes and *Heatsticks*).

Putting tobacco's water footprint into context

Tobacco growing and manufacturing take around one-third of the water required to make the same amount of tea or one sixth of that required for coffee or chocolate (per weight of finished product).¹



¹ Estimation based on PMI water use data for manufacturing and "The green, blue and grey water footprint of crops and derived crop products", M. M. Mekonnen and A. Y. Hoekstra, 2011. (<http://wfn.project-platforms.com/Reports/Mekonnen-Hoekstra-2011-WaterFootprintCrops.pdf>)

We joined the Alliance for Water Stewardship (AWS) in 2017, a leading organization dedicated to better managing water within the local watersheds. We successfully piloted the adoption of the AWS Standard in our factory in Brazil and developed a toolbox for wider implementation. In March 2018, our factory became the first factory in the country to be certified by AWS. Based on the results and learnings from this pilot, we will roll out the AWS Standard globally. As a priority, we plan to certify the ten factories which ranked highest in our previous risk assessment by 2020 and to extend to the rest of our operations until 2030.

Water stewardship in tobacco agriculture

More than half of the tobacco crops supplied to PMI globally are rain-fed and do not require supplementary irrigation other than at the seedling stage.

In 2017, water baseline studies were conducted in 60 different geographical areas where specific types of tobacco are grown. The selected areas represent 90% of PMI's global purchases of tobacco leaf. A water risk assessment system has been developed, including a global risk assessment tool and a tailored local risk assessment methodology and guideline. Three important tobacco-sourcing countries – Brazil, Malawi and U.S. – were selected to pilot and validate the risk assessment methodology.

The pilot risk assessment in Malawi helped us highlight the lack of access to adequate safe Water, Sanitation and Hygiene services (WASH), which poses a risk to farmers' and workers' health and livelihoods. In Malawi, more than 30% of the rural population lacks access to basic WASH services,⁴⁷ and there are no

indications that the situation of smallholder tobacco farmers and contracted workers would differ much from other rural households. Our first priority is on smallholder farms where PMI's active support in providing WASH services is most needed.

The pilot project in Malawi aims to provide a concrete example of how to invest into improving WASH services for farmers in the supply chain and to identify opportunities for further roll-out of a WASH intervention. In developing our project, we used UNICEF/WHO criteria for basic service level provision, which are defined as:

- An improved drinking water source within a 30-minute roundtrip;
- An improved sanitation facility which is not shared with other households; and
- A handwashing facility with water and soap.

In 2018, we plan to begin a program of providing and adapting boreholes fitted with hand pumps. We are also investigating more innovative solutions, such as cloud fishing nets (condensing water from air) and ferro-cement water storage tanks. PMI is engaging with local stakeholders during the pilot to leverage their local expertise and networks, and we already see their strong interest to be involved and contribute to the socio-economic development of Malawi.



A live barn structure in Malawi

Conserving biodiversity and combating deforestation

Biodiversity

Biodiversity represents the diversity of natural habitats, of species in these habitats, and of the genome within these species. Its conservation is essential, not only because we utilize a great diversity of species but also because healthy habitats provide vital services like pollination, biological pest control, filter functions of soils, and the regulation of nutrient cycles.

It is important for successful agriculture that diversity in habitats and species is maintained, as biodiversity raises the resilience of ecosystems and helps provide valuable ecological services including genetic diversity, which is key for biological pest control.

Due to the nature of PMI's business, there are no significant impacts on biodiversity or deforestation from our own operations. Where we do have a larger role to play on biodiversity is in our supply chain. Impacts linked to tobacco farming are addressed through our Good Agricultural Practices program for tobacco suppliers, where we describe our requirements for good environmental practices, including integrated pest management and soil conservation practices, as well as biodiversity management.

GAP provides guidance on biodiversity management practices and requires our tobacco suppliers to develop and implement a biodiversity management plan that incorporates, and goes beyond compliance with the applicable laws, and regulations for tobacco- and forest-growing areas. Tobacco production areas must not be located in places that could cause negative effects on national parks, wildlife refuges, biological corridors, forestry reserves, buffer zones, or other public or private biological conservation areas.

The tobacco supplier plan must aim to enhance habitats, promote native species, maintain biodiversity on the farm through protection of conservation areas and endangered species; the conservation of natural habitats and corridors between natural habitats; land conversion; soil conservation practices; and minimization of pollution to the air, water, or land.

Biodiversity initiatives are linked to tobacco-farming systems or farmed landscape where our tobacco suppliers work with the farmers to make them understand the requirements and provide examples that apply to their daily work.

Responsible management of chemicals for crop protection

To achieve responsible management of chemicals for crop protection, and to reduce risks to the health and safety of farmers and farm workers, we have established an Integrated Pest Management (IPM) program.

IPM plans are underway in all the main areas where tobacco is grown for PMI. Tools have been developed to support the implementation of the program in collaboration with the not-for-profit Centre for Agriculture and Bioscience International (CABI),⁴⁸ namely a manual to help screen bio pesticides, a database with over 300 non-Highly Hazardous Pesticides (non-HHP) alternatives, and best practice guidelines for Personal Protective Equipment (PPE) and for the disposal of empty Crop Protection Agent (CPA) containers. Our newly launched IPM app has reached approximately 700 users, while the new IPM website⁴⁹ has reached more than 6,500 views in 2017. Both the IPM app and website benefited from the addition of newly developed content.

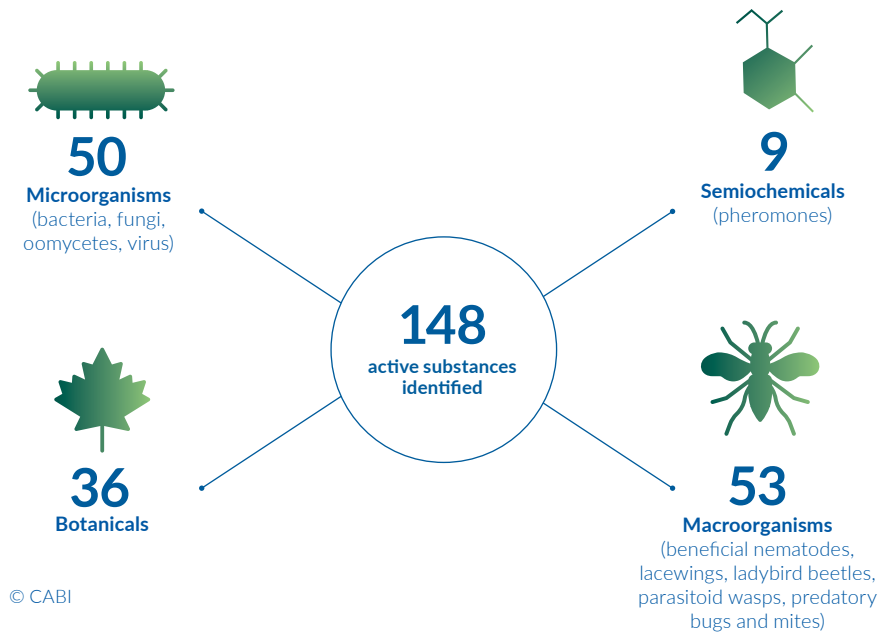
We have made significant progress towards achieving our target to eliminate WHO TOX1⁵⁰ CPAs by crop year 2018 and HHPs by crop year 2020 through promoting alternative and less toxic CPAs and bio pesticides. At the end of 2016, the volume of purchased tobacco without quantifiable level of any WHO TOX1 CPAs was at 98%, in line with our target to reach 100% by 2018. Eighty-four percent of our tobacco purchases did not contain any other quantifiable HHP residues, which represented progress against our target to completely eliminate the use of HHPs by 2020.

