# Remarks by
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# Philip Morris International Inc.

**ANDRE CALANTZOPOULOS**

**(SLIDE 1.)**

Thank you, Janet. It is my great pleasure to be back at CAGNY. Let me extend a warm welcome to those joining us on the webcast.

I would like to introduce the team here with me today who will join me for the Q&A session: Jacek Olczak, Chief Operating Officer, Martin King, Chief Financial Officer, and Nick Rolli, Vice President Investor Relations.

**(SLIDE 2.)**

Our remarks contain forward-looking statements and, accordingly, I direct your attention to the Forward-Looking and Cautionary Statements section of today's presentation. Reduced-risk products, or "RRPs," is the term we use to refer to products that present, are likely to present, or have the potential to present less risk of harm to smokers who switch to these products versus continued smoking.

**(SLIDE 3.)**

I will begin the presentation with a quick recap of our 2018 performance and outlook over the near term.

Next, I will cover our combustible tobacco business.

I will then turn to reduced-risk products, our single-largest growth opportunity. I'll provide an overview of the international e-vapor landscape, which is distinct from that of the U.S., explain our strategy for category leadership, and end with a discussion of our unrivaled performance in the heated tobacco category.

**(SLIDE 4.)**

Let me reiterate a few key metrics that highlight the robust overall performance across our business in 2018.

Our heated tobacco unit in-market sales volume nearly doubled, reflecting growth in all *IQOS* launch markets, and drove a 0.5 percentage point increase in our total international market share.

Our cigarette and heated tobacco unit shipment volume was flat, excluding the net impact of total estimated distributor inventory movements. This was our best annual performance since 2012.

Net revenues increased by over 3%, excluding currency, driven mainly by strong combustible product pricing.

Adjusted diluted EPS increased by over 10%, excluding currency, driven by both a lower effective tax rate and net interest expense resulting from the 2017 U.S. tax reform.

**(SLIDE 5.)**

I believe we have laid the foundation for strong business performance in 2019 and beyond, thanks to significant investments in product portfolio development and organizational capabilities.

As outlined during our Investor Day last September, we are targeting currency-neutral compound annual growth for net revenues and adjusted diluted EPS of at least 5% and 8%, respectively, for the 2019 to 2021 period.

**(SLIDE 6.)**

As we announced in our press release today, we are re-affirming our 2019 reported diluted EPS guidance provided on February 7th. On a currency-neutral basis, our guidance represents a projected adjusted diluted EPS increase of at least 8%, and assumes net revenue growth of at least 5% and operating income margin expansion of at least 100 basis points.

**(SLIDE 7.)**

I will now cover our strong combustible tobacco business, which is performing very well and still represents the majority of our earnings and cash flow.

**(SLIDE 8.)**

The annual decline in total industry volume – including cigarettes and heated tobacco units – has averaged 2.3% since 2014, the year we launched *IQOS*. While the total market in a given year can be impacted by specific factors, such as, in the case of 2018, the significant recovery of volumes from the illicit market in both Pakistan and Turkey, we see no major changes to the underlying multi-year trend going forward.

Clearly, the growth of heated tobacco products is driving a shift in the composition of industry volume, reflecting a higher decline rate for the cigarette category as adult smokers out-switch to heated tobacco.

**(SLIDE 9.)**

Combustible tobacco pricing also remains consistent with historical trends, largely reflecting the rational global excise tax environment and competitive landscape.

Since 2008, our combustible tobacco annual pricing variance has ranged from 5.2% to 7.7%, with year-to-year variability that mainly reflects the timing and level of excise tax and retail selling price increases. Importantly, cigarette price elasticities have remained stable at -0.3 to -0.5.

The fundamental strength of our pricing, driven by our leading cigarette brand portfolio, remains intact.

**(SLIDE 10.)**

As we transition our product portfolio to reduced-risk products, we are committed to maintaining our cigarette market leadership and price positioning for our cigarette brands at the top of their respective segments.

To achieve this, we have a focused innovation strategy that entails fewer, more impactful initiatives that can be deployed globally and swiftly. This strategy resulted in a 44% success rate for new products in 2018. This approach is complemented by portfolio rationalization, largely through brand morphing and the elimination of low-volume SKUs.

**(SLIDE 11.)**

The success of this strategy is further evidenced by our cigarette market share performance. In 2018, our share of the international cigarette category was stable at 27.4%, despite over-indexed *IQOS* out-switching and the shift of resources to heated tobacco products, which drove our total international share growth.

