

CEO's Presentation

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Slide 1 – Agenda

Good morning everyone. What my colleagues and I would like to do today is first of all reiterate and explain to you why we believe that our dual strategy of leading both a smoke-free product category and obviously our existing business is what makes eminent sense from a consumer perspective, from a business growth perspective, obviously from a shareholder perspective and for society at large, and would make our business even more sustainable than today. We will show the progress we have made on the regulatory front because that is obviously something that can seriously accelerate people switching to the new category.

Although we all know it is still uncharted territory for many governments, both NGOs and people in public health but there we are making very steady and good progress. Although clearly there are still skeptics and we will discuss about that. I guess the category is new for many of you here, investors and people that do the analysis, so we will try to give you as much granularity as we can in the economics of our RRP products, starting with IQOS.

I know there is a concern amongst shareholders that we have a lot of investment in this category and indeed we have built the necessary infrastructure for us to be able to execute in terms of product pipeline, getting the products to consumers, improving efficiency and effectiveness in the way we do it. However, this infrastructure can carry much more volume and I will show you the leverage it has.

I also know that there are concerns that I am sure we will discuss during the breaks and the Q&A regarding, where is this category going? Is the fact that some companies lead and some companies may have different positions in their smoke-free products going to trigger unusual behavior or price wars in the cigarette category? I do not think that is a concern or it makes sense and I will try to explain this to you. Without sounding dismissive, it is like trying to fight with the horse prices the new cars. That is what we want to cover, and also I am sure there will be discussions about e-vapor and Juul. I will tell you upfront we are not concerned about Juul and we will explain why. Except for the impact and the hype that has been around teenage use of e-vapor products, which has to do with marketing practices rather than anything else. Clearly we want to distance ourselves completely from this situation.

Slide 2 – PMI: Strong Business with a Strong Future

I think the opportunities presented by smoke-free products or in other words scientifically substantiated reduced-risk products is enormous and undiminished. For sure, as I said many times, the category is at its infancy. Like any new category that is at its infancy, the growth rates are going to be there but we will have slowdowns and accelerations. Some of you were not there when mobile phones started but they did not grow like this. They went like this very often. VCRs, computers that you have in front of you and even Marlboro did not go all the way like this. It took time. However, because that corresponds to the need of the vast majority of consumers, I think this is what the future is.

Our goal is to convince every person who smokes today and would not quit or continues to smoke to better alternatives. For that we need governments, regulators, NGOs, everybody to help because if we obtain the right regulatory environment we will both avoid issues like the one raised recently in the US with the FDA and electronic cigarettes, have a level playing field, but most importantly there will be supply and demand measures, from fiscal to the way we communicate, to more marketing freedoms, that can accelerate the move.

I know that investors say we talk a lot about reduced-risk products and very little about our existing business. First of all we do not talk much because it is doing very well. However, myself and Jacek will spend a bit of time explaining to you why we believe we are in a very good position.

Slide 3 – PMI's Strategic Priorities

I think to succeed in this new world we need fundamentally four things. The first, in order to convince the people who smoke to switch, you need product. Product that is differentiated, superior in terms of taste, satisfaction and overall user experience in today's world. In the past we called it marketing. Today, delighting the consumer in every interaction they have with your company through all your assets, digital or non-digital, is absolutely the way to go. Frankly speaking, we are learning every day. However, if we had not put a product like IQOS on the market years ago, we would not have learned what we have learned today. I will come to this.

All our products will be anchored in superior science and technology. This is very important for consumers. We may not feel it today because some of you have asked me, 'Why are you spending all this money? Some of your competitors spend less in R&D or in substantiation and they still follow your lead.' Temporarily that may be the case, but I think at the end of the day most governments will require the same thing as FDA requires. Then we will have the data, and data that not only applies to one product. It is data that is the base for you to do what we call bridging. Any new product, if you demonstrate its aerosol characterization, for example, and other pre-clinical, are similar to what you have already submitted, then you do not need to go all the time through the entire battery of tests including clinical studies that are the most expensive. These data sets are owned by the company that produced them, not by the others. I think that reassures consumers over time and differentiates products.

