

**Remarks by Leo McLoughlin
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Good afternoon ladies and gentlemen. Welcome to Moscow. My name is Leo McLaughlin and I am the Managing Director of Philip Morris International's affiliate companies here in Russia. I had the pleasure of meeting some of you already at lunch and I would like to thank Credit Suisse again for providing an opportunity to talk about PMI's exciting business achievements and prospects in Russia.

During my presentation today, I will start with an overview of the current tobacco business environment in Russia and the main trends among Russia's adult smokers. I will then share with you the strategies we have developed to grow PMI's business in this important market. You will see what our strategies mean in practice, as I focus on the way we are developing and enhancing an already great PMI brand portfolio. You will also see what we are doing to get the maximum benefit from our infrastructure investments and how we are adapting and improving field execution in order to capture every bit of profitable growth we can. After a few concluding remarks - at the end of my presentation, I will be happy to answer your questions.

Before I begin, let me inform you that my observations today may contain projections of future results and other forward-looking statements that involve a number of risks and uncertainties and are made pursuant to the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995. I should also add that I will not be commenting on our results outside of Russia and we will not be talking at all about our third quarter results, which we will release on October 22nd.

Philip Morris International is proud of its long history in Russia, which started more than three decades ago in the mid-1970's when we signed break-through agreements with the Soviet authorities. From these early Soviet era initiatives, which included the development of the commemorative brand *Apollo-Soyuz* and the license production of *Marlboro* at five factories across the country, we learned a lot about doing business in Russia and a lot about Russian adult smokers. So when the market opened in the early 1990's, we were ready.

In 1991, PMI entered a joint venture for the local production of its cigarettes with the Samara Tobacco Factory. The same year we supplied the Russian government with our largest single export order ever, twenty two billion cigarettes. The brands sold at the start of the 1990's – including *Marlboro*, *L&M* and *Bond Street* – remain Russian best sellers today. We also moved early to build a professional, trained sales force with national reach.

The purchase in 1993 of the state-owned Krasnodar Tobacco Factory gave us improved access to the lower price end of the market. And the construction, beginning in 1998, of our large, state-of-the-art Greenfield plant - Philip Morris Izhora - near St. Petersburg allowed us to end importation, cut customs duties and bring our international brands even closer to our customers.

Let me introduce my management team, starting with the members who are here today: Sergey Slipchenko, our Marketing Director, Patrick Brunel, who heads Finance, Administration and Information Services and Dan Richards, our Planning and Business Development Director. Not able to attend today are Artyom Chernis, our General Manager for Field Operations, Julia Bondarenko, our chief local attorney, Nicolas Floros, who oversees production and supply chain activities, Brian Harrison, who is in charge of Human Resources and Alexey Kim, our Corporate Affairs Director.

The Philip Morris International team in Russia is a high performance group with - collectively - 115 years of experience with PMI across a number of markets and particular expertise concerning Russia. They have been selected for their skill, knowledge, business acumen and drive to succeed, as well as demonstrated success in building and leading diverse teams, often in remote locations.

Let me turn now to the Russian market.

Russia is a huge country. It stretches across eleven time zones and is twice the size of the European Union or the USA. In commercial terms, Russia's geographic size often requires material investments in infrastructure and logistics capabilities. However, the greater part of Russia's population resides west of the Urals and along the country's southern tier. This makes the hard work of connecting with Russian consumers slightly easier than it might first appear - but still very challenging.

Russia's economy is growing fast, partly due to demand for Russian oil and gas but increasingly due to rising domestic consumption. Last year real GDP increased by more than 8 percent – and consumer incomes are rising just as quickly.

Total cigarette industry volume, based on Russian state statistics, was estimated at about 387 billion units last year, making Russia the world's second largest cigarette market after China. Our share of the Russian market – according to Business Analytica retail market surveys – was 26.7% during the first half of this year. That ranks us second – in volume terms – after Japan Tobacco but ahead of BAT and Imperial.