Deforestation

One of the most significant environmental issues facing the world is deforestation, which results in both a loss of biodiversity and climate change impacts.

PMI has been working for many years with suppliers and farmers to address the issue of wood used as fuel in tobacco curing, which in some places is associated with risk of deforestation. We address this by improving curing-barn efficiency and increasing the use of sustainable and traceable curing-fuel sources. We currently purchase 94% of tobacco cured at no risk of deforestation, up from 88% in 2016.

Identifying and promoting the use of natural agents to combat pests in tobacco plants



An example of our efforts in this area is the collaboration with our tobacco suppliers in the "Live Barn" initiative in Malawi and Mozambique: Trees are planted in such a way that they will eventually serve, in-situ, as the poles for a curing barn, hence removing the need to cut trees to build curing barns. More than 85,000 live barns have been planted across the two countries, and the first 1,000 are starting to be used in the current curing season.

Tobacco growing is, however, not a significant contributor to deforestation through land-use change, mainly due to the decreasing area of tobacco farmland. A 2017 study using the Big Chain Tool⁵¹ confirmed this for PMI's tobacco supply chain. In 2017, we also supported a land-use change study, which led to the publication of the Land-Use Change Guidance.⁵²

In addition to considering deforestation risk in tobacco farming, in 2017, PMI assessed the risks of deforestation across its entire value chain. Among the commodities most linked to deforestation, wood pulp is important to PMI as the raw material for paper, cardboard, and cigarettes filters. The corresponding supply chains tend to be more complex than for tobacco, and a small share of these materials is made from pulp sourced from countries known to experience

deforestation. We plan to work with key suppliers to map these material flows and increase the traceability of our supplies.

Going forward, we intend to develop a company-wide policy and increase our disclosure on this topic through submission to CDP Forests in 2018.

Waste management

Each of our factories operates a waste management program to reduce, reuse, and recycle waste before any final treatment or disposal. In 2017, 94% of our factory waste was recycled, composted or sent for energy recovery.

Beyond our own manufacturing operations, a bigger challenge lies in the waste resulting from the use of our products. Our products and packaging are mostly made of renewable materials, such as tobacco leaves, paper, cellulose acetate filters, and cardboard. After use, paper and cardboard components, such as empty packs, are recyclable, and the rest, such as plastic film wrapping and cigarette butts, should be properly disposed of with general waste.

Littering

Littering of consumer goods is an issue of concern to society in many parts of the world and is linked to two main drivers: consumer behavior and the availability of waste disposal infrastructure.

Cigarette butts are among the most frequently littered items. In natural environments, cigarette butts decompose slowly, leach smoke residues, and risk being accidentally ingested by animals. Smokers should avoid littering and dispose of their cigarette butts responsibly.

We believe that the best way of dealing with cigarette butts is to stub them out and dispose of them with general waste, which in many countries is processed for energy recovery.

We can play an important role in raising awareness and encouraging consumers not to litter, through both information campaigns and the distribution of portable ashtrays. As littering is an increasingly important topic in many places, we recognize that there is an opportunity to be more impactful in our work over the long term.

We can achieve more by working with others – industry peers, anti-littering organizations and authorities – and sharing best practices across cultures and geographies. We are developing a guidance and a toolbox of best practices that we intend to share with our affiliates in 2018, when they develop and support local anti-littering campaigns.

Recycling after consumer use

With the growth of smoke-free products, such as IQOS, we want to ensure that the entire life-cycle of these products is managed sustainably. Heated tobacco units for IQOS do not burn and carry less odor than cigarette butts. Our observations also suggest that they have a lower propensity to be littered than conventional cigarettes.

In 2017, we started the collection of used heated tobacco units from employees in our Operations Center, Factory and R&D facility in Switzerland. During the year, we collected 356,000 units, which represents an estimated 50% of consumption. The user feedback and collection statistics confirmed the interest and readiness of users to

dispose of their used products responsibly, and we have confirmed the feasibility of this approach. We are currently studying the economic feasibility of developing market recycling schemes for these heated tobacco units.

Electronic waste

The IQOS heated tobacco units are used with an electronic device, composed of a holder and a pocket charger. PMI's aim is that the devices are returned after use and recycled to the highest industry standards in every country where we market IQOS.

In all countries where IQOS is sold the devices can be returned at service points for proper disposal. Consumers

can either bring back the device to a point of sale or return the device through a delivery service if bought online in countries with online sales. Returned devices were inspected and sent for recycling and recovery. In 2017, in our largest market for IQOS, Japan, returned devices were recycled to recover valuable metals. The share of recycling is limited by currently available infrastructure and market conditions, so our objective is to improve this over time. In cooperation with recycling experts, we have defined new internal standards for traceability and sustainable recycling. We are now identifying global partners to manage the inspection and recycling process incorporating these new standards.



PMI employees discuss recycling of HeatSticks for IQOS during a pilot recycling initiative at PMI's Operations Center in Lausanne, Switzerland

Looking ahead

Our business transformation brings new challenges but also significant opportunities for environmental sustainability. Our long-term targets on environment, including our science-based targets, have been developed taking into account the changes in our business.

Beyond our own operations, we also want to apply good environmental stewardship practices. Building on the successful Brazilian pilot, we plan to start implementing water stewardship across our operations, with ten factories expected to be certified by 2020 and the remaining by 2030.

We believe that we can also play a role in combating deforestation in the tobacco supply chain and, to some extent, in our wood pulp supply chain. We want to work more closely with suppliers to improve pulp sustainability and traceability.

With the success of our smoke-free products, our new electronics supply chain is gaining importance. We want to ensure a responsible and sustainable use of batteries, plastics, and printed circuits. We are identifying potential partners to make the production process for our electronic devices more efficient.

We are committed to continuous improvement by incorporating good environmental management into product design, using components that can be recovered or recycled, and working with experts to develop the best technologies to reuse materials. This is especially important for future IQOS models and other new products.



A tobacco field in Dowa, Malawi

Our performance: Reducing our environmental footprint	2010 (baseline)	2015	2016	2017	Goal	Scope
CO ₂ e scope 1 (metric tons)	443,186	361,720	351,990	388,384		PMI factories, offices, and fleet
CO ₂ e scope 2 (metric tons)	470,864	329,323	314,049	241,355		PMI factories and offices
CO ₂ e scope 1+2 (metric tons)	914,050	691,044	666,039	629,739		PMI factories, offices, and fleet
CO ₂ e scope 1 from fleet (metric tons)	143,148	119,471	122,434	119,588		PMI fleet
CO ₂ e emissions from vehicles (g CO ₂ e per km driven)	296	215	227	226		PMI fleet
CO ₂ e scope 3 ('000 metric tons) ¹	6,487	5,690	5,025	4,519		PMI operations and value chain
CO ₂ e scope 1+2+3 ('000 metric tons)	7,401	6,381	5,691	5,149		PMI value chain
CO ₂ e scope 1+2+3 per million cigarettes equivalent (kg)	7,911	7,070	6,620	5,994		PMI value chain
CO ₂ e scope 1+2 absolute reduction versus 2010 baseline (%)		24	27	31	30 by 2020 40 by 2030 60 by 2040	PMI factories, offices, and fleet
CO ₂ e scope 1+2+3 absolute reduction versus 2010 baseline (%)		14	23	30	40 by 2030	PMI value chain
CO ₂ e scope 1+2+3 intensity reduction versus 2010 baseline (%) ²		11	16	24	30 by 2020	PMI value chain
Energy used and purchased (Gigajoules)		8,025,559	8,230,327	8,875,006		PMI factories, offices, and fleet
Renewable electricity (%)	0	30	32	53	80 by 2030	PMI factories
Water use ('000 m ³)	4,998	3,654	3,394	4,152		PMI factories
Water ratio (water use in m ³ per million units of cigarette equivalent)	5.34	4.05	3.95	4.83		PMI factories
Waste (metric tons)		127,631	130,077	140,316		PMI factories
Waste recycled (%)		87	87	82	85	PMI factories
Waste disposed to landfill or incineration without energy recover (%)		5.7	4.8	6.5	<5.0	PMI factories
Manufacturing facilities certified to ISO14001 (%)		93	93	91	100	PMI factories
CDP Climate Change (rating)	B	A	A	A		
CDP Water (rating)		B	B	A		
CDP Supplier engagement (rating)			A-	A		

