

**Remarks by Frederic de Wilde  
President, Philip Morris Japan**

**CITI Investor Presentation  
Tokyo, March 8, 2010**

**(SLIDE 1.)**

Good morning everyone and welcome to our offices in Tokyo. I am Frederic de Wilde and, on behalf of Philip Morris Japan, it is my great pleasure to share with you an overview of developments in the Japanese cigarette market and the success we have had in building a very strong business in this market.

**(SLIDE 2.)**

My remarks today contain forward-looking statements and I therefore direct your attention to the Forward-Looking and Cautionary Statements slide of today's presentation for a review of various factors that could cause actual results to differ materially from forward-looking statements.

**(SLIDE 3.)**

Japan is roughly the size of California with 128 million inhabitants concentrated primarily in densely populated urban areas. It is currently the world's second largest economy in terms of GDP, exceeded only by the USA, although it will soon be overtaken by China. Also in terms of GDP per capita, with just under \$40,000 in 2009, Japan is one of the wealthiest nations in the world.

The economy has been in limbo since the 1990s and this has been exacerbated by the recent economic crisis, leading to a contraction of the GDP by 5% last year, increased deflation, and rising unemployment, which reached a level of 5.1% in 2009. Furthermore, the Japanese government is faced with the highest debt-to-GDP ratio in the industrialized world.

The Japanese cigarette market is the fifth largest in the world, after China, Russia, the USA and Indonesia. Smoking incidence is about 25% and average daily consumption around 20 cigarettes.

**(SLIDE 4.)**

As I am sure you are aware, the Democratic Party of Japan, or "DPJ", won the parliamentary Lower House elections in August last year in a landslide victory. This was an historical event that ended 50 years of rule by the Liberal Democratic Party. One of the DPJ's stated intentions is to fundamentally overhaul the Japanese policy-making process by reducing the power of the bureaucrats, concentrating decision-making in the cabinet and its associated committees, and increasing the independence of the government from the political parties. Most of the new government's priorities are focused on improving social welfare, but the difficult economic conditions and the rising budget deficit have prevented the

government from being able to implement many of the announced policy plans so far.

The next key political test will be Upper House elections in July, during which the DPJ will try to solidify the majority it acquired in 2007, and thus control both chambers of Parliament.

**(SLIDE 5.)**

Starting in 1985, PMI has a long history in the Japanese market. In 2005, we took back the *Marlboro* license after more than 30 years of the brand being manufactured and sold in Japan by Japan Tobacco (or “JT”). This change not only significantly improved our profitability but also allowed us to take full control of our flagship brand’s strategy and its market execution.

With our headquarters located here in Tokyo, we now conduct business with 1,780 dedicated employees across Japan and we operate under a buy/sell business model.

**(SLIDE 6.)**

Please allow me to introduce my management team. We have a diverse and experienced team comprised of professionals from 6 different countries. Collectively, our team has accumulated a wealth of experience with an average of more than 12 years each in the company in a wide range of markets and functions. I am very proud to lead such a diverse group which not only features some of the best professionals in their respective fields, but also allows us to maintain an optimal balance between an invaluable international perspective and a deep understanding of the local environment.

**(SLIDE 7.)**

Our objective is to achieve profitable growth in Japan that is sustainable in the long-term. To accomplish this, we are pursuing four main strategies.

Our first strategy is to remain a key, well respected interlocutor for stakeholders in Japan and thus effectively participate in the dialogue about future tobacco policies and regulations, including taxation and pricing.

**(SLIDE 8.)**

In Japan, a number of local authorities have enacted ordinances which restrict or prohibit smoking on the street or in certain outdoor areas. With regards to indoor public smoking restrictions, Kanagawa was the first prefecture to enact such a regulation and this will come into effect next month. The Kanagawa ordinance bans smoking in public places where people have to go such as hospitals and government offices, while permitting physically separated smoking rooms. It requires restaurants and bars over 100 square meters and hotels over 700 square meters to choose between being non-smoking or installing a separate smoking area. On the other hand, restaurants and bars of 100 square meters or

less, and hotels of 700 square meters or less are exempted. We believe that the Kanagawa ordinance could serve as a model for future public place smoking restrictions in Japan. This would imply a balanced approach to indoor public smoking regulations as it takes into account the wishes of smokers and non-smokers alike.

**(SLIDE 9.)**

As far as advertising and marketing are concerned, brand communication is banned outdoors but allowed at point of sale, smoking rooms and in print media. One-to-one direct consumer contact activities such as sampling are permitted.