Record oil and gas prices have meant huge monetary inflows into Russia over the last few years. However, Russian policy has – quite conservatively – aimed at isolating or “sterilizing” excess hard currency inflows, by setting them aside in state stabilization funds. In the event of an economic slowdown, Russia's massive hard currency reserves would tend to cushion the economy.

Inflation has jumped this year, in part due to increased consumer demand but also reflecting a rise in government spending. GDP continues to grow and, despite inflation, most Russian consumers are seeing big increases in wages and in purchasing power.

In the cigarette category, the rise in consumer purchasing power has resulted in significant consumer up-trading. Nevertheless, if we measure purchasing power as the amount of time in minutes that it takes to earn the cost of a pack of *Marlboro*, it's clear that there are significant regional variations. In Novosibirsk, for example, average consumer purchasing power is still only about half that of Moscow.

Income differences from region to region and from rural to urban locations can still be significant. We have taken these differences into account in developing our brand portfolio by offering "best in class" products in all profitable price categories and not just the premium segment, which is mainly favored by high income adult smokers in urban locations.

Economically, the regions are developing differently, but federal laws and regulations govern alike everywhere in Russia and this helps provide a level playing field for our industry. Russia has consolidated its tobacco laws, with one set of federal product regulations, one advertising code, and a single, mainly specific excise tax regime. Russia has also ratified the World Health Organization's Framework Convention for Tobacco Control and the outlook is for increased regulation of the industry. We support the Russian government's efforts to assure clear, comprehensive regulation based on the principle of harm reduction. And we expect continued reasonable legislation and regulation of the industry. As you know, PMI has an excellent, proven record of competing very effectively in regulated environments.

Two years ago, Russia enacted fundamental excise tax reforms, which took effect in January 2007. The reformed excise system is now predominantly specific in structure and features a minimum specific excise rate. Also, under the reformed system, manufacturers now set maximum retail selling prices and these maximum prices are printed on each pack for consumers to see. Retailers are free to sell below the printed prices but are subject to fines if they price above them. Excise liabilities are calculated based on the printed prices. This system helps to safeguard state excise revenues and to address public health objectives. Based on independent market surveys of retailer pricing compliance, we believe the new law is working well.

This summer, the Duma passed and the President signed legislation setting out excise rates for the next three years, through 2011. The planned excise increases are mainly on the specific component of the tax. The impact of the minimum excise feature of the tax system sees the excise fully specific rise to nearly 13 Rubles per pack by 2011 from below 8 Rubles per pack today.

The minimum excise is important, because it reduces the incentive for a manufacturer to cut prices – as the manufacturer would have to fund most of the price differential itself while government revenues would tend to be unchanged. Along with providing a significant degree of fiscal predictability, this long-term legislation also helps with price gap management and facilitates the development of our brand strategies.

This is important for PMI as a whole as Russia is the world's number two cigarette market – in terms of volume – second after China, but well ahead of Japan and Indonesia.

Estimated industry volume of 387 billion in 2007 was down compared with 2006, reflecting trade inventory movements and other impacts associated with excise tax reform. In the first half of 2008, the market has recovered to levels slightly above those seen in the first half of 2006. Importantly, while industry volumes have been roughly stable or slightly up over the past few years, the retail value of the cigarette category has increased significantly. We estimate the retail value of the industry will reach – and may exceed – 14 billion dollars this year. This is about double the retail value of four years ago, reflecting higher taxation and adult consumer up-trading on price.

Let us now look more closely at the workings of this giant market and some of the key consumer trends.

The Russian adult smoker – you might say – is on “fast forward”. Driven by rising incomes, the most important trend in the Russian market today is the tendency of adult smokers to switch to higher priced and especially international brand cigarettes.

Together the combined Medium and Premium – or “Medium Plus” price segment – where cigarettes retail at above eighty US cents per pack – has increased by half over the last four years to an estimated 43% of the market today.

The second key trend in Russia is an increasing preference for smoother, lighter tasting cigarettes, which now are estimated to account for over 60% of the total market.