1 The breakdown of scope 3 emissions is published in our CDP submission.

2 Intensity is measured in CO₂e per million cigarettes equivalent.

Our performance: Environmental metrics in our tobacco supply chain	2015	2016	2017	Goal
Tobacco purchased through direct contract by our leaf operations or our tobacco suppliers (%)	88	88	90	>90
Tobacco purchased without detection of any WHO TOX1 Crop Protection Agents (%)	94	98	Not yet available	100% by crop year 2018
Tobacco purchased without any detection of other identified HHP residues (%)	69	84	Not yet available	100% by crop year 2020
CO ₂ e intensity reduction versus 2010 baseline (%)	12	14	38	70 by 2020
Tobacco purchased at no risk of deforestation of old growth forest (%)	87	88	94	100 by 2020

Next steps

In this third Sustainability Report, we have tried to provide a more comprehensive picture of our sustainability work. With the aim to achieve greater transparency and to allow readers to assess our progress, we have included a fuller set of metrics and data trends.

We have also shared more contextual information on our business and how we manage sustainability, and we have taken into account the feedback we received on our last report.

The progress we have made across the four pillars of our strategy is an indication of our sustainability ambition: We are on track with the transformation of our company, we are delivering towards our CO₂ reduction targets within our operations and beyond, we are improving on our inclusion and diversity KPIs, and we have strengthened the governance of our sustainability management.

We realize that the transformation of our company brings along new challenges we need to address: reducing the environmental footprint of smoke-free products manufacturing process, promoting crop diversification amongst tobacco farmers, and equipping our people to successfully transform the company.

Starting in 2018, we aim to:

- Refresh the analysis of our significant sustainability topics;
- Implement our Human Rights Roadmap and carry out a Human Rights Impact Assessment pilot for one market;
- Update our Agricultural Labor Practices (ALP) program based on learnings of the past years;
- Expand our efforts on deforestation prevention and post-consumer waste management;

- Conduct a carbon and water footprinting of our new product portfolio; and
- Further raise internal awareness of sustainability.

We welcome your feedback on this report and look forward to sharing our progress in our next report.



PMI's state-of-the-art R&D facility for smoke-free products in Neuchâtel, Switzerland

Forward-looking and cautionary statements

This report contains projections of future results and other forward-looking statements. Achievement of future results is subject to risks, uncertainties, and inaccurate assumptions.

In the event that risks or uncertainties materialize, or underlying assumptions prove inaccurate, actual results could vary materially from those contained in such forward-looking statements.

Pursuant to the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995, PMI is identifying important factors that, individually or in the aggregate, could cause actual results and outcomes to differ materially from those contained in any forward-looking statements made by PMI.

PMI's business risks include: excise tax increases and discriminatory tax structures; increasing marketing and regulatory restrictions that could reduce our competitiveness, eliminate our ability to communicate with adult consumers, or ban certain of our products; health concerns relating to the use of tobacco products and exposure to environmental tobacco smoke; litigation related to tobacco use; intense competition; the effects of global and individual country economic, regulatory, and political developments, natural disasters and conflicts; changes in adult smoker behavior; lost revenues as a result of counterfeiting, contraband, and cross-border purchases; governmental investigations; unfavorable currency

exchange rates and currency devaluations, and limitations on the ability to repatriate funds; adverse changes in applicable corporate tax laws; adverse changes in the cost and quality of tobacco and other agricultural products and raw materials; and the integrity of its information systems. PMI's future profitability may also be adversely affected should it be unsuccessful in its attempts to produce and commercialize reduced-risk products or if regulation or taxation do not differentiate between such products and cigarettes; if it is unable to successfully introduce new products, promote brand equity, enter new markets or improve its margins through increased prices and productivity gains; if it is unable to expand its brand portfolio internally or through acquisitions and the development of strategic business relationships; or if it is unable to attract and retain the best global talent. PMI is further subject to other risks detailed from time to time in its publicly filed documents, including the Form 10-Q for the quarter ended March 31, 2018. Aspirational targets do not constitute financial projections. PMI cautions that the foregoing list of important factors is not a complete discussion of all potential risks and uncertainties. PMI does not undertake to update any forward-looking statement that it may make from time to time, except in the normal course of its public disclosure obligations.

Annex 1: Overview of marketing principles for combustible products

What we do

Our Guidebook for Success (Code of Conduct) and internal Practices and Policies, including the PMI Marketing Code, reflect our commitment to market our products responsibly, in compliance with applicable laws, only to adult smokers, and providing accurate information. This is a summary of those standards, as they are set forth on different internal documents. Our brands are among the most valuable in the world. We put our creativity and innovation into developing and maintaining brand value. At the same time we know that tobacco products create health risks to consumers. This is why it is so important to market our products responsibly and only to adult smokers. At PMI we have to ensure that our employees and agents only engage in responsible sales and marketing practices.

How we do it

The Marketing Code contains our minimum global standards that apply to all sales and marketing activities of PMI relating to Combustible Tobacco Products. We apply these standards voluntarily when there is no applicable law or when the applicable law is less strict. As Combustible Tobacco Products represent the largest part of our business today, the Marketing Code provides a solid foundation for responsibly selling and communicating these products.

The top priority for PMI is to develop and market smoke-free products that are a better choice for smokers than continued smoking and have the potential to reduce the risks of smoking-related diseases.

These innovative smoke-free products, like heat-not-burn, are subject to different marketing and sales rules, namely the "Good Conversion Practices".

While we are moving with speed to make our vision of a smoke-free world a reality, we must acknowledge that the majority of our business today is traditional combustible cigarettes. At PMI, we operate under Responsible Marketing Principles. These principles, as defined below, embody our Company's commitment to engage in responsible marketing directed only to Adult Smokers.

Responsible marketing principles

1. We market and sell our combustible tobacco products to adult smokers only

What do we mean?

We sell Combustible Tobacco Products and compete for market share among Adult Smokers who have chosen to smoke. We do not seek to influence any adult consumer's decision about whether or not to smoke.

Our standards:

- We must not use images that have particular appeal to minors, including youth-oriented celebrities or cartoons. We must not use models who are or who clearly appear to be under the age of 25.
- We must only place Advertising in media channels, venues or events that are not directed to minors and whose audience is reasonably estimated to be at least 75% adults. Advertising on television, in radio broadcasts, or in cinemas should only appear in the later evening hours.
- We must not place Advertising on the front or back cover of a printed publication for general circulation or general circulation to the trade.
- We must not use outdoor Advertising that exceeds 35 square meters in total size, either individually or in deliberate combination with other Advertising, unless we can do so responsibly in light of existing local circumstances (e.g., where most of the billboards available for placement of Advertising exceed 35 square meters in size).
- We must not place outdoor Advertising where the Advertising is readable from facilities attended or frequented primarily by minors. Outdoor Advertising should not be placed within 100 meters of such facilities.
- Company activities involving engagement and interaction with consumers, whether offline or online via digital media, such as events or Direct Communication, must be directed only to age-verified Adult Smokers, subject to specific age verification process.