Then there is a lot of work, because to convince people to switch you do not just need to tell them this is the product. You have to work on creating awareness or understanding and you will see from Jacek's presentation how much difference you have between people who just have heard about IQOS and the ones that really start understanding the benefits. There is a big difference there and over time for a consumer, 'I understand your product. Maybe I am interested. It is relevant to me.' For various reasons. It can be health. It can be not bothering the others around you. It can be the way you project yourself. However, at the end of the day I have to believe you as well, and that is why the science is important. The way we convey the messages is important and that is something we are learning also. This is now how you build and you can deploy all the time.

The second, as I said, is today there is clear debate still whether this product should be made available to consumers. I think that is very particular. It happened before in other categories but this is particularly acute, and you all know, in our category. There is too much past, too

much emotion, I think, and too much adversarial relationship. However, at the end of the day, the debate should not be whether these products should be available if they are substantiated scientifically. The debate should be, what is the best way to bring them to market so that consumers are not misled? We have a lot of misleading of consumers with this debate. They understand what these products are and what they are not because they are not risk-free, how to use them and most importantly also with the right regulation, minimize the unintended consequences like increases in teenage smoking, people relapsing or less people quitting.

I think this is a little bit the dilemma or the situation we are in in the US, when the only alternative product available to consumers today is e-vapor products. However, because of the timing the FDA took jurisdiction over these products, the e-vapor products have not been through the regulatory process. The post-market surveillance, the pre-market approvals, the PBAs, all these things that we have to do before, including the review of the product's characteristics, its looks and so on, have not happened. They can only now intervene post-market and they did very forcefully. That is the situation we are in. If we have a regulated product, I think the checks and balances can be in place from the beginning and that is what we are advocating to avoid the situation we have just now.

Thirdly and most importantly is the transformation of the organization. Without this, nothing can happen. What we are doing and we will go into more detail, we are clearly bringing in technical skills. We have new disciplines, life sciences, electronics, connectivity, cognitivity, data analytics, things that were embryonic before. Consumer-centricity, user interfaces, all these kinds of things require technical skills that we are bringing in from top industries.

The second is, I would say we need to achieve three things. Be faster, because we are very good but sometimes we are slow, learn faster and be more efficient. When we started the IQOS journey, clearly we had to go to market. We put in a lot of incremental resources, new people, new processes and new things. Now we have an opportunity, as we move to new ways of working like project-based organization and lean techniques, to also create efficiencies.

Digitalization helps you improve internal operating efficiency but also the way we go to the consumers. Our initial operations were extremely manual. More coaches to scale up, more people in the call centers, you name it. Now that we digitalize obviously we have the ability to scale up much faster and with lower costs. That also gives room for productivity or cost reduction initiatives and Martin is going to talk about that.

As I said a few times and I repeat it, we will compete with more focus obviously in our combustible business to maintain our leadership and make no gifts for our competitors. Although we all know if the RRP's grow, the category will naturally decline.

Slide 4 – PMI's Strong Combustible Business Enables the Strategy

This is what I was saying. You all know that, yes, the RRP's are growing, profitability is growing, but the combustible business is still the lion's share of our business. We will give you a three-year mid-term perspective. Still, that will be the predominant part of our business. Let's face it, if we had started without this business we would not be in 40 markets because we would have no access to consumers; the infrastructure we have, although we need to supplement it with new things; and the money. For us it is important to maintain the

leadership of the category, and as you will see and I will show you in a second, we have the pricing power. It is intact although the volume is a bit smaller, but still an average of 6.5% price variance reported always on the combustible revenue base. It is still very good. Industry decline is 2-3%, so I think we have maintained our share even in the markets we have the RRP in. There is always concern about this reallocation of resources. Yes, we could reallocate resources, and we did.

Slide 5 – PMI: Robust International Market Share

This one I wanted to show you. This is our international market share and it is very clear with the advent of IQOS as the first RRP on the market, we are increasing our total share. IQOS is already 1.5% worldwide share excluding China and the US. That would place it almost in the top ten cigarette brands if it were a cigarette today. Given premium I have not seen anything since Marlboro that has achieved this. As I said, the two categories are not comparable but I think it is remarkable.