**(SLIDE 10.)**

Since July 2008, all cigarette vending machines have been equipped with age verification technology. In order to purchase cigarettes from a vending machine, adult smokers have to obtain a personal card known as Taspo (which stands for "Tobacco Access Passport") that verifies their age. The Taspo card contains a chip that, when swiped, connects to a central server and, upon verification, unlocks the vending machine. The holder's name and picture are also printed on the front of the card in order to discourage third party use.

**(SLIDE 11.)**

The tobacco industry in Japan is regulated by two laws that were promulgated in 1985: the Tobacco Business Law and the Japan Tobacco Inc. Law. The first stipulates that JT has a monopoly on the manufacturing of tobacco products in Japan and must purchase all the locally-grown tobacco. It also mandates that tobacco products must be sold at a single uniform retail price regardless of sales outlet and that this price, and any proposed modifications to it, must receive prior approval from the Ministry of Finance. The final key provision is that all tobacco retailers must obtain a license to operate from the Ministry of Finance.

The Japan Tobacco Inc. Law established JT as a semi-private company and requires the state to maintain at least a one third ownership and approve major corporate decisions. As you know the state currently owns 50.1% of JT.

**(SLIDE 12.)**

The Japanese cigarette market peaked in 1998 and has declined over the last 10 years at an average rate of 3.3%. This has been driven by the unfavorable demographics of an aging population, as well as declines in both smoking incidence and daily consumption levels due to societal trends, increased smoking restrictions and slightly higher real prices. The decline accelerated somewhat following tax driven price increases in 2006 and the introduction of the Taspo age verification system in 2008 was temporarily disruptive. We estimate that the underlying market decline is between 3.5% and 4.0% a year.

**(SLIDE 13.)**

The retail selling price of the most popular price category (or MPPC) in Japan is

300 Yen per pack, which is equivalent to about \$3.25. In comparison with GDP per capita, the retail price of cigarettes in Japan is lower than in other developed economies.

**(SLIDE 14.)**

Cigarettes remain relatively affordable in Japan also in relation to other consumer products, with a pack of *Marlboro* currently selling at the same price as a *Big Mac*.

**(SLIDE 15.)**

Cigarette excise taxes in Japan are specific and currently stand at just under 175 Yen per pack. After taking into account the consumption tax of 5%, the total tax incidence currently stands at 63% for the most popular price category.

In December last year, the Government proposed to increase taxes by 70 Yen a pack as of October this year. This was approved in the Lower House of Parliament on March 2nd during the budget process and is expected to be approved in the Upper House by the end of this month.

**(SLIDE 16.)**

The proposed tax increase is an exceptionally high 40%. Even to maintain constant unit revenues, the pass on would be 82 Yen a pack, taking into consideration the consumption tax and current trade margins. The proposed tax increase will result in unprecedented price increases in a market where consumers are known to be particularly price sensitive and therefore a significant market contraction is projected. While different scenarios can be developed, a forecast of the exact impact on market volumes in 2010 and in 2011 is inevitably speculative.

**(SLIDE 17.)**

In our view, this proposal is a turning point in the government's approach to tobacco policy since it has been justified on public health grounds, while the need to take into account the interests of the industry, tobacco growers and retailers has also been recognized. The government has mentioned its willingness to review both the Tobacco Business Law and the Japan Tobacco Inc. Law. This new perspective should logically lead to a more liberalized tobacco market in which manufacturers should be able to determine the prices of their brands.

**(SLIDE 18.)**

In this context, we have submitted a request to the Ministry of Finance for an increase of 20 Yen per pack for all Philip Morris products effective June 1st, 2010. On Thursday of last week, we have been informed by the Ministry of Finance that this submission is approved, and will be official once published in the official gazette. This, in our view, represents a very positive development, underscoring our cautious optimism that pricing freedom will ultimately be granted in Japan. We will continue our constructive dialogue with all key stakeholders on this important topic and on all relevant regulatory developments I previously

mentioned.

**(SLIDE 19.)**

Our second strategy is to further develop and fully leverage our well established and comprehensive brand portfolio. We have built some of the best known and most reputable franchises in the Japanese tobacco market. We have developed a solid understanding of evolving Japanese adult consumer preferences that serves as a foundation for our innovation process. We see plenty of exciting opportunities for further expanding our brands in response to new adult consumer expectations and to satisfy their preferences with innovative solutions.

**(SLIDE 20.)**

In this highly competitive cigarette market, PMJ steadily increased its market share until 2005. It then declined somewhat as we focused primarily on sales and distribution tasks related to the take back of *Marlboro*. However, once this was successfully completed, we again focused our attention on the consumer, new product development and marketing and have now successfully reversed the trend, recording a slight market share gain in 2009 to reach 24.0%.