– Premiums must be designed for adults and must not have particular appeal to minors. We may brand smoking-related premiums such as ashtrays and lighters. If premiums are not smoking-related, the branding, if any, must not be visible to others when the premium is used.

– We may sell and deliver Combustible Tobacco Products directly only to age-verified Adult Smokers residing in the country of intended sale.

– We may offer free Combustible Tobacco Products in limited quantities (typically no more than one pack) only to age-verified Adult Smokers as part of product trial, switch-selling or swapping activities. We must not engage in switch-selling until after the initial purchase has occurred.

2. We warn consumers about the health effects of our combustible tobacco products

What do we mean?

Smoking causes serious disease and is addictive. We warn consumers about the health effects of smoking.

Our standards:

- All Advertising and Consumer Packaging must have health warnings, even if the law does not require these warnings. If the law does not require or specify health warning content and appearance, we must ensure that health warnings are clear and conspicuous.
- If there is a legal requirement to print yields, we may voluntarily print tar, nicotine and/or CO yield numbers on Advertising and on Consumer Packaging in addition to yield labeling required by law, as long as we also print the following statement in a clearly legible typeface and size: "The amount of tar, nicotine and/or CO you inhale will vary depending on how you smoke the cigarette."

3. Our marketing must be honest, accurate and transparent

What do we mean?

All of 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 implemented.

Our standards:

- Product or brand-related statements must be accurate and not misleading, including about the health risks of smoking. All product-related claims require adequate substantiation.
- PMI employees or contractors who interact with consumers, including in the context of Unbranded platforms or campaigns, must make it clear that they are working for a tobacco company.
- We must not pay to include the use of Combustible Tobacco Products, a Combustible Tobacco Product brand name or items bearing a Combustible Tobacco Product brand name in movies, entertainment programs or theatrical productions, on television or radio, on the Internet or in any other production (e.g., video games).
- Standard brand presentation (i.e., brand name, trademark and/or logo) must predominate in all Consumer Packaging designs. We must not use Advertising visuals on Consumer Packaging. Any text placed on the external part of Consumer Packaging must be factual, brand-related and/or product-specific, and not Advertising copy.

4. We respect the law and also ensure that:

- All persons, such as hosts, hostesses, brand ambassadors and trend experts, acting on behalf of the Company to engage with Adult Smokers must be of legal age to purchase Combustible Tobacco Products and at least 19 years old. We must ensure that it is clear to Adult Smokers that these persons are acting on behalf of the Company. We must also adequately monitor their activities for compliance with these principles and practices.
- All written communications with Trade Partners must clearly state “For Trade Only. Not for Distribution to Consumers.” Advertisements in

publications intended for general circulation to the trade must have health warnings in black text on a white background, occupying no less than 10% of the total area of the advertisement.

5. Implementation

We have a robust process for ensuring that our Marketing Code is implemented at the market level. The Affiliate Head is accountable for compliance with these principles and practices, and must ensure that the affiliate uses a robust and substantive review and approval process, such as a Brand Marketing Review. All activities subject to these principles and practices must be (i) approved by the Affiliate Head and the Affiliate Head of Marketing and/or Sales and (ii) reviewed by the Affiliate Law and Corporate Affairs Departments. All decisions taken during the review process must be documented.

6. Training

All Company employees who are directly involved in marketing and sales activities must receive training on these principles and practices. All third parties who are substantively involved in marketing and sales activities on behalf of the Company must be trained on the parts of these principles and practices that are relevant to their activities. The Affiliate Heads, the Regional Marketing & Sales Heads and the Marketing Code Program Owner are accountable to implement these trainings for all employees in and third-parties contracted by their respective organizations.

Definitions

Advertising – any branded commercial communication aimed at promoting a PMI Combustible Tobacco Product to Adult Smokers, regardless of the medium.

Adult Smoker – a consumer of Combustible Tobacco Products who is of legal age to purchase such products and is at least 18 years old.

Company or PMI – Philip Morris International Inc. and its direct and indirect subsidiaries.

Consumer Packaging – packaging, wrapping, bundles or any materials in which Combustible Tobacco Products are offered for sale to Adult Smokers.

Combustible Tobacco Products – cigarettes and other combustible tobacco products, such as “roll your own”, “make your own”, pipe tobacco, cigars, cigarillos, and cigarittos.

Direct Communications – Company communications to an Adult Smoker that are not intended for the general public, including communications via one-to-one consumer engagement, direct mail, electronic mail, telephone, short-messaging, and Company consumer websites.

PMI Marketing Council – the PMI Senior Vice President Marketing and Sales, the Senior Vice President Corporate Affairs and the Vice President & Associate General Counsel responsible for Brand Building.

Smoke-Free Products or Reduced Risk Products (RRPs) – products that present, are likely to present, or have the potential to present less risk of harm to smokers who switch to these products versus continued smoking. We have a range of RRP's in various stages of development, scientific assessment and commercialization. These products are not Combustible Tobacco Products and because they do not burn tobacco, they produce far lower quantities of harmful and potentially harmful compounds than found in cigarette smoke.

Trade Partner – any representative of a retail outlet, legal age meeting point (LAMP), or other business that is involved in the sale of Combustible Tobacco Products.

Unbranded – without a name, trademark, logo or indicia of a Combustible Tobacco Product brand.

Who must follow the marketing code

This Marketing Code applies to Philip Morris International Inc. and its direct and indirect subsidiaries, collectively referred to as Philip Morris International, PMI, or the company. Compliance with the Marketing Code is mandatory for all PMI employees and anyone doing business on behalf of PMI.

Annex 2: Overview of engagement principles

Our framework

Our Guidebook for Success (Code of Conduct) and several Principles & Practices set out detailed standards for engaging with governments and public organizations or third parties generally, doing external communications or public statements, making contributions or providing financial support to certain projects, giving gifts or providing entertainment to third parties, and recording and reporting such expenses.

This document does not replace those standards, but it describes their basic tenets and summarizes their spirit. It also provides a means for PMI to tell the public what is important to PMI when interacting with governments and public organizations, and allows PMI to invite feedback on these fundamental tenets.

Key points to remember

- Communication and respectful exchange of informed, substantiated, and reasoned ideas is the best way to achieve regulatory and fiscal frameworks beneficial to the societies they apply to.
- We think it is our responsibility to share our knowledge and expertise with governments, authorities and public organizations.
- The merit of PMI's ideas, the rigor and validity of its scientific conclusions, the verifiability of its facts and the integrity of its employees should be the only means through which PMI advances its positions and communicates them to governments, public organizations and opinion leaders.
- 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.

What we do

- PMI's research and development activities follow rigorous scientific standards. When it comes to our Reduced-Risk Products, PMI makes its findings public and invites external review.
- PMI scientists are committed to those rigorous standards.