This is what has happening in the markets where IQOS is present. This is essentially European Union, Russia, Japan, Korea and a few markets in Latin America. They roughly represent one billion units of total market in total consumption. We are doing pretty well despite the cannibalization we naturally have that is a little bit over-indexed at the beginning.

Slide 6 – Strong Combustible Business with a Focused Approach

What we have done in reallocating resources is, first of all, doing it smartly on a market-by-market basis when we launch reduced-risk products. There is a big difference between a country like Russia, where if you take your field forces massively out of the combustible business and move them into RRPs, you will have an impact on your market share. To Germany where there are big key accounts with central agreements, where you can have more freedom to move people.

The second thing is, we have defined the innovation corridors in which we launch new products. We are launching less new products, but as Jacek will show you, the success rate out of these new products is much higher than we used to have before. Our people have more time to work on the brands. If you launch five products in a year you can spend three months on every launch. If you launch two you can spend more. Yes, your chances are lower but the time you have to work is bigger and if you are more focused you are more successful.

Then we have done a lot of morphing, especially in the European Union. We moved many of the local or less important brands into the international brands, which provide a scale because they are developed centrally, and that makes sense. Wherever we could, and we will continue doing, we automated the interactions with the traditional trade so we can free up people's time.

I think now if we look at the markets we are present in with the RRPs, we have optimized this reallocation and I do not see significant reductions anymore in the resources we put behind the combustible business. If it is needed, obviously we will invest resources to maintain our position.

Slide 7 – Ahead of Plan with Smoke-Free Future

Now, let us start talking a little bit about numbers before I talk about governments, and the RRP portfolio and technology. At the 2014 Investor Day, I made the projection that by 2020 we will be between 30 and 50 billion heated tobacco units. In the markets and scope we set today, it just so happened that their volume is exactly the volume of the markets we are in, one billion. That would correspond to 3-5% share of market. We are there ahead by two years if we look at our in-market sales.

Slide 8 – RRP: Our Future and Most Promising Growth Opportunity

The most important part is that there are 5.8 million smokers who have quit smoking completely. They do not use cigarettes and they have switched to IQOS, and a further 2.8 million that are using increasingly less combustible products and moving into heated tobacco products. However, we are scratching the surface, as I said. We are only 4.5% of the almost 190 million consumers in these markets and there is one billion worldwide. It is always the first step to have a big journey. I am just saying the size of the opportunity obviously is high and although there are various degrees of speed – I will come back to this – in different markets, this product is growing everywhere.

Slide 9 – RRP: Our Future and Most Promising Growth Opportunity (cont.)

Now this slide requires a little bit of explaining not to get it wrong, but I tried here to give you a little bit of detail on how you should look at this business. I will take you through it. First of all, we had to set ourselves a realistic mid-term target for heated tobacco units. Of course, there will be as well, and we will discuss this here today, the e-vapor category. There will be additional volume in there, but I tried to focus here on these products because that is what you need to understand and probably it is of interest to you today to understand that.

If we take an additional ten billion units of annual sales of HeatSticks, that corresponds to roughly two million consumers annualized. Consumers are not acquired in January. You acquire consumers during the year but on average if you have a linear progression, a consumer consumes half of HeatSticks this year and half next year. If I annualize the ten billion that corresponds to roughly two million people. If I want to have ten billion in one year I need three million people, by definition, because I have half of the year in. If I look at what this brings to the revenues, ten billion HeatSticks and two million people bring HeatSticks consumption at revenue level which is roughly \$0.9bn.

However, at the same time they also bring additional sales of IQOS devices and at the same time there is cannibalization. It just happens that the additional IQOS devices, the revenue from them, offsets the revenues from the cannibalization of the combustible products. I am talking here in the markets we are currently in and at current prices and current excise taxes, but that is the drill.

Obviously this is happening at the revenue level. At the margin level – we all know IQOS heated tobacco units have higher margins than combustible. At the margin level, obviously you add the margins of the heated tobacco units. We know today that despite the accretion at the revenue level of the devices, they have a slightly negative margin. Let us assume that for the future we continue having the same, although clearly we are hopeful we can turn into positive margin. Let us take for the moment that it will be negative and obviously you have the negative margin of the cannibalization, roughly \$0.6bn marginal contribution. However,

marginal contribution – revenues net of any allowance, it is cleaned revenue, minus variable costs of producing devices and obviously the heated tobacco units.

