



PHILIP MORRIS INTERNATIONAL

Sustainability Report

Communication on Progress 2016
United Nations Global Compact

Key facts about Philip Morris International Inc. (PMI)

Company footprint



180

Countries where PMI operates



48

Production facilities in 32 countries



2

Research facilities – one in Neuchâtel (Switzerland) and one in Singapore.

Consumers

Financial

150m

Combustible products (2015)

>3m

Smoke-free products (August 2017)

8,000

Smokers switch to IQOS every day (June 2017)

\$70bn

Excise taxes on PMI products (2016)

\$7bn

Net profit (2016)

Employees



80,000

Employees worldwide



+400

Scientists and experts hired since 2008 to work on smoke-free products



32.8%

Women in management positions



68%

of employees covered by collective labor agreements

Suppliers

Distribution



380,000

Farmers contracted by PMI and our suppliers in 28 countries



50,000

Suppliers worldwide



77,000

Distributors and wholesalers



5.9m

Retailers selling PMI products

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Our approach to sustainability

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Our ambition for a smoke-free future

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Acting with integrity

Find out more on page 30

Letter from the CEO

Philip Morris International Inc. joined the United Nations Global Compact (UNGC) in 2015. By doing so we committed to embed its Ten Principles into the strategy, culture and daily work of our company, and I am pleased to renew this commitment.



>3m

People have stopped smoking cigarettes and switched to IQOS (August 2017)

8,000

Smokers switch to IQOS every day (June 2017)

Metrics

Publication of metrics to make our business transformation verifiable

>30%

Part of PMI shipment volume taken by smoke-free products (ambition 2025)

A-list

In CDP Climate Survey for 3rd year in a row

USD 100m

Pledged for programs to fight illicit trade (PMI IMPACT)

There is no doubt that the greatest contribution PMI can make to society is to replace cigarettes with less harmful alternatives.

Smoking cigarettes causes serious disease, and the best way to avoid the harms of smoking is never to start, or to quit. But much more can be done to reduce the health risks for the world's 1.1 billion smokers. While nicotine is addictive, it is the smoke generated by burning tobacco that is the principal problem. Through groundbreaking research, we have developed a range of smoke-free products that are enjoyable for smokers and have the potential to significantly reduce health risks when compared to smoking.

In last year's UNGC report we announced our ambition to replace cigarettes with less harmful, smoke-free products as soon as possible. We intensified our work and are now focusing our efforts to transform our company from a cigarette maker to a smoke-free technology leader. We have re-allocated a very significant part of our company's resources to make our vision of a smoke-free world a reality. We announced plans to invest in four factories in Germany, Greece, Italy and Romania to manufacture heated tobacco units for IQOS, our main smoke-free product. Today, the product is available in key cities or nationally in more than 25 countries. Already over three million people have stopped smoking cigarettes and switched to IQOS, and 8,000 more are switching every day.

Starting with this report, we will regularly publish key metrics for investments, resource allocation and results to make our business transformation verifiable by the outside world. Furthermore, we plan to support the establishment of an independent foundation to accelerate progress in achieving a smoke-free world by focusing on science-based approaches. The foundation will operate independently of PMI, scrutinizing the progress of PMI and other companies in the sector, and ensuring that the public health interests of society are met through the foundation's Board of Directors.

I am fully aware that many people are skeptical about our company and our products. I am frequently asked when we will stop selling cigarettes. Our objective is to reach this moment as soon as possible and we will spare no effort to convince smokers to switch to smoke-free alternatives. However, we cannot achieve this alone. It also depends on a number of factors out of our direct control, mainly support from regulatory and public health authorities, that will influence the pace and scale of switching. Whether or not PMI alone stops selling cigarettes is in any case irrelevant from a public health perspective. As long as there is smoker demand for cigarettes there will be supply.

Our minimum ambition is that by 2025 at least 30% of our volume comes from smoke-free products. It could be higher with the right demand side measures. Longer term, PMI will be ready to support industry-wide supply side measures as soon as scientifically substantiated smoke-free products become widely accepted and a large majority of smokers have switched to them.

Other points of concern raised by our critics relate to our marketing and lobbying practices. We have strong policies in place, and in this report you will find an overview of our marketing principles and engagement principles on which we welcome feedback.

As this report shows, we continue to make progress in embedding the UNGC Principles into our thinking and activities. Highlights include our comprehensive action on climate change, which is, in my view, one of the biggest challenges facing humanity today. I'm particularly proud that PMI has received recognition on CDP's Climate A-List for the third year in a row. The environmental challenges related to tobacco go beyond CO₂ emissions. We particularly recognize the need and opportunity to improve the prevention of litter and the recycling of waste, including new programs for our smoke-free products.

Our Agricultural Labor Practices (ALP) program continues to raise the bar on corporate efforts to improve labor conditions in agriculture. I believe the scale and transparency of our ALP program are unique, and the extensive data collected shows both significant progress and many complex challenges we still need to overcome.

Another focus area is the fight against illicit cigarette trade, which fuels broad-ranging crime and deprives governments of essential revenue. In 2016, we launched PMI IMPACT, a global initiative governed by independent experts to sponsor third-party initiatives to prevent tobacco smuggling and related crimes – an area of continued concern for our business and society.

We are pleased to share with you this report outlining our work to transform our company. We aim to successfully prevent and manage the negative externalities associated first and foremost with our products, our own operations and our value chain, inspired by the UNGC Principles and framework. We are committed to continue operating responsibly, while successfully delivering solutions not only to our consumers, employees and shareholders, but also to society in general.

I cordially invite you to comment, challenge, and guide us as we continuously seek to improve the sustainability of our business and to contribute to the UN Sustainable Development Goals.



ANDRÉ CALANTZOPOULOS
CHIEF EXECUTIVE OFFICER

The role of PMI's Board of Directors



PMI Operations Center, Lausanne, Switzerland

The global business environment is being reshaped by technological breakthroughs, climate change, resource scarcity, rapid urbanization and demographic change.

In the context of a fast-changing world, PMI's Board of Directors (the "Board") understands that environmental, social, and governance (ESG) factors relevant to the company's business are critical to PMI's long-term success. At the core of the Board's oversight framework is a focus on management's efforts to enhance shareholder value responsibly and sustainably.

The Board understands PMI's responsibility as a global tobacco company. Over the last decade, the Board has spent an increasing portion of its time overseeing the company's progress in developing smoke-free products and is now closely following the steps to commercialize them, as well as all management efforts to ensure that the company and its employees are prepared to meet the new and substantial challenges of its business transformation. The Board has also monitored the development of business transformation metrics, which are presented in this report, so that PMI can track and publicly disclose its transformation progress.

With the Board's encouragement, PMI became a signatory to the UNGC in 2015. Over the years, the Board has encouraged the company's efforts in relation to the topics covered by the UNGC's Principles. Specifically, the Board strives to link pay to performance in areas ranging from PMI's business ethics and compliance culture, to agricultural labor practices, climate change, and the ongoing efforts to train and develop the workforce and promote diversity and inclusion. Sustainability performance is built into the equation that determines the level of incentive awards earned by the company's executives.

PMI's commitment to publicly report on how it operates in relation to the UNGC's Principles is a real opportunity to show progress, efforts and challenges, while continuing to take a systematic and transparent approach to all its work in relation to these principles.

Our approach to sustainability

For PMI, sustainability is about seeking opportunities to create value while minimizing the negative externalities associated with our products, our own operations, and our value chain.

We seek to embed the UNGC Principles into our day-to-day work and to continuously improve our understanding, management and performance regarding our environmental and social impacts.

Defining our focus

In our last report, we highlighted the need for a systematic approach to assess and prioritize the most significant sustainability areas to our business. We did so in 2016. Working with Business for Social Responsibility (BSR), we identified the areas that are most significant to our business sustainability and to our stakeholders and prioritized them. That analysis also highlighted for us the areas of opportunity and risk, emerging themes, and gaps for management action. The analysis consisted of a structured review and engagement process, carried out by BSR, involving PMI's functional leaders or subject matter experts and external stakeholders. It considered both our current business and the change driven by our vision of a smoke-free future. In many areas described below we already have strong programs in place on which we can build; in other areas new approaches may be needed. The results were sorted into four categories as follows.

Fundamental to our business strategy

Three key areas are fundamental to the sustainability of PMI's business strategy:

- **Product Innovation for Harm Reduction:** Our continued recognition of the health impacts of our products and the prioritization and investment in reducing or eliminating those impacts through innovation and development of products that can substantially reduce individual risk and population harm when compared to cigarettes.

- **Public Health Policy and Research:**

Our role and proactive approach in supporting public health and harm reduction policies and research.

- **Respect for Human Rights:**

Our understanding, due diligence and actions to respect human rights throughout our global operations and value chain.

Credibility and responsibility

The analysis also identified a number of aspects that are critical to building the credibility and engagement required for our business transformation, particularly the need to substantiate our commitments, demonstrate transparency and consistency in our approach, and maintain the highest standards in our policies, practices and actions. This also includes ensuring that we continue to market all of our products in a responsible way, and only to adult consumers, and being even more transparent in how we advocate on policy issues related to our products, including taxation and regulation.

- **Corporate Governance and Ethics:**

Promotion of the highest standards of compliance and integrity across our global operations and value chain.

Clear alignment of our public policy advocacy with our core strategy and commitment to stakeholders.

- **Responsible Marketing and Youth**

Tobacco Prevention: Actions to ensure that we continue to market our products responsibly and only to adult consumers.

- **Transparency and Reporting:**

Disclosure of our significant sustainability performance risks and opportunities in a clear, comparable and accessible manner.

Turning strategic risks into opportunities

A number of other areas were identified as strategic priorities from a risk management perspective, including good agricultural and labor practices in tobacco farming, and the need for climate change mitigation and adaptation action throughout the value chain. We also need to anticipate and manage the supply chain risks related to our non-tobacco materials, especially as our product portfolio shifts to electronic devices. Our ambition is to turn these strategic risks into opportunities to add value.

- **Responsible Sourcing of Non-Tobacco**

Materials: Actions to identify and trace non-tobacco materials to origin and source those materials in a responsible and sustainable manner (including electronics and considering conflict minerals);

- **Agricultural Labor Practices:** Actions to eliminate all forms of labor abuses and achieve safe and fair working conditions on tobacco farms;

- **Good Agricultural Practices:** Actions to ensure tobacco farmers have access to the information, systems and tools needed to be successful business owners who minimize the environmental impacts of their activities and provide good working conditions on their farms;

- **Climate Change Mitigation and**

Adaptation: Efforts to reduce greenhouse gas emissions and prepare for the effects of climate change in our operations and supply chain, including water stewardship actions;

- **Post-Consumer Waste:** Actions to minimize impacts through product design, waste management programs and recycling where possible. Littering prevention through consumer education.

Underpinning our approach

Finally, a number of governance, product, environmental and employee-related aspects were identified as being important for our continuous improvement efforts. Many of these aspects are described in this report and include:

- Employee engagement and well-being, labor relations, workplace health and safety, diversity and inclusion, and talent recruitment and management;
- Our efforts to fight illicit trade;
- Good laboratory and clinical practices in our R&D efforts;
- The good environmental management of our operations.

The outcome of this analysis has helped us to focus on where we need to prioritize and allocate resources to mitigate negative impacts and create opportunities for wider societal value, keeping product harm reduction as the fundamental premise of our new business strategy, now and in the future.

How our work relates to the UN Sustainable Development Goals (SDGs)

The SDGs represent the future we all want. PMI has welcomed the adoption of the SDGs and is committed to play its part in making them become a reality. This means:

Taking decisive action where we have the greatest impact



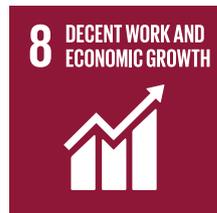
Smoking cigarettes causes serious disease. By replacing cigarettes with less harmful alternatives we can significantly reduce the negative impact of our products on society.

This report's section on "Our business transformation" describes in detail how our business vision aligns with this SDG.

Taking ownership where we can provide a substantial contribution



Through good agricultural practices and crop diversification we can help to improve the productivity and food security of smallholder farmers.



We ensure good working conditions for all our employees and can play a role in promoting good working conditions for millions of workers in our supply chain.



We improve the life cycle impacts of our products. From the environmental impacts of tobacco growing, to efficient, low carbon, manufacturing, and litter prevention and recycling programs.



Our efforts to combat illicit trade in tobacco products are particularly relevant for this goal, because illicit trade fuels broader criminal activity and corruption.

Aligning our practices with the overall goals, even when we have less impact



We care about all SDGs, and on some of these – such as Climate Action – we consider ourselves leaders. Nevertheless, given the related impacts of our business we can only make a relatively modest contribution to these global objectives.

External perspectives on our business transformation and smoke-free vision

As we assessed the most significant sustainability issues, we also sought the perspectives and questions stakeholders have about our business transformation and ambition to create a smoke-free world.

We have aggregated and captured the main questions stakeholders ask about our transformation. We attempt to address these concerns in this report as we outline the different aspects of this transformation.

Business rationale

“How does PMI plan to transform its existing cigarette business (market volumes and timescale)? When will you stop selling cigarettes?” See pages 26-27.

“What’s driving PMI’s business transformation and why now? Do investors really support this move away from cigarettes? Is the launch of these new products simply an opportunity for PMI to expand its commercial footprint in places with declining cigarettes volumes?” See page 21.

“PMI’s new products contain nicotine and are still addictive. This means household income is diverted from other items. Is this a new business strategy to get more people addicted to nicotine and boost sales of both smoke-free products and cigarettes?” See pages 16, 19, 21.

Affordability

“Are these new products aimed at wealthier consumers? Are they being funded by cigarette sales from lower income smokers, in developed and developing markets?” See page 24.

Responsible marketing and advocacy

“Is PMI being consistent in upholding stringent marketing standards across all countries where it operates, irrespective of local regulation and enforcement? How can we trust PMI to market these new products responsibly and in an ethical way?” See pages 24, 30 and Annex 2.

“How can we be sure that PMI is being honest and transparent with regulators, smokers and the general public when they advocate for smoke-free products? How is PMI proactively advocating for a smoke-free future when its cigarette portfolio makes up 99% of its sales? Why is PMI still fighting against tax and regulation of cigarettes?” See page 20 and Annex 3.

“How is PMI supporting youth smoking prevention measures for its cigarette business today? How will PMI ensure its smoke-free products won’t lead youth to start smoking or former smokers to relapse?” See pages 17, 24, 30 and Annex 2.

Independent verification of the science behind smoke-free products

“PMI’s smoke-free products are not risk free. Is PMI being transparent in communicating about the risks of these new products to consumers? How can we trust the science behind these smoke-free products? Similarly, is PMI proactively talking about the health risks of cigarettes to consumers?” See pages 16, 17, 24, 30 and Annex 2.

Transparency and collective action for a smoke-free future

“Is PMI’s new business vision simply a way to distract from the negative impact of its core business? Is PMI really serious about creating a smoke-free future? If so, how is it leading and bringing its tobacco industry peers towards the same vision?” See pages 21, 26, 27.