JT remains the market leader with a 65.0% market share, while BAT is the other main player with 10.5%.

**(SLIDE 21.)**

In Japan, the top 15 brand families accounted last year for more than 90 percent of the total market volume. All our five key brands are in the top fifteen, with two in the top 5, led by our flagship brand *Marlboro*. The *Marlboro* family has been performing very well and is the second fastest-growing brand in the market in terms of annual market share gain.

**(SLIDE 22.)**

PMJ has built a strong brand portfolio across the three main price segments.

The so-called mainstream price segment, currently priced between 290 and 300 Yen per pack, accounts for almost three-quarters of the market but is gradually declining. We compete in this huge segment, traditionally led by JT, with *Lark* and the *Philip Morris* brand.

The high price segment of 320 to 330 Yen per pack, which accounts for 22.5 percent of the market, has increased primarily as a result of the growth of the major international brands. PMJ is the clear leader in this segment with a growing share of just under 60% behind *Marlboro* and *Virginia Slims*.

The top end of the market, which we refer to as the premium segment here in Japan, priced at 340 Yen and above, has been stable at slightly over 2% of the market. With the 100mm variants of our *Parliament* brand, we are the clear segment leader with nearly an 80% share.

**(SLIDE 23.)**

There are two main taste segments that we have identified as key growth opportunities. The menthol segment is expanding and reached 22.8% of the market in 2009. Thanks to the success of innovative new *Marlboro* and *Lark* variants, PMJ has consolidated its leadership position in menthol with a 45.2% segment share.

**(SLIDE 24.)**

Another growing segment is 1mg tar, which accounted for 23.9% of the market last year. PMJ remains slightly under-represented in this segment, but grew its share to 20.3% in 2009, thanks mainly to *Marlboro*.

**(SLIDE 25.)**

The demographic profile of our brands is very favorable as we have a smoker share in the Legal Age (minimum 20 years old in Japan) to 24 years old categories that is nearly 50% higher than our market share. This is driven by *Marlboro*, which has achieved a smoker share among 20 to 24 year olds that is more than double its overall market share. We believe that this augurs extremely well for the future of *Marlboro* and our business as a whole in Japan.

**(SLIDE 26.)**

Japan is known as a country of innovation, and the cigarette market is no exception. Over the past five years, a total of 177 new cigarette SKUs have been launched in Japan, with an average of almost 3 new products a month. By the end of 2009, these new products had achieved a cumulative market share of approximately 18%.

This demonstrates that the Japanese market is a very dynamic one in which consumers are eager to try new product offerings. Accordingly, building a long-term pipeline of relevant product innovations is essential to ensure continued success in this market.

**(SLIDE 27.)**

The industry introduced 30 new SKUs in 2009. However, only nine of these, or 27%, achieved or surpassed the threshold of 0.3% market share, which is the normal minimum criterion that allows these products to maintain distribution in the major key accounts.

PMJ has been able to achieve a very high rate of new product success. All the four new brands that we launched nationally in 2009, namely *Lark Classic Milds*, *Lark Mint Splash*, *Lark Black Label* and *Marlboro Black Menthol One* surpassed the 0.3% market share threshold.

**(SLIDE 28.)**

One of the key success factors for us has been to build a solid long term vision for our brands based on an in-depth knowledge of the marketplace. From our portfolio strategy, to the brand positioning, consumer engagement activities and our new products, all the fundamentals of our marketing are based on a deep understanding of Japanese adult smokers.

Based on a thorough analysis of the market, we first identified 5 key societal trends that should remain valid for the next 10 years, and will fundamentally impact adult consumers in Japan. Then, we defined 8 unique consumer segments, differentiated by their preferences and attitudes. Projecting these trends, and understanding how they are affecting our key segments, makes us better prepared to anticipate future consumer preferences. These fundamentals are translated in our brand strategies so as to ensure the relevancy and sustainability of all our marketing initiatives.

I will show you some examples of these brand strategies, beginning with our flagship brand, *Marlboro*.

**(SLIDE 29.)**

One of our key objectives with *Marlboro* is to expand the reach of the brand to cover a higher proportion of the existing adult smoker population. Thanks to the new global architecture for the brand, which consists of three distinct pillars, we are now in a position to address the taste preferences of all legal age smokers in Japan.

The flavor pillar, symbolized by the red color, is aimed at adult consumers looking for a rich tobacco taste in a non-mentholated cigarette, and was successfully expanded at the end of 2008 with our first 1 mg offer, *Marlboro Filter Plus One*, which complemented the *Marlboro* Red and Medium propositions.

