

## **COO's Presentation**

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### **Slide 1 – Opening Remarks**

Thank you. I was asked on numerous occasions that I should speak slower, so I will try. It doesn't mean that I don't feel good. I feel good, okay? I was just asked to speak slower. I may not comply fully for the 1-hour presentation.

### **Slide 2 – Operating Around the Adult Consumer**

### **Slide 3 – Operating Around the Adult Consumer**

I have three subjects I want to cover. One is the continued strength of the combustible business, the remarkable results which we have on RRP and the impact which the journey towards the RRP, and the impact the journey has on our organizations and what capability we are building.

### **Slide 4 – Our Eye is On the Ball: Robust Cigarette Fundamentals**

Still when I was CFO, at least for the last year when I was a CFO, in some of the one to one, or one too many occasions, I got these questions: "Are you guys keeping an eye on the ball?" I know it is an American or English expression. I will translate it into my Polish language. We do keep both eyes on the ball. It means the same, but just to make it very clear, and avoid any misunderstanding.

André talked about the longer period, 6.5% pricing variance, not many companies know it very well. You can enjoy similar pricing variance for this year, and specifically we target 7% combustible pricing variance on the combustible revenues. I think it is very strong, although there are a few markets which always there are some pricing tensions, if you like, but overall we can deliver the 7%.

We are, for many years, and we continue to be, the market share leader, 26.8% on a cigarette only, and obviously I need to add back to this one what we have achieved so far with an IQOS 20% including the heated tobacco units.

You know it very well. We do have four brands in the top ten global brands, with one brand truly, by any standards, by any definitions truly global international brand, which is Marlboro.

And, we do operate from an industry total volume perspective at the times when it is still pretty manageable, the volumes in terms of the rate of decline. You will remember we have been guiding you on a number of occasions to 2% to 3%. I think this year, we think the total industry is going to close the year at about 2.5%. And actually, if we are looking at developments in some markets as of the Q2 going into the Q3, I would not be surprised if the total industry comes even better than 2.5%, and obviously the volume share, etc., will benefit from that.

**Slide 5 – Our Strong Cigarette Brand Portfolio**

I mentioned four brands in the top four, six brands in the top 15. André did this as well, this comment. I mean, there is not much movement in the rank of the top brands in a combustible business, other than essentially for the morphings, and all of these things happen essentially at the lower-priced, below-medium priced segments. Marlboro 9.7%, followed by L&M, Chesterfield. You know how we construct this portfolio in essentially most of the markets: Marlboro and Parliament sits in the premium, and they very nicely complemented each other with the number of geographies; L&M and Chesterfield, which plays more of the role in the mid segments or below-premium segments; and Philip Morris and Bond Street which help us acting with the consumers in the lower-priced segments.

**Slide 6 – Solid Global Cigarette Brand Share of Market**

That's the performance over the last two years plus the year to date August. Despite the fact that the Marlboro and Parliament, to the large extent in some geographies have obviously the pressure coming from IQOS (i.e., consumers from premium segments going to IQOS proposition), we hold a share at 9.7%, as I mentioned, very nicely complemented by Parliament at 1.6%. It's the two premium brands doing very well. L&M holding its position in the mid segment. Chesterfield, which we remember over the last few years, we have paid more focus to Chesterfield presence in a number of geographies but also working for the brand family to extend that broader 2.3%. And, Philip Morris, which you know, over the last two/three years, we started activating that brand in the number of the geographies, including some morphings that helps us consolidating the portfolio at the 1.8%, remarkable performance. And, Bond Street at 1.2%, down very much because of some consumers going to Philip Morris and some down trading which continues to take place in Russia.

**Slide 7 – Cigarette SoM Resilient Despite Investment Shift to RRP**

That's not the chart which you typically see during Martin's earnings call. I was just trying to demonstrate how do we perform in the markets in which IQOS is present. So it's 43 markets. And, this is the question whether we keep our eye on the ball or not is essentially relevant or mostly relevant into these two places. Obviously, there is a reallocation of resources, we're taking our resources, manpower and dollar resources from a conventional business and obviously growing attentions behind RRP or IQOS propositions in these places.

So, if I take the cigarette performance, our own cigarette performance versus the industry in these markets, since essentially we started, in this case from 2017, you can see that we are holding the share. Yes, maybe the ten basis points sort of decline, it is essentially we are holding the share there. Obviously, if I add what is happening into these markets, the IQOS performance, we grew the share by the remarkable size. So in these markets, we lifted the share by more than two points. I think there would not be other than any sort of a price propositions in the market in the history of this industry over the last ten or 15 years, there wouldn't be any entry into this market at the premium or slightly below premium proposition which would yield that sort of a result.

So I think we are doing very well in these markets. Obviously, in the markets where IQOS is not yet present, we continue our good performance. As André said, there is no time and it is not in our thinking that we are going to give free gifts to the competition just because we are at the same time trying to build a category.

**Slide 8 – Focused Product Launches Yielding Higher Success Rate**

While obviously focusing on RRP and non-RRP markets with the combustible portfolio, it is also very important to us that we are becoming year after year more effective and better in addressing consumer needs. You might recall from the previous investors' day meetings, we have internal threshold on the measure of the success for the new launches into the market set at the 0.4% of the market share. Couple of years ago, we said maybe the 0.4% allows still for too many things going to the market and don't really stick for a longer time with the consumers. They take a lot of time in terms of a product pack, etc., development; and obviously, it's a lot of resources while deploying them into the markets. So we moved that rate to 0.7%, and very pleased actually, that despite the fact that we internally moved the threshold, we actually have even achieved a much better strike rate. So 42% of the new products going to the market, they deliver 12 months later at minimum 0.7% market share, which allows us to scale down a lot of product launches. That's very important when we are talking about the resource allocations, because in the past, when we were only focused on combustible business, these resources were tied up to serve the new product introductions into the market. Right? You need to build distributions, you need to do the communications in a shops, you need to inform the consumers, you need to somehow initiate among the adult smokers the trial of that product. This all takes time in the design and it takes a lot of effort and attention during the deployment. So, we are coming to the formula that we can serve the market from supporting our combustible market share with the less products flow in the market, which are better designed, better executed, better for the resources, can be very safely morphed in a market when this is appropriate to RRP.