Our business transformation



**Key developments
since 2000**

See page 12

**Our ambition for a
smoke-free future**

See page 18

**Our global progress
overview**

See page 22



Our products



In 2016, PMI manufactured and sold over 800bn cigarettes to approximately 150m adult consumers in more than 180 countries

Smoking cigarettes causes serious disease. Smokers are far more likely than non-smokers to get heart disease, lung cancer, emphysema and other diseases. In addition, smoking is addictive, and it can be very difficult to stop.

The best way to avoid the harms of smoking is never to start, or to quit. But much more can be done to improve the health and quality of life of those who continue to use tobacco and nicotine products, through science and innovation.

For over a century the basic design and use of cigarettes have not changed. A smoker lights the cigarette, shredded tobacco leaves are burned, and the smoker inhales nicotine, flavors and various other substances present in the smoke. While nicotine is addictive and not risk-free, experts agree that the primary cause of smoking-related diseases is found in a number of toxicants generated by combustion and inhaled in cigarette smoke.

While several past attempts have been made to develop better alternatives to smoking, drawbacks in the technological capability of these products and a lack of consumer acceptance rendered them unsuccessful. Recent advances in science and technology have made it possible to develop innovative products that consumers accept and that are less harmful alternatives to continued smoking.¹

PMI has developed a portfolio of smoke-free products, including heated tobacco products and products without tobacco, that have the potential to significantly reduce individual risk and population harm compared to cigarettes. We currently commercialize Platform 1 under the brand name IQOS and a range of e-cigarettes (Platform 4) under brand names such as Solaris and Vivid.

The timeline on the next pages shows the key product innovations since the year 2000 in the context of policy developments.

¹ Source: UK Royal College of Physicians, "Harm Reduction in Nicotine Addiction," 2007.



Replacing cigarettes with smoke-free products

Many stakeholders have asked us about the role of these innovative smoke-free products in the context of our business vision. Are these products an extension of our cigarette product portfolio? Are they intended for developed countries only? Are they aimed at compensating a decline in cigarette sales? In 2016, we made a bold announcement: our business vision is to replace cigarettes with less harmful, smoke-free products as soon as possible.

Smoke-free products – our product platforms

Heated tobacco products

Platform 1



IQOS, using the heated tobacco consumables (heated tobacco units), features an electric holder that heats tobacco rather than burning it, thereby creating a nicotine-containing vapor with significantly fewer harmful toxicants compared to cigarette smoke.

Platform 2



TEEPS uses a pressed carbon heat source that, once ignited, heats the tobacco without burning it, to generate a nicotine-containing vapor with a reduction in harmful toxicants similar to *IQOS*. A city launch of the product is planned in 2017.

Products without tobacco

Platform 3



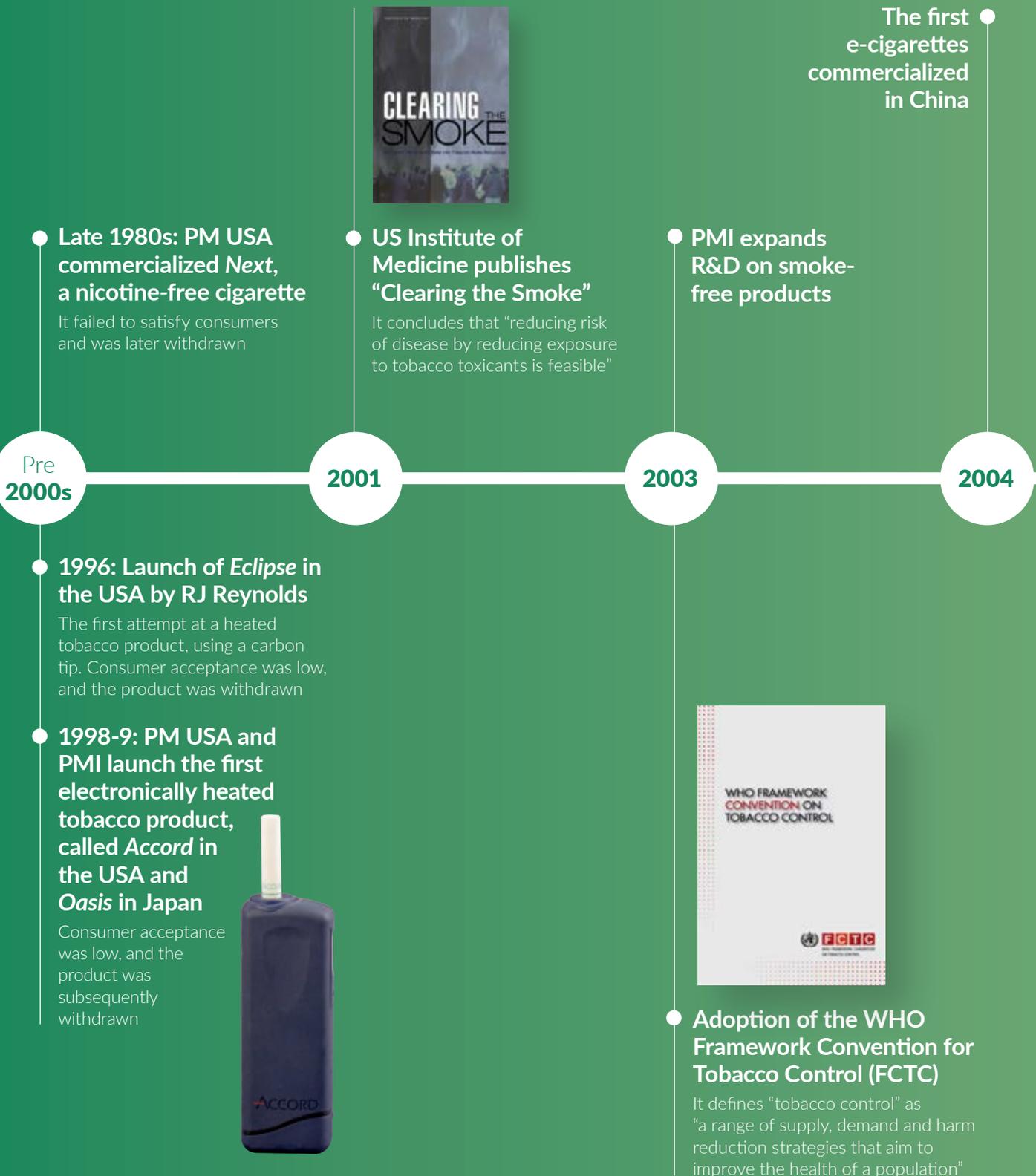
Platform 3 is based on acquired technology that uses a chemical process to create a nicotine-containing vapor. We are exploring two routes for this platform: one with electronics and one without. A city launch of the product is planned in 2017.

Platform 4



Products under this platform are e-vapor products – battery-powered devices that produce an aerosol by vaporizing a nicotine solution. One of these – *MESH* – uses new proprietary vaporization technology.

Key developments since 2000





The Cube R&D facility in Neuchâtel, Switzerland

PMI opens The Cube, a new R&D facility dedicated to smoke-free products in Neuchâtel, Switzerland

2006

2006-7: Launch of Heatbar by PMI in Switzerland and Australia

Heatbar is the second generation of electronically heated tobacco products; consumer acceptance was low due to the bulky device and sub-optimal taste, and the product was withdrawn



2007



UK Royal College of Physicians publishes a report on tobacco harm reduction

It states that "nicotine itself is not especially hazardous" and that "if nicotine could be provided in a form that is acceptable and effective as a cigarette substitute, millions of lives could be saved."

2009

US Family Smoking Prevention and Tobacco Control Act

Provides authority to US Food and Drug Administration (FDA) to regulate tobacco products and creates a regulatory framework for the commercialization of "Modified Risk Tobacco Products"



R&D facility in Singapore

2010

- PMI opens R&D facility in Singapore dedicated to assessing smoke-free products

2012

- US FDA releases draft guidance on evidence that should support a Modified Risk Tobacco Product Application (MRTPA)

2014

- PMI completes multiple five-day clinical studies on IQOS, one of its smoke-free tobacco products

Smokers who switched to IQOS reduced their exposure to harmful chemicals, on average to levels approaching those found in smokers who quit for the duration of the study



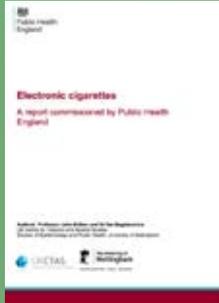
- Launch of PMIScience.com to share PMI's research methods and findings

- PMI launches IQOS city tests in Italy and Japan
- PMI acquires Nicocigs Ltd. and enters the e-cigarette market
- PMI announces its first new factory dedicated to heated tobacco unit production
PMI invests USD 680m in its first purpose-built factory for heated tobacco units in Bologna, Italy
- EU Tobacco Products Directive II adopted
establishing specific rules for marketing "novel tobacco products" and electronic cigarettes





- PMI launches an e-vapor product, *Solaris*, in Spain and Israel



- Public Health England publishes report on electronic cigarettes

The report concludes that e-cigarettes are significantly less harmful than cigarettes

- PMI's CEO announces ambition to convince all adult smokers who intend to continue using tobacco products to switch to smoke-free products as soon as possible

- JT launches *PloomTECH* in Japan

a hybrid e-vapor product

- PMI city test of *MESH* in Birmingham, UK

an innovative e-vapor product



- In Japan, *HeatSticks* for IQOS achieve a 10% market share in Q2, 2017

- PMI reaches 200 peer-reviewed publications and book chapters on the science around its smoke-free research to date

- UK Department of Health publishes five-year tobacco control plan

welcoming innovative technologies that minimize the risk of harm for smokers

- FDA announces comprehensive plan to significantly reduce tobacco-related disease

recognizing that innovation can lead to less harmful products

2015

- *IQOS* available in six countries

launches in key cities in Portugal, Romania, Russia and Switzerland

- PMI completes two three-month clinical studies

in the US and Japan on *IQOS*, confirming results from the earlier five-day study

2016

- *IQOS* available in 19 countries

launches in key cities in Canada, Denmark, Germany, Greece, Israel, Kazakhstan, Monaco, the Netherlands, New Zealand, South Africa, Spain, the United Kingdom and Ukraine

- BAT launches *Glo* in Japan

a heated tobacco product

- PMI submits an MRTPA for *IQOS* to the US FDA

- More than 1m people have stopped smoking by switching completely to *IQOS* (December 2016)

2017

- *IQOS* available in more than 25 countries

launches in key cities in Colombia, Czech Republic, France, Lithuania, Poland, Serbia and South Korea

- More than 3m people have stopped smoking by switching completely to *IQOS* (August 2017)



Scientific assessment of our smoke-free products

We knew from the outset that our science would be met with skepticism. Since 2008, we have hired over 400 scientists and experts who are working in state-of-the-art facilities and using cutting-edge technologies to develop and assess our smoke-free products. Our scientific assessment programs align with leading pharmaceutical industry standards and guidance issued by the US Food and Drug Administration's (FDA) Center for Tobacco Products. Our research includes laboratory and clinical studies based on internationally accepted Good Laboratory Practices and Good Clinical Practices.

We follow a thorough and systematic approach to smoke-free product development and assessment, including clinical and behavioral studies to assess individual risk and population harm.

Take IQOS, our main smoke-free product so far, as an illustrative example of our scientific research. Findings to date show that switching completely to IQOS is likely to present less risk of harm than continued smoking. Specifically, the results show that:

- IQOS does not generate combustion or smoke;¹
- IQOS vapor contains on average 90-95% lower levels of toxicants compared to the smoke from a reference cigarette designed for scientific research, with nicotine at similar levels to cigarette smoke;²
- Laboratory studies conducted in animal models of disease confirm that these lower levels of toxicants result in IQOS vapor being significantly less toxic than cigarette smoke;²

- Laboratory studies confirm that switching to IQOS, conducted in animal model of diseases, led to a reduction in key smoking-related diseases and their associated mechanisms. These reductions approached those observed in the cessation group;²
- Clinical studies conducted to date confirm the results of our laboratory studies. Smokers who switched completely to IQOS in two one-week and two three-month clinical studies significantly reduced their exposure to 15 toxicants. These reductions approached levels observed in the cessation groups;²
- IQOS use does not adversely affect indoor air quality and is not a source of second-hand smoke;³ and
- Smokers indicate a strong intention to use IQOS while people who have never smoked or who quit smoking do not.⁴

These results give us confidence that switching fully to IQOS is likely to present less risk of harm than continuing to smoke. We also believe its introduction will benefit public health. On this basis, in December 2016 we submitted evidence to the US FDA in the form of an application for IQOS as a modified risk tobacco product (MRTP) – the first ever for a heated tobacco product.⁵

Our research efforts will continue to seek ways to further reduce the risk of harm and to broaden our smoke-free product portfolio such that we have products that are acceptable and affordable to all smokers. We fully recognize that there is concern about the addictiveness of nicotine products, however nicotine delivery is an important factor in helping to ensure rapid and complete switching of cigarette smokers to smoke-free products in the short- to mid-term.

Engaging the scientific community and encouraging scrutiny of our science

Sharing our science, gathering feedback and participating in robust scientific debate help answer important questions we receive about our innovative products from the public, scientific experts, and regulators. **In 2016, our scientists presented research results at 79 leading scientific conferences and published over 50 book chapters and articles in peer-reviewed journals.**

Our systems biology program uses large datasets to build an understanding of disease mechanisms, predict the extent of damage to the body from exposure to toxic substances, and estimate improvements if those exposures are reduced. In 2011, we launched our **SBVImprover platform, a crowd-sourcing initiative** developed with IBM, to enable independent scientific experts to review and validate our scientific methods and conclusions. It does so through the publication of Challenges and defined criteria by which scientific institutions can independently develop methodologies and draw their own conclusions. Through this robust, 21st century approach to peer review and scientific verification, we can gauge the extent to which our own research is in line with these crowd-sourced results. Since the inception of the SBVImporter platform, nearly 200 institutions across the globe have taken part in the program, and the Challenges have verified our research. The Challenges and all publications and news articles related to this platform are available online.⁶

In addition, we recently launched the **Investigator-Initiated-Studies (IIS) program** to encourage others to review our science and conduct additional studies to confirm, improve or challenge our findings.⁷

1 <https://www.pmiscience.com/news/absence-combustion-pmi%E2%80%99s-heated-tobacco-product-platform-1>; and https://www.pmiscience.com/system/files/publications/gfn_2017_mcgrath_what_is_combustion_and_why_the_absence_of_combustion_is_important_in_heated_tobacco_products.pdf

2 <http://www.sciencedirect.com/science/article/pii/S0273230016301891>

3 https://www.pmiscience.com/system/files/publications/jsfec_2017_ggoujon_air_quality_assessment_during_indoor_use_of_ths_2.2.pdf

4 <https://www.fda.gov/TobaccoProducts/Labeling/MarketingandAdvertising/ucm546281.htm>

5 Read more here: <http://pmiscienceusa.com/wp-content/uploads/2017/06/Brief-Summary-of-PMIs-MRTP-Application-May-2017.pdf>

6 <https://www.sbvimprover.com/sbv-improver/publications>

7 <https://www.pmiscience.com/our-goals/investigator-initiated-studies-program/supported-investigator-initiated-studies>

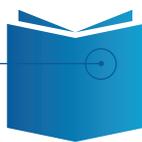
79

Scientific conferences where our scientists presented research results



50

Book chapters and articles in peer-reviewed journals



SBVImprover

200

Institutions across the globe have taken part in crowdsourcing initiative



Transparency in our science at PMI

At PMI we use various print and online communication tools to share our science and encourage further debate and understanding about our smoke-free products. We have a **dedicated website** (www.PMIscience.com) to share the latest information about our ongoing research, **peer-reviewed publications**, and we issue a regular 'Scientific Update for Smoke-Free Products.'