Now on a slightly different basis, the next bullet point or hyphen is a comparison between what a clean ten billion heated tobacco units, after cannibalization, brings compared to ten billion incremental sales of cigarettes in these markets, if we ever managed to do this, which we never did. You can see very clearly the accretion at the revenue level of the heated tobacco units and the even higher accretion in leverage to the margin, which explains obviously the higher margin they produce, versus the combustible products. They make sense, that is all I am saying.

Now the question is, this is wonderful but how do you spend this money and how much comes to the bottom line? If I look at our current fixed or semi-fixed infrastructure, because there is no such thing as a fixed infrastructure forever. Let us take a two- or three-year horizon, and in the fixed infrastructure, I have put all the fixed manufacturing expenses because we built the capability today to produce more than our current 45.6 billion units in-market sales. I have the digital infrastructure in there. Obviously, the stores or the direct stores we have. I even put there R&D, which typically you do not put under this thing because it is general stuff, but most of our R&D is RRP R&D. Our R&D obviously depending on the projects we run because some of them are long-lead, may vary in any given year. However, overall this infrastructure today is 70% of all the costs of IQOS on a worldwide basis. Only 30% is variable. Jacek will talk about the view from a market perspective because what I am trying to give you here is a classical, Philip Morris, P&L view of the world. Jacek will give you the consumer perspective view. How much the cost to acquire a person, the royalty and how much lifetime revenue you get and why it makes also total sense.

All I am saying here is, of course, even the fixed can vary a little bit, but that can carry the entire projection we have quite safely. The leverage we have going forward is much higher. On the variable side, if the volume goes up 20% you do not have to increase your expenses by 20%. I think with digitalization and everything else we can do a better job going forward of scaling up. Was that clear? Thank you.

Slide 10 – RRP: Public Health at a Pivotal Moment

Now let us move a little bit onto the regulatory and public health side. You heard me saying this many times, but I think scientifically-substantiated reduced-risk products are an absolute supplement and inseparable from the restrictive regulatory measures that have been implemented so far. Restrictions have decreased somehow or contributed to decreased consumption, although the biggest contributing factor is pricing. However, they are not resolving the problem. These products can resolve the problem much faster.

The fundamental question, as I said previously, is not whether this product should be available. Yes, there are a lot of adversarial views and I will show you one in a second, but at the end of the day consumers have the right if there is a better product to have access to it and be informed about it. Regulatory measures and taxation do influence consumer behavior. We know that.

The first thing is to clearly state and admit that all tobacco products are not the same. Yes, tobacco can be harmful, but there is a continuum in the tobacco products and obviously there is a continuum in all nicotine products, by definition. All are not the same, and there is an

increasing tendency and trend to say, 'Yes, it is logical that they should be regulated and taxed accordingly.' We are far from having unanimity in the subject, but I am hopeful we will be getting there because at the end of the day it is logical.

I am not saying it is done, but I am saying it makes sense. We see the UK moving in this direction and others. It will take time, and I am not counting on this when I project three years. However, if it happens it is nice to have the icing on the cake or cherry on the cake.

We all understand and we had this discussion with many of you, that this is a complex issue. Regulating these products is not an easy thing. Many regulators around the world have never done it because tobacco control in the past was increasing the health warning or doing a display ban, or ultimately having plain packaging. However, the blueprint from the FDA exists. Others can move in, so I think even the European Union has a bit more succinct regulation but the principles are there. I am hopeful we are moving there.

Slide 11 – RRP: Public Health at a Pivotal Moment (cont.)

Yes, there is skepticism, and the recent event in the US clearly gave a lot of ammunition to the skeptics, undeniably. Despite all that, I think at the end of the day, the discussion should be how we can minimize these unintended consequences, because it is possible that if we have products that are previewed and then we have the right protocols, if we focus on the most disturbing thing – that is increased use of nicotine by teenagers – I think if we have the right protocols so we study exactly what is happening and why it is happening, it is much easier to act. If we take the example in the US, we had a lot of speculation initially and a lot of hype and media talk. At the end of the day, this very talk makes it even more desirable for teenagers to use. If we had done the job properly without emotion and with the right studies and protocols, I think we would have had a bit cooler action plan than today. That is what I am calling for: the right protocols and sound science so we can act. I think we can resolve this problem.