- PMI only communicates to governments and public organizations product information that has been substantiated by such rigorous scientific methods.
- The positions PMI publicly advocates for, and the arguments supporting such positions, are consistent with PMI's internal positions and do not overlook any information that PMI may internally have that might be material to PMI's audience.
- PMI's positions on regulation of its products, taxation, harm-reduction, employment, safety, and a vast array of important topics result from self-critical, respectful internal debate that considers not only business objectives but also, among other things, PMI's legal obligations, societal expectations, human rights, long-term environmental effects, and consumers' rights to full and accurate information.
- We believe that regulation and taxation of tobacco and nicotine products should be consistent with their different risk profiles. We make our views known through our website, the media, and communications to governments such as through public consultations and other available platforms.
- We do not bribe or try to inappropriately influence other people's objectivity.
- We have strict standards governing how we provide gifts and entertainment to government officials, members of public institutions and private individuals. We comply with those standards.
- We have strict rules concerning what contributions are appropriate, what due diligence is required before making them, what disclosures are in order and, when needed, how to maintain the independence of those that receive such contributions. The same applies to our membership in external organizations. We comply with these rules.
- We require third parties interacting with governments, public institutions or other audiences on our behalf to refrain from engaging in bribery or in other forms of inappropriate influence. We make our internal standards known to them and monitor their compliance therewith.
- We require third parties interacting with others on our behalf and communicating about PMI's position on topics such as harm-reduction, product regulation, taxation and others, to disclose their relationship with, and any financial support they receive from, us so that their audience has access to the information material for them to make a decision or adopt a view.
- We keep accurate and complete financial records of all expenses incurred in interacting with government officials, public organizations and any other third party.
- We communicate honestly and respectfully, internally and externally.
- We market and sell our products according to the following principles:
 - We do not market or sell to minors, non-smokers or non-users of nicotine products.
 - Consumption of combustible tobacco products is harmful to health.
 - Non-combustible products are not risk-free.
 - People concerned about the risks associated with any of our products, should quit.
- Any positions or messages communicated or advocated for with governments or public organizations are consistent with, and respectful of, these principles.
- We comply with reasonable, legal governmental requirements to provide information to authorities.
- We communicate institutionally and do not allow the use of personal email accounts, or other means that might be misleading, for company communications or the transmittal of PMI information.
- We do not seek to gain access to, nor discuss with governments or other third parties, confidential information of others, including our competitors. We comply with anti-trust regulations.
- Our Compliance help-line and Department are available to anyone working at PMI wanting to report suspected violations of our Guidebook for Success or Principles & Practices. Reports can be made anonymously. PMI respects and protects the identity of those that raise concerns. PMI does not tolerate retaliation of any kind against good-faith reporting.

Overview of our sustainability performance

Transforming our business

Our performance: Transforming our business	Actuals			Aspiration	
	2015	2016	2017	2018	2025 ¹
R&D expenditure (Smoke-free/Total)	70%	72%	74%	>80%	
Commercial expenditure (Smoke-free/Total)	8%	15%	39%	>55%	
Net Revenues ² (Smoke-free/Total)	0.2%	2.7%	13%	>16%	>38%
Smoke-free product ³ shipment volume (billion units)	0.8	7.7	36	>46	>250
Combustible product ⁴ shipment volume (billion units)	881	845	791	<755	<550
Smoke-free product shipment ratio (Smoke free/Total)	0.1%	0.9%	4.4%	>6%	>30%

1 Assuming constant PMI market share. We do not set aspirational targets for R&D and commercial expenditure but we expect both ratios to continue increasing to enable the stated outcome in terms of shipment volume.

2 Excluding excise taxes. For future periods, at today's pricing and excise tax assumptions.

3 Includes heated tobacco units and e-cigarettes. The 2018 aspiration pertains to in-market sales.

4 Includes cigarettes and other combustible tobacco products.

The 2017 metrics are subject to PwC's Assurance Report. See page 75.

Driving operational excellence

Our performance: Ethics and compliance	2015	2016	2017
Number of compliance trainings ('000) ¹	193.54	238.36	186.00
Ratio of employees trained versus third parties trained (%)	77/23	76/24	75/25
Number of reports of suspected misconduct	753	792	714
Number of substantiated claims	279	292	317

1 2015 and 2016 training numbers have been updated to include live trainings that were conducted during these years but reported late, after the publication of our 2016 report.

Our performance: Tackling illicit tobacco trade	2015	2016	2017	2018 goal
Keeping full coverage for tracking and tracing – master case level ¹	100%	100%	100%	100%
Tracking and tracing – % of sold packs with unique code applied	53%	67%	75%	85%
Extending Memoranda of Understanding (MoU) with law enforcement agencies/governments – number of countries	6 additional	5 additional inclusive of SELEC (11 countries)	10 additional	5 additional
Regional studies and country analysis to improve awareness of illicit trade – % of global cigarette consumption covered	25%	25%	25%	27%
Training for law enforcement agencies to monitor diversion of PMI products – number of law enforcement officers trained	507 across 15 countries	2,176 across 14 countries	717 across 15 countries	At least 500 across 10 countries
Number of views on stopillegal.com ('000) ²	n/a	n/a	18	90

1 Full coverage equates to 95% tracking and tracing in our supply chain (excluding Kretek business). There are 5% of master cases not covered – these are destined to countries which are not identified as a source of potential diversion or where PMI sells to a single customer in the country.

2 Data for period July 16, 2017 – December 31, 2017 (the website was launched in 2017).

Our performance: Agricultural supply chain ¹	2015	2016	2017	Goal
Tobacco purchased through direct contract by our leaf operations or our tobacco suppliers (%)	88	88	90	>90
Number of tobacco supplier locations (countries) assessed by AB Sustain	n/a	8 (22% of purchased tobacco)	8 (33% of purchased tobacco)	Every tobacco supplier every three years
Systematic monitoring of labor practices (% coverage) ^{2,3}	32.5	72.0	77.0	100
Cumulative number of tobacco supplier locations (countries) assessed by Control Union since 2013 (ALP topics) ³	13	15	19	24 countries by 2020
Number of contracted farms in the scope of Control Union assessments per year (ALP topics) ^{3,4}	11,043	7,508	6,433	

1 Data relate to our total tobacco supply chain, except when explicitly mentioned in footnotes.

2 Data relate to crop season, which may span over more than one calendar year.

3 Data cover approximately 90% of our sourced tobacco.

4 According to our methodology, these assessments cover different countries and tobacco suppliers every year. Depending on the geography and typical farm size in different countries, the number of farms covered by the assessments will vary. The variation in the number of farms assessed over the last three years does therefore not reflect a reduction in the scope of the assessments.

Managing our social impact

Our performance: Working at PMI	2015	2016	2017	Goal
Number of employees	80,200	79,500	80,600	
Women employees (%)	40.6	41.2	41.6	
Women in management positions (%)	31.0	32.8	34.4	40 by 2022
Number of women in Company Management (management board)	1 (out of 16)	1 (out of 17)	2 (out of 20)	
Number of women on Board of Directors	2 (out of 12)	2 (out of 13)	2 (out of 13)	
Employee turnover rate (%) ¹	13.8	11.2	11.0	
Employee voluntary turnover rate (%) ¹	4.3	4.3	4.9	
Employees covered by collective labor agreements (%)	67	68	67²	

1 The aggregated data cover approximately 70% of our employees.

2 As of October 1, 2017, approximately 74% of our workforce in non OECD countries was covered by collective labor agreements.