We have also opened the doors of our R&D center in **Neuchâtel, Switzerland**, to those interested in learning more about our science.



Our seven-step approach to assess individual risk and population harm

Product design and control principles

The first step of the assessment is designed to ensure that a given smoke-free product is manufactured to appropriate quality standards and is sufficiently characterized to document product performance parameters. This product characterization enables the establishment of a product specification, which all products entering the subsequent assessment steps must meet, as must the products that are introduced to the market. In this initial phase, PMI verifies that the product's design is likely to result in a significant reduction in risk for smokers who switch to it and that it does not pose any additional risks to those already known for cigarettes. Realizing the risk reduction potential of a smoke-free product relies on the quality of the product design and on strict manufacturing controls to ensure that the product operates consistently and reliably.

Aerosol chemistry and physics

We analyze the chemical composition of the aerosol generated by the smoke-free product to quantify the reduction in formation of harmful and potentially harmful constituents in comparison with a cigarette. We also evaluate whether new potentially harmful constituents are generated by the smoke-free product and confirm the absence of combustion in aerosol generation.

Standard toxicology assessment

Once a product has been developed, we use robust laboratory techniques to evaluate whether a product is less toxic than cigarette smoke. We do this by assessing whether it causes less damage to cells and organs using *in vitro* and *in vivo* techniques.

Systems toxicology assessment

We use highly sophisticated laboratory techniques to assess the effect of switching to a smoke-free product on the development of smoking-related disease

in comparison with smoking and cessation. Our systems toxicology program allows us to compare the effects of switching with those of cessation on the molecular-level disease mechanisms caused by smoking. This is achieved by measuring the changes in gene, protein and metabolite levels caused by switching and cessation in comparison with continued smoke exposure and analyzing this data using advanced computational methods.

Clinical studies

We conduct clinical studies with adult smokers according to the principles of Good Clinical Practice. These studies help us understand whether switching to a smoke-free alternative reduces a smoker's exposure to toxicants compared with on-going smoking. We also determine whether this leads to a reversal of clinical risk markers linked to smoking-related diseases. These studies compare the effects in continued smoking, switching and quitting cigarettes for the duration of the studies. This phase is fundamental to help substantiate claims.

Perception and behavior studies

Our program of Perception and Behavior Assessment studies is aimed at developing understandable and scientifically accurate consumer messages; assessing the comprehension of these messages and the risk perception of the smoke-free product among various adult consumer groups; and assessing the suitability of the smoke-free product as a substitute for cigarettes among adult smokers.

Post-market studies and surveillance

Once a smoke-free product is on the market, we conduct post-market studies to understand how the product is used and by whom. Our aim is to ensure that the product does not attract significant numbers of never and former smokers, but does lead to a significant portion of current adult smokers switching to it completely. Additional clinical studies are conducted to determine the health outcomes of switching to the product compared with ongoing smoking and to cessation.

Our ambition for a smoke-free future

Projection of smoking prevalence

Today, an estimated 1.1 billion people around the world smoke cigarettes or other combustible tobacco products such as cigars, bidis and pipe tobacco. Smoking prevalence, which was estimated at 22.1% in 2010 (age 15+), has been in constant decline for several decades, and the World Health Organisation (WHO) projects it will continue declining by 0.21 percentage points per year.¹ At the current pace, it will take almost 100 years until the world is smoke-free.

At the same time, global population is growing by around 70 million people per year. The combined effect of a growing population and a declining smoking prevalence is a projected number of 1159 million smokers by 2025. Slowly declining numbers of smokers in OECD countries, China and India are offset by growth in the rest of the world. These WHO projections assume current tobacco control policies and do not consider the potential of smoke-free products.

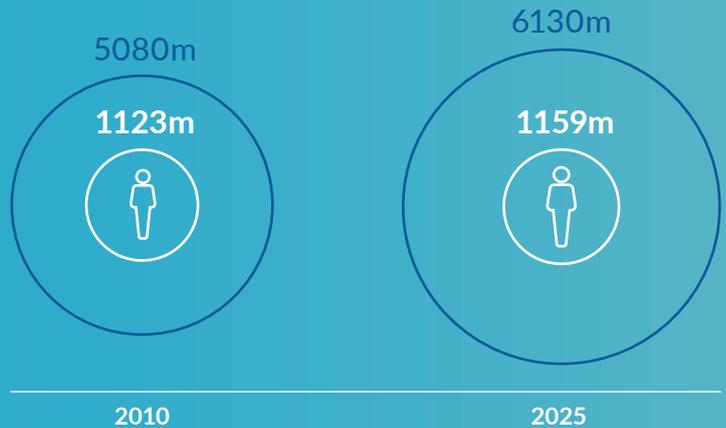
WHO target

The member states of the WHO are rightly dissatisfied with the slow pace at which smoking is declining and have established a 2025 target to reduce the prevalence of tobacco use by 30% compared to 2010.² As population growth partially offsets the impact of this prevalence target, there will still be approximately 950 million smokers by the year 2025 if the WHO achieves its objective.

Projected smoking prevalence



Projected number of smokers



- Global population increase
- Projected number of smokers

These projections are based on WHO/UN data and refer to age 15+

1 Data and projections are based on WHO *global report on trends in prevalence of tobacco smoking, 2015* and UN *Population Prospects*. These official projections refer to age 15+.

2 WHO *Budget 2016-2017*.

PMI's ambition

We believe smoking prevalence can be reduced much faster by supplementing the measures that governments take to discourage smoking initiation and encourage cessation, with efforts to encourage smokers who would otherwise continue smoking to switch to smoke-free products. To illustrate the opportunity for public health, we project the number of consumers of PMI products for the year 2025. These calculations are consistent with the WHO projections, the PMI business transformation metrics shown on page 26, and assume a constant global market share for PMI.

In the base case scenario, and without smoke-free products, the number of smokers buying PMI products is projected to increase slightly to an estimated 152 million by 2025. The WHO target to reduce the prevalence of tobacco use – assuming a proportionate effect on PMI – implies a 19 million reduction to 133 million smokers of PMI products by 2025.

It is our ambition that at least 30% of our consumers who would otherwise continue smoking switch to our smoke-free products by 2025. We project that by 2025, at least 40 million PMI cigarette smokers will have switched to smoke-free products.

The combination of measures to discourage tobacco initiation and encourage cessation, and our full-scale effort to replace cigarettes with smoke-free products could reduce smoking of PMI products by 40% within a decade – a major acceleration towards a smoke-free world.

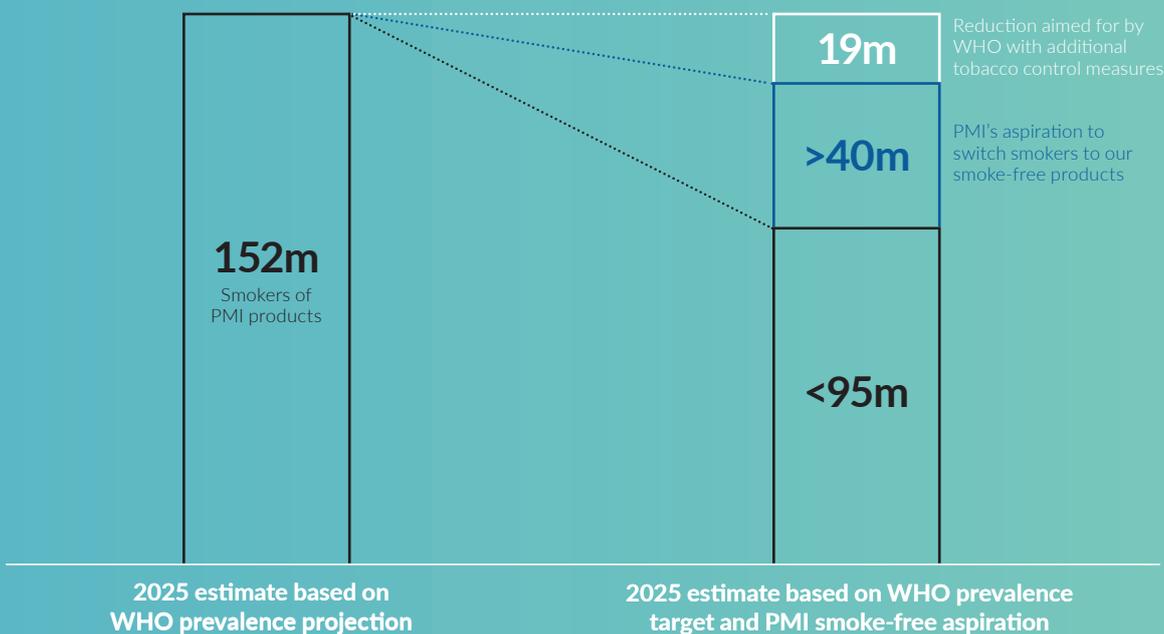
These are illustrative calculations. We left out the possibility for PMI to grow market share by switching consumers of competing cigarette brands to our smoke-free products. This would further amplify the opportunity for public health.

Of course we cannot achieve a smoke-free future by ourselves. Government and civil society, especially leading scientists and public health professionals, and ideally the WHO, can play a decisive role in encouraging smoke-free products to replace cigarettes for people who would otherwise keep smoking.

Our competitors are also increasing their efforts to develop and commercialize their own smoke-free products. As a result, we expect a positive acceleration of innovation, competition and consumer adoption that could reduce global smoking prevalence at a pace significantly beyond past reductions and future goals set by the WHO.

Consumers of PMI products – projection 2025 (assuming constant PMI market share)

- People who quit or less people starting
- People who switch to PMI smoke-free products
- Smokers of PMI products



Our view on tobacco regulation

The well-known risks of smoking have led regulators to impose more restrictions and higher excise taxes on cigarettes than apply to any other consumer product – while allowing cigarettes to remain available to adults. There’s absolutely no doubt that tobacco products should be subject to strict rules and enforcement.

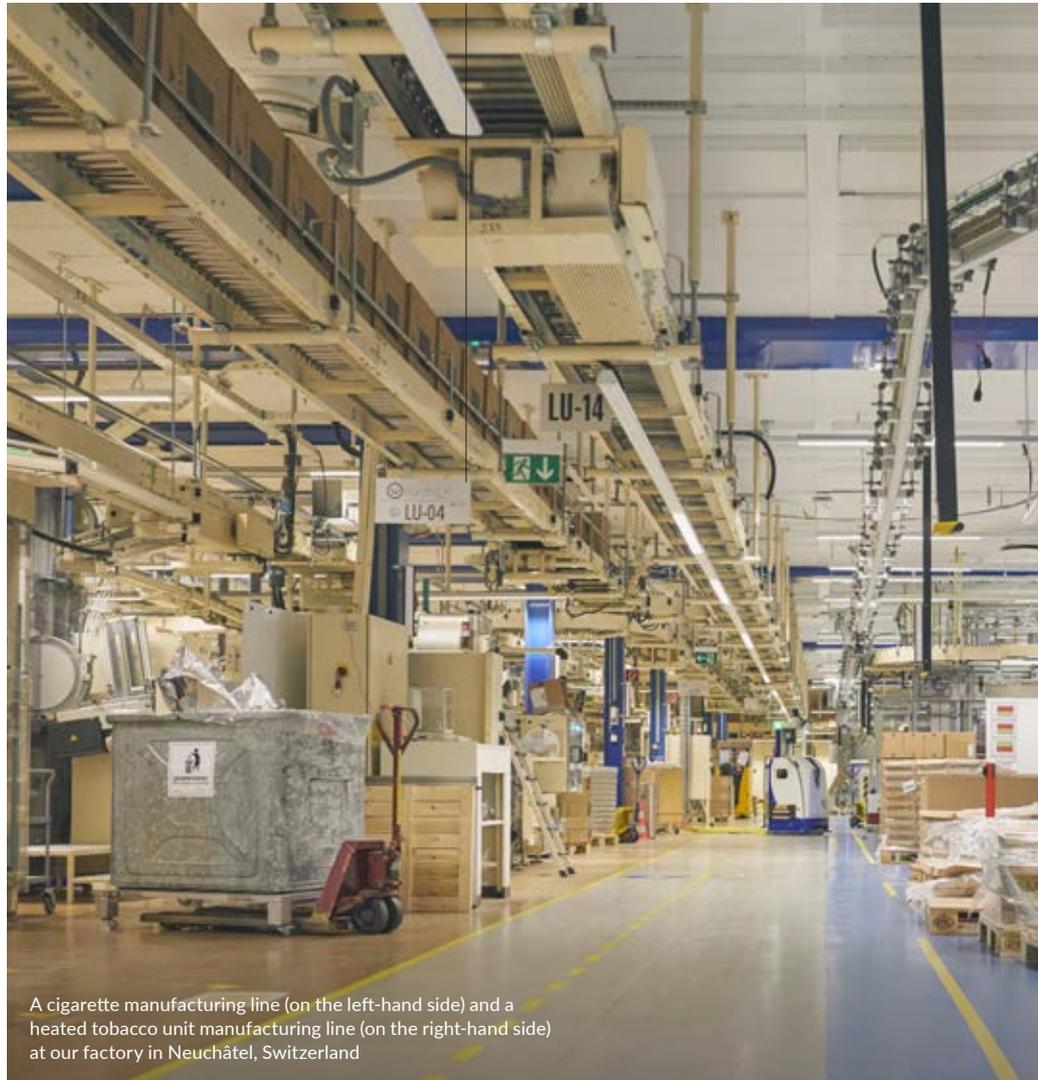
At times, we have forcefully objected to regulations, such as those that remove branding from our cigarette packages. We still believe that plain packaging inappropriately treats adult smokers as unable to make their own decisions. And we don’t agree that banning legal sales of cigarettes makes sense for smokers or for society at large.

With comprehensive requirements in place to control nearly every aspect of the cigarette business, the question becomes: what’s the plan to address the needs of more than one billion people who still smoke?

The answer, in our view, is innovation – in products and in policies. As we work to design a smoke-free future, our priorities are changing. Technology that we and others have developed makes it possible to shift the tobacco and nicotine market towards a future in which cigarettes are replaced by less harmful, yet satisfying, smoke-free alternatives.

In this context, sensible, science- and risk-based regulation of smoke-free, combined with further restrictions on cigarettes, can help address the harm caused by smoking more effectively – and faster – than any other traditional regulatory measure.

To be clear, regulations should continue to dissuade people from starting to smoke and encourage cessation. But it’s equally clear that millions of men and women will continue to smoke, and they should have the opportunity and information to switch to better alternatives.



A cigarette manufacturing line (on the left-hand side) and a heated tobacco unit manufacturing line (on the right-hand side) at our factory in Neuchâtel, Switzerland

The rationale for our business vision

We understand that our vision of replacing cigarettes with smoke-free products is unprecedented for a tobacco company. Some will question our motives, and others will question why PMI would seek to transform a very profitable market for cigarettes. The answer is simple: our goal of developing and commercializing less harmful products to replace cigarettes is completely aligned with the expectations of smokers, society and our shareholders.