Finally, Russian adult consumers increasingly demand – and are willing to pay for – products with “new and improved” features. For example, reduced diameter products have recently gained significantly in popularity and now account for about 12% of the market, according to Business Analytica.

These trends – as we will see in a moment – strongly favor PMI’s portfolio of high quality, international brands.

Independent market surveys for the first half of the year show that Medium Plus priced cigarettes – that is cigarettes priced at or above the level of our *L&M* brand – account for an estimated 43 percent of the total Russian market in volume terms.

In terms of profitability, however, we believe the Medium Plus segment generates more than 80 percent of manufacturer margins – and this proportion is growing.

The Value Minus segment in Russia is huge in volume terms – about the size of the entire Indonesian market, for example. But, we believe, the segment generates less than 20 percent of manufacturer margins.

In the Premium segment, where we compete with *Parliament*, *Marlboro* and *Virginia Slims*, we held an estimated 38 percent share in the first half of 2008.

In the larger Medium price segment, where *Chesterfield*, *Muratti* and *L&M* are positioned, our estimated share was also 38 percent.

In the very large Value Minus segment, where we offer *Bond Street* and *Next* as well as local heritage brands like *Apollo Soyuz* and *Optima*, we had an estimated 18 percent share.

These more affordable brands extend our reach into less affluent parts of the market and also serve as a potential hedge against any eventuality of an economic slowdown.

Looking at the relative price positioning of the four international cigarette manufacturers in Russia, you can see each manufacturer's estimated share of the total market and the relative importance of the two main price segments – Medium Plus and Value Minus – in each company's estimated volume base.

For the first half of 2008, PMI held an estimated 26.7 percent of the total market with 61 percent of our sales coming from the growing, high profit Medium Plus segment.

Our clear lead in the fast growing, high margin Medium Plus segment means PMI has the "pole position" in the Russian market.

In financial terms, our portfolio skew in favor of Premium and Medium brands – together with efficient infrastructure and close attention to costs – means we are already today generating superior operating margins. And for the future, we plan to do much better.

Looking at the first half of 2008, we continued to achieve strong results in Russia. Shipment volume increased by 8 percent, with our key *Parliament*, *Marlboro* and *Chesterfield* brands achieving double digit volume growth.

During the first half of 2008, industry volume increased at a similar rate – rebounding from a weak first half last year that followed the implementation of the new excise regime in January 2007. Consequently, our market share has remained stable at an estimated 26.7 percent. However, our mix improved and, together with higher selling prices, this drove a significant improvement in the profitability of our Russian business.

This performance places Russia as one of the key drivers of PMI's strong overall results during the first half of 2008.

We have implemented a number of strategies to keep our volume and profitability growing in Russia.

First, we are further developing our strong brand portfolio in the Medium Plus price segment. To do this, we are continuously improving existing products and extending the reach of our franchises with new variants, notably in the Slims segment. We also have a robust innovation pipeline to satisfy emerging adult smoker preferences.

Second, we are continuing to improve our execution. We are adapting our infrastructure, organization and marketing programs for greater effectiveness, speed and flexibility. We have nearly 3,500 motivated and capable employees in Russia and we are investing for the long term to develop their skills and knowledge – thus helping to underwrite our future success.

Third, we are focusing on growing our margins with top line revenue growth and close attention to costs. We believe that these strategies should enable us to deliver sustainable profit growth in the future, but let us look now at what they mean in practice.

An excellent example of successful, focused innovation is *Marlboro Filter Plus*. *Marlboro Filter Plus* features an innovative tobacco-based filter system, a unique, sliding pack and offers great flavor in a lighter tasting cigarette. *Marlboro Filter Plus* retails at a five Ruble premium to *Marlboro* King Size and was launched last year – at first - in limited high end venues in Moscow and St Petersburg. This year we expanded distribution to Russia’s largest 50 cities, supported with nearly 300,000 successful – that is product selling – adult consumer contacts. By June this year the brand held an average 0.4 percent share in these cities. Our consumer research shows that the addition of *Marlboro Filter Plus* has generated excitement and a “halo effect” benefiting the entire *Marlboro* franchise.