The smooth taste pillar, symbolized by the gold color, is aimed at consumers looking for a smoother tobacco taste in a non-mentholated cigarette and consists of our Lights and Ultra Lights offers. As we speak, it is being expanded with our first innovative Gold offer, *Marlboro Black Gold*. This is an 8mg *Marlboro* with a very smooth taste and sold in a refined black pack.

Finally, the Fresh pillar, symbolized by the green color, encompasses all our menthol offers. It has been the main driver of *Marlboro's* recent growth in Japan.

**(SLIDE 30.)**

Our solid understanding of adult consumers and trends enabled us to design the most successful launch ever for PMJ: *Marlboro Black Menthol*. This innovative line extension pioneered the refreshing and cool taste segment in Japan, and allowed *Marlboro* to extend its leadership in one of the fastest growing segments. Following the tremendous success of the 8mg variant, and knowing the

preferences of numerous adult consumers for a 1mg product, we extended the concept by launching *Marlboro Black Menthol One*. During the fourth quarter, the *Black Menthol* franchise achieved a combined market share of 1.3%.

**(SLIDE 31.)**

*Lark* is the 4th largest brand in the Japanese market and was the first charcoal filter product to be launched here back in 1964. In recent years, *Lark* has suffered share erosion, but it is now gaining momentum. The brand grew by 0.4 share points in the fourth quarter of 2009, thanks to a number of successful new initiatives.

*Lark Mint Splash* has a menthol capsule embedded in the filter. This enables the consumer to crush it at their leisure in order to enjoy an increased and differentiated refreshing sensation. *Lark Mint Splash* has become the best-selling capsule product in the marketplace. *Lark Black Label* offers a surprisingly smooth taste in a very stylish, masculine black package. It seeks to reach to a more traditional audience that prefers the taste associated with domestically manufactured products.

These initiatives have not only successfully achieved significant shares but have also contributed to the strengthening of the brand equity of the entire *Lark* franchise.

**(SLIDE 32.)**

*Virginia Slims* has been the driver of our performance amongst adult female smokers, a segment that requires constant innovation, but is also extremely prone to out-switching.

We have developed creative and exclusive offers in collaboration with Japanese fashion designers, which have allowed us to successfully address the preferences of adult female smokers, while avoiding an unnecessary fragmentation of *Virginia Slims'* product portfolio. *Virginia Slims* enjoys solid equity and is positioned as a key player in the adult female segment.

**(SLIDE 33.)**

We are currently engaged in an ambitious project to overhaul and re-launch the *Philip Morris* brand in Japan. The brand currently benefits from a high level of awareness and a distinct perception of lightness that has been built over a long period of time. It is also perceived as being high-quality, while being competitively priced in the mainstream segment.

Many adult smokers are sensitive to tobacco smoke odor and look for products that offer a low-odor solution. We have, therefore, developed a new cigarette that incorporates a paper technology which reduces tobacco smoke odor and does not compromise on taste. The re-launched *Philip Morris* brand will be an ideal candidate to enlarge our company's reach among Japanese adult smokers who



seek a smooth and light taste experience, as well as the additional benefit of low odor.

**(SLIDE 34.)**

The last major brand in our portfolio is *Parliament*, which leads the very profitable premium segment with an 80 percent segment share. Thanks to its very solid reputation, the brand has been very resilient despite the difficult economic situation and numerous unsuccessful attempts by competition to challenge its leadership.

In order to further reinforce the brand's prestige image, we recently introduced *Parliament Nouveau*. The concept is similar to wine: we used a blend of tobacco leaf exclusively harvested in 2009. This has successfully re-enforced *Parliament's* leadership in terms of "true smoking pleasure".

**(SLIDE 35.)**

As I have already highlighted, understanding our consumers is critical to develop the right product offers. However, it is also equally crucial to determine the best way to engage them.

In today's very competitive marketplace, where consumers face a deluge of messages, traditional advertising has shown its limitations. It is therefore crucial to develop high quality one-to-one contact opportunities to promote our offers in targeted locations. In order to convey the right messages and identify the ideal touch points, we have built a dedicated organization that specializes in high quality face-to-face interaction. Coupled with Internet-based age-verified marketing programs, this allows us to provide exciting brand experiences to adult smokers in Japan and to further strengthen the equity of our brands.

**(SLIDE 36.)**

Of course, the best portfolio and marketing programs cannot succeed without an effective product distribution and sales channel strategy.