Frankly speaking, I think this should not preempt the product from reaching the market because there are still the bulk of smokers today that have the right to get this product. I think that the debate is the wrong debate, as I said. But, this debate is continuing.

Slide 12 – RRP: The Single Most Impactful Tool in Reducing Cigarette Consumption

If we look at RRP not from a financial perspective but from a perspective of reducing cigarette use, which is the public health perspective. If you take Japan, this is the single biggest intervention that has ever happened in this market since regulation has started. By the way, the post-market surveillance in Japan that we are running on thousands of consumers, shows that there is no change in any of these concerns – teenage uptake, relapse or quitting.

This is what is happening in the market in Japan. If you look at total prevalence based on total market, we do not see any dramatic change with the advent of IQOS. We are still hovering around 2%, 1.8% reduction of total volume. However, there is a 22% decrease in cigarette use and I know no market on earth that any regulatory intervention has ever achieved that effect.

Slide 13 – How is This Going to Convince People who Smoke to Change their Behavior?

We are still not there. I do not want to be provocative here, but I do not understand how this statement can make any consumer on earth change behavior. I hope that sooner rather than later we will move the debate from a very adversarial relationship, which I can understand given emotions in the past, to a more adult conversation that is centered upon the interests of people and not whether I like Philip Morris or dislike it. I hope we will get there one day. That is the constellation of, I do not like them.

Slide 14 – Korea: Deceptive Statements Mislead Consumers

There is another problem that is even more acute, and this is the problem of scientific studies that we discussed already in this room and with you individually, that have the effect of dripping down to the consumers. I do not think we have any problem with scientific debate, actually we invite it with full transparency. What we have a problem with is when studies that are unsubstantiated or purposefully done to demonstrate something are sent by the media and the social media to consumers. Then we see reaction.

The Korean FDA analyzed our products, found that the reductions in harmful substances was in line with what we had found. However, all of a sudden they said their tar is the same as cigarettes. Tar, as you all know, is the measure that consumers naively have in their heads based on cigarettes. They look at tar full flavor, they look at tar lights and for them less tar is better, which is incorrect, and similar tar means the same product. Tar is what is left in a pad after you filter the aerosol. If you take water that has sugar at 5 grams, or benzopyrene and everything in the same quantity they will have the same tar, but it is not the same composition of the tar. The end result of that is we rebutted it, and the BfR and other institutions, including WHO, have said tar is not a measure of comparison, but they used it. What was the end result in Korea? Less people enter the category and many people that were in conversion went back to cigarettes. You see even some consumers using less heated tobacco products and more cigarettes. I think this is a temporary phenomenon but who is accountable for that? That is the problem.

I think there is work to be done there but in between we are going to have all of these ups and downs undeniably. There is less and less of this science coming out and we are getting better and better in opposing it. We have to all understand, also for you, that what the media and what we say, it takes a week or ten days for our scientists before they can – from a scientific purity perspective – give an answer because they have to review all the data, although we know from day one that this is not correct.

Slide 15 – RRP: The Growing Weight of Our Scientific Evidence

On the other side, there is the positive part. First of all, we have completed all the sets of data we needed on IQOS. Mirek is going to go into more detail on the clinical studies, but essentially we had promised the world and especially the US FDA, after TPSAC, we will submit subsequent studies: the six-month clinical exposure response study and the first-ever study on mice on lung cancer, and both demonstrated IQOS, at least for the clinical exposure study was successful and demonstrated reduction in metabolites of disease or precursors of disease. And the lung cancer on mice showed that there is no difference between the mice exposed to IQOS and air. I think this completes the set.

So this completes our submissions to the FDA. The package now is complete and we are awaiting both the decisions on PMTA and MRTP. We are hopeful that PMTA may happen before year-end, because I think also there the questions have finished. This is up to the FDA to decide on the timing.