We have also recently added a number of new and enhanced product offers in the growing Slims category. *Virginia Slims UNO* – in modern, designer black and white packs – is boosting the premium image of the entire Virginia Slims family. And innovative programs for *Virginia Slims UNO* extend the brand experience from well established to new, under-exploited venues, such as beauty parlours and nail salons. *The UNO* variants retail at the high end of the Premium segment at 50 Rubles, more than 30 percent above the price of the mainline *Virginia Slims* family.

This spring, we renovated and extended our medium-priced *Muratti Slims* variants. The new pack offers a tactile “jewelled” surface. The introductory campaign generated over 200,000 successful adult consumer contacts and the brand is gaining rapid acceptance among adult female smokers. *Muratti Slims*, priced at a premium to the most popular competing brand, gained an estimated 0.4% share of the total market as of June.

Our newest Slims effort is *L&M King Size Superslims* – Russia’s first medium-priced King Size Superslims product – featuring an attractive compressed pack and with initial distribution limited to the top 31 cities.

Altogether our Slims initiatives brought excellent volume growth through the first half of this year.

Our newest Slims entry is *Parliament Reserve* – now in pre-launch with the trade - featuring specially cut high quality tobaccos, the unique *Parliament* recessed filter and a very attractive new compact King Size Slims pack. First indications from our trade partners are very positive and we believe that *Parliament Reserve* should perform well in the Above Premium price segment. *Parliament Reserve* will soon be available at retail.

Innovation is central to our strategy in Russia and selected examples only begin to tell the portfolio development story at PMI. Altogether, over the past two years, we have renovated and improved nearly every product we sell while adding a number of new products as well. As a result, our portfolio has never been in better shape and this translates directly into our operating results. Let us look at our key franchises, starting with *Parliament*.

Parliament holds a distinctive luxury appeal in Russia with its prestige packaging and unique recessed filter. We reinforce the brand's appeal with subtle but continuous and tangible product enhancements and with exciting marketing programs that provide intriguing and pleasurable experiences to adult smokers.

Retailing at 53 Rubles – or slightly more than two dollars per pack – with a market share of about 2.6 percent in terms of volume, *Parliament* alone accounts for 7 percent of the retail sales value of the entire Russian market, according to Business Analytica surveys.

Parliament continues to perform very strongly in Russia with shipment volumes up 20 percent during the first half of this year.

Marlboro is also performing very well in Russia. *Marlboro Filter Plus* is adding volume and helping to keep *Marlboro's* image modern and relevant and this has benefited the entire brand family.

Marlboro – the world's best selling international cigarette brand – offers adult smokers distinctive promotions and memorable brand experiences.

In Russia, we have had great success with exciting racing promotions based on our agreement with Ferrari and the *Marlboro MxTronica* clubbing experience, among others.

One important result of our marketing investment is that *Marlboro's* share among "Young Adult Smokers" (aged 18 to 24) is more than one and a half times higher than its overall smoker share, as measured by our General Consumer Tracking Survey.

During the first half of 2008, *Marlboro* shipment volume was up 18 percent reflecting the impact of *Marlboro Filter Plus* as well as progress across the entire *Marlboro* family.

Chesterfield offers a classic smoke in an attractive, modern pack retailing at the top end of the Medium price category. Our programs for *Chesterfield* emphasize word-of-mouth, alternative venues and understated promotions which, according to our consumer research, carry impact among relevant Young Adult Smokers.

In the first half of 2008, *Chesterfield* shipment volume grew by 41 percent in Russia and, according to independent market surveys, for the first six months of the year, *Chesterfield* achieved the best share performance of any standard diameter King Size product in the Medium price segment.

L&M is our leading medium-priced brand in Russia. With the rapid shift in consumer preferences towards lighter and smoother tasting products, *L&M* - with its full-flavor heritage - has been under considerable pressure.