At the same time, so despite the fact that, yes we do continue with the launches of new products on a combustible market, we're also taking out of the market SKUs, or product variance, brand variance, which are simply not performing. Right? Because there is this hidden cost, actually it is not that much hidden to be frank, of maintaining the existence of these products in the market.

So, we have growing share, maintain the share in the markets where we are focused on IQOS. Yes, we do product launches at the same time as you can see on the blue bars on the slide, we are reducing the number of SKUs in the market. And, that liberates a lot of resources, which you can very safely start allocating behind RRP.

**Slide 9 – Region/Market Snapshot**

I will now zoom in into a few geographies. And, I do not want to steal the attentions to Martin's earnings calls, when I know you guys are always interested in a market share in every geography. And, it takes a lot of preparations from our side to be able to respond to these questions. I just focus on a few geographies.

There is the history, or there is the reasons why I talked about the EU Region, because it is still the bulk of our volume profitability, very much, how we're doing in there. Turkey, Saudi, for obvious reasons... Saudi, very much because it put a lot of pressure or drag, if you like, on our performance last year and it continued with this year. Russia, Philippines, Indonesia, so you have a pretty good mix of markets, with and without IQOS ...that is obviously still focused very much on a combustible business.

**Slide 10 – EU Region: Strong Total Market Share Performance**

So, on the EU. First, starting with a total market (which you have on the top of the chart, the grey numbers), on a year-to-date August, the total industry estimate is 1.7% decline, and I think that is going to continue for the year. And, there is nothing in terms of a headline news which would think us that that trend may change in the near term, at least. I remember a couple of years ago, the EU going with the mid-single digit volume declines, total market, and obviously start to put a lot of pressure on us. But I think we are operating with a pretty stable, from this perspective, environment..

From market share perspective on brands, other than Marlboro, doing very well. The only reasons why Marlboro, which we managed to grow the last few years until 2016, and then Marlboro starts declining the share, is just because there is cannibalization with HEETS. So, I allowed myself to put the HEETS on the top (one full share point). You think about this, one full share point on the total EU geography! We are at the stage where we start seriously building a serious brand in the Region. It is not just one market, or it is one city, this is on the total volume which we are selling in the Region.

**Slide 11 – Turkey: Solid Business Fundamentals**

I go to Turkey. Year-to-date August, total market 13.7% up. You know that Turkey, this is combustible business. You know that Turkey was a very sizeable total market. You remember in the past we have been talking, okay, there was the problem with illicit trade, so this was dragging the industry down. There was a lot of great things, good things which Turkish Authorities or Government has done, and addressed that situation. We know that this is the country which has an attractive consumer propositions, or attractive population proposition, etc., when you see the results. You don't necessarily see, in the tobacco industry total market, while addressing the right problems which are there, which will go despite that level, to that sort of rate of growth.

I am also very pleased that despite the fact, especially very recently when Turkey's going through some, let's put it economic difficulties, the evaluation of Lira and inflation, etc., that both Marlboro and Parliament, which obviously occupy the premium space in the market, are doing extremely well. So, we have a market when a consumer is going under the pressure, yes, there is inflation, etc., we have a total market growth and, at the same time, we are maintaining, or actually growing, the share of both Marlboro and Parliament. There was a tax change, you may recall, in the mid of this year, at the end of June, which essentially reduced ad valorem component and increased the specific, which I think should further support the positive developments in this market. But as I said, the headwinds in Turkey will come now how the evaluation, etc., will roll through the economy and how consumer might be impacted.

**Slide 12 – Russia: Improving Pricing**

I go to Russia. On a year-to-date August basis, and this is the data which we can estimate, market is at 8.6% decline. You remember last year, there was some significant lack of pricing in the market. What we can see over the last few months, or through this year, yes there is improved pricing, there is still a lagging of the competition, but I think directionally we are going in the right direction.

There was a tax increase in the mid of this year (RUB 5). Next year, if the current governmental proposal stays, the pass-on is in a range of up to RUB 9 (RUB 8.8, precisely).

There will be a VAT increase, an excise tax increase, that's the complete number. I think it should be manageable.

Form the cigarette performance, we are holding very nicely the share of premium, the 5.1%. We are under pressure, or there is a pressure very much for the delays of the pricing implementations in the mid-segment. That's the decline, 4.6 to 4.0 share points on a year-to-date basis. And we, I think especially, when we reactivated Philip Morris and we're going for the consolidations of the portfolio, were holding very strong or stronger and stronger positions in the long segment.

I have to mention, I think, we know that we're in Russia, and IQOS is essentially in two plus five, sorry, St Petersburg and Moscow, plus five other cities. We are just scratching literally the surface of the Russia market. And, already now, on a year-to-date basis, IQOS is at 0.7% of the total Russian market. Obviously, I will show in a second how are we doing in more specific geographies. But again, it is very much like the EU, we start delivering materially significant shares across the larger geographies despite the fact that the focus is still very much behind the few very much urban type of locations, etc.

### **Slide 13 – Indonesia: Solid SoM Performance Supported by Marlboro**

I go to Indonesia. Total market, surprise, year-to-date August is 1.2%! And, do you remember, I remember myself, you may not remember, I do remember myself saying Indonesia is one of the markets that we are getting excited about. The monthly or quarterly total industry volumes developments takes a lot of energy behind emotions, but you are actually not left with a much better understanding of the market. That is the case, if I recall, on the year-to-date June basis, the market was in a decline. There was always the seasonality of the holiday season in Indonesia. In the market as of August, when we are comparing more and more apples to apples, it is a 1.2% growth. So, that was just a remark which I had to make, because I know how many times I have been tortured about the Indonesian volumes. They will go up, and they will go down, this is the life, and we have to live with this and don't get excited about the short term type about what is happening.