Our performance: Safety in the workplace	2015	2016	2017	Goal
Lost Time Injury (LTI) rate (per 200,000 hours worked)	0.11	0.12	0.10	<0.10
Fatalities (PMI employees and contracted employees)	0	1	2	0
Fleet crash rate – vehicles crashes per million km driven ¹	5.3	6.8	6.2	<4.0
Fleet collision rate – vehicles collision per million km driven	1.24	1.22	1.01	<1.50
Manufacturing facilities with OHSAS 18001 certification (% of PMI factories)	93	93	91	100

1 Regarding fleet safety, as of our 2018 Sustainability Report we will no longer report on Fleet crash rate (which includes cosmetic damage) as we believe collision rate (collisions per million km driven), which covers higher severity road accidents, is a better indication of our safety performance.

Reducing our environmental footprint

Our performance: Reducing our environmental footprint	2010 (baseline)	2015	2016	2017	Goal	Scope
CO ₂ e scope 1 (metric tons)	443,186	361,720	351,990	388,384		PMI factories, offices, and fleet
CO ₂ e scope 2 (metric tons)	470,864	329,323	314,049	241,355		PMI factories and offices
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CO ₂ e scope 1 from fleet (metric tons)	143,148	119,471	122,434	119,588		PMI fleet
CO ₂ e emissions from vehicles (g CO ₂ e per km driven)	296	215	227	226		PMI fleet
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CO ₂ e scope 1+2+3 per million cigarettes equivalent (kg)	7,911	7,070	6,620	5,994		PMI value chain
CO ₂ e scope 1+2 absolute reduction versus 2010 baseline (%)		24	27	31	30 by 2020 40 by 2030 60 by 2040	PMI factories, offices, and fleet
CO ₂ e scope 1+2+3 absolute reduction versus 2010 baseline (%)		14	23	30	40 by 2030	PMI value chain
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Energy used and purchased (Gigajoules)		8,025,559	8,230,327	8,875,006		PMI factories, offices, and fleet
Renewable electricity (%)	0	30	32	53	80 by 2030	PMI factories
Water use ('000 m ³)	4,998	3,654	3,394	4,152		PMI factories
Water ratio (water use in m ³ per million units of cigarette equivalent)	5.34	4.05	3.95	4.83		PMI factories
Waste (metric tons)		127,631	130,077	140,316		PMI factories
Waste recycled (%)		87	87	82	85	PMI factories
Waste disposed to landfill or incineration without energy recover (%)		5.7	4.8	6.5	<5.0	PMI factories
Manufacturing facilities certified to ISO14001 (%)		93	93	91	100	PMI factories
CDP Climate Change (rating)	B	A	A	A		
CDP Water (rating)		B	B	A		
CDP Supplier engagement (rating)			A-	A		

1 The breakdown of scope 3 emissions is published in our CDP submission.

2 Intensity is measured in CO₂e per million cigarettes equivalent.

Our performance: Environmental metrics in our tobacco supply chain	2015	2016	2017	Goal
Tobacco purchased through direct contract by our leaf operations or our tobacco suppliers (%)	88	88	90	>90
Tobacco purchased without detection of any WHO TOX1 Crop Protection Agents (%)	94	98	Not yet available	100% by crop year 2018
Tobacco purchased without any detection of other identified HHP residues (%)	69	84	Not yet available	100% by crop year 2020
CO ₂ e intensity reduction versus 2010 baseline (%)	12	14	38	70 by 2020
Tobacco purchased at no risk of deforestation of old growth forest (%)	87	88	94	100 by 2020

Glossary and acronyms

ALP – Agricultural Labor Practices

APAC – Asia and Pacific

CDP – Carbon Disclosure Project

CPA – Crop protective agent

CLAs – Collective Labor Agreements

CU – Control Unions

EEMA – Eastern Europe, Middle East, and Africa

EMS – Electronics manufacturing services

EU – European Union

FDA – U.S. Food & Drug Administration

GAP – Good Agricultural Practices

GCP – Good Conversion Practices

GHG – Greenhouse gas

GTS – Green Tobacco Sickness

HHP – Highly hazardous pesticides

HPHC – Harmful and potentially harmful constituents

LA&C – Latin America and Canada

MACC – Marginal abatement cost curve

NGOs – Intergovernmental organizations and non-governmental organizations, respectively

OECD – Organisation for Economic Co-operation and Development

P&C – People and Culture

PMI – Philip Morris International Inc. and its subsidiaries

PMJ – Philip Morris Japan Limited

PPE – Personal protective equipment

R&D – Research & Development

RSP – Responsible Sourcing Principles

SDGs – Sustainable Development Goals

STP – Sustainable Tobacco Program

UNGC – United Nations Global Compact

WHO – World Health Organisation

Aerosol – Gaseous suspension of fine solid particles and/or liquid droplets

Combustion – The process of burning a substance in oxygen, producing heat and often light

Combustible products – The term PMI uses to refer to cigarettes and OTP, combined

Converted IQOS Users – The estimated number of Legal Age (minimum 18-year-old) IQOS users that used *HeatSticks/HEETS* heated tobacco units for over 95% of their daily tobacco consumption over the past seven days

Direct materials – Include printed board and paper (used to manufacture packs, cartons and bundles), acetate tow (the key component of cigarette filters), fine papers (used to manufacture cigarette and filter rods), flexibles (mainly wrapping films, inner liner and tear tape) and a variety of materials such as shipping cases, and ingredients

An e-vapor product – An electrical product that generates an aerosol by heating a nicotine or non-nicotine containing liquid, such as electronic cigarettes (or “e-cigarettes”)

Heated tobacco units – The term PMI uses to refer to heated tobacco consumables, which include *HEETS*, *HEETS Marlboro* and *HEETS FROM MARLBORO*, defined collectively as *HEETS*, as well as *Marlboro Heatsticks* and *Parliament HeatSticks*

HPHCs – Harmful or potentially harmful constituents which have been identified as likely causes of tobacco related diseases

Illicit trade – Domestic non-tax paid products

IQOS – The brand name under which PMI has chosen to commercialize its Platform 1 controlled heating device into which a specially designed and proprietary tobacco unit is inserted and heated to generate an aerosol

MESH – The brand name that PMI has chosen for one of its Platform 4 reduced-risk products that leverages new proprietary vaporization technology

MRTP – Modified Risk Tobacco Product, the term used by the U.S. FDA to refer to RRP

MRTP application – Modified Risk Tobacco Product application under section 911 of the FD&C Act

Heated tobacco unit “offtake share” – The estimated retail offtake volume of heated tobacco units divided by the sum of estimated total offtake volume for cigarettes, heated tobacco units and, where the data is available, other RRP

OTP – Other tobacco products, primarily roll-your-own and make-your-own cigarettes, pipe tobacco, cigars and cigarillos, and does not include reduced-risk products

Reduced-risk products (RRPs) or smoke-free products – Products that present, are likely to present, or have the potential to present less risk of harm to smokers who switch to these products versus continued smoking. We have a range of RRP in various stages of development, scientific assessment and commercialization. Because they do not burn tobacco, they produce an aerosol that contains far lower quantities of harmful and potentially harmful constituents than found in cigarette smoke.