Slide 16 – Evidence-Based Conclusions of RRP are Encouraging

I said this is the positive part. First of all an increasing number of third party laboratories evaluating the product are coming with conclusions very similar to the conclusions we have. An increasing number of positions, Mirek is going to go more in detail, from governments that RRP as a supplement to other public health measures makes sense.

Slide 17 – IQOS Portfolio Brand Architecture

Mirek obviously is going to go through much more detail here, but I want to explain to you very briefly the architecture of IQOS. First of all, IQOS is the umbrella brand that we will use for all platforms and all emanations of these platforms. IQOS essentially stands for sensorial satisfaction, superior user experience and solid scientific substantiation for any product we will put on the market. This is the reason sometimes we are a bit late, like we were with the MESH product or e-vapor, because as we are building a brand we cannot put any products on the market. It is now that we feel comfortable we have the first variant of e-vapor product that – first of all – resolves many of the issues of reliability, repeatability, manufacturing and better sensory, which is the MESH product. Mirek will explain more. However, also a set of liquids that none of them has anything characterizing or anything going closer to what we have seen in the US, but still very complex flavors. I think we resolved the vaporization system that is superior to the existing products on the market. We are working on the next generation also of liquids and tastes. You will have the opportunity, for the ones of you who use e-vapor, to try them today, although they are not yet in the market. They are coming.

This product is already in the UK, but what I want everybody to understand is we are very serious about the category. We do believe that amongst our platforms initially heated tobacco products, because of their taste, satisfaction, nicotine delivery, are the closest to cigarettes and they can switch smokers easier. That does not mean the other products do not have a role to play. Clearly there is a category electronic cigarettes. I am sure we will discuss Juul, but what we tried to do here with the MESH is to start bringing differentiation in an undifferentiated category.

At the end of the day, to succeed you need a superior product or service and you need brand equity, in any product category. If you do not have these two you cannot have high margins. Putting Juul in parentheses, the e-cigarette category worldwide is fragmented. There is no technology differentiation, not even Juul is different technology. There was no branding, so the only way to lift the category in the minds of people is to do the two things I was explaining. That is precisely what we are trying to do. That is why we use IQOS because IQOS is the brand.

Between each of these categories, clearly there are products in the pipeline for the next generation, for improvement of the current generation of these products. It is not only one. Mirek is going to talk more about this, but obviously we have announced the next version of IQOS that you will see today. This is not a core engine heating system change. It is a vast improvement in everything else including consumer interface. However, we are also working

on the next generation of heating technology for heated tobacco products, which will have one advantage also that it will have HeatSticks recognition. Nobody can use another heat stick with your product or vice versa. That is very important given what is happening just now.

Slide 18 – RRP: Key Innovation Corridors

I wanted to outline here the corridors of research for everybody to understand. The first is research on what I call the core engine technology, how you vaporize the product. Be it a liquid or solid substrate, tobacco, or none of those, nicotine salt like P3. The second which is even more important and something that we have neglected initially when we came with IQOS, is the consumer interface, the interaction, apps and all these things were not really there. Our effort has been to reduce the risk and clearly as our knowledge of consumers, data from them and everything evolves it is pretty clear. We understand that the interface and the way people interact with the product is equally important, so that is what we are working on. Ecosystem is the entire system that surrounds consumers in terms of services and everything. There is a lot of work to be done there, and consumer care before and after, for retention in particular.

One objective we had and I had announced to you since the beginning of this journey, is that one day, except probably for P2, we can use with the same device all consumables. I said that there is a time for every platform but it is also a situation. You can very well imagine that a user of IQOS heated products in certain situations, times in the day or moods, wants to use something else, something that does not produce any cloud or anything, like P3 or P4. Actually, we see it even in the office with P4 – some people from time to time, IQOS users, use P4 as well. It is both over time as people move out of cigarettes they move to other products, but also in space, where it is important to get results.