**(SLIDE 37.)**

As mentioned previously, PMJ operate on a buy/sell model, sourcing its products from Philip Morris Products SA, an affiliate of PMI, and selling them to Sojitz, one of the major Japanese trading houses. Sojitz is responsible for the importation and transportation of the cigarettes into Japan. Sojitz sells the cigarettes to TS Network, a 75 percent-owned subsidiary of JT that is responsible for the distribution. TS Network services more than 290 thousand licensed cigarette retailers across the country.

The cigarette retail universe can be divided into two main categories. The first is vending machines, with a network of around 420,000 units, and the other is over-the-counter (or "OTC") sales.

In the context of Japan, this category comprises convenience stores, which, although relatively small in terms of the total number of outlets, are a very important and growing channel from a volume perspective. A large portion of the other OTC outlets consist of traditional tobacconists, but this category also includes other types of outlets, such as supermarkets, grocery stores and railway kiosks.

**(SLIDE 38.)**

The importance of the different sales channels has shifted substantially over the last couple of years, triggered by the relatively complicated requirements of the Taspo card, which led many adult consumers to change their purchasing behavior. As a result, there has been a dramatic shift from vending to convenience stores, which now account for nearly 60 percent of the total market volume.

**(SLIDE 39.)**

PMJ has successfully adapted to this dramatic transformation of the market environment and has maintained its competitiveness. Our share in convenience stores of around 27% is slightly over-indexed compared to our total market share. All our five key brands are available in every C-store chain across the country, and each of our new product launches has been systematically welcomed and put on display. Year-after-year, we have secured promotional space and a product presence that has allowed us to support our key brand initiatives nationwide through chain-specific promotions and unique consumer programs. We believe that these strategies, coupled with a continued focus on specific customer requirements, will enable us to further strengthen our overall performance in the convenience store channel going forward.

**(SLIDE 40.)**

Despite the decrease in the vending machine network from 520,000 units in 2007 to around 420,000 today, vending remains an important purchasing channel for many adult smokers. Currently, over 9 million adult smokers, representing over one-third of the total adult smoking population, have a Taspo card and continue to purchase products from tobacco vending machines. PMJ is well represented in this key channel, which is also an important vehicle for generating new product awareness. Accordingly, PMJ is leveraging its vending network with creative marketing executions that enhance our brand communication.

**(SLIDE 41.)**

Our fourth strategy is to continuously develop an agile and winning organization.

**(SLIDE 42.)**

Let me illustrate this in the context of our sales organization.

Following the shift in volume to convenience stores, we have reorganized our field sales structure to optimize our allocation of resources. All sales territories

have been redesigned based on our new point of sales coverage and the re-prioritization of visit frequency based on our ranking of customers.

We have trained our people to build what we call a consumer-centric approach. This means they are now looking at their actions through the “eyes of the consumer”. We expect them not only to focus on conventional sales metrics such as handling, share of facings or point of sales material placement, but also to look at how their combined initiatives reach our target audience effectively.

We have also streamlined our reporting tools and reorganized our field logistics with the aim of maximizing our sales force presence at the point of sale. This, combined with a reviewed in-call mission, has greatly increased the effectiveness and productivity of our sales team as a whole.

Another important success factor is the ability to be flexible in our approach to different regions and to consumers’ preferences in specific areas and outlets. To take advantage of the distinct opportunities resulting from taking a localized approach, we have decentralized part of the decision-making process and Territory Sales Managers can now utilize a number of business building tools at their discretion to carry out tailor-made initiatives best suited to their respective areas.

**(SLIDE 43.)**

With this summary of our key strategies, I hope to have given you a good overview of our activities in the Japanese market.

The cigarette market in Japan remains one of the largest in the world. While the planned tax increase will be disruptive, especially in 2011, should pricing freedom be obtained, this should provide a viable business model for future long-term profitability growth.

We have a very good understanding of adult smoker preferences and have developed a very strong and broad brand portfolio that covers all the price and key taste segments. We are notably over-indexed in the growing menthol category and have proven, most notably with *Marlboro Black Menthol*, our ability to successfully respond to consumer demand for continuous, relevant innovation. *Marlboro* again has growth momentum and its very good demographic profile augurs well for future growth. We are able to present our brands successfully through superior realization with our trade partners.

Our experienced and talented organization is well prepared to execute behind our four key strategies, focusing on both individual and company performance, and ensuring the Japanese adult smoker is at the center of what we do.

I strongly believe, therefore, we have both the ability and resources to achieve sustainable future growth for our business. Thank you very much for your interest.

I would now like to open the floor to your questions.

**(SLIDE 44.)**