Our success as a business was primarily built on offering the best smoking experience through our top quality cigarette brands, including *Marlboro*, *L&M* and *Chesterfield*. We are convinced that our continued success will depend, above all, on our ability to offer men and women who smoke less harmful alternative products.

Our business case is straightforward. PMI leads the smoke-free category thanks to sustained R&D investments. We are therefore in an excellent position to not only switch consumers who smoke PMI cigarettes, but also those who smoke competing cigarette brands.



We are observing this in Japan, where the majority of IQOS users previously smoked cigarettes made by our competitors. We thus have the opportunity to increase market share which would enhance business results. In addition, the profit margins of smoke-free products are similar to or exceed those of cigarettes as a result of differentiated excise tax.

A smoke-free world can be achieved faster if the industry as a whole, including new entrants, accelerates its efforts in this direction. A wide variety of companies – from small start-ups to multinational tobacco companies – is increasingly active in the smoke-free category. Virtually all multinational companies commercialize at least one smoke-free product, and the category is undergoing rapid change.

Technological innovation is transforming our industry. **Developing, assessing and commercializing novel, less harmful alternatives to cigarettes should in our view become the focus of competition.** PMI has been, and will continue to be, a driving force of this transformation.

We are also often asked about our willingness to license our technology to other tobacco companies. PMI has granted Altria an exclusive license to sell IQOS in the United States, and we are in principle open to other partnerships where it makes business sense and helps to advance a smoke-free world.

Investing in production capacity for smoke-free products

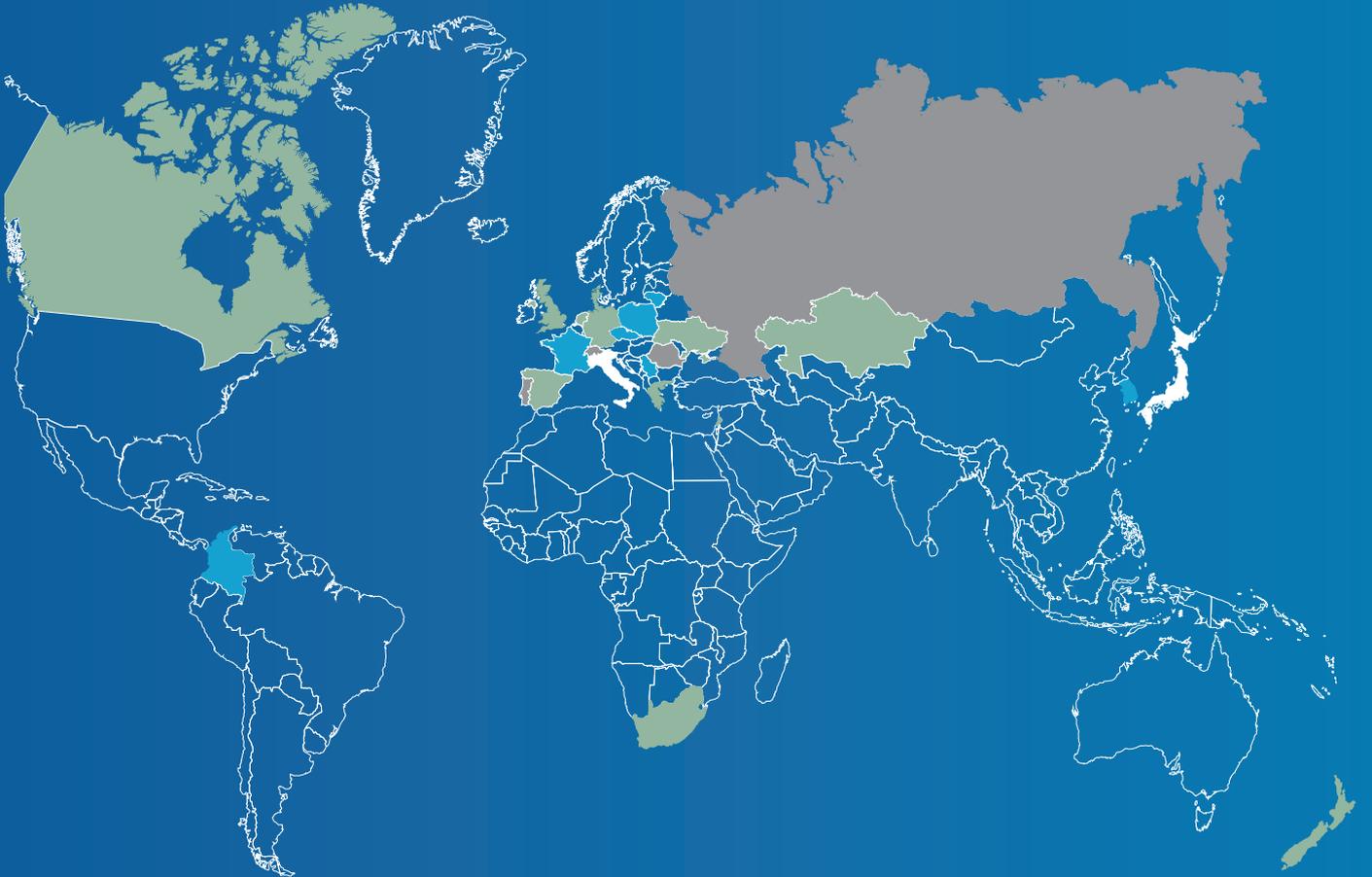
Our company's shift toward a smoke-free future means going beyond developing the products and science. It also means supplying the demand. The case of IQOS in Japan illustrates the need to anticipate demand. Despite optimistic projections for a nationwide roll-out of IQOS in Japan, in 2016, consumer demand greatly exceeded our expectations. We were surprised by the rapid pace of adult smoker conversion to the product once we hit a critical mass of 2-3% market share nationwide. By June 2016 we had to ration the number of IQOS devices sold across the country to avoid smokers who had switched to IQOS not being able to find heated tobacco units. At the same time, we accelerated investment in IQOS heated tobacco units manufacturing capacity.

Our factory in Neuchâtel, Switzerland, was the first to produce the heated tobacco units used with the IQOS device. In 2015, our factory in Bologna became the first site fully dedicated to heated tobacco unit production. To keep pace with demand, we are rapidly building new manufacturing facilities and converting existing factories. In the next pages we describe the substantial investment in our manufacturing transformation.



Our global progress overview

IQOS launches in key cities or nationwide: 2014 – to date



By the end of 2017, we expect IQOS to be in key cities or nationwide in 30 to 35 countries, subject to capacity.



2014

Italy
Japan



2015

Portugal
Romania
Russia
Switzerland



2016

Canada
Denmark
Germany
Greece
Israel
Kazakhstan
Monaco
Netherlands
New Zealand
South Africa
Spain
UK
Ukraine



2017*

Colombia
Czech Republic
France
Lithuania
Poland
Serbia
South Korea

*As of July 2017.



Milestones and investments

+USD 3bn

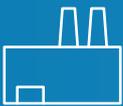
Since 2008, we have invested more than USD 3bn in fundamental research, product and commercial development, production capacity, scientific substantiation and studies on adult smoker understanding.

+400 scientists

Since 2008, we have hired over 400 scientists and experts to work on our portfolio of smoke-free products in two R&D facilities – one in Neuchâtel (Switzerland) and one in Singapore.

30 locations

PMI scientists also work with a network of research and technology partners in over 30 locations worldwide.



Plans for further investment in heated tobacco manufacturing (total USD 1.7bn)

Germany

USD 320m

Plan to invest USD 320m in a new facility for heated tobacco units in Dresden, expected to create approximately 500 new jobs and be operational in 2019.

Greece

USD 320m

Plan to invest USD 320m to convert our cigarette factory in Aspropyrgos to heated tobacco unit production and create 400 new jobs.

Italy

USD 550m

Following the inauguration of our new facility in Bologna in 2016, a further investment of approximately USD 550m is foreseen to expand its capacity to meet growing demand, bringing total investment to USD 1230m, creating an additional estimated 600 new jobs.

Romania

USD 550m

Plan to invest approximately USD 550m to transform our cigarette production factory in Otopeni into a heated tobacco manufacturing facility, creating about 300 additional jobs.



Production capacity

Around 100bn heated tobacco units

By end 2018, PMI anticipates a total manufacturing capacity of around 100 billion heated tobacco units per year.

Our commercialization efforts behind smoke-free products

Developing and manufacturing scientifically substantiated smoke-free products is only the start: the next challenge is to convince smokers to switch. We learned a great deal about the consumer conversion journey since our city tests of IQOS in Milan, Italy, and Nagoya, Japan, in late 2014. Smokers need time to fully switch (usually one to two weeks), and they need information about how these novel products work.

The regulatory environment in which we commercialize our smoke-free products varies substantially around the world. As a result, it is easier in some countries than others to make smokers aware of smoke-free products and how they should use them. The differences in the regulatory environment explain, to a large extent, why switching to smoke-free products varies from one geography to another.

Smoke-free products contain nicotine, are addictive, and not risk-free. We understand that any communication with adult smokers about these products must be carried out responsibly, attuned to the local environment and observing regulatory obligations. Our employees and third parties acting on our behalf must follow strict principles in the commercialization of smoke-free products, which are formalized in our "Good Conversion Practices" (GCPs) which are being implemented as smoke-free products are launched.



An IQOS flagship store in Japan

A substantial part of our marketing and sales budget in countries where we have launched IQOS has been re-allocated from cigarettes to IQOS. Clearly, to promote our smoke-free vision we must allocate our budget and headcount accordingly.

Our goal to replace cigarettes with smoke-free products extends to all countries where we operate, regardless of development status. We are only at the beginning of commercializing a fully fledged portfolio of smoke-free products and realize that additional efforts are necessary in finding products that are affordable and acceptable for consumers in different parts of the world. We acknowledge the need to continue working to develop different product platforms that can achieve this goal. We are also experimenting with other solutions to reduce the financial barrier to switch to smoke-free products, such as the temporary lending of IQOS devices, combined with promotional offers if permitted by local legislation.

Good Conversion Practices (GCPs) for smoke-free products

1. Smoke-free products are for adult smokers who want to continue enjoying tobacco or nicotine.
2. We do not offer smoke-free products to people who have never smoked or who have quit smoking.
3. Our goal is to switch every adult smoker who would otherwise keep smoking to smoke-free products such as IQOS. We are committed to supporting adult smokers in their switching journey through education and guidance.
4. Smoke-free products are not an alternative to quitting. The best choice for consumers concerned about the health risks of smoking is to quit tobacco altogether.
5. To experience the benefit of smoke-free products, adult smokers should switch completely and abandon smoking permanently.
6. Smoke-free products are not risk free or a safe alternative to cigarettes, but they are a much better choice for smokers who wish to continue to use tobacco and nicotine.



Our post-purchase consumer care approach to support switching



“Product understanding, post-purchase support and encouragement, and consumer care through a helpline, are all important elements in the smoker switching journey, especially during the critical initial 2-3 weeks to avoid relapse to cigarettes.”

CEMHAN OZGUVEN
DIRECTOR, CUSTOMER CARE AND
E-COMMERCE, SMOKE-FREE
PRODUCTS

Equipping our people to successfully transform our business

Our transformation goes beyond the product itself. Trainings and employee engagement have taken on a new level of significance across our organization to ensure employees are involved in and help achieve PMI's transformation. We have introduced three key initiatives in the past year to support us on this journey:

- **An entrepreneurial way of working.** Learning from the disruptive innovation of other companies and start-ups, we have taken elements of approaches such as Lean, Agile and Design Thinking and complemented them with existing PMI methodologies. Known as Fast-Forward (FFwd), this new way of working has a strong customer-centric approach – putting the customer at the heart of everything we do – and embeds a new experimental approach to how we work to help unleash new ideas and pilot test what works (and what doesn't) in a short period of time so that we can then scale-up and execute those that are successful as quickly as possible. As of July 2017, **over 2,000 employees across the globe had participated in intensive FFwd workshops to instill this new way of working and mindset across our organization;**
- **A new methodology to improve the performance of our Operations:** Over the last year we have introduced an integrated way of working called OPEN+. This uses new standardized routines, processes and tools, deployed sequentially to develop the capabilities of our people. This is aimed at permanently eliminating non-value-added activities, increasing effectiveness and reducing waste in a systematic way; and
- **A new training program to equip Management Teams for our transformation:** We have developed a 12-week training program for all Management Teams worldwide known as our Transformation Academy. The program aims to build the foundational knowledge, alignment and mindset needed to help us achieve our business vision of a smoke-free future. The program includes a module on sustainability, and in 2017 a first wave of management teams of over 30 countries are scheduled to complete this training.

Managing significant changes in our value chain

Our transformation will have implications for our value chain. We are committed to managing these consistently with the UNGC Principles, and contributing to the SDGs where we can make a positive difference.

Our current smoke-free products use less tobacco than cigarettes; they also have specific requirements in terms of the variety and quality of the tobacco. We recognize that this will eventually impact tobacco farmers and are putting plans in place to help support farmers throughout this transition, including ongoing efforts to promote crop diversification.

The commercialization of our smoke-free products also means a whole new sector is gaining increasing relevance in our supply chain – electronics – which presents its own challenges and risks. We expand on how we plan to responsibly manage these challenges and our progress to date in the chapter on Our supply chain (page 47).

Another issue we are addressing is post-consumer waste of our smoke-free products, both the consumables and the electronics. Read more about our work and commitments in this area in the chapter on Managing our environmental footprint (page 56).

Business Transformation – Metrics

	Actuals		Estimate	Aspiration ¹	
	2014	2015	2016	2017	2025
R&D expenditure ² (Smoke-free/Total)		70%	72%	>70%	
Commercial expenditure (Smoke-free/Total)	2%	8%	15%	>30%	
Net Revenues ³ (Smoke-free/Total)	0.0%	0.2%	2.7%	>10%	
Smoke-free product ⁴ shipment volume (billion units)	0.2	0.8	7.7	>30	>250
Combustible product ⁵ shipment volume (billion units)	890	881	845	<800	<550

1 Assuming constant PMI market share. We do not set aspirational targets for R&D and commercial expenditure but we expect both ratios to continue increasing to enable the stated outcome in terms of shipment volume

2 R&D expenditures for smoke-free products were tracked separately as of 2015; the related metric was therefore left blank for 2014

3 Excluding excise taxes

4 Includes heated tobacco units and e-cigarettes

5 Includes cigarettes and other combustible tobacco products

The 2014, 2015 and 2016 metrics are subject to PwC's Assurance Report included in Annex 3



Business Transformation Metrics

We are introducing a set of five Business Transformation Metrics to make the actions we are taking to pursue our smoke-free vision measurable and verifiable. The first two metrics show our resource allocation between combustible products and smoke-free products, while the following three show progress in making smoke-free products the core of our business. We will publish updates on these metrics on a regular basis.



The first metric – R&D expenditure – shows how much of our total spent on research and development is dedicated to smoke-free products. It includes the costs related to clinical studies, the development of new machinery, prototype and product acceptability testing. The R&D expenditure for our combustible tobacco products are largely related to legal compliance requirements, such as the measurement and reporting of tar, nicotine and carbon monoxide for cigarettes, and adaptation to regulatory changes.