Of course, we have life sciences that we can leverage over time. I will not elaborate further on that. Data and digital assets is something that has been new to us. However, it allows us, as I said, to scale up, replacing some of the initial legacy operations that were all manned or “analog,” as Jacek says. At the end of the day, we are building a very strong technical expertise in areas that we were not in five years ago or they were in R&D partially but nowhere in the rest of the organization. We are looking at developing strong partnerships now. We work with top-notch manufacturers of electronics that have expertise and can provide help. We are always looking at promising technologies or start-ups because we are not going to invent everything ourselves. I know you are all concerned about disruption from a start-up or something. I think there is possibility too, if there is something promising that I have not seen so far. For speed and efficiency, as I said, project-based organization, and so on and so forth.

We have very strong intellectual property. We will defend our intellectual property. We are doing it in Japan and we will do it in other places. However, this is not enough. In today's world, I do not think technology stays put for 17 years and nobody invents something else. The real expertise, in addition to the IP that we are building is the know-how of the organization of how to deliver superior consumer experience. That is what we are learning every day and that is what we are gearing the organization to deliver. That can service all our existing businesses and any new segment or adjacencies we open in the future. I think we are not there yet, but we are on the right path to get there.

Slide 19 – RRP: Our Strategic Focus

I think I talked about many of these things. I will just repeat once again that you cannot compare what has happened in a fragmented industry that was small companies starting it, like electronic cigarettes, to what is happening in the heated tobacco category, or even if we enter with a superior product that is brand equity, the e-cigarette category. I said if you do not have a brand or you do not have a differentiated technology or differentiated taste, other than putting some flavorings in a liquid, it is very difficult to have a successful, growing business. I was told that the UK electronic cigarette business has 40,000+ SKUs. There is room to consolidate here in the future but for that we need the two things I described.

I think the trade margins that electronic cigarettes initially had to pay to get into the traditional trade wiped almost three quarters of the tax advantage they had because some of them were not paying taxes. I think here in the heated tobacco category, and the ambition is to get somehow there with a superior product in e-vapor, is that the products provide superior taste and satisfaction. They have a very high conversion rate, which means people can justify the time, effort and money they put in converting. That is the question we get in the markets where e-cigarettes or e-vapor products existed before. They say, 'Okay, I tried five times in the past. Convince me that this time I will try again, I pay the money, I will try again to move out of cigarettes. It takes time. It takes two or three weeks and a lot of care. This time it is worth it.' The best credibility you have is because you can demonstrate that there is a lot of people that have tried and stayed with the product. The rates were at 70-80% compared to 20-25%.

Our job here is not to sell a product. It is not to sell IQOS devices. That we could sell much more. It is to sell them to people that are convinced and want to make the effort. Then they will stay with the product. Very often when you have hype products, people buy them because it is hype but then they do not use them. That is not the purpose here. More so because clearly our devices are expensive. The time, if somebody just buys the device, is not justified.

The dynamics of the heated tobacco category are different from e-vapor category. The margins are better, the products are more regulated and they will be more regulated. The characteristics there that lead to fragmentation and margin dilution, I do not see them. I have not seen one place yet where there is one heated tobacco product that margins are inferior to cigarettes at the same pricing. Yes, over time we need to cater to every consumer. We will discuss Japan. We need to enter the heated tobacco category with a lower price product. Not a problem. We have it in cigarettes as well. If you go to a lower price you have a lower margin but it is always a better margin than cigarettes.

Slide 20 – RRP: Our Strategic Focus (cont.)

I think we covered most of these points in this conversation. The only thing I will remind you is, yes, there is initial effort to acquire consumers. It can vary from \$200 to \$1,000 in the initial stages. I told you these numbers before. However, the payback is very fast because people stay with the product.

Slide 21 – RRP: We Hold a Strong Interest in the E-Vapor Category

I think we covered all this and I think, as we were explaining, I covered also our approach to e-vapor. We are serious about it. We wanted to offer a product that we can start

differentiating technologically and has a branding that can be built. More of that to come. Mirek will explain better the category, including the technology that underlines the liquids so we all understand where we are, including products like Juul.

Slide 22 – Improving our Internal Capabilities

The important thing here, as I said, is we are an organization that is bringing new technical skills, but also we realized very clearly that the old traditional organizational structures of functional silos, yes for certain transactional things they operate but in reality to get any project done today given the complexity you need to put together different disciplines. It is a project-based organization that we are moving to, using a lot of digital, both to get consumer data, get the information out, analyze and scale up. That gives the base for a zero-based budgeting approach that we are going to implement in the months and years to come.