We are doing pretty well in the machine-made segment, holding very strong our positions. You will remember we are over-represented, or strongly represented, in the hand-rolled kretek segments. Yes, we have a decline but we know that the consumer preferences are to go to the machine-made cigarettes and we just follow this trend.

Finally, I am extremely pleased that in Indonesia, for many years, we couldn't really fulfill our Philip Morris dream, which is if we grow the share there has to be a contribution from Marlboro. Here we have a contribution from Marlboro. You remember we extended Marlboro into the kretek type of kretek flavor, and Marlboro, yes, there was some cannibalization from the white Marlboros, or the non-kretek Marlboros, but all in all the franchise has a very significant growth. If I take it two years, almost one full share point, again on the size of the Indonesian market, you are talking now billions of Marlboros which are moving to the franchise. So this is a very good performance.

### **Slide 14 – Philippines: Gaining Share and Increasing Profitability**

I go to Philippines. Finally, this year, we will come above the profitability levels which we used to have in the Philippines before the Mighty illicit trade and all of this, you remember this very well, all the negatives which we have in the market. I think the market compliance

rate when it comes to the tax regulations, etc., today is completely different than it was in the Mighty times.

We are doing very well in terms of the shares. There are two key brands, which we primarily focus on, Marlboro, and Fortune at the lower price classes, are very nicely growing. We managed the price gaps. There was a tax increase, you will remember, it is a specific system.

I think the Philippines should be on a good path of the continued good strong business performance. Again, I think there is room for the manageable pricing from excise perspective and I think a portfolio is doing extremely well.

And, I think we have excellent muscle, as is Indonesia by the way, when it comes to the deployment. I think in terms of our reach to the retail trade, the sales force, the quality which we are having in both markets, I think we will really have a very strong muscle in these two markets.

### **Slide 15 – Saudi Arabia: Sequential Improvement**

I go to Saudi. This is a negative story because of the impact on us, but I think it is actually positive as we consider the sequential improvements. So, I show it here, the quarterly improvements in a total industry volume and our in-market-sales, as well as heavy recovering on the market share. I mean, our volumes were more impacted than the industry just because of the 100% tax price increase, which is a result of the tax implementation. Obviously, we had a very sizeable position of Marlboro. So there was down-trading, and there continues to be some down-trading, but I think the way we address it by standing behind Marlboro, you see the recovery of Marlboro, and I think it's going to continue. We played very well the positioning of L&M in order to participate in this new structure of the market following from a price perspective and consumer price preferences. This is one of the markets that we complemented the portfolio very nicely, at the right time, with Chesterfield, so at least we haven't lost the touch of the consumers. Almost 41% market share for the first half of the year, and I think every month now we should see the progression in the same direction.

So, I should have mentioned, normally when I would talk about, or talk about the key markets on the combustibles, one market which is missing, which I will address separately on RRP's, is Japan. But, frankly speaking, all eyes are on Japan, driven by IQOS. The only thing, which I think you noted, we have registered for the price increases, so there will be a price increase in fourth quarter of this year going for Japan, which is great from this perspective. Well, always price increase is great, you know very well, but this is the only thing, which I think, which I should mention about Japan.

### **Slide 16 – Our Eye is On the Ball: Robust Cigarette Fundamentals**

So all in, again my Polish, two eyes are on the ball. I have a pricing, we have a pricing, we know how to manage the portfolio, we are doing the portfolio management more efficiently even than we used to do in the past, and we operate with the underlying industry volume trends, which are manageable.

Frankly speaking, if not IQOS quote-un-quote "pollution" of our results with the cannibalization, resource allocations and investment for the future, if I would take on a

standalone basis combustible business using Philip Morris language, we will issue the press release and have a year of solid performance, etc.

Yes, there was a drag from Saudi, but if you take a bit of a bit longer-term perspective, it is just a blip in the performance, rather than something which is structurally broken.

So, I think I will close the chapter and please, do me a favor, and when Martin or whoever from us goes again for the meeting with investors, just trust us, we do keep both eyes on the ball. It is a good business, but I think we can make this business greater.

### **Slide 17 – Everything Else Comes On Top**

Now, this is the same chart with our top six brands, top 15 brands globally. IQOS on a standalone basis as it should be treated, or HEETS as a standalone basis, 1.5% market share international. As André mentioned, there was no introduction and there was no movement, not even introductions, into the list of the top 15 brands if not driven by the morphings of the price, as usually low price. Okay, so IQOS is very nicely going up. I mean, it is essentially knocking at the top ten, okay, and this is just the year-to-date August basis, and I think it is on a good path to become one of the top four and hopefully one day to replace Marlboro as the top one brand in the world.

### **Slide 18 – Operating Around the Adult Consumer**

So this leads me to reduced-risk product performance.

### **Slide 19 – Every Consumer Matters**

Every consumer matters. From now on, you will realize that I am trying to use more of the consumer language rather than the market share, IMS and definition-type language. I understand this has tremendous importance when we go through our financials but the language which we are more and more using in Philip Morris, the management and how we look at the business is more from the consumer lenses, and the focus on, you know, how do we serve the consumers, what consumers tells us, how we can improve the overall experience, which we are supposed to deliver to the consumer, knowing that if we're doing it right, the output will follow, the output is your volume and the shares, etc.

So we have 5.8 million people, consumers who fully, fully switch from cigarettes and are using IQOS.