The second metric – commercial expenditure – shows how much of our total spend on the commercialization of our products is dedicated to smoke-free products. Commercial expenditure includes costs for marketing, consumer engagement, and trade promotions. As with the other metrics these refer to our global business and therefore include commercial expenditures related to cigarettes in the many countries where we have not yet launched smoke-free products. For countries where we are commercializing our new products, this percentage is and will be significantly higher.

The third metric – net revenues – shows the portion of our revenues that is generated by the sales of smoke-free products (including electronic devices and accessories). Excise taxes are excluded from the net revenue figures.

Finally, the last two metrics show our smoke-free product shipment volumes (including both heated tobacco units and e-cigarettes) and our combustible tobacco product shipment volume (mainly cigarettes).

It is our ambition that by 2025 at least 30% of our volume comes from smoke-free products.

Of course, we hope that even faster progress can be achieved, and our experience in individual countries shows that this is feasible. In the second quarter of 2017, less than three years after our test launch of IQOS in Japan, smoke-free products already represent over 40% of our nationwide shipment volume in the market.

This section outlined our major activities to advance a smoke-free world: significant investments in research and development, ramping up production capacity, substantial reallocation from cigarettes to smoke-free products and increases in commercial expenditure, equipping our people and facilitating the transformation for the whole value chain.

But we recognize that achieving a smoke-free future does not only depend on us. Many challenges lie ahead of us, and a collaborative approach with many different stakeholders is essential for success. To further accelerate progress in achieving a smoke-free world, we plan to support the establishment of an independent foundation that will focus on strengthening science-based approaches. The foundation will operate independently of PMI, scrutinizing the progress of PMI and other companies in the sector, and ensuring that the public health interests of society are met through the foundation's Board of Directors.

Strengthening our sustainability fundamentals



PMI R&D facility, Neuchâtel, Switzerland

Acting with integrity

See page 30

The guiding principles on business and human rights

See page 38

Our people

See page 40

Our supply chain

See page 47

Managing our environmental footprint

See page 56

Next steps

See page 66



Strengthening our sustainability fundamentals

Acting with integrity

We believe that doing business with integrity and preventing unlawful and unethical behavior is essential to our long-term success; that includes how we advocate on issues related to our products, and our efforts to tackle the illicit tobacco trade.

Our Compliance program and our culture of ethical business conduct provide a strong foundation for our commitments as we transform our business.

In this section we provide an update on key developments in 2016 under our Compliance program, including training our own employees and third parties working on our behalf to prevent misconduct. We also share our ongoing work to address the illicit tobacco trade and report on one of our key initiatives in this area, PMI IMPACT. Lastly, we look at some of the main challenges we anticipate as our business changes, namely in:

- ensuring our Compliance systems provide support and guidance for our employees on how to handle new risk areas related to smoke-free products;
- further improving the transparency of our advocacy efforts; and
- efforts to combat the illicit tobacco trade, both of cigarettes and our smoke-free products.

Our Compliance program

Honesty, respect and fairness are core values which unite and guide us at PMI. They are an integral part of our company culture and are the basis of our Code of Conduct (known as our “Guidebook for Success”).

We believe that a strong compliance culture is achieved through a combination of the right Code of Conduct and Principles & Practices, the required level of awareness, training and commitment to our values from all employees, a working environment that fosters and facilitates appropriate conduct, an understanding on how and why people behave in certain ways, followed by a diligent and fair investigation process for suspected misconduct and humane, proportionate disciplinary action.

The Guidebook for Success, together with its supporting Principles and Practices, covers the following core risk areas: competition law, conflicts of interest, environment, health, safety and security (EHSS), fiscal and trade (including anti-illicit trade), protection of information, marketing and sales, and workplace and labor practices. It also covers a range of anti-bribery topics, including giving and receiving gifts and entertainment, facilitating payments (prohibited), contributions involving or connected with government officials, third parties who interact with government officials on our behalf, membership of organizations, advocacy activities and reporting and record keeping.

Awareness of, and commitment to, our Guidebook for Success is implemented through training for all employees and relevant third-parties (in the form of classroom and online training, town halls, leadership communications and team discussions), and the promotion of a working environment where employees feel comfortable and safe speaking up when things don't seem right or can be improved. We have a Compliance Helpline available 24 hours a day, seven days a week, in all languages spoken at PMI.

In 2016, we increased the number of Compliance-related trainings provided through different channels to employees and relevant third parties.

In 2016, Compliance received 792 reports of suspected misconduct (vs. 744 in 2015). **82% of the people that decided to help PMI by reporting suspected misconduct trust the Compliance Program enough to be comfortable giving their name when reporting.** 292 of those reports (54%) resulted in substantiated misconduct (vs. 52% in 2015).



A pack of Marlboro with a graphic health warning in Germany

Marketing

One area where many of our critics express concern relates to our marketing principles and practices. Some of the concerns raised include whether our communications to adult consumers are appropriate, whether we target non-smokers or minors, and whether we have lower marketing standards in developing countries than in developed countries.

Our Marketing Code for cigarettes is based on these key principles which are applied across the world without any exceptions:

1. We market and sell our cigarettes to adult smokers (not to minors or non-smokers);
2. We warn consumers about the health effects of cigarettes;
3. Our marketing must be honest, accurate and transparent; and
4. We respect the law and our high standards.

In order to proactively invite discussion with stakeholders about opportunities to improve our approach, we are providing a complete overview of our marketing principles for combustible products together with this report. See Annex 2.

Compliance Training

	2015	2016
Compliance Law	7,784	5,831
Compliance Overview	51,001	111,588
Environment, Health & Safety	7,565	9,393
Employment/Privacy	11,520	10,516
Fiscal & Trade	22,705	13,882
Government Relations	18,994	11,771
Information Security	8,956	7,562
Intellectual Property	10,259	4,402
Marketing	44,264	37,832
Records Management	9,611	15,226
Regulatory Affairs	473	298
Taxation	346	540
Total Trainings	193,478	228,841



77%
Employees



23%
Third Parties



53%
Live



47%
Online

Our Chief Compliance Officer oversees the application of our Compliance Program, and adherence to our Principles and Practices is monitored by our Internal Controls function along with our independent Corporate Audit department, which reports directly to the Audit Committee of the Board of Directors.

In 2016, Compliance, together with the Internal Controls and Corporate Audit functions, integrated our risk assessment into one single process leading to a more holistic view of risks both at corporate level and in the affiliates.

Looking ahead: maintaining a strong compliance culture

As our company transforms, we must also be mindful of new challenges.

Our commitment to continue to uphold a strong culture of ethical business conduct, including anti-corruption, is essential. In particular, we plan:

- A comprehensive, third-party assessment of our Compliance Program in 2018;
- A company-wide employee survey on our compliance culture in 2018 to gain insights into areas for further improvement;
- A revision to our Code of Conduct and related Compliance Principles & Practices in 2017 to address new challenges and ensure ethical behaviour on fields such as scientific integrity.



Our culture of Compliance: new challenges as our company transforms

These include engaging with a wider range of stakeholders (government officials, scientists and the public health community), explaining our smoke-free products and the science behind them, deploying new methods of commercialization to make adult smokers aware of them, their attributes and how to use them, and the implementation of a post-purchase consumer care approach to support the switching journey.

Our interactions with government

Some of our critics have voiced concerns about the way in which we interact with governments. Our Code of Conduct and specific Compliance Principles & Practices govern these interactions, which are conducted transparently, with integrity, and in adherence to local laws. We comply with rules for advocacy, report on our activities as required in several jurisdictions, and we are transparent when others engage on our behalf. We also publicly disclose the limited political contributions we make (www.pmi.com/transparency). While confident about our practices, we want to be more proactive in addressing concerns raised. **Together with this report we are making available and inviting feedback on our principles for engagement with governments and public organizations. See Annex 3.**

Strengthening efforts to tackle the illicit tobacco trade and related crimes

Preventing the illicit tobacco trade is one of PMI's core business strategies. Recent studies by the OECD,¹ Transcrime,² and others show that illicit tobacco is a highly-profitable trade for organized crime groups and is linked to corruption and many related crimes, such as terrorism and trafficking of other illicit goods or even human trafficking. Global illicit tobacco trade deprives governments of tax revenue and undermines the effectiveness of excise tax policy to reduce smoking. Given its sheer scale, it is clear that coordinated, integrated action is needed to tackle this problem. For us this means continuing to invest time, effort and resources in maintaining the integrity of our supply chain and working with governments and other partners to improve law-enforcement measures to tackle the problem's systemic causes.

Our efforts focus on three main objectives:

- effective measures to secure our supply chain and prevent the illegal diversion of our own products;
- support for regulation and multi-stakeholder public-private partnerships to stop illicit trade; and
- investing in research to improve understanding of the size and drivers of the problem, alongside education and training for public officers in charge of tackling the issue.

1 OECD, Reviews of Risk Management Policies, "Illicit Trade, Converging Criminal Networks", April 2016: <http://www.oecd.org/gov/risk/charting-illicit-trade-9789264251847-en.htm>

2 Transcrime, "European Outlook on the Illicit Trade in Tobacco Products", January 2015, p. 47

3 Our Anti-Diversion Toolkit provides detailed information about these tools and is available here: https://www.stopillegalcigarettes.com/anti_diversion_toolkit.pdf

Effective measures to secure our supply chain and prevent the illegal diversion of our own products

Our commitment and governance

Our commitment is to ensure our products are legally sold in the market for which they are intended. In 2015, we created an Anti-Diversion Governance Committee (ADGC), comprising senior management team members, to help ensure our Policies and Practices are applied systematically across PMI. The Committee adopts a risk-based approach, mapping smuggling hotspots of PMI legal products, implementing tools and processes to address root causes. A stand-alone Progress and Outlook report on the status of our efforts will be available in September 2017.

Our tools

Principles and Practices:

Our "3 Knows" (Know Your Customer, Know Your Payment, Know Your Vendor) provide a system of due diligence to ensure we know to whom we sell our products. They include checks to ensure our customers have the legal right to trade in or purchase tobacco products.

Given the fast-evolving nature of criminal activity in this area, our tools and processes are continuously refined and updated to help address new areas of risk.³

Tracking and tracing

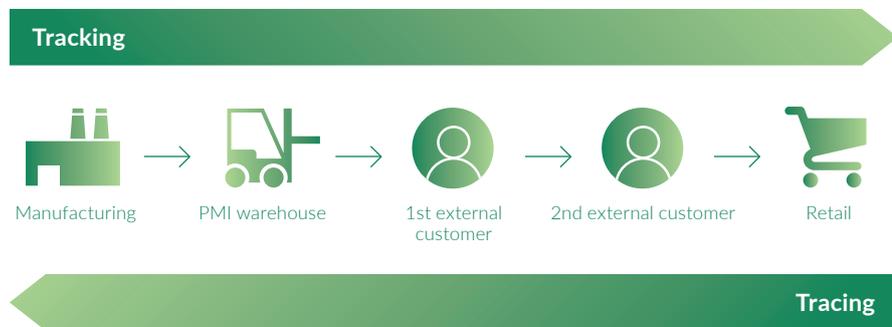
Tracking and tracing is a process to follow and keep track of product shipments. It helps determining where products have been diverted from their legitimate supply chain. In our business environment, we are continuously implementing tracking and tracing at the master case (10,000 cigarettes), carton (200 cigarettes, 10 packs) and pack level.



A customs official and member of the European Anti-Fraud Office (OLAF) check the authenticity of a shipment of cigarette master cases
© European Communities, 2003; Source: EC – Audiovisual Service

Tracking and tracing to prevent the illegal diversion of our products in the supply chain

Tracking and tracing of our products occurs across our global supply chain. Today we have more than 700 tracking locations in more than 130 countries, which required an investment of more than USD 100 million.



PMI employee scans a master case as part of our tracking and tracing system

Support for regulation and cooperation with governments and third parties

PMI welcomes regulation and partnerships to help address illicit trade. In addition to supporting country ratification of the World Health Organization's FCTC Protocol to Eliminate Illicit Trade in Tobacco Products, which we expect will introduce new controls in tracking and tracing, licensing, and due diligence processes, we also support regulations which extend beyond national borders covering trading blocs, such as in the European Union (EU). With much of the illicit tobacco trade entering the EU from outside its borders, we know that concerted action is needed to have a real impact.

Last year, a joint agreement between the European Commission and PMI to tackle illicit trade of our brands in the EU expired. Despite its expiration, PMI remains committed to the same anti-diversion practices through bilateral cooperation agreements with governments and local customs authorities in the EU (in the form of "Memoranda of Understanding" – or "MoUs"). These MoUs have resulted in the continued exchange of information and technical training for law enforcement officers who act on this issue. In 2016, PMI signed 5 MoUs with 15 countries bringing the total to more than 50 MoUs with governments in 40 countries.



Greek police officers participate in a training program to learn how to authenticate PMI brands

Volume monitoring

In addition to standard controls of Know your Customer, we need to be alert to any unusual activity or trend in our volumes sold. As part of our Fiscal Compliance programs, on a regular basis, all markets analyze the sales trends to our direct customers. In hot spots for illicit trade, we extend our monitoring further into the supply chain by examining not only monthly volumes to our direct customers, but also volumes sold to our indirect customers.

¹ We do not apply tracking and tracing to kretek cigarettes due to negligible risk of international diversion.

PMI IMPACT: A unique initiative to tackle illicit trade

PMI IMPACT was established in 2016 as the first-of-its-kind global initiative to support public, private, and nongovernmental organizations to develop and implement projects against illegal trade and related crimes, such as corruption, money laundering, and organized crime. PMI has pledged USD 100 million for three funding rounds.

The centerpiece of PMI IMPACT is an independent Expert Council,¹ whose members evaluate and select project proposals to be awarded the grants and review the progress of the projects during their implementation.

The PMI IMPACT Expert Council selected 32 projects for funding in the initiative's first round, which focused on tackling illegal trade and related crimes in the European Union.

The selected projects have real potential to advance global efforts against illegal trade. Many of them go beyond tackling the illegal tobacco trade and will explore the nexus with organized crime, terrorism, online and offline trafficking, and the interdependencies with illegal trade of other goods.

Overview

The projects are expected to be completed over the next two years and include:

- Research from public universities and independent think-tanks exploring the scope and drivers of illegal trade to develop recommendations tackling the issue from different perspectives, including consumer demand, legislative and judicial frameworks, stakeholder action;



- Projects building technical solutions and equipment to support law enforcement operations and strengthen the control over illegal activities;
- Activities to enhance the capacity and proficiency of law enforcement and customs officers, relevant public institutions, and the expert community;
- Educational and awareness programs for opinion leaders and the broader public, including forums for greater cross-sectoral collaboration.

PMI IMPACT

First funding round



32

Projects selected with activities in more than 20 countries



USD 28m

Total amount of grants allocated for the projects' implementation

¹ See: <http://www.pmi-impact.com/Apply/Expert>



The x-scanner donated by our Greek affiliate, Papastratos, to customs to help combat the illicit tobacco trade

X-ray scanner helps fight illicit trade in tobacco

In Greece the illicit tobacco trade is significant, with one in every five cigarettes consumed being illegal.² In December 2016, our Greek affiliate, Papastratos, donated an x-ray scanner valued at EUR 2m to customs' authorities to help combat the illicit tobacco trade. The impact in the first few months has been significant. It resulted in 68,420,000 cigarettes seized, corresponding to avoided duties and taxes of around EUR 13m.³



“Progress against illegal trade requires ideas, resources, and actions – and that’s why we’re excited to launch PMI IMPACT. We’re especially grateful that distinguished experts have agreed to guide this effort, and we are encouraged by the positive response from civil society. In parallel, PMI is continuing to control its own supply chain and to support international protocols against illicit trade.”