Importantly, *Marlboro*'s international share of the cigarette category was also stable, with share growth across a range of markets.

**(SLIDE 12.)**

The strategy's success is also visible in the performance of our other top international cigarette brands, with *L&M*, *Chesterfield*, *Philip Morris* and *Parliament* recording growing or stable share in 2018.

**(SLIDE 13.)**

I will now turn to reduced-risk products, but before I touch on specifics, I would like to reiterate our overarching RRP strategy.

**(SLIDE 14.)**

It is our ambition to build our future on smoke-free products that are a much better choice than cigarettes for the millions of adult smokers, as well as for the people around them. PMI is at the forefront of this major transformation.

We offer, and will continue to offer, our consumers an array of breakthrough products so that they can make the choices they undeniably deserve. This in turn will offer our shareholders much more sustainable business growth for many years to come. But we should not forget that success in the cigarette business gave us the resources to develop, scientifically assess and commercialize smoke-free alternatives at unprecedented speed, and we will maintain our leadership until the day cigarettes are completely replaced.

**(SLIDE 15.)**

There are three strategic pillars supporting our ambition: consumer satisfaction, key external stakeholder engagement and organizational readiness. We are absolutely focused on executing these seamlessly.

**(SLIDE 16.)**

Let's start with our consumers. Convincing them to switch out of cigarettes is not an easy task. It depends on personal preferences and beliefs, health concerns, cultural traits, regulatory environments and the point in time of their conversion journey.

One type of product is unlikely to be the answer. This is the reason we adopted a portfolio approach for our smoke-free products, from heated tobacco to non-tobacco nicotine-containing aerosol.

But all these products will carry certain fundamental characteristics for our consumers:

- The best taste and satisfaction in their respective category;
- A much better choice for those who switch to them and the people around them;
- Unparalleled and transparent scientific substantiation of their harm reduction potential, to build trust and understanding among consumers and regulators;

- Iconic design language, user experience ecosystems and brand image; and
- Excellent service and care across all consumer touch points.

In other words, we aim for products that are the most worthy of adult smokers' efforts to switch out of cigarettes and never go back.

Our investment behind our smoke-free portfolio is and will be commensurate to their potential, but pragmatic and highly sensitive to minimizing any unintended use, particularly among youth.

Notwithstanding the strength of our smoke-free portfolio, and the considerable resources we are investing, the speed of adult smoker switching can accelerate significantly with the help of others.

**(SLIDE 17.)**

This leads me to the second strategy, which focuses on key external stakeholders, including regulators, the scientific community and NGOs. We are eager to see fiscal and regulatory measures introduced that drive large-scale switching as quickly as possible.

On our side, we have put in place a rigorous and transparent scientific pre- and post-market assessment program that is unmatched in the industry. This program has become a cornerstone of our external engagement, in which we advocate for public health authorities and policy makers to adopt the same evidence-based approach to designing regulations that foster healthier consumer behavior compared to continued smoking.

**(SLIDE 18.)**

The third strategy focuses on our internal capabilities so that our organization is always fit-for-purpose and at the leading edge of technology, science and user experience.

This means:

- Developing or acquiring new technical skills, and implementing more agile, entrepreneurial structures and practices enabled by digitalization;
- Developing new products and services not only internally, but also through partnerships and acquisition; and
- Driving efficiency through every level of our operations to liberate resources and reallocate them to where they will have the maximum benefit.

Successful execution of our strategies not only gives us the confidence that we can continue convincing consumers to switch, but also that we can compete effectively as competitive entries in this category increase. Since the beginning of the journey we never assumed we would be alone. But we are deliberately disrupting our industry and accumulating considerable expertise along the way.

**(SLIDE 19.)**

Behind our portfolio of heated tobacco and nicotine-containing e-vapor platforms, we have invested over $6 billion in research, product and commercial development, production capacity, scientific substantiation, and studies on adult smoker understanding.

It is important to understand that the smoke-free category is not a zero-sum game or winner-take-all. While we believe that – for years to come – heated tobacco products will be the preferred solution for the vast majority of adult smokers looking to switch from cigarettes, e-vapor products do represent an important alternative. In our view, heated tobacco and e-vapor will co-exist within the RRP category, and their trajectories will follow differentiated paths, ultimately complementing, but not fully substituting for each other in the broader reduced-risk context.