Notes

- 1 As of December 31, 2017.
- 2 Data and projections are based on WHO global report on trends in prevalence of tobacco smoking, 2015, and UN Population Prospects. These official projections refer to age 15+.
- 3 WHO Budget 2016-2017.
- 4 Smith et al. (2016) Evaluation of the Tobacco Heating System 2.2. Part 1: Description of the System and the Scientific Assessment Program. *Regulatory Toxicology and Pharmacology*, 81 Suppl 2:S17-S26. (PMID: 27450400).
- 5 <https://www.pmscience.com/news/absence-combustion-pmi%E2%80%99s-heated-tobacco-product-platform-1> ; and https://www.pmscience.com/system/files/publications/gfn_2017_mcgrath_what_is_combustion_and_why_the_absence_of_combustion_is_important_in_heated_tobacco_products.pdf
- 6 Schaller et al. (2016) Evaluation of the Tobacco Heating System 2.2. Part 2: Chemical composition, genotoxicity, cytotoxicity, and physical properties of the aerosol. *Regulatory Toxicology and Pharmacology*, 81 Suppl 2:S27-S47. (PMID: 27720919).
- 7 Phillips et al. (2016) An 8-Month Systems Toxicology Inhalation/Cessation Study in Apoe-/- Mice to Investigate Cardiovascular and Respiratory Exposure Effects of a Candidate Modified Risk Tobacco Product, THS 2.2, Compared with Conventional Cigarettes. *Toxicological Sciences*, 149:411-432. (PMID: 26609137).
- 8 Mitova et al. (2016) Comparison of the impact of the Tobacco Heating System 2.2 and a cigarette on indoor air quality. *Regulatory Toxicology and Pharmacology*, 80:91-101. (PMID: 27311683).
- 9 Haziza et al. (2016) Evaluation of the Tobacco Heating System 2.2. Part 8: 5-day randomized reduced exposure clinical trial in Poland. *Regulatory Toxicology and Pharmacology*, 81 Suppl 2:S139-S150. (PMID: 27816672).
- 10 Luedicke et al. (2018) Effects of switching to the Menthol Tobacco Heating System 2.2. Smoking Abstinence or Continuing Cigarettes on Biomarkers of Exposure: A randomized controlled, open-label, multicentre study in sequential confinement and ambulatory settings (Part 1). *Nicotine and Tobacco Research*, 20:161-172. (PMID: 28177489).
- 11 <https://www.sbvimprover.com/sbv-improver/publications>
- 12 <http://intervals.science/>
- 13 In this report, we describe our continued commitment to a strong culture of ethical business conduct and sustainability of our business. Despite our high ethical standards and rigorous control and compliance procedures aimed at detecting and preventing unlawful conduct, given the breadth and scope of our international operations, we may not be able to detect all potential improper or unlawful conduct by our employees and partners.
- 14 www.pmi.com/transparency
- 15 https://www.pmi.com/resources/docs/default-source/pmi-sustainability/0000-pmi-human-rights-commitment-whitepaper_final.pdf?sfvrsn=c71985b5_4
- 16 https://www.pmi.com/resources/docs/default-source/pmi-sustainability/responsible-sourcing-principles.pdf?sfvrsn=15c19ab5_14
- 17 <https://www.pmi.com/sustainability/good-agricultural-practices>
- 18 https://www.pmi.com/resources/docs/default-source/pmi-sustainability/alp-code9a7cd8bc6c7468f696e2ff0400458fff.pdf?sfvrsn=908b0b5_0
- 19 <https://www.pmi.com/sustainability/good-agricultural-practices/upholding-labor-rights-on-the-farms>
- 20 https://publications.iom.int/system/files/pdf/wmr_2018_en.pdf
- 21 <http://www.italy.iom.int/en/activities/vulnerable-groups-and-minors/terra-munda>
- 22 <https://www.unodc.org/unodc/en/frontpage/2012/July/new-unodc-campaign-highlights-transnational-organized-crime-as-an-us-870-billion-a-year-business.html>
- 23 US: congressional Hearing, Helsinki commission, July 2017 – US Congressional appointment where PMI was invited to testify as expert witness.
- 24 Panama: Business Council for International Understanding October 2017 financially supported by PMI and by Panamanian Alliance Against Illicit Trade.
- 25 FT's Combating Illicit Trade event in London, organized by the Financial Times and financially supported by PMI.
- 26 https://www.stopillegal.com/docs/default-source/anti-diversion/anti-diversion_toolkit.pdf?sfvrsn=2da673d7_2
- 27 https://www.stopillegal.com/docs/default-source/anti-diversion/anti-diversion-governance-committee-report-2016-17.pdf?sfvrsn=b8973d7_2
- 28 Argentina, Croatia, Czech Republic, Denmark, Dominican Republic, Estonia, France, Poland, the Philippines and Switzerland.
- 29 Internal estimation based on the assumption that the main targeted markets would have been Germany, France and the UK.
- 30 E.g.,The Nielsen Company: <http://www.nielsen.com/eu/en.html>
- 31 <https://www.verite.org/>
- 32 https://www.pmi.com/resources/docs/default-source/pmi-sustainability/responsible-sourcing-principles.pdf?sfvrsn=15c19ab5_14
- 33 <http://www.lbma.org.uk/refiners-gold-current> (London Bullion Market Association- Good Delivery list) <http://www.responsiblemineralsinitiative.org/conformant-smelter-refiner-lists/>
- 34 <https://www.absustain.com/>
- 35 We excluded Venezuela from our analysis due to hyperinflation rate in the country throughout 2017.
- 36 The numbers provided in this section are approximate numbers, considering the limitations faced during the data collection, the high number of people reported and the diversity of the markets assessed. The scope of our ALP data excludes China, France and the Dominican Republic.
- 37 http://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/documents/publication/wcms_575499.pdf
- 38 https://www.pmi.com/resources/docs/default-source/pmi-sustainability/alp-code9a7cd8bc6c7468f696e2ff0400458fff.pdf?sfvrsn=908b0b5_0
- 39 <https://certifications.controlunion.com/en>
- 40 <https://www.pmi.com/sustainability/good-agricultural-practices/upholding-labor-rights-on-the-farms>
- 41 <https://www.verite.org/verite-pilots-participatory-impact-evaluation-technique/>
- 42 ALP Progress Report 2014-2015: https://www.pmi.com/resources/docs/default-source/pmi-sustainability/alp-progress-report-2014-2015.pdf?sfvrsn=6c08b0b5_6
- 43 Philip Morris International is a member of the PCSD Partnership and the specific mention to it in this report is provided for informational purposes only and is not to be construed as providing endorsements by the OECD or the United Nations.
- 44 <https://globalagribusinessalliance.com/>
- 45 Green Tobacco Sickness is a form of nicotine poisoning that may be contracted by handling wet, fresh, green tobacco leaves.
- 46 Estimations based on requirements for a classical American Blend. For an overview of our tobacco types, please see: <https://www.pmi.com/our-business/about-us/products/tobacco-farming>.
- 47 Miombo is an ecosystem that includes tropical and sub-tropical grasslands, savannahs and scrublands.
- 48 According to the Joint Monitoring Program for Water Supply and Sanitation (WHO/UNICEF).
- 49 <https://www.cabi.org/>
- 50 www.tobaccoipm.com
- 51 http://www.who.int/ipcs/publications/pesticides_hazard_2009.pdf
- 52 <https://www.tfa2020.org/en/reports/annual-report-2017/#the-big-chain-tool>
- 53 <https://quantis-intl.com/lucguidance/>

Recognition in 2017:



Photography credits:

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Independent Assurance Report on the Business Transformation Metrics Reporting 2017

To the Board of Directors of Philip Morris International Inc.
Lausanne

We have been engaged to perform assurance procedures to provide reasonable assurance on the Business Transformation Metrics reporting of Philip Morris International Inc. and Subsidiaries ('PMI').

Scope and subject matter

Our reasonable assurance engagement focused on the Business Transformation Metrics of PMI for the financial year ended December 31, 2017 included in the Sustainability Report 2017:

- The application of the internal financial reporting guidelines for the preparation of the Business Transformation Metrics published on page 24;
- The internal reporting system and procedures to collect and aggregate the Business Transformation Metrics data; and
- The data and information in the Business Transformation Metrics table, in all material aspects, on page 25.