ALVISE GIUSTINIANI,
VICE PRESIDENT, ILLICIT TRADE STRATEGIES & PREVENTION

Partnering with others

Working with other private sector companies is essential to combat the illicit trade in tobacco products and other goods. In 2016, PMI signed a joint Declaration of Intent to Prevent the Maritime Transportation of Counterfeit Goods together with eight other global brand owners and five of the world's largest shipping companies – the first of its kind. The intent of this commitment is to strengthen and improve supply chain controls by developing operational tools that can be applied as best practices in the industry (such as Know Your Customer programs).¹

Research, education and training to combat the illicit tobacco trade

A key element of our strategy includes increasing awareness of the illicit trade problem and its drivers. By assessing these aspects, PMI and others can provide insights to government and local authorities to inform future actions and combat illicit trade more effectively.

1 For more details please read <https://iccwbo.org/media-wall/news-speeches/brand-transport-leaders-sign-historic-declaration-stop-maritime-shipping-counterfeit-goods/>
2 <https://assets.kpmg.com/content/dam/kpmg/uk/pdf/2017/07/project-sun-2017-report.pdf>
3 Data at mid-June 2017



SUN Report 2016

The SUN Report¹ is an annual study of the illicit cigarette market in the EU, Norway and Switzerland. The research is based primarily on the analysis of legal or duty-paid sales of cigarettes and cigarette pack surveys (EPS methodology).

The latest report for 2016 shows that the joint efforts of governments, law enforcement agencies, manufacturers and retailers are working to slow the illegal flows of cigarettes in the region, but it is still a huge problem which underscores the need for more joint action, effective policies, and broader awareness to continue to address its increasing complexity.

Illicit trade flows of cigarettes decreased by 8.8% versus 2015. Despite this progress, one in every ten cigarettes consumed in the EU is still illegal (that's an estimated 48.3bn illegal cigarettes, amounting to EUR 10.2bn in lost tax revenue in 2016).

Research: A tool to guide us in improving our strategy

A standard research methodology introduced in the mid-2000s (known as Empty Pack Surveys or "EPS") helps us gain a better understanding of the size, nature, trends and wrongdoers typifying the illicit tobacco trade. In 2016, 126 EPS were conducted in 82 countries, and 79 of these were done jointly with other cigarette manufacturers. EPS surveys are also widely used in independent research conducted by KPMG, Oxford Economics and UK-based think-tank, Royal United Services Institute (RUSI).

Education and training to authenticate PMI legal products

PMI works in partnership with law enforcement agencies in countries worldwide, investing in education and technical training as another key part of our anti-illicit strategy. **In 2016, we trained more than 2,000 members of law enforcement agencies in 13 countries on how to authenticate tobacco products bearing PMI trademarks and to differentiate between counterfeit and authentic packs of PMI cigarettes.**

Looking forward

The realities of globalization and a booming online economy provide an environment which is vulnerable to counterfeiters and illicit traders, allowing them to sell goods directly to customers worldwide with virtually no barriers to entry, low overheads, easier distribution and fewer risks of being caught. Add to this the strong propensity for the manufacture and distribution of fake and smuggled electronic devices and consumables, we see new risks for PMI as we commercialize smoke-free products. Assuring the integrity of products with scientifically substantiated claims is critical to the health outcomes of consumers. To respond to these challenges, alongside our continued efforts to combat illicit trade of PMI brands, we are:

- Registering and maintaining trademarks, patents and other intellectual property rights (IPR) to provide legal remedies against counterfeiters;

- Setting up online controls to detect the parallel distribution of our electronic devices and their consumables, removing platforms which violate our IPRs and reinforcing controls of suppliers of key product components and logistics operators;
- Developing anti-counterfeit and anti-diversion policies to secure our supply chain and the integrity of our smoke-free products;
- Applying unique serial numbers and other security features to PMI devices and heated tobacco units for authentication and tracking and tracing purposes;
- Cooperating with authorities to enhance their knowledge about our products and our supply chain which helps law enforcement to increase their effectiveness to tackle fraud;
- Enhancing intelligence and research tools to monitor illicit trade;
- Using best practices from our combustible tobacco business and the medical and electronic device industries.

Read more about our efforts on www.stopillegalcigarettes.com

¹ <https://assets.kpmg.com/content/dam/kpmg/uk/pdf/2017/07/project-sun-2017-report.pdf>



Customs officers in Ecuador attend a training session to understand how to identify illicit trade of tobacco products

Preventing illicit trade – Metrics

Metrics	Goal for 2017	Goal for 2018
Tracking and tracing – master case level ¹	Full coverage ² in more than 130 countries	Full coverage in more than 130 countries
Tracking and tracing – % of sold packs with unique code applied ²	75%	85%
Extending Memoranda of Understanding (MoUs) with law enforcement agencies/governments – number of countries	Five additional	At least three additional
Regional studies and country analysis to improve awareness of illicit trade – % of global cigarette consumption covered	25%	27.5%
Training for law enforcement agencies to monitor diversion of PMI products – number of law enforcement officers trained	At least 500 across ten countries	At least 500 across ten countries

1 Box with 500 cigarette packs (10,000 cigarettes).

2 For PMI, full coverage equates to 95% tracking and tracing in our supply chain. There are 5% of master cases not covered – these are destined to countries which are not identified as a source of potential diversion or where PMI sells to a single customer in the country.

The guiding principles on business and human rights

Overview of our progress

Following our commitment to the UNGC Principles, we have been working to align our business practices with the United Nations Guiding Principles on Business and Human Rights (“Guiding Principles”). We continuously strive to ensure that our policies highlight and foster respect of human rights of all rights-holders, including consumers, employees, workers in our supply chain and our downstream value chain, and the communities in which we operate.

In our last Communication on Progress, we highlighted the many existing policies and procedures we have in place to address human rights risks throughout our value chain. We also committed to improving those “with our foremost focus on risks to rights-holders.” Over the last year, we engaged internally and externally to identify the strengths and weaknesses of our existing framework from a Guiding Principles perspective. We are drawing on this broad-based engagement and research to develop a detailed action plan to inform concrete and practical measures we will take to ensure we respect the human rights of stakeholders throughout our operations.

This section seeks to provide a candid account of the steps taken to respect our commitment.

Our commitment

The foundation of PMI’s human rights program is our Commitment to Human Rights.¹ Approved by our CEO, the Commitment is the result of internal cross-functional consultations and external stakeholder dialogue. The final text reflects the breadth of this engagement by setting out PMI’s fundamental principles and the practical steps we will take to respect the rights of all stakeholders:

“Honesty, respect and fairness are the core values that embody our commitment to society. Every day, we interact with millions of men and women: consumers, employees, workers in our supply chain, shareholders, and the communities in which we live and operate. We care about their dignity and human rights.”

We are committed to business practices that respect internationally recognized human rights in line with the United Nations Guiding Principles on Business and Human Rights. We base our commitment on the International Bill of Human Rights and the International Labor Organization’s 1998 Declaration on Fundamental Principles and Rights at Work.

We will talk with and listen to people whose human rights we might affect. We will look closely at our practices, continuously strive to improve them, and operate systems to implement this commitment from supplier to consumer.”

At the heart of our Commitment is a structured governance process for ongoing human rights due diligence:

- **Capacity building** for our employees and business partners to understand and implement our human rights commitment;
- **Assessments to identify human rights risks and adverse impacts**, which we may request third parties to conduct, either on a stand-alone basis or as part of the company’s overall integrated risk assessment;
- **Effective action in response to assessment findings** in our operations and, to the extent possible, throughout our value chain. Actions may include practical guidance, process improvements, revised commercial terms and other measures;
- **Monitoring effectiveness of measures**, including through third-parties as appropriate, to mitigate or address human rights risks and adverse impacts; and
- **External communication** about our work on human rights and the key indicators we are using to assess performance. Further to our United Nations Global Compact commitments, we will formally report on progress at least once a year, or by other appropriate means.

¹ <https://www.pmi.com/sustainability/our-commitment-and-ongoing-focus>

Human rights core team

To ensure continuous oversight and improvement of our human rights program, we have established a cross-functional Human Rights Core Team of specialists from our various business functions, including Operations, Human Resources, Law, Corporate Affairs, Marketing & Sales, Sustainability, and Compliance. The Human Rights Core Team is supported by the functional leaders who report to our CEO and is coordinated by the Sustainability Team reporting to our Senior Vice President of Corporate Affairs. The Human Rights Core Team also engages externally for advice and expertise on human rights.

Training and capacity building

Practical knowledge on human rights is critical for our objective of embedding our commitment in the organization and our 80,000 employees. We have developed a general e-learning on human rights for all employees, rolled out at the same time of the release of our Commitment to Human Rights. In addition, we are developing tailored functional training to ensure a more in-depth understanding of what human rights mean for individual functions and to PMI as a whole, as well as the concrete steps and actions expected from the different functional areas.

Company-wide gap and risk analysis and human rights action plan

In 2016, PMI engaged the Danish Institute for Human Rights (DIHR) to conduct a high-level, company-wide human rights risk mapping and gap analysis. Over a seven-month period, the DIHR team reviewed PMI's group-level policies, procedures and practices. Though this was an informative and group-level assessment, the research process was wide-ranging, incorporating document review, interviews with managers and senior-level employees from across the central organization, two cross-functional workshops, and consultation with external stakeholders with whom PMI has engaged regarding labor and human rights.

The Human Rights Core Team is now drawing on the DIHR's analysis and our broader engagement with experts and stakeholders to develop a detailed human rights action plan. We will report on this work separately before the end of 2017.

We remain committed to do our best to continuously improve our processes and work with our business partners and suppliers to support our commitment.



A hand-roller of kretek cigarettes in Indonesia

Our people

We are a multigenerational, diverse community of around 80,000 employees worldwide, speaking over 80 languages and working together in a culture of honesty, respect and fairness.

Our priority is to be a top employer and to **attract, support, and retain people from every part of the globe – regardless of race, ethnicity, age, gender, gender expression, sexual orientation, religion, national origin, citizenship, marital status, physical ability, or similar status.** Our differences foster innovation and support our company's transformation.

In this section we look at employment at PMI and our company culture, our approach to diversity and inclusion, our labor relations as a foundation of sustainable business, and ongoing efforts in the area of employee safety, health and well-being. We also look to the future and the steps we are taking to equip our people to adapt and thrive as our company shifts towards smoke-free products.

Strong governance as a foundation for our culture

Our Human Resources (HR) Leadership Team is accountable for establishing and implementing the Principles and Practices to shape employee behavior as part of maintaining a workplace of honesty, respect and fairness. Together with management across different functions, our company-wide HR organization is responsible for creating and implementing

the relevant processes and tools to nurture a workplace that is inclusive, safe and professional. With this in mind, we have adopted a suite of Principles and Practices to meet the expectations set out in our Guidebook for Success and implemented specific programs to advance its integration.

Diversity and inclusion

We operate in many countries and as we move forward in a rapidly changing business environment, our people continue to come from and represent a wide spectrum of backgrounds and perspectives. We continue to promote an inclusive workplace that is safe and professional and free from discrimination. We also know that this is key to improving our creativity and performance in the future, and we are making progress in a number of areas.





Progress in 2016

- We are on track to reach our 2022 goal of increasing the representation of female employees in management positions to 40%, with the percentage of women hired and promoted by PMI increasing in 2016. By the end of 2016, 32.8% of management positions were held by women and 43.1% of PMI's new hires at the managerial level were women.
- Through a series of workshops, we continued to educate our management on inclusive leadership and constantly increase opportunities to stimulate diverse perspectives. Workshops were held in 24 countries and in two of our Shared Service Centers. We also launched an Unconscious Bias e-learning tool, available to all employees worldwide, and we integrated into our standard PMI training curriculum key learnings about the benefits of diversity and how to be more inclusive.
- We received external recognition for our work in a number of countries:
 - In Australia, we received the Employer of Choice for Gender Equality Award by the Government's Workplace Gender Equality Agency; and
 - In Switzerland, we achieved the Innovation Excellence in Diversity and Inclusion Award from the Profiles in Diversity Journal for our strong advocacy in closing the gender pay gap worldwide.
- The Equal-Salary Foundation examined and certified another of our affiliates – Japan – for equal compensation practices among men and women. Following this key milestone, our aspiration is to attain a global Equal-Salary certification by 2019 as the assessor develops their organizational capacity.
- We are also working to better support our people in balancing business and personal priorities. PMI has now implemented flexible work arrangements under our FlexAbility program in 48 countries where we operate. The program gives employees various options including flexible start and finish times, working from home one day a week or working a shorter working week by compressing their normal working hours.

Our employment principles and practices

We make employment decisions on merit. We do not engage in or condone forced or child labor anywhere we operate. We do not employ persons below the age of 15, or the local minimum employment age or mandatory schooling age, whichever is higher, except for official apprenticeship programs authorized under local laws and regulations. We do not employ persons below the age of 18 for any hazardous work. Our Labor Relations Principles recognize our employees' right to freedom of association and to collective bargaining. We do not accept any form of discrimination or harassment. We make safety of all our employees and those who might be affected by our operations a priority.



Employer certification program

The Top Employer certification program is designed to recognize the best employers around the world. It is awarded by the Top Employer Institute following an assessment validated by an external auditing company of the companies' practices in several areas including compensation and employee benefits, career development, working conditions and training and development. PMI has been certified in Europe for five years, the Middle East for two, and Africa for the first time in 2016.

Good labor relations – finding common ground is not always easy: The case of Pakistan

Although we do our best to foster positive and meaningful dialogue, at times this proves challenging, and issues often ensue from necessary changes in our operations. One such instance occurred with the reorganization of our affiliate in Pakistan in 2015-2016. PMI seeks to avoid job losses wherever possible, but this reorganization was necessary because of reduced leaf purchase and processing requirements and affected a total of 186 employees. Even though the reorganization process complied with all legal requirements in the country, one of the trade unions took the view that our consultation had been inadequate and filed petitions before the National Industrial Relations Commission in Pakistan. The petitions were later dismissed however, this instance was unfortunately described in the International Trade Union Confederation report of 2016, as a violation of union rights.

This event reinforced our resolve to continuously and proactively promote constructive dialogue and positive relations with employee representatives to ensure that we are able to cooperate on matters of mutual concern and observe high standards of labor relations.



Leading the way in equal-salary certification

In 2015, we were the first multinational company to receive the equal-salary certification in Switzerland. Following this, we embarked on a certification procedure in Japan which consisted of statistical analysis of all Japanese employees' salaries followed by a thorough onsite audit. Our Japanese affiliate was officially certified in September 2016.

Currently, we are focused on the equal-salary certification project that will give us the possibility of receiving a global equal-salary certification for PMI, with the Equal-Salary Foundation working in partnership with PricewaterhouseCoopers (PwC) for the 18-month audit and certification procedure.