**(SLIDE 20.)**

Against this backdrop, let’s look at the retail value size and split of the total nicotine market, excluding China and the U.S., which offers perspective on the current international landscape. While these figures are clearly estimates, they nonetheless provide useful insight.

In 2018, the total nicotine market had an estimated retail value of approximately $465 billion dollars internationally. Of this total, combustible tobacco products accounted for the vast majority – approximately 95%.

**(SLIDE 21.)**

Heated tobacco and e-vapor products had an estimated total retail value of approximately $18 billion in 2018, following year-on-year growth of around 70%.

Heated tobacco accounted for the lion’s share of the total and was the main driver of that growth.

**(SLIDE 22.)**

*IQOS* alone accounted for approximately 57% of the total retail value, representing nearly double that of all e-vapor products combined.

**(SLIDE 23.)**

The e-vapor category is currently top-of-mind for many investors given recent developments in the U.S. I will now provide some additional insight into the current international landscape where, for certain aspects, the category has followed paths comparable to the U.S. market, but also presents a higher degree of complexity in terms of consumer acceptance, product and marketing limitations, as well as operating infrastructure scale-up and costs.

**(SLIDE 24.)**

E-vapor products are certainly not a novel phenomenon, as they have been present and tried by the majority of adult smokers in many markets for more than a decade. Today, the category is relatively small. The number of fully-converted or dual e-vapor users in addressable international markets is estimated at some 24 million, or around 4% of all nicotine users outside China and the U.S.

The vast majority of e-vapor users, or close to 60%, are in the European Union, with the U.K. and France being the largest markets. And of all international e-vapor users, less than 40% are fully converted, or around 1.8% of total nicotine users.

The potential is there, but significant consumer disappointment with the product exists, which, along with some regulatory issues, needs to be addressed.

**(SLIDE 25.)**

Regulation plays an important role. Although, in general terms, e-vapor products enjoy more communication freedom than cigarettes or heated tobacco products, such as *IQOS*, there are many limitations, especially compared to the U.S. market.

In addition, nicotine concentration ceilings exist in many markets, notably in the EU. These are a serious limiting factor and will require significant product innovation.

Regretfully, many countries have introduced outright or maintain de facto e-vapor product bans. These countries represent some 20% of cigarette volume outside China and the U.S. While a reality today, the bans are illogical and they will hopefully be lifted over time.

Currently, e-vapor products are subject to low or no excise taxes. As the category becomes more sizable, it will be important to maintain a significant excise tax differential to cigarettes in a similar logic to heated tobacco.

**(SLIDE 26.)**

From a manufacturer's point of view, the competitive environment is fragmented, with:

- very high trade margins, up to three times those of cigarettes;
- undifferentiated vaporization technologies, all based on the old coil and wick platform;
- lack of product consistency and performance standards; and
- SKU proliferation with few brands having created a brand image, especially as an estimated 80% of e-vapor consumption is via open systems.

Manufacturer margins are reasonable at the premium end of the closed system market, but still below cigarettes and, to a larger extent, *IQOS*. This is due, in part, to higher unit cost of goods sold for e-vapor cartridges, which can range from 2.5 times to five times those of *IQOS* consumables and cigarettes, assuming one cartridge is equivalent to one pack, which is rarely the case.

The optimal price-volume-full adoption equation is admittedly difficult to harness today, as almost every e-vapor user has a different pattern of daily consumption and many dual users of e-vapor and cigarettes view the product as a way to balance their overall cost of nicotine use.

Also, geographic expansion requires infrastructure and organization-building to drive product awareness and availability, and to adapt to local regulations.

**(SLIDE 27.)**

From an existing cigarette smoker point of view, the category still needs to deliver convincingly against key sensory and satisfaction dimensions.

Furthermore, there remains consumer uncertainty in many countries about the real health benefits of the category relative to smoking, due to a number of confusing studies and inflammatory media headlines, as well as the fact that, as of today, no manufacturer has produced a total scientific evidence package, as we have done with our *IQOS* heated tobacco product.

As no e-vapor product addresses all current consumer preferences or pain points, we see a significant opportunity with *IQOS MESH* in terms of vaporization technology, liquid formulation and scientific substantiation, as well as capitalizing on the rapidly-growing *IQOS* brand image, and the use of our existing infrastructure. I will cover this point in more detail in a moment.

**(SLIDE 28.)**

With this in mind, let me now take you through how we have approached the e-vapor category.