We have set ourselves also some targets to achieve financially out of this exercise. Although the key thing on the exercise is, the new working methods bring speed and better consumer outcomes. Martin will talk about that.

This is an organization that will be fit for purpose in anything we do in the future, including our existing business. Many of the things we do, do benefit the efficiency of what we do in conventional as well. We should not underestimate this.

I need to align the organization behind the RRP, but everybody keeps a very strong eye on the way we run our conventional business.

Slide 23 – Sustainability at PMI

A few words about sustainability. We issued our sustainability report. I think we have done a very good job on that. However, the most important impact we can have on the sustainable agenda of the United Nations is clearly the product change. That is the biggest impact. We are working on many others, from climate and diversity within management. We are the only company that soon is going to be worldwide equal salary certified. Not a de minimis achievement, I would say. However, again, the biggest contribution we can make is the smoke-free future and that is what we are working on.

Slide 24 – Mid-Term Performance Expectations

Coming with our outlook a little bit, the RRP clearly play, as you have seen, an important role in the profitability, revenue and margin. I hope that was given with sufficient granularity to all of you. But, there is volatility in the RRP, as we have seen this year. When we build the expectations or our objectives for the years to come, clearly we have to take into consideration this parameter.

We assume in our projections that the industry will continue declining at a rate of 2-3%. I am talking total consumption. I think the pricing power of our existing business is strong. The portfolio is very good, so we do not think we can lose market share. Actually, we can gain in the category, but the category will naturally go down over time because of the RRP.

RRPs vary because we have different diffusion curves, progression curves based on culture obviously. Germany is not the same as Japan. The relevance to people or the motives why they want to move to the category vary. You have markets where the vast majority of consumers still need to be educated about the health effects of cigarettes. I am talking certain segments in the Philippines or Indonesia, and others with higher degrees of readiness.

We have different speeds of word of mouth in different markets and, as we have seen in Japan, we are not alone anymore in the category. There will be new offerings so the offerings lead to consumer experimentation. That is natural. However, the new offerings also make certain consumers that will come into the category wait a little bit until the dust settles so they know with what they enter. However, that is natural, as in any category. It has a bit of a dilutive effect as consumers try different things. You can see it in Japan. People had IQOS. We had reliability problems we have fixed. People say, 'Okay, maybe as a second device instead of buying IQOS, I buy Glo. I try a bit of Glo.' We have some dilutive effect, but there is one reality. People do recognize that this is the best and most satisfactory product.

Korea is the poster child, where many people buy a device from a competitor. It is kind of compatible, but they use HeatSticks. I think we have the superior product. We will continue to have the superior product, but this churn dilutes a little bit and can delay the curve. We took all this into consideration. I think also sometimes, as I said, I do not think we have done all things right in places like Japan, in terms of how we marketed the product, how early we should have intervened in anticipating that we are reaching the most conservative consumers. Move more emphasis to retention, rather than only acquisition. However, these are learnings you can integrate and you do a better job the day after. I repeat, if we were not in the market with these products, which I think have had phenomenal success, we would not have learned anything. Sometimes you have to slow down a little bit in order to run faster after.

Slide 25 – 2019-2021: PMI Compound Annual Growth Targets

These volatilities are reflected in the way we are going to look at the future. We decided to give two metrics because all the others are related. We said essentially we will look at a 5%, or higher obviously, compound average growth rate over the next three years and adjusted EPS growth of 8% on a compounded average growth rate ex-currency, obviously, both of them. The underlying assumption here is, as I said, the industry is declining at 2-3%.

What I want to say here is we made this as simple as possible. We think this is a realistic base for all of us. Martin will give you much more detail under each metric, so I do not want to spend more time on this. I think this is something achievable. There will be fluctuations from year to year, but I think that is a good guidance for what we think we can deliver as a base. Obviously there is upside if things go our way faster and better.

Slide 26 – Our Confident Outlook

Thank you very much for your time with me.

[END OF TRANSCRIPT]