Labor relations

Our approach to labor relations reflects the vision, culture and identity of our company. **We believe that dialogue with employees and their representatives is a cornerstone of strong business performance.** Our Global Employment Policy, which all PMI employees are expected to know and follow, speaks of our commitment to fundamental rights and principles at work. We respect the right of our employees to join trade unions and representative organizations of their own choice, and we encourage engagement and dialogue with our employees. We recognize workers' right to bargain collectively through workers' representatives, who may communicate openly and without fear of retaliation. We promote cooperation on matters of mutual concern and observe high standards of employment and labor relations.

Progress in 2016

Collective Labor Agreements with trade unions and employee representatives illustrate our genuine labor relations engagement. They govern many of our employees' terms and conditions at work and may include working hours, occupational health and safety, holidays, wages, and procedures for dispute resolution. Our status in 2016 included:

- 79 collective labor agreements in 35 countries covering 68% of our employees;
- The development of a set of comprehensive labor relations principles aimed at establishing the crucial elements to advance and sustain successful engagement and collaboration between management, employees and their representatives; and
- The continuous strengthening of the labor relations capability within our HR function. After deploying a labor relations assessment toolkit in 2015, we developed an e-learning tool for HR employees who lead our labor relations work at the country level, which we plan to roll out to all HR staff in our affiliates in 2017.



Logistics worker in our manufacturing facility in Neuchâtel, Switzerland

Compensation

We are convinced that motivated and engaged employees drive individual and, ultimately, business performance. This is why in every country we operate we offer career and development opportunities through diverse and inspiring professional experiences, including international assignments. **Compensation and benefits** are also important, and PMI's policies in this area **in every country are at or above the market median.** Alongside these efforts, we are looking at ways to educate and enable our employees to reduce short- and long-term financial impact inherent to changes in employment or retirement.



We encourage the establishment of local H&WB committees in our affiliates. Composed of cross-functional team members and employee representatives, they foster the collaboration and dialogue necessary to tailor the activities according to the specific needs of local employees. **To date, we have H&WB committees in the EU, where the program was piloted, and our ambition is to expand to the remaining regions.**

As part of continuously improving our efforts, we are studying best practices in other companies and looking at ways to define and embed evidence-based employee H&WB metrics into our broader corporate reporting framework, which we envision to include data in line with the most recent Global Reporting Initiative (GRI) standard.

'Balanced You' program key areas



Illness and disease prevention



Encouraging physical activity



Promoting healthy eating



Support in stress management and work-life balance

Living wage

According to surveys conducted by unions, academia and the International Labor Organization (ILO) on the concept of living wage, in some countries minimum legal wage levels may not fulfil the needs of employees and their families to have a decent life. In 2016, we started a project with Business for Social Responsibility (BSR) to assess whether the lowest-paid people in our organization are able to maintain an adequate standard of living. Together with BSR we have defined the concept and methodology, and after conducting initial desk research, we have decided to run a **living wage survey in countries where we have more than 50 employees.**

We want to define living wage rates, identify where we can improve and establish adjustment actions if needed for those employees whose wages might be below these rates. We are in the process of identifying the first countries to be part of this exercise.

Health and well-being

The health and well-being (H&WB) of our employees, both inside and outside the workplace, is a key part of our people management and is something we continuously seek to improve.

H&WB is a multifaceted topic touching on the physical, emotional and behavioral aspects of living. H&WB is understood differently from country to country and is influenced by personal preferences, local culture, behaviors, and demographics. With this in mind, we continue to roll out our framework and minimum requirements on promoting H&WB initiatives through our "Balanced You" program across our affiliates worldwide. This covers four main areas:

- Illness and disease prevention;
- Encouraging physical activity;
- Promoting healthy eating; and
- Support in stress management and work-life balance.

The PM EU Works Council celebrates 20 years of sustained, meaningful dialogue

"I have the pleasure of participating in the EU Works Council of PMI as its Vice-Chairman. The EWC is a high level dialogue body that discusses topics relevant to the social partners – business performance, employee health and well-being, reorganizations – and shares successes and challenges, good practices, projects and initiatives taking place in the PMI EU region. In 2016 we celebrated the 20th anniversary of sustained collaboration in EWC. Despite sometimes challenging topics, discussions are always constructive; we have meaningful dialogue to find the best solution for everyone concerned. This is something we can all be proud of."

HARALD WIEDENHOFER
GENERAL SECRETARY OF THE
EUROPEAN FEDERATION OF FOOD,
AGRICULTURE AND TOURISM TRADE
UNIONS (EFFAT)

Safety in the workplace

PMI has 48 production facilities in 32 different countries. We have developed and implemented a leading environmental and occupational health, safety and security management system, which involves policies, standard practices and procedures at all of our manufacturing centers.

We set minimum requirements based on PMI best practices and local regulations and embed these requirements into every level of our organization. Training and awareness programs support our ambitions, globally and at the affiliate level. In 2016 we revised our Mission Zero program to reinforce the importance of safety beyond compliance (now called Mission Zero "Because We Care"). We have rolled out a Safety Climate Survey in all our manufacturing sites to get feedback from 20,000 employees.

In 2016, our Lost Time Injury (LTI) rate, the most widely used benchmark to assess prevalence of serious work-related injuries, was the best in our industry and one of the lowest among our Fast-Moving Consumer Goods peer group. In 2016 the LTI rate across the whole of PMI was 0.12 (injuries per 200,000 hours worked) and in our factories it stood at 0.05. Thirty five of our factories have achieved zero LTI for more than a year and several sites have reached up to five years without LTIs.

We also conduct regular safety assessments at our offices, warehouses and car fleet organizations. Additionally, we have engaged Bureau Veritas, an external certification body, to assess the management systems at our manufacturing centers around the world in accordance with internationally recognized standards for safety and environmental management. **In 2016, 93% of our factories were certified to the international safety management standard OHSAS 18001, and two additional factories were in the process of gaining certification.**

Despite good results and low injury rates, we are committed to explore more innovative and engaging ways to keep our performance world-class. Managing change with safety in mind is essential as we convert existing factories or build new production sites for smoke-free products. From 2017 onwards, we are implementing our Mission Zero "Because We Care" program beyond our manufacturing operations to reach our country sales and marketing organizations.



An engineer operating a make-pack cigarette machine at our facility in Neuchâtel, Switzerland

Engaging our people through training and learning as our company evolves

The ability to learn and adapt quickly and effectively is of particular importance in light of the major changes that come with our business transformation. In addition to novel initiatives to equip employees to adapt and thrive, we are also implementing the following tools to support our collective learning effort:

- **We have created a Learning Council**, which is a decision-making body with oversight of all global, regional and functional training programs covering general employee learning and development. Its main accountabilities are twofold: first, strategic governance, setting global and regional priorities for learning; and, second, operational governance, related to efficiency and effectiveness factors.



- We developed a 360° learning platform which is a simple, web-based tool for employees. The platform can be accessed on multiple devices and accommodates different affiliates' needs with local content where staff can access the same training tools.
- Our company culture is also key to our future success. In 2017, we launched a **Shape our Culture and Leadership initiative (SHAPE)** focused on gathering feedback from employees about the culture and leadership behaviors we need to succeed in our business transformation and will report back on our progress in 2018.

Safety across our fleet

With a fleet of more than 25,000 vehicles in more than 100 countries, road safety is a key concern. We manage our vehicle fleet with an integrated approach based on nine elements: leadership, baseline assessment, risk assessment, hiring of drivers and placement, training, performance recognition, vehicle selection and maintenance, incident reporting and investigation, management reviews and communication.

Progress in 2016

We are making good progress across all nine areas of our Fleet Safety program:

- We **implemented our Fleet Safety program** in all countries where we operate and involved our sales force organization;
- While our overall crash rate (which includes cosmetic damage) has increased, reflecting better internal reporting, **our preferred indicator – collision rate (collisions per million km driven), which covers higher severity road accidents, has declined to 1.22 (from 1.24 last year);**

- We created **Fleet Safety Teams/ Committees in the largest countries** where we operate to help reduce the risk of workplace injuries and illnesses and maintain compliance with safety regulations;
- We launched a **fleet safety e-learning tool** in 79 countries, with 15,000 drivers enrolling each year and reaching a training completion rate of 90% across our organization worldwide;
- We also established a **PMI Fleet Safety Award**, which receives 50-60 submissions each year and senior management attention; and
- We have gained **better understanding of safety dynamics in our fleet based on employee feedback and reporting (5,000 individual reports per year).**

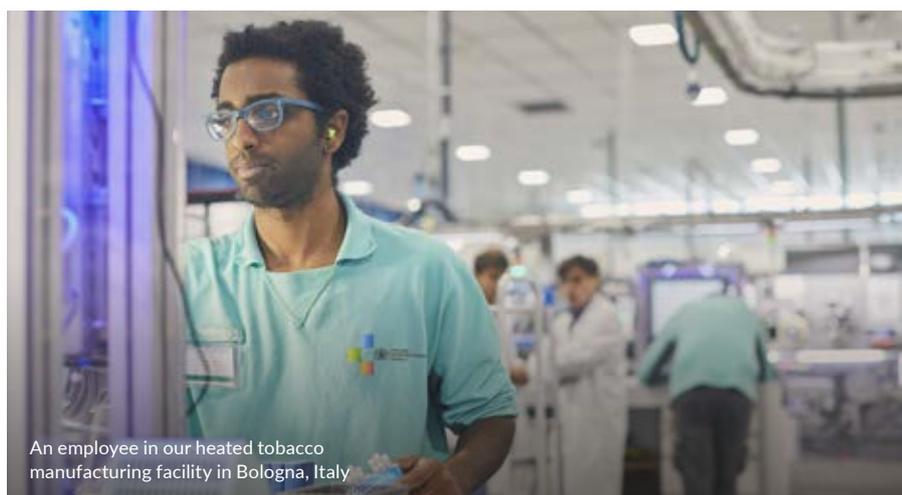
Looking ahead

Our business vision to create a smoke-free future entails an organizational transformation which calls for a new mindset and perspective. Employee centricity, greater inclusiveness and diversity are key enablers to achieve this.

In the next couple of years, we will continue to work on our goal of increasing the representation of female employees in management positions to 40% by 2022, and we will pursue our goal to reach a global equal-salary certification by 2019 with the Equal-Salary Foundation working in partnership with PricewaterhouseCoopers (PwC) for the 18-month audit and certification procedure.

We are looking ahead with confidence that sound labor relations and a constructive dialogue with our employees and their representatives will help us to respond to the challenges and opportunities arising from our company transformation. We will continue building and reinforcing our labor relations capabilities across the globe.

We want to define living wage rates and identify where we can improve and establish adjustment actions where needed. As part of continuously improving our efforts, we are studying best practices and looking at ways to define and embed evidence-based employee H&WB metrics into our broader corporate reporting framework.



An employee in our heated tobacco manufacturing facility in Bologna, Italy

We will maintain safety as one of the pillars of our new way of working across operations, known as OPEN+ (see page 25). This will serve to further drive sustainable safety performance and our safety culture evolution. Operational discipline, continuous health checks (gap assessments) and scorecards will help accelerate progress.

We will expand our Mission Zero "Because We Care" program beyond our manufacturing facilities. Starting in 2017, we will launch new safety leadership workshops and tools, upgrade minimum requirements and undertake employee engagement activities across our affiliates. We will also launch a country-level

Environment, Health and Safety Award to recognize those functions that have already started applying the Mission Zero philosophy to their day-to-day work, the objective being to encourage their further commitment to sustaining PMI's safety culture, environmental commitments and in identifying best practices that can be shared and applied globally.

In 2017 and specifically in respect to our fleet of vehicles, we will focus on innovative technology solutions (gamification/telematics) to facilitate safe driving and accident prevention. We are also implementing safe route planning systems, driving style and safe driving simulators.

Our people – Metrics

Metrics	Coverage	2014	2015	2016	Goals	Status Check
Total number of employees	All PMI	82,500	80,200	79,500		
% of management positions held by women	All PMI	29.5	31	32.8	40 by 2022	On Track
Equal-Salary certification	All PMI	N/A	Switzerland	Switzerland and Japan	Global by 2019	On Track
% of employees covered by Collective Labor Agreements	All PMI	67.7	67.0	68.0		
Lost Time Injury (LTI) Rate – LTIs per 200,000 hours worked	All PMI	0.14	0.11	0.12	<0.1	Note 1
Fleet Crash rate – Vehicle crashes per million km driven	PMI vehicles	5.9	5.3	6.8	<4	Note 2
Fleet Collision rate – Vehicle collisions per million km driven	PMI vehicles	2.4	1.24	1.22	<3	Note 2
% of manufacturing facilities with OHSAS 18001 certification	PMI factories	91	93	93	100	Note 3

Note 1 – Safety comes first at PMI so despite our LTI rate being the best in our industry and one of the lowest among our Fast-Moving Consumer Goods peer group, we continue to seek improvement. By extending Mission Zero "Because We Care" program beyond our manufacturing facilities we believe we can beat our LTI rate goal.

Note 2 – Our overall crash rate (which includes cosmetic damage) has increased, reflecting better internal reporting; our preferred indicator – collision rate (collisions per million km driven), which covers higher severity road accidents, has continued to decrease – we will focus on this indicator going forward.

Note 3 – Newly acquired or built factories have begun the certification process. Because there might be new factories we may not reach 100%, but that remains our goal.

Our supply chain

With a complex global supply chain comes a number of significant sustainability issues that we need to understand, manage and continuously address.

These range from climate change and environmental impacts (discussed in the environment chapter on page 56), to the potential for labor and human rights abuses or corruption.

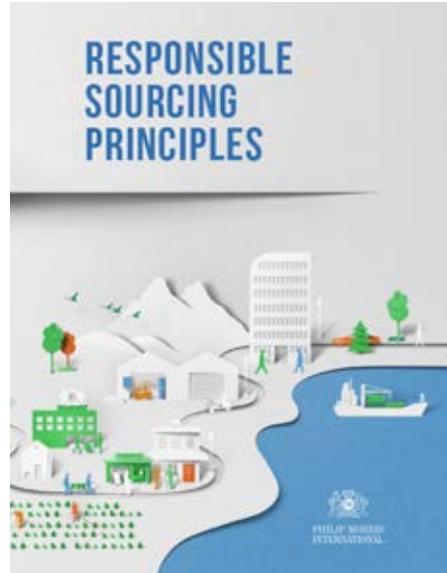
We take our role seriously and are working with our business partners to proactively identify, manage and reduce risks, create mutual value and have a positive impact on the wider communities from which we source. We see this as a fundamental part of upholding our commitment to the UNGC and embedding its Principles into our daily work.

To date, our efforts have concentrated largely on our agricultural supply chain to address labor and other risks in the places where we source tobacco. Our priority as we continue this work is to establish a comprehensive approach to sustainable supply chain management for a broader and more complex supply chain.

In this section, we cover the framework and programs we have put in place to move us forward, our progress so far, and where we are concentrating our efforts to both overcome existing challenges and anticipate future ones.

Building a framework for sustainable supply chain management

During 2016 we set the foundations for a more comprehensive and systematic approach to addressing supply chain sustainability through the development of a set of **Responsible Sourcing Principles (RSP)** and **Implementation Guidelines**.¹ These establish our expectations in the areas of Human Rights, Labor Rights, the Environment and Business Integrity, and apply to all suppliers doing business with PMI.