### **Slide 20 – Continued IQOS User Growth**

In addition to this, we know that the total IQOS users group is about 8.6 million at this stage. So, the delta, or the difference (8.6 to the 5.8) is nothing else than the group of people who purchased IQOS device, they know about the benefits, the benefits are some how, or to some extent, convincing them, and they are on their path to the conversion. As you know, IQOS has unrivalled conversion rates versus any other competitor, being e-cigarettes, or any attempts to challenge, at least at this stage, our positions in heat-not-burn propositions, being in Korea, propositions from the competitor, or the two other propositions which we're confronted with in Japan. They do create some pressures on our consumers in terms of a curiosity -"let me try the other proposition"- but essentially, I think many vast majority of this delta (8.6 to 5.8) is convertible fully to IQOS in the near term. This is how we are looking for us. So, we're chasing in each, no sorry, we do chase but, we're focusing in each market of

this leading indicator. Is it interest, is it awareness, are they buying the devices? Then knowing that, we can gradually move them fully to the franchise.

### **Slide 21 – Total IQOS Users by Region**

This is how the composition of these total IQOS users and fully IQOS converted across the regions, East Asia and Australia, almost 6.6 million people, very much driven obviously by Japan and Korea, because this is where we're present. With EU, Eastern Europe follow. And, Middle East and Africa and Latin America and Canada, but with much smaller groups today, but also our focus was not at this stage in these places. One Region where we completely didn't touch with IQOS, if you like, so far it's the Regions which comprising Indonesia, Philippines, etc. So this is still to come.

### **Slide 22 – IQOS in Italy**

I start now with the reviewing of a few geographies, but also very importantly for you to try to understand the optics how we start looking at the business. There is a reason why I put the users at the top and the market share at the bottom. So, all of us – and I am less than 25 years in this industry before IQOS arrived – I always was very excited weekly, monthly, quarterly... you have Nielsen?, you have whatever data?, what was the share? I also have to change myself. I said okay, the share is going to come, when is my consumer going to come?

So going to Italy, we had added about 300,000 consumers, users, over the last eleven months. We know that we can with every addition of a new cohort of consumers for our panel with measurements etc., we know we can establish that we are growing the conversion rate. Conversion rate here is measured at the 95% plus, which essentially means that, at best, you have whatever was your underlying daily consumption, one, or maybe half cigarette per day. So it is a very hard data. It is much more, much better conversions if you were to cut it off at the 70%, right? So, 70% areas of IQOS, 30% cigarettes (conventional cigarettes). But for us, we are thinking "how far we can push the number to full conversion?"

Then we check very thoroughly what is the awareness level, right? So, I am operating here with the two terms, it is the Tier 1, Tier 3? Tier 1 is nothing else but: "Am I aware of IQOS? Okay, I have heard about IQOS. So what?" Tier 3 is trying to measure: "Am I aware of the benefits of IQOS, and at least one of the benefits of IQOS, which could be short-term hygiene, long-term, better proposition from a risk perspective versus the cigarettes, is it relevant to me?" It still, unfortunately, doesn't capture whether I should do something about it. So, if I ask you a question: Is health important to you? Yes. Is it relevant to you? Yes. What would you do about it? Nothing. So you need a bit of a trigger in order to move into these directions. But it gives you a better feeling that measuring just the awareness of the product is one thing, but you need to go closer what sort of awareness or understanding of the propositions may trigger consumer to get into that. So you have to do the proposition.

So we look at Italy, you have this growing, slowly, but growing awareness, 19% to 23%, and a 5% to 8% awareness with understanding and relevance. Very much the factor of regulatory environment that usually we have to operate in Italy. So, ability to deploy the messages, in the way as I think every adult consumer should be available to receive this information, is not existing. Mirek has mentioned Italy has recognized IQOS as a separate product category. This is an excellent first step but I think we would require some



differentiations in terms of a marketing mix, which we could use in order to be able to talk to the consumers. As you know, it's not really an omni-channel territory because most, all of the products have to go through the tobacconists, right, through the authorized retailers. It creates a lot of constraints for us. Needless to say, even with that, we have managed to grow the market share by more than a point over the last 11 months. So, on a total Italy basis, I think it is remarkable what we are achieving despite knowing that our freedom to operate is very much constrained versus another market which I will show in a minute.

Now our focus is, we are nationally available, it's difficult to hold the horses in a few cities over such a period of time, but the focus in terms of execution, consumer work etc., is on the few key cities. So, I just show here few examples: in Rome market share was 3.8%; Bologna 5.4%; Milan, which was the whole starting of the whole journey with IQOS, 2.5%; etc. So that's Italy.

### **Slide 23 – IQOS in Germany**

I go to Germany. They tripled their consumer base from 36 to 111. We are growing the conversion rate. Germany is the example of the market when you can grow the awareness because you have a media available, so I have a multichannel in terms of the retail: I can fully operate my own brand retail infrastructure, we can use digital, we can use billboards. Yes, there is a growing understanding of the benefits of IQOS, with some relevance. Now, the key question is, what makes the German doing something about it? That German consumers are doing something about it. So we are still working on this whole thing. But in the meantime, focusing on the cities: Berlin is about 1%, presumably the most challenging environment we have due to its diversity and so on. But Munich and Frankfurt, in this case, are doing very well.

One of the ways that we are looking at the business is, we are trying to look at the growth rate of IQOS users so in other terms, my 111,000 over 36,000, and compare it with why market share is progressing at the same level on the different levels. So, our objective is, or the expectations are, that the consumer base growth goes ahead of the market share growth because this is my past, if you like, and this is my future. So this is how we look at the business.

### **Slide 24 – IQOS in Greece**

I move to Greece. Nothing to do with André, just happened. The lower level of awareness: Greeks decided to do something about the bad things coming from cigarettes, compared to Germans. But this is at the lower level of awareness, we have much better responses. So, it is a lot of work which we are doing in understanding these messages which theoretically should be universal to everyone but actually they require the tweaks at the market level and try to respond to what really drives the consumer there. So you have, as Germany, tripled the consumer base. Very high conversion rates, very high, one of the highest conversion rates which we have. Growing awareness, and nicely progressing, on a total Greece basis, market share in August, reaching 4.3%. Athens actually greater Athens: 6.7% market share. So, I think we are on a very good path there.