Consequently, we have re-positioned *L&M* as “the progressive international medium-price brand delivering smooth taste”. The new *L&M* KS features a unique triple filter, smoother taste, a more modern pack, and fresh, new communications.

The re-launch of *L&M* KS took place at the end of summer last year and we have also added new dimensions to the *L&M* franchise with the addition of *L&M* Extra-Slims and last month’s launch of *L&M* King Size Superslims in a compact pack.

At the same time *L&M* KS’s traditional base among more conservative, adult male smokers has contracted and *L&M* shipment volumes were down by approximately 2 billion units through the first half of 2008, reflecting the transition in the brand’s smoker base.

The repositioning of *L&M* is a complex, global and multi-year initiative for PMI and we believe the program will bring significant long term benefits.

In the near term, many of the adult smokers leaving *L&M* have switched to *Chesterfield* and other PMI brands. Growth among these brands has more than compensated the *L&M* contraction in volume terms.

Importantly, in income terms, as *Chesterfield* retails at 27 Rubles per pack compared to 23 Rubles for *L&M* – thus yielding a superior margin - we have seen a net gain in overall profit, due to favorable mix.

We focus our efforts primarily on the Premium and Medium price categories. But we also offer more affordable international and local heritage products, which sell very well among less affluent Russian smokers especially in smaller towns and rural areas.

Bond Street is a reliable, affordably priced international brand which is gaining strongly on modernized packaging and an improved tobacco taste. Shipment volumes were up 15 percent for the first half of the year, helped by branded van sales in under-marketed venues such as open markets and other high-traffic areas. Over the first six months of the year, *Bond Street* posted the largest share gain of any Value priced brand on the market.

Returning to the three key consumer trends discussed earlier, PMI is extremely well positioned in the large, high margin and growing Medium Plus price segment in Russia thanks in particular to *Parliament*, *Marlboro*, *Chesterfield*, and *L&M*.

Our portfolio is also very strong - and over-indexed compared with our total share of the market - in the large, fast growing lighter taste segments. Our strength in these huge and growing segments positions us for continued growth in the future.

In the smaller but important, emerging Slims diameter segment, we are as yet slightly under-represented relative to our total share of market.

However, as you have seen, we have a number of new Slims initiatives already underway and we are confident we will take no less than our fair share of profitable segment growth.

We manufacture all the cigarettes we sell in Russia in our two Russian factories: Philip Morris Izhora, near St. Petersburg in the North, and Philip Morris Kuban, in Krasnodar in the South.

We also export certain specific brands from Russia to other markets in the region, such as the Ukraine and Kazakhstan.

Our Izhora facility was built from the ground up and is among Philip Morris International's largest and most modern facilities worldwide. Izhora is a fully integrated production center, sized for efficiency and easily expandable to cover future growth. Most of our premium and medium priced products are produced at Izhora. Izhora also produces a number of new specialty products. To expedite new product development, we have located a team of technical specialists inside the Izhora factory premises. The Izhora development team's global expertise and familiarity with changing Russian smoking preferences and their direct access to production enhances our "speed to market" and agility in commercializing new products.

Philip Morris Kuban – an acquired facility which has been fully modernized – focuses on production of value and low priced cigarettes.

Cumulative investment in manufacturing is approximately 900 million dollars, giving us combined production capacity for well in excess of 100 billion cigarettes, annually.

Together Izhora and Kuban give us an excellent balance of efficient scale and plus flexibility to cover any manufacturing need.

Russia has nearly 400,000 retail outlets stretched across 18,000 kilometers making product flow a key aspect of any consumer goods business.

Our products move from factory to retail via a national logistics service company, which provides direct to store delivery to over 150,000 outlets, accounting for 47 percent of our sales volume.

Our distributor also sells on to large supermarket chains and other key accounts. This sector today generates about 13 percent of our volume, but is rapidly increasing in importance.