The prospective data in the Aspiration columns for 2018 and 2025 are not subject to this assurance report. Consequently, we do not express any conclusion on this data.

Criteria

The reporting criteria used by PMI are described and disclosed on page 24 and in the internal financial reporting guidelines. These define those procedures, by which the Business Transformation Metrics data are internally gathered, collated and aggregated.

PMI's Management Responsibilities

PMI's management is responsible for both the subject matter and the reporting criteria as well as for the entire reporting process of the selected information in accordance with the criteria. This responsibility includes the design, implementation and maintenance of related internal control relevant to this reporting process that is free from material misstatement, whether due to fraud or error.

Our Responsibility

Our responsibility is to perform a reasonable assurance engagement to express an opinion on positions in the related Business Transformation Metrics table on page 25. We planned and conducted our engagement in accordance with International Standard on Assurance Engagements (ISAE 3000) (revised) 'Assurance engagements other than audits or reviews of historical financial information'. That standard requires that we comply with ethical requirements and plan and perform our procedures to obtain reasonable or limited assurance whether the related Business Transformation Metrics summary was prepared, in all material aspects, in accordance with the reporting criteria

Our Independence and Quality Control

We have complied with the independence and other ethical requirements of the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants, which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

Our firm applies International Standard on Quality Control 1 and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

Summary of work performed

Our assurance procedures included the following work but are not limited to:

- Reviewing the application of the internal financial reporting guidelines
- Interviewing PMI representatives responsible for the internal reporting and data collection
- Test a sample of data from PMI operations in Switzerland, Japan and Germany concerning the completeness, accuracy, consistency and classification as Smoke-Free Products
- Inspecting relevant documentation on a sample basis, including PMI policies, management reporting structures and documentation
- Reviewing and assessing the management reporting processes for Business Transformation Metrics data and consolidation and their related controls

We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our assurance conclusions.

Reasonable assurance conclusion

In our opinion,

- The internal financial reporting guidelines are applied in all material aspects as published on page 24;
- The internal reporting systems to collect and aggregate the Business Transformation Metrics data are functioning as designed and provide an appropriate basis for the reporting; and
- The data and information disclosed in the Business Transformation Metrics table on page 25 give a fair picture of PMI's Smoke-Free Product performance.

Lausanne, May 9, 2018

PricewaterhouseCoopers SA

Richard Thomas

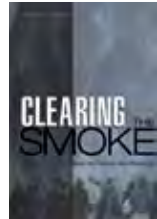
Raphael Rutishauser



Key developments since 2000 towards a smoke-free future

Late 1980s: PM USA commercialized Next, a nicotine-free cigarette

It failed to satisfy consumers and was later withdrawn



US Institute of Medicine publishes "Clearing the Smoke"

It concludes that "reducing risk of disease by reducing exposure to tobacco toxicants is feasible"

PMI expands R&D on smoke-free products

The first e-cigarettes are commercialized in China

Pre 2000s

2001

2003

2004

1996: Launch of Eclipse in the USA by RJ Reynolds

The first attempt at a heated tobacco product, using a carbon tip; consumer acceptance was low, and the product was withdrawn

1998-9: PM USA and PMI launch the first electronically heated tobacco product, called Accord in the USA and Oasis in Japan

Consumer acceptance was low, and the product was subsequently withdrawn



Adoption of the WHO Framework Convention for Tobacco Control (FCTC)

It defines "tobacco control" as "a range of supply, demand and harm reduction strategies that aim to improve the health of a population"



The Cube R&D facility in Neuchâtel, Switzerland

PMI opens The Cube, a new R&D facility dedicated to smoke-free products in Neuchâtel, Switzerland

2006

2006-7: Launch of Heatbar by PMI in Switzerland and Australia

Heatbar is the second generation of electronically heated tobacco products; consumer acceptance was low due to the bulky device and sub-optimal taste, and the product was withdrawn



2007



UK Royal College of Physicians publishes a report on tobacco harm reduction

It states that “nicotine itself is not especially hazardous” and that “if nicotine could be provided in a form that is acceptable and effective as a cigarette substitute, millions of lives could be saved.”

2009

US Family Smoking Prevention and Tobacco Control Act

Provides authority to US Food and Drug Administration (FDA) to regulate tobacco products and creates a regulatory framework for the commercialization of “Modified Risk Tobacco Products”



PMI's R&D facility in Singapore

PMI opens R&D facility in Singapore dedicated to assessing smoke-free products

US FDA releases draft guidance on evidence that should support a Modified Risk Tobacco Product Application (MRTPA)

PMI completes multiple five-day clinical studies on IQOS, one of its smoke-free tobacco products

Smokers who switched to IQOS reduced their exposure to harmful chemicals, on average to levels approaching those found in smokers who quit for the duration of the study



Launch of PMIScience.com to share PMI's research methods and findings

2010

2012

2014



PMI launches IQOS city tests in Italy and Japan

PMI acquires Nicocigs Ltd. and enters the e-cigarette market in the UK

PMI announces its first new factory dedicated to heated tobacco unit production

PMI invests USD 680m in its first purpose-built factory for heated tobacco units in Bologna, Italy

EU Tobacco Products Directive II adopted

establishing specific rules for marketing "novel tobacco products" and electronic cigarettes



PMI launches an e-vapor product, Solaris, in Spain and Israel



Public Health England publishes a report on electronic cigarettes

The report concludes that e-cigarettes are significantly less harmful than cigarettes

PMI's CEO announces ambition to convince all adult smokers who intend to continue using tobacco products to switch to smoke-free products as soon as possible

JT launches PloomTECH in Japan
a hybrid e-vapor product

PMI city test of MESH in Birmingham, UK
an innovative e-vapor product



In Japan, HeatSticks for IQOS achieve a 10.8% or 13.9% in Q4 2017 market share in 2017

PMI reaches 200 peer-reviewed publications and book chapters on the science around its smoke-free research

UK Department of Health publishes five-year tobacco control plan

welcoming innovative technologies that minimize the risk of harm for smokers

Launch of the Foundation for a Smoke-Free World (September 2017)

FDA announces comprehensive plan to significantly reduce tobacco-related disease

recognizing that innovation can lead to less harmful products

2015

IQOS available in six markets

launches in key cities in Portugal, Romania, Russia and Switzerland

PMI completes two three-month clinical studies

in the US and Japan on IQOS, confirming results from the earlier five-day study

2016

IQOS available in 19 markets

launches in key cities in Canada, Denmark, Germany, Greece, Israel, Kazakhstan, Monaco, the Netherlands, New Zealand, South Africa, Spain, the United Kingdom and Ukraine

BAT launches Glo in Japan

a heated tobacco product

PMI submits an MRTPA for IQOS to the US FDA

More than 1m adult smokers have stopped smoking cigarettes and made the change to IQOS (December 2016)

2017

KT&G launches its lil heated tobacco product in South Korea

UK Committee on Toxicity (COT) issues report on heated tobacco products

The report concludes that, while still harmful to health, they "are likely to be less risky than smoking conventional cigarettes"

Pilot test of PMI heated tobacco products TEEPS in the Dominican Republic (December 2017)

IQOS available in key cities in 37 markets and nationally in Japan

Nearly 40% of global commercial expenditure is dedicated to smoke-free products

More than 4.7m adult smokers have stopped smoking cigarettes and made the change to IQOS (December 2017)