### **Slide 25 – Growing IQOS User Base in the EU Region**

I just put altogether now EU because there is no point at this stage to going through every market. Over the last 11 months, you have all numbers here. We have 1.3 million users,

863 thousand who have fully switched. There is a group of people, which is the delta again, or difference between 1.3 and 863, which are in the conversions, they have a device and they are using this more and more frequently.

Unlike in Japan, and initially Italy, etc., EU, you remember, was coming a little bit later into the journey with IQOS commercialization. The number of the markets which we managed to deploy more of the digital assets or the digital processes and digitalizing the relations with the consumers. Out of 1.3 million consumers, which IQOS users, we will have now established direct contact of about 80%. So that is full registration, right? So the consumers, which comes, they register, and we can move the whole dialog, or experience or significant parts of the experience conversations with consumers to the digital, rather than talking to the anonymous, if you like, group of people. So that is something which is very much a focus for us. Therefore, we have been investing on building a digital infrastructure, which would allow us now to digitalize the contacts, the conversations with the consumers going forward, which is also a very critical factor, not only from an experience perspective to the consumer, but from the cost perspective, because clearly the digitalization is a much better, from a cost perspective, opportunity proposition for us than this manual hand-holding almost type of activities.

### **Slide 26 – IQOS in Russia**

I go to Russia. I mentioned Russia was 0.7% on a year-to-date July. On the IMS, August was 1.1%. So, it just shows you how Russia is nicely progressing. One of the fastest growing IQOS users communities today, if I isolate some smaller geographies, but on a sizable market. Reaching almost 500 thousand by August. Very nice conversion rates, they started high compared to the other markets when they were at the beginning, where they very nicely grew that thing.

Russia has one of the most digitalized consumer journeys out of the markets, many markets which we have today.

Awareness level, I just show here, Moscow is pretty much pretty nicely growing tier 3. You see the Moscow market share on the chart, 5.7%, and I think we are on a good path of making very significant inroads in these markets going forward.

### **Slide 27 – IQOS in South Korea**

Then I go to South Korea. Again, the same metrics. The issue here is not much about the numbers which you can read on the slide. One thing which presumably attracts your attention is the IQOS conversion rates. Remember, it is a conversion to IQOS, it is not a conversion to the category. So, this is one of the few markets where we have a competitor there, which is one thing, which I think the launch of the IQOS 3, IQOS 3 Multi, which Mirek just talked about a few moments ago will, to a very large extent, address some of the pain points which were left unaddressed, and the competitor tries to exploit that sort of vulnerabilities of IQOS device. IQOS HeatSticks are still the most preferable consumables, and you know from our previous disclosures that, even if you buy the competitive device, you still, in majority, will try to use IQOS HeatSticks. So when it comes to the taste flavor experience, which IQOS consumables are offering, I do not think anybody is coming close to us, today. So, we need to fix the device. Mirek talked about the reliability, the defects which

we will have over the last few years, how we address it and I think IQOS 3 and 3 Multi should very much help us addressing this one.

The real issue which has happened in Korea, okay, so these competitor products, and addressing and improving the product through the pipeline, I think this is one thing which is very much on us, and is very manageable, and I think both André and Mirek demonstrated that we have the power in the company now to start fixing the user experience type of a problem, knowing that the energy from a harm reduction perspective is absolutely very, very rock solid.

The real issue in Korea is the regulator. You have heard the story, KFDA in the mid of the year, all of a sudden, tar is the cigarettes, confused a lot in the consumer's mind. What we observed from consumers is that, those people who are fully converted to IQOS, and they start realizing themselves, 'Yes, this is a better than what I was ..., I feel better versus how I felt when I was using a cigarette', they stay! But this whole group of people who just bought the devices, or were thinking about buying the devices, they said, 'You know what, I am not sure it is really better, because I hear from KFDA, Korean FDA, there is tar, I am confused, I am not very clear, etc.'. So I think there is a lot of damage done by the regulator in Korea to the people who were about to enjoy the better life, couldn't quit smoking, they found an alternative, they would reap the benefits of IQOS and then all of a sudden, almost in a very responsible way, the regulator steps in, saying it's the tar. We know there is no tar, and even if there is tar, whatever you measure, it's the quality, it's what is the content of the whole thing. So, a lot of damage, frankly-speaking, to the consumers. They send back these consumers to the combustibles, it's not that the people quit smoking. So, if I was very nasty, and I do not want to be, we have enjoyed the benefit because they moved the consumers to combustible. But this is very bad, from our company perspective, and from a societal perspective what has happened. So that is the situation in Korea.

### **Slide 28 – IQOS in Japan**

Last one, I have Japan, which is obviously now thousands of eyes are on Japan. So, what is happening? From a user's perspective, we are growing total users, there is still an acquisition of IQOS users. So, we are selling the devices, we activated a lot of our internal sales force resources as the final move from holding, or focusing on combustibles is going behind RRP's, and especially addressing these societal groups which will require different marketing and access. I think the last few months' results were very good.

Conversion rates came down because now I have to share, or my consumers are sharing IQOS with two other competitors' products.

The awareness level, we have what we have, right, it's 87%/88%, one of the highest awareness levels in terms of IQOS, and pretty high awareness levels in terms of Tier 3. But, one point that I should raise here is that that Tier 3, i.e., again, I understand the benefits and I find one or two of these benefits relevant to me, for the groups of people which we have addressed so far. So, remember, we operate with these early adopters, innovators, etc., and once you start going to the slightly older group, more traditional group of people, we need to regroup and to rephrase, reshape the way and the content of our messages there.

And, the market share, the 15.2%, but this is the least important, for me, number at this stage in Japan because fundamental question is: Is Japan a proxy for the performance of this

category in other markets? i.e., should we expect that the only group of people which we can convert in each market, using Japan as a proxy, is the 15% category, 20-something per cent, that this is the first resistance level, and then something will have to happen in these markets to unlock the remaining part of the consumer group.