We have long recognized that e-vapor has a role to play in our reduced-risk product portfolio and overall strategy for a smoke-free future. However, we have deliberately prioritized our *IQOS* heated tobacco platform because we know that it best addresses the preferences of adult smokers, as it has the highest switching ability, which, in turn, builds consumer credibility and trust, and a strong brand image. Actual results have confirmed that our approach is the correct one.

But we have not been idle on e-vapor products. We have invested significantly in their development and are now ready to introduce them at scale.

**(SLIDE 29.)**

To address the e-vapor product shortcomings that I mentioned earlier, we have developed the *IQOS MESH* heating technology, which is manufactured in Europe. The patented *MESH* heater inside each flavor cap eliminates the need for manual replacement – a common issue with coil and wick-based open system e-vapor devices. The technology can be adapted to a variety of form and design factors, from small to larger devices, and can operate efficiently with a wide array of e-liquid formulations.

The *MESH* heating technology prevents the formation of formaldehyde in the aerosol at the end of cartridge consumption. Furthermore, tobacco-specific nitrosamines and toxic metals are not detected in the *MESH* aerosol.

In addition, the *MESH* technology is approximately 30% more efficient compared to coil and wick systems at the same power level or at the same size, a factor that is particularly relevant in markets with nicotine concentration ceilings.

**(SLIDE 30.)**

Last summer, we successfully introduced our first *MESH* product in the U.K. on a limited scale under the *IQOS* brand. The large format primarily addresses open system consumer preferences and was positively received.

Adult consumers view the *MESH* technology as addressing the fundamental requirements of consistency, reliability and convenience. In addition, they appreciate our range of superior flavors, which offer sensorial satisfaction. Our learnings instructed further product improvements that we have also incorporated in the different device formats that we will commercialize. So, from a product perspective, we believe that we have the right initial combination of formats and corresponding liquid formulations and flavors to address the vast majority of e-vapor consumer segments. From this base, we should be in a position to expand further.

**(SLIDE 31.)**

*IQOS MESH* will greatly benefit from the rapidly-growing *IQOS* brand image and equity. Its commercialization will be propelled by the existing *IQOS* retail, customer care and e-commerce infrastructure, and a very experienced PMI organization and field force.

We are making further investments to support our e-vapor manufacturing capacity, and plan to meaningfully enter the category later this year and expand in 2020 as we build capacity.

Our clear objective is to achieve sustainable e-vapor category leadership over time.

**(SLIDE 32.)**

I will focus the balance of my remarks on the performance of *IQOS*, including some early takeaways from the *IQOS 3* global launch and ongoing roll-out.

**(SLIDE 33.)**

Today, *IQOS* is available in key cities or nationwide in 44 markets across five of our six Regions.

**(SLIDE 34.)**

There were an estimated 9.6 million total *IQOS* users as of December 2018, with nearly 70% of the total -- an estimated 6.6 million users -- having already stopped smoking by switching to *IQOS*, and the remaining three million in the process of conversion.

**(SLIDE 35.)**

In 2018, our *IQOS* heated tobacco unit consumables would have qualified as a top-15 international tobacco brand by market share, an unprecedented achievement for a new tobacco brand, let alone a premium-positioned offering.

**(SLIDE 36.)**

Finally, we recorded reduced-risk product net revenues – driven almost exclusively by *IQOS* – of over $4 billion in 2018, representing nearly 14% of our total net revenues.

**(SLIDE 37.)**

Turning to Japan, our most successful *IQOS* market, we are encouraged by the sequential trend in national heated tobacco unit offtake share, which reached 17.3% during the second week of February.

The initiatives that we introduced during the second half of 2018 to restore share growth are starting to pay off, though more time is needed to fully assess their impact. Importantly, we only recently expanded *IQOS 3* device distribution to the convenience store channel, and the full national expansion of our mid-price *HEETS* brand began last week. As of January, *HEETS* had reached a weekly offtake share of over 1.6% in its initial launch areas, contributing to incremental share growth.

We are mindful of the potential impact of increased competitive activity this year, though this may also serve to accelerate category growth, which would be a clear positive.

**(SLIDE 38.)**

While I know that many investors are focused on the short-term share progression in Japan, it is important to also take a broader view of the effect of *IQOS* on the market over a longer period.

In this regard, I would like to highlight the impact that *IQOS* has had on price segment dynamics in Japan. When we launched *IQOS* in 2014, the premium segment accounted for 36% of total industry volume, of which our products represented 44%. Just four years later, the premium segment had grown by eight points to reach 44%, our share of which had increased by sixteen points to 60%. Clearly, *IQOS* has served to “premiumize” the market, and we have captured a much larger proportion of the growing segment in the process.