The remaining 40 percent of our volume is sold to the wholesale trade, who, in turn, cover more remote regions and small localities where direct store delivery does not make business sense.

The retail landscape is shifting very fast, in line with consumer behavior. Today by far the most important channel is the thousands and thousands of kiosks – like the ones you can see on Moscow's streets – and small neighborhood groceries. These still account for 63 percent of adult smoker purchases of cigarettes. But modern trade outlets – such as supermarkets and hypermarkets are fast gaining importance – reflecting a shift in consumer buying behavior. These already account for 23 percent of volume. Traditional open-markets account for the remaining 14 percent of volume but are losing importance rapidly.

Recently several regional Russian distribution companies combined to form a streamlined, national logistics provider mainly focused on tobacco products and sized to handle the Russian market. The new distribution set up is achieving significant scale benefits. For us, in turn, a reliable, efficient nation-wide physical logistics service simplifies our internal processes and helps limit our overheads. It also frees up our own field resources to focus even more intently on smoker purchase decisions.

Our field force – at over 1,000 well trained people, merchandising 80,000 retail outlets – is big enough and experienced enough to take on even Russia-sized national marketing programs.

We leverage the benefits of scale in implementing national programs across the huge Russian market. But increasingly we tailor execution to the local territory. This means better, closer working relations with the trade, focused and controlled implementation of special programs and better and more meaningful engagement with adult smokers.

In addition to adapting our execution capabilities, we are also adapting and improving our marketing mix for a changing Russia. Global promotions developed for PMI's global brands work very well in Russia. For example, motor racing and club events such as *Marlboro MxTronica* have great and proven appeal, while *Parliament's* upscale image fits very well with the famous Moscow Millionaire fair.

With traditional communication channels increasingly restricted, we are focusing not only on point of purchase but increasingly on one-on-one adult consumer contact and controlled-access digital one-on-one promotions. Innovation is part of everything we do, including our contacts with adult smokers.

None of this would be possible without the great group of people our affiliates employ here in Russia. From a small group of “pioneers” 15 years or so ago, we have grown to nearly 3,500 experienced and well-trained employees in every part of the country, giving us a true national reach. With just a tightly limited number of expatriates, providing guidance in such areas as strategic direction, finance and operations, we are very much a Russian company in Russia. We have achieved this, over the years, by recruiting promising young Russian professionals, by training them and by developing them, for example with well planned cross functional and international assignments outside Russia. Career development is also a key motivator among talented Russians and we believe this translates to an above average retention of our employees.

Let me now recap the main points of my presentation.

- Russia is the world’s second largest cigarette market.
- The current regulatory and fiscal environment in Russia is reasonable and appears to be predictable, in particular with excise rate legislation in place through 2011.

- PMI brands already lead in the increasingly profitable and growing Medium Plus segment of the market.
- During the first half of 2008, *Parliament*, *Marlboro* and *Chesterfield* all increased shipment volumes at double digit rates in Russia. This shows that our portfolio of Premium and Medium priced brands is in great shape and very well positioned to gain from consumer up-trading. And we are getting better.
- Our innovation pipeline and our ever-improving understanding of the adult consumer drive our portfolio and product development strategies.
- Through our investments in the Izhora and Kuban factories, we have built a state-of-the-art manufacturing base which combines scale economies with flexibility and the highest levels of product quality.
- Our third party national distribution system is efficient and frees us to focus on value-added activities – especially field execution.
- Our agile and adaptable field force gives us national reach, tailored and enhanced relations with the trade and an ability to expand our network of adult smoker contacts.
- And our local management team and employees have a demonstrated ability to deliver continuously improving results to the corporation and to PMI shareholders.
- We are very focused on opportunities to improve our margins through revenue growth, tight control of costs and productivity.

These factors – volume growth, mix improvement, attention to margins – augur very well for our ability to deliver sustainable volume and profit growth going forward.

That concludes my prepared remarks and I would be happy to answer any questions on our business in Russia you may have at this time. Thank you.