### **Slide 29 – Japan: Market Opportunity for Smoke-Free Alternatives is Real**

So, for us, the most important thing is the consumers know there is heat-not-burn, there are three different products available today, at least officially. Very important is, I know what I do about it, but if consumer comes to your e-commerce, when consumer comes to your store and pays for the device, whatever is the price of the device, for us, is the signal consumer is ready to consider, seriously consider, alternative to smoking. So, it is not just the awareness, now I walk the talk, I have read about it, I have seen the advertisement, I have the communications, I have seen it on TV, I have heard about this on the radio. Why I am going to the store and why I am putting my money on the table, even if the cheapest device today on the Japanese market, by one of the competitors, goes well below JPY 1,000, I bet you, you can go to the streets of Tokyo, Nagoya, and will not find one single person who will hand over to you JPY 1,000 for nothing. So what makes the consumer spending whatever amount of money going into the category?

Second number which we chase, which we look very carefully at is past-seven day usage. So, are they buying? Are they using? You can see both numbers are continuing to grow. You can speculate, debate, you can take these numbers into the pieces, is the growth rate in 2016, 2017 or year-to-date August different? But, you can see that both numbers are growing. What the issue which we have as we're speaking in Japan is, and this is demonstrated here by the heat-not-burn total volume category share, which definitely has slowed down its growth – there is a growth, but slowed down its growth – is that IQOS still today stays as the proposition with the highest conversion rate, in other words, has the highest average daily consumption. Because I essentially took my consumption from conventional, as a user, and I am now using IQOS on the one-to-one basis at the same level that I used to use conventional, which is not the case of the competition. So, I have one effect that the competition, yes, I have heard that IQOS is existing, I have heard also that IQOS has some early teething problems, there is a reliability, maybe they don't have a consecutive use, and may not really understand whether I need the consecutive use, but I have heard they do not have consecutive use – you know what, I will try product from the PloomTech or I try the Glo. And, I go to the product and I realize this is not the taste which I was expecting. Yes, maybe the user experience is better, but I am not entering into this category for user experience. First, I want to get my taste. If the taste is wrong, I stay with the old thing.

So that is the battle, which as we speak we have now in Japan. Again, as I mentioned in the case of Korea, I think, to a large extent, 3 and 3 Multi should address this one but this is not at the end of the story. There always will be pain points which will be revealed when we go to the market. The question is how quickly we will learn from the consumers who get the pain points. The trick is whether the next pipeline of the device is addressing these pain points as fast as possible. So that is the situation in Japan. So again, to me, I don't see the slowdown in the device ownership, I don't see the slowdown in the past-seven day use, but I do see the average daily consumption driven by the competitive products which drags the category down, okay? And, this is the thing. And obviously, I think if you would go back to the history

of combustible business, and you'll have to go back to '50s, which most of you don't even know that the '50s presumably were existing because we have a young group of people. In the '50s, when the industry was not consolidated where they were, by far, much larger number of brands, et cetera, switching rates, i.e., how consumers were switching between the products, et cetera, was much higher than you go to this current state of the industry. Because people have to go through and trying this whole thing. I think it will be very unfair to assume that we went with an IQOS, people like it, but they don't know what good means because there is no reference. And they need to go through this period when they have to try the competitive products to establish what in this category is really good and what is not good.

### **Slide 30 – Initiatives in Japan**

What we have done also in the meantime, Mirek talked about improved versions of 2.4, including 2.4 Plus. So, there was a number of reliability and performance issues which we have addressed. I just want to make very clear when Mirek talked about the defect rate, our obsession was, and will be, that any cigarette, any HeatSticks consumers will smoke, will never endanger his or her health, versus what we have promised this device is going to deliver. So our focus is, engine has to work. Okay. If there is any issues at the beginning, yes, maybe it shouldn't charge faster, etc., this has nothing to do with your health. Okay, so our focus is to make sure we will never compromise on the quality of the device when it comes to the core promise. The rest, even if we have to go through some painful times, we will address going forward. So we improved the 2.4 Plus. We have realized that some consumers would like to have another device, maybe they don't have to buy the device, maybe they just need to buy the second holder, which addresses, to some extent, in the meantime, the consecutive use. I have two holders, so always one I can use after the other one. Some people just want to have a piece of mind and saying, 'Look, I am worried that if that thing stops working, I am so much converted into IQOS, what I do if IQOS breaks?' So we started seeing that there was an uptake in the second device, and we tried to facilitate these things instead of you buying the second device, just buy the second holder. We also have -- and that's the digital component here now. We have simplified grossly the steps you need to get to get registered by Philip Morris, get access to the discount, get your warranty, etc., etc. We give a lot of focus on it now, reassuring the existing consumers group that look, your choice was the right choice, 5 million people have already made the same choice, and the points #5 and #6 are IQOS 3 and the stronger tasting, different taste directions, which we'll have on our HeatSticks today, will reach to market also in Q4 of – Q4 this year.

### **Slide 31 – 2018 IMS Evolution for IQOS Kit and Holder – Japan**

Okay, so this is what has happened now in the market. We had about the lowest moment in terms of IQOS kits, the full-fledged devices, holder and a charger, and the holders in the market was about May. Right, so I just showed here this data. So you could see we have been selling 343 thousand devices per month, IMS (in-market-sales), in an addition to about 200 thousand holders. So altogether, 543. And as of May, when we started deploying the second holder and rolling more and reinforcing the message about the quality reliability, etc., and other things which you saw before behind the IQOS 2.4 Plus, you could see the growth of IQOS kits and IQOS holders.