**(SLIDE 39.)**

Turning to Korea – one of the most competitive heated tobacco markets today, along with Japan – *IQOS* remains the preeminent brand in the category. This position has been reinforced by the launch of our new *IQOS 3* devices.

Fourth-quarter share for *HEETS* of 8.5% increased by 3.0 points compared to the same period in 2017, or by 1.1 points sequentially. It should be noted that our share in the quarter was favorably distorted by trade inventory movements ahead of the change in health warnings on heated tobacco products in late December.

**(SLIDE 40.)**

In the EU Region, our incremental investment behind *IQOS* in 2018 and improved execution are driving strong sequential share performance and growth in the total number of *IQOS* users. Importantly, we have now reached an estimated two million *IQOS* users in the Region based on February data.

*IQOS* is still only present in geographies representing approximately 47% of total industry volume in the Region. Thus, its 1.7% share largely understates the strength of the brand in the areas where we focus our support.

**(SLIDE 41.)**

As seen on this slide, a broad range of EU Region markets recorded substantial fourth-quarter *HEETS* share growth.

**(SLIDE 42.)**

Russia has also recorded strong sequential *HEETS* share performance and total *IQOS* user growth, despite a still limited geographic presence. Given this success, we are now rolling out *IQOS* to additional areas – continuing our targeted approach to geographic expansion – while leveraging our ability to scale up efficiently.

**(SLIDE 43.)**

Before closing on our heated tobacco unit share performance, I would like to highlight our offtake shares in select cities. These city-level performances compare very favorably to the corresponding national shares and provide an encouraging indicator of the opportunity that can come with broader focus and support in *IQOS* markets.

**(SLIDE 44.)**

As announced last year, we began the global launch of our *IQOS* 3 devices in mid-November, starting with our own retail and e-commerce channels.

Though still early, with full device availability and expansion to our main distribution channels only occurring this quarter, we are very pleased by the initial consumer reaction to the new device line-up across *IQOS* markets.

In Japan, *IQOS 3* has significantly increased the number of smokers who switched to *IQOS* compared to the 2018 monthly average prior to the launch. We are encouraged by the initial offtake, which has been split fairly evenly between the two device types.

**(SLIDE 45.)**

The strong overall performance and favorable momentum for *IQOS*, supported by our unmatched innovation machine, further underscores our confidence in the 90 to 100 billion heated tobacco unit shipment volume target for 2021 that we first provided at our Investor Day last September.

The growth underlying this target is driven by every *IQOS* market, including Japan and Korea, and reflects geographic expansion within current *IQOS* markets, as well as new market launches. In addition, it assumes no improvement in the current regulations for heated tobacco products, which, today, are generally no different than those for combustible tobacco products.

Regarding our submissions to the FDA in the U.S., the public comment period for our Modified Risk Tobacco Product Applications closed on February 11th. This is certainly an important step. As a reminder, our Pre-Market Tobacco Product Applications pending for *IQOS* are dealt with through a separate process. We are hopeful that the FDA will issue its decisions soon. It is important to note that, if our applications are granted, *IQOS* will be the first alternative to cigarettes to have undergone the full FDA authorization process, from comprehensive pre-market review to post-market surveillance and, as such, be in alignment with the FDA policy announcement of July 2017.

**(SLIDE 46.)**

Our 2021 heated tobacco unit volume target corresponds to total 2021 *IQOS* revenues of approximately $8.5 to $9.5 billion, assuming current retail selling price and excise tax levels.

**(SLIDE 47.)**

I would like to leave you with some key messages.

We recorded robust overall results in 2018 and are positioned for strong business performance in 2019 and beyond.

Our combustible tobacco portfolio remains the foundation of our business, supported by pricing and other industry fundamentals consistent with historical trends.

*IQOS* continues to grow globally, with an increasing number of markets making an important contribution to its success.

The e-vapor category presents an additional opportunity internationally, and we are investing behind our portfolio of products thoughtfully and deliberately in order to best address the preferences of adult smokers.

Finally, we are convinced that our smoke-free strategy continues to provide us with the single-largest opportunity to accelerate business growth and generously reward our shareholders over time.

**(SLIDE 48.)**

Thank you. Jacek, Martin and I are now happy to take your questions.