Now, this is all great and I am very pleased what us, here, and the Japanese organization has achieved, the only problem is, if this would happen as of January, February, or the beginning of the year, we wouldn't create the hole versus expectations which we had. Returning now to getting into consumer acquisition, problem is that this consumer will not generate enough of the consumable revenue this year, because I am coming late. I think we should continue with this trend and now we are very pleased that we finally can bring to the market 3 and the 3 Multi devices as well who further help the situations there. Just to make very clear, when we come with 3 and 3 Multi, we are not taking from the market 2.4 Plus. Okay, you may know this in some markets was reported. We have adjusted the prices of 2.4 Plus worldwide essentially, by playing with the level of the discount and we created the space for the 3 on the top of this. So from now on, consumer, if he is in a doubt whether I should try this category and do I want to buy 3 with all the bells and whistles, etc., they can just start with 2.4 Plus, which is a more accessible or more affordable price. If you are more convinced, etc., into the category, you will go to the 3. Although, I think at the beginning, the existing consumer, loyal, very loyal base of IQOS users will jump into 3 and the Multi because they are offering the functionality, and also people are already three or four years with the same look and feel of the devices and I think they want to refresh something which they hold on a daily basis in their hand. So that's Japan.

### **Slide 32 – Increasing Interactions with Adult Consumers**

Now, I will go a little bit into insights how we are looking closer maybe to the financial side and organizations on the business. So combustible business, I know is not rocket science, mostly business-to-business model. We have great brands, we move them through the wholesale and we stop or we move them through the wholesale, manage the part of the retail. Our interactions with the consumers, if I take the entire consumer journey, is very narrowed to essentially, 'Try me, buy me, stay with me.' And, the whole consumer journey, especially if you are going to the new products, new categories, very narrow and highly transactional, the experience component is almost not existing other than obviously the product quality which Marlboro and other brands, our brands have demonstrated. We have this good quality for which our brands are being recognized.

When we go to IQOS or other platforms, so we just use IQOS but that is essentially applicable 100% to other platforms, we need to recognize something. We want to and we are going to the business-to-consumer model. So yes, obviously you have infrastructure of moving the product through the market, which is your wholesale, retail, etc., but there is a growing, growing, and we want growing and growing number of interactions we have directly with consumers, and we need to build the infrastructure to have this direct relations with consumers. That obviously starts as early in the consumer journey as, 'I am a smoker, I couldn't quit, I haven't heard that there are alternatives to smoking and I need to learn about this something. It is not necessary even if I see an IQOS store that I will walk into this store because I do not understand what it is about.' So we need to start preparing and facilitating our content very much in the digital, etc., that the consumer is exposed to the information. Then slowly, as all of us when we are trying to buy new things, etc., we are doing our own research, we talk to the friend, we Google, we Google once, we Google a second time, I go to the Amazon reviews, I look for all opportunities, I am exploiting all opportunities I have today to figure it out should I do it. Because you don't want to feel stupid when you come to the store. You want to be informed. Your decision is being made before you come to the store.

Store is the component when I can further delight you and not that I opened IQOS store, I entered IQOS store and said, 'Excuse me, what are you selling here, shoes, tomatoes or alternatives to smoking?' So, we need to cater to these needs of a consumer.

It's very exciting because at this stage, you are learning a lot about what really triggers consumer to get rid of smoking and to move to this proposition. Then there is the whole beauty of staying with the consumer from the moment they buy and use for the conversion, bonds, etc., because that's the clear path to the word of mouth. So, that's the transformation. This is the biggest challenge which we will have here from infrastructure and organizational perspective how the business-to-business infrastructure which serves us and continues serving us very well on a combustible business, I can add to this the right components and add it to the business because the business will be a different business, with a great opportunity.

### **Slide 33 – Investing for Revenue Growth**

This is how it looks. Now, I took a privilege, I was for five-plus years CFO, this is not US GAAP. Okay, I am just making that statement. It is not US GAAP and we will continue reporting as prescribed per US GAAP guidelines, etc. However, the reality of the business is that I have acquisition cost which is in a different period when my revenue from my target of acquisitions is coming from. For all public who is hearing this conference, I do not attempt to challenge US GAAP rules, but I do have to recognize that the business is looking or is run a little bit differently. We know today that before, from the moment consumer first interacts at the learn phase, discovery consideration phase, until that moment, the consumer will come by and are going to conversion, and they have even six months. My infrastructure with the content has to start working at the beginning, not giving up knowing that this consumer is slowly, slowly, slowly ready to make the decision. Remember, IQOS requires behavioral change. 'I want to quit, I couldn't quit smoking, I am looking for alternative'. Many consumers will tell you by moving to IQOS, I almost quit smoking because they literally quit smoking, they went out of combustion to non-combustion. So, that has to be catered. So, yes, there was an acquisition cost obviously including infrastructure, etc., which has to be rolled out for the market, prepared by a central rule for the market, and as of the moment when I have a buy, which is my first revenue which is devices, and then the faster I move you to the first full conversion, the faster I am generating the entire revenue potential from the consumer from the HeatSticks recurring sales, and then I need to recognize that I want to maintain you in my franchise, so I need to continue spending my retention cost.

On a combustible business, you haven't seen it, because we didn't have to explain what is the cigarette about, we did not have to explain which part of the cigarette you put into your mouth, we did not have to explain which part of the cigarette you should light it up. All of these things were done, maybe, in old PMUSA books, if you go to the 1950s or 1960s, if that concept would exist, they would be confronted with this, but this is not what we have inherited or we have today on the combustibles. So, that is the fundamental difference. That obviously sends distortions for our quarterly performance, and we know about it. You keep on asking this, you keep on adding, you keep on investing, but we see that revenue. Yes, you need to go and pre-invest in order to capture the value.

**Slide 34 – RRP Commercial Investment at Market Level**

This is how we look at the cost. I continue: this is not US GAAP part of the presentation. Martin will cover the US GAAP components. 20% of my acquisition cost in the market – this is commercial market, not development here, not the central cost here – in the market, 20% of my acquisition cost is my infrastructure, and 80% is the variable, okay? So it's very much, and very much -- sorry, to a large extent, consumer-driven than volume-driven, okay? When we think about the variable, we always think is that, per thousand, per billion, and more billions, etc., yes, there is a relation or a correlation with the consumer. But, when we go out and we try to inform these consumers, when we try to acquire these consumers, I am not targeting consumers with a 20-cigarettes-per-day consumption, 15per-day, a consumer is a consumer. This thing is being discovered as we move the consumers, what is the potential of the consumer.

And, on the retention side, the proportions are about 40% fixed cost, and 60% variable. If I go to the market which is at the beginning of the consumer journey, you will have 80% on acquisition and very little on the retention. And obviously, whilst we start building the base in the market, the resources, allocations of the resources is going more into the retention than acquisition, because obviously, you need to serve this existing consumer base.

**Slide 35 – Cost per IQOS User – Index**

This is how it looks on a cost per IQOS user. For obvious reasons, I indexed this. So, if Japan in year 1 was 100%. Today, Japan in acquisition is 20% of this. If this was the dollar – it is not – but if this was the dollar, Japan cost me – sorry, consumer in Japan cost me \$100 to acquire, today cost me \$20 to acquire.

And, in Japan, at that time, if that \$100 was for acquisitions, \$39 was on a retention, and you could see also the progression of the retention.

So, when André talked that the infrastructure, which we start putting in place – very much here, but also in the market – we start seeing the benefits of the whole thing. We don't have to expand that infrastructure. So obviously, you're reaping the benefits of scale. The same goes with Italy. Russia started later on, but is the same dynamics.

**Slide 36 – IQOS User Economics – Index**

When I go to a top line, or closer to actually bottom line, closer to the bottom line, that's marginal contribution. And, you could see – and I compare it here – this is essentially to show you the attractiveness of this, compared to the combustible cigarettes. So, Marlboro adult smoker in Japan is 100. The fully converted IQOS users is 121. Consumer who is not fully converted, so he doesn't have 100% of IQOS consumption, will be, we estimated about \$80 level, and you could read the numbers from other markets. You realize that in some markets, already at situational and predominant level (i.e., not fully converted) the economics for IQOS is better than the economics for cigarettes.

**Slide 37 – Business Model Evolution Opens New Doors**

I was trying to explain how we look at the acquisition of the consumers, retentions, how we look at the cost, how we manage the business. There is something which is coming on the top, right?



**Slide 38 – RRP Portfolio Drives New Revenue Opportunities**

I compare the tobacco, combustible cigarettes, to the consumables, the acquisitions, etc. Once we acquire the consumer, there are few things which are coming on the top of this (i.e., what do we offer to the consumer?).

Once we go to the large group of people, however we will design the devices, there always will be further need for the further personalisation, okay? That's the value, right? People are moving into those needs, in a number of categories.

And, obviously, once we have the devices, once we have accessories, which are more functional, initially, more inter-personalization literally tomorrow, then also it opens the way for all the services, other services, which you can start monetizing your relations with the consumers.

Just give you the example: If consumers through the warranty service can expect that I will replace the device, I ship the device to your home/office address within 12 hours, there are consumers today that, for the promise I will do it in two hours, are willing to pay extra. This is one of the earliest opportunities which we see as well what we can do with the consumers, but they are more of the services which you will see coming from the Philip Morris, going forward.

**Slide 39 – Growing Revenue Stream: IQOS Accessories**

On the accessories, which Mirek touched a little bit, when we started with IQOS, until today, they were very functional. I call them here "narrow range." We know today, that 30% of our users are buying accessories, whatever it is. The average spend of a consumer today is a little bit less than 25 bucks, with the margins which are well above 30%, and we haven't paid attention to the accessories business. This comes on top of your acquisition and retention, because the consumer who starts coming to us today. We need to have the infrastructure prepared for this, because obviously, more and more consumers are going to come, and then we need to cater for their needs, etc. That's also the reasons why we invested not only in e-commerce, but on the brand retail and other forms of creating touch points with the consumers.

So, I mentioned the "wider range," actually, the same range which we have today, but we didn't want to show you what we will have tomorrow, so we used the pictures from the past. But conceptually, you need to believe us, this is what will come with the 3 and the Multi

**Slide 40 – Operating Around the Adult Consumer**

So, that what's happened on these additional things. And, the last slide I have for the last point, which I want to cover with you, is upskilling of our organization.

**Slide 41 – Aligning Organization Along the RRP Consumer Journey**

So, because we decided that we will do it in one business, and, there is, however you look at this thing, it absolutely makes sense that we are doing these transformations as a one business rather than as separate businesses.

We need to recognize one thing. We have a great infrastructure, including the human capital, which serves very well the combustible business, but then going to the business which is different or has different dimensions than a combustible business, and we need to add to this.

The cycle times have to be faster, not just that the consumer wants to be served faster is the one thing, but the faster I am in understanding or faster we are in understanding the consumer needs, the better strike rate I will have in innovation pipelines which Mirek and the group is working on.

The new capabilities which you have heard from us is the digital, is the communication. It is not only digital from a perspective of infrastructure, but now understanding, putting yourself in the shoes of a consumer in the second decade of the 21<sup>st</sup> century which fully operates in digital. Call centres, which have a fabulous call rating from consumers today which we operate, they are still like, at best, in the 20<sup>th</sup> century. People want to go digital; people want to have these seamless interactions at the moment when I want, etc., and we need to cater to these needs. This is what we have to build, and we are building this.

And, now, here is the important thing: I am not a start-up, but I tried something in California, in the suburbs of the city in California, and I am progressing with the scale. Because my combustibles business in most of the markets is operating at scale, so I am dragged into ability to operate at scale almost immediately. When we started talking initially, we do Milan, a couple of cities in Switzerland and Nagoya. It looks much nicer on a PowerPoint, but in the reality, it is not a Chinese wall, you cannot isolate. The consumer learns about these products immediately, and we need to start going and following the consumer.

So, this is what I wanted to cover. I know at the end, I was faster, but I make the promise at the beginning that I will not fully stay to this promise. Thank you.

[END OF TRANSCRIPT]