The RSP were developed in consultation with external expert stakeholders on human rights and sustainability and with a select group of our key suppliers. The RSP operationalize our commitment to the UNGC's Principles across our supply chain. They complement our existing programs in our agricultural supply chain (our Good Agricultural Practices (GAP) and Agricultural Labor Practices (ALP) programs) and set process and performance requirements for all suppliers doing business with PMI.

Looking ahead

In 2017, we will roll out the implementation of the RSP starting with our global and strategic partners, supported by a comprehensive training program for our procurement organization. Our intention is to reach over 90% of our suppliers (weighted by total spending) by mid-2018.

¹ https://www.pmi.com/resources/docs/default-source/pmi-sustainability/responsible-sourcing-principles.pdf?sfvrsn=15c19ab5_12

Ensuring our responsible sourcing program starts on the right foot

As a preliminary step, we informed PMI's suppliers of our commitment to the UNGC's Principles and of our intention to develop a comprehensive responsible sourcing program with a view to sourcing our products and services from suppliers who themselves are committed to the same principles. Our communication, in 25 languages covering more than 90% of our supply chain spend and across all procurement categories, emphasized the importance of working together on these topics as a way to strengthen our business relationship.

The feedback from our suppliers was very positive, with many expressing their support and readiness to work with PMI in the area. As a next step, we actively engaged with some of our key suppliers to better understand their existing programs, discuss our expectations in different areas, and consolidate our views regarding the due diligence processes we need to have in place so that we can make progress.

Managing risk as we develop our electronics supply chain

We will be increasingly reliant on a new and complex supply chain that includes electronics manufacturing. Electronics suppliers are new business partners to PMI, often in geographies where PMI has not previously done significant procurement of direct materials (mainly China and Southeast Asia) and where human rights issues have been flagged in the recent past. Further, the fast-growing nature of this novel part of our business means that new suppliers are continuously being added to our electronics supply chain, particularly for suppliers at tier two and below.

Assessment and selection of electronics manufacturing services (EMS) suppliers

Our focus so far has been on our main smoke-free product IQOS. In 2016, PMI engaged a leading not-for-profit organization, Verité,¹ specializing in labor and human rights issues (and which is also our strategic partner on the Agricultural Labor Practices (ALP) program) to carry out a comprehensive assessment of the labor management systems starting with our main EMS supplier. The purpose of the assessment was to identify strengths and gaps in the supplier's systems and to understand the living and working conditions of workers, particularly foreign migrant workers that make up a significant percentage of the supplier's labor force. PMI is working with the supplier and Verité on the management action plan which will be implemented during 2017 and 2018.

In addition, we started to map out the IQOS supply chain to identify human rights risks down to fourth tier suppliers. We have identified all suppliers (totaling more than 140) and have engaged Verité to conduct the risk assessment. We aim to complete this work during 2017 with action plans to address the prioritized risks, scheduled for implementation in 2018.

We are also taking steps to integrate sustainability criteria into the assessment of new EMS suppliers for PMI.

To select PMI's second EMS supplier, we established specific qualifying criteria (e.g., regarding labor/human rights risks, preference to suppliers contracting and managing workers directly), and conducted a one-day assessment with an on-site visit and management interviews for each of the three finalists in the bidding process. We have conducted a full sustainability review of the selected supplier to gain a more in-depth understanding of their status and seek alignment with our RSP early on, and we plan to conduct such reviews with all future EMS suppliers.

Looking ahead

Increasing our visibility over the IQOS supply chain will be paramount in helping us to better identify and manage risks. We intend to establish a monitoring and auditing system for specific groups of suppliers in this part of our supply chain, including manufacturers and suppliers of IQOS accessories. Mapping our IQOS supply chain will also enable us to identify a priority list of sub-tier suppliers for further due diligence.



Our overall goal



"PMI's supply chain strategy for sustainability is based on three key pillars: first, the identification and mitigation of risk; second, integration into the business; and third, the creation of value. During 2016, we set the foundations for this strategy with the RSP and our first comprehensive analysis of the main categories of risk in our supply chain. In the coming years we will work to communicate our expectations, and make continuous progress in its implementation. Our ultimate goal is to create value for PMI, for our suppliers and for society."

HAFED BELHADJ
VICE PRESIDENT, SUPPLY CHAIN

Conflict minerals due diligence

During 2016 we strengthened our conflict minerals due diligence process related to 3TG minerals (tungsten, tantalum, tin, and gold) that are mined in the Democratic Republic of the Congo and neighboring countries.

- We engaged with our direct suppliers of Platform 1 and Platform 4 products to communicate our expectation that they should increasingly source minerals from smelters or refiners that are certified as "conflict-free" by the available third-party sources.² In 2016, all but two smelters or refiners in our supply chain were reported as "conflict-free" in our conflict minerals report.
- We included conflict minerals due diligence in the Management Systems of our main supplier.
- We engaged Verité to help us provide a conflict minerals due diligence training for PMI staff involved in the procurement of electronics.

¹ <https://www.verite.org/>

² <http://www.lbma.org.uk/refiners-gold-current> (London Bullion Market Association- Good Delivery list)

<http://www.conflictreesourcing.org/conflict-free-smelter-refiner-lists/> (CFSI- conflict free smelters)

Agricultural supply chain

We take our role in promoting sustainable agricultural production very seriously, and our Good Agricultural Practices (GAP)¹ program is mandatory for farmers contracting with PMI or our suppliers. In 2016, PMI and our suppliers contracted with approximately 380,000 tobacco farms worldwide.

A unique business model underpins our work with farmers: The Integrated Production System (IPS)

We source the vast majority of our tobacco (approximately 88%) through direct contractual relations (established by us or by our suppliers) with independent farmers across nearly 30 countries worldwide. This is critical to enable us (or our suppliers) to work collaboratively with farmers and to drive the systematic implementation and monitoring of our standards. Direct contractual relations also benefit the farmer in a number of ways:

- Ahead of the growing season, the contractual agreement on the volume and price of the tobacco protects the farmer from market fluctuations and ensures there is a buyer for the crop;
- Farmers can access crop inputs (e.g., fertilizer) at a lower cost;
- Removing middlemen reduces transportation costs or other non-value-added fees charged to farmers;
- The contract can be used by the farmer as collateral for credit or other financing arrangements;
- Trained agronomists provide support to contracted farmers throughout the tobacco growing season to improve overall conditions and production.

1 <https://www.pmi.com/sustainability/good-agricultural-practices>

Our Good Agricultural Practices (GAP) program

Our GAP program defines the principles and standards we expect to be met by all farmers and suppliers of tobacco for PMI. It includes three focus areas:

- **How to make tobacco farming more profitable and sustainable.** Promoting practices to improve farmers' yields and crop quality, maximizing their production to use less land for tobacco and reduce labor requirements. This helps to generate a higher income for the farmer, frees up land for alternative crops for local food security, and with surplus crops, helps to create an alternative source of income;
- **How to minimize the impact of tobacco farming on the environment.** Promoting environmentally sustainable practices, including curing barn improvements, the use of more sustainable tobacco curing fuel sources, CPA reduction, reforestation, as well as water and waste management; and
- **How to improve working conditions on the farm.** Promoting and monitoring good labor practices, including health and safety conditions, and prevention of child or forced labor (the Agricultural Labor Practices program).

The GAP program encompasses a wide range of initiatives to support farmers in the implementation of best practices, ranging from farmer training programs on sustainable land stewardship or management and entrepreneurial skills, to the provision of personal protective equipment to safely apply chemicals for crop protection and on the use of new technologies.

Farm economics, mechanization and innovation

Tobacco is a valuable crop that allows farmers to generate significant income, particularly in the case of smallholder farms. However, tobacco growing is also labor intensive, and as such efficiency improvements are crucial for the optimal outcome of the production. Initiatives to reduce the number of working hours required to grow the crop range from packing simplification, to mechanization, or curing preparation.

While this is a global effort, the specific initiatives depend on the particular characteristics of the crop and the farms in each country. For example, in Indonesia, preparing the land for cultivation is mostly done manually, and farmers increasingly face difficulty in finding workers during the crop season. PMI's Indonesian affiliate (HM Sampoerna), together with three tobacco leaf suppliers, Alliance One, Universal Leaf and Sadhana, has been helping to make mechanical handheld cultivators available to groups of five to six farmers in regions of light soils since 2014. These machines are used for ridging, soil tillage and weeding and help farmers save 13 labor days/hectare in tobacco. Half of the farmers also use these mechanical handheld cultivators for other crops such as corn, rice and onions. In 2016, 289 handheld cultivators were made available, reaching a total of 493 cultivators being used by more than 3,000 farmers since the beginning of this initiative. For 2017, our plan is to make 300 to 400 new cultivators available.

Another example comes from Turkey. In Turkey's oriental tobacco growing, labor is not only the main cost, but it is also the bottleneck limiting the volume that each farmer can produce, due to the labor-intensive preparation of the small Oriental leaves for curing. The "vento" machine technology allows farmers to harvest Oriental tobacco leaves in bulk by enabling the curing preparation in a cotton net tube instead of the traditional practices whereby tobacco leaves need to be carefully aligned during harvesting so they can be individually sown on a string for curing.

These machines enable the farmer to make an estimated labor saving of 25 labor days/hectare and allows farmers to harvest larger volumes, thereby significantly increasing income. With PMI's technical and financial support, around 1,700 farmers, representing 27% of PMI's volume sourced in Turkey, were using "vento" machines by the end of 2016. In 2017, we expect to source over 40% of our tobacco in Turkey to be cured using this technology.



Tobacco farmer in Brazil
© Sarah Hazlegrove, Tobacco People



Food crops (maize and ground nuts) grown alongside tobacco on an IPS contracted farm in Malawi



Tobacco farmer operating hand-held cultivator in rice crop © Sarah Hazlegrove, Tobacco People

Looking ahead

Smoke-free products require less tobacco compared to cigarettes. When large numbers of consumers eventually switch to smoke-free products, we do expect a gradual decrease in tobacco leaf requirements, which will free up land and capacity for other uses. We are actively working with the relevant stakeholders and other potential business partners to explore new opportunities and to prepare and manage potential mid- to long-term impacts. We already encourage and support crop diversification efforts as a way to improve farm outcomes, manage environmental impacts and strengthen the resilience of tobacco growing communities. These efforts will continue as they become even more important in a context of change, and we will continuously adapt our programs to the local realities. We envision that the foundation referred to on page 27 will also focus on addressing the consequences of declining demand for tobacco alongside its efforts to accelerate this decline.

Farmer testimonial

“Vento changed a lot our life. Before Vento we were manually stringing tobacco from noon time to the late evenings and we did not have any spare time for resting and for our other farm activities. I was producing one ton of tobacco. Now I managed to double my production with the same labor force. I have also more comfort in my life so I can also deal with my livestock and other crops. My near future plan is to produce three to four tons of tobacco.”

MEHMET DEMIR
(TOBACCO FARMER)
ADIYAMAN, TURKEY



Continued support to farmers to grow alternative crops

For several years, we have been supporting smallholder farmers to grow food crops alongside tobacco. In Africa (Mozambique, Malawi and Tanzania) these efforts encompass technical assistance and financing for food crop inputs (fertilizer and seeds for mainly maize). In 2016 the total tonnage of food production supported by PMI in these countries (over 260,000 tons) already surpassed the production of tobacco, with the program reaching 60,000 farmers.

In 2017, we expect that direct support for food crop production will reach approximately 150,000 smallholder farmers across the three countries. We have seen significant improvements in food crop yields, up by nearly fourfold in the case of maize, which are strengthening food security and oftentimes generate a surplus for sale at local markets. Together with our suppliers, we are currently exploring with other international food crop buyers the possibilities to create a route to market for surplus food crops produced by tobacco growers in these countries, leveraging on the infrastructure and logistics already in place for tobacco production.

In Brazil, farmers contracting with PMI's affiliate (Philip Morris Brazil – PMB) usually grow maize as a rotation crop after tobacco, as fertilizer remains available in the soil after tobacco harvest. Since 2016, through a collaboration with DuPont Pioneer (a leading seed company) PMB started to provide farmers with certified maize seed, enough for 1 hectare per farmer. Yield improvements applying certified seed and best practices in corn can increase average productivity by 30%. DuPont Pioneer trained PMB field technicians on maize good agricultural practices, to support over 1,500 contracted farmers enrolled in this project in the southern area of the country. PMB is now considering alternative avenues for the farmers to commercialize their surplus corn production. Although the proportion of farmers growing food crops for their own consumption remained stable globally (approximately 70%), the number of farmers growing and selling food crops as an additional source of income rose from 35% in 2015 to 41% in 2016.



A field technician discusses the ALP Code with a farmer in Malawi

Monitoring progress with the Agricultural Labor Practices (ALP) program

The ALP program¹ aims to eliminate child labor and other labor abuses in tobacco growing. Verité is our strategic global partner in this program, which reached approximately 380,000 contracted farmers in 2016. Since its inception, we have committed to full transparency regarding the evolution and status of the program, publishing standalone regular updates and external assessments of implementation status on a country-by-country or supplier basis. The next stand-alone complete update is due in early 2018, but we take the opportunity in this report to highlight some key developments in 2016, particularly as they relate to the program's monitoring.

ALP includes a farm-by-farm monitoring system (conducted by us or our suppliers) and third-party assessments conducted by Control Union Certifications (CU).² While the internal systematic monitoring is implemented by approximately 2,800 trained field technicians who support farmers on a day-to-day basis, the third-party work consists of country and supplier-specific assessments. The results of these CU assessments are disclosed publicly in a detailed report, which also includes the action plans of our affiliates and suppliers to address identified issues.

The third-party assessment process, including assessor training, was specifically designed for this program, leveraging on Verité's experience with in-depth supply chain social assessments. Verité continues to play a quality control role in the whole process, but does not participate in the actual assessments themselves, in order to safeguard the third-party autonomy of Control Union. The selection of countries where a third-party assessment is conducted takes into consideration the relative volumes of tobacco sourced and aims to represent the geographic and socio-economic diversity of PMI's tobacco supply chain. The external assessments are conducted once PMI's affiliates or suppliers have rolled out the ALP program, looking at how it has been set-up and taking stock of the quality of implementation.

In each third-party assessment, CU evaluates the implementation of the ALP program, including knowledge of the ALP Code, the internal training and organizational capacity of our affiliate or supplier, how the ALP program is being communicated on farms, the processes being used to monitor labor practices, whether issues are being addressed, and the working and living conditions of farmers and farm workers.

Assessors from CU collect information on individual farm practices for each of the ALP Code Measurable Standards, review all relevant program documentation of PMI's affiliate or supplier and interview the staff involved in the program's implementation, including senior management. Unannounced farm visits and interviews with farmers, family members and workers are also conducted for a random sample of farms.

This information enables PMI's affiliates and suppliers to evaluate and enhance their implementation of the program. As a requirement following each assessment, they are expected to develop comprehensive plans to change conditions on farms in light of the CU assessment findings and reflect improvement needs and priorities. These action plans are included as an addendum to each CU assessment report.

1 <https://www.pmi.com/sustainability/good-agricultural-practices/upholding-labor-rights-on-the-farms>

2 <https://certifications.controlunion.com/en>



Tobacco field of PMI contracted farmer in Indonesia
© Sarah Hazlegrove, Tobacco People

Illustrative example of Control Union (CU) Assessments and action plans disclosed in 2016:

In 2016, we released the reports from the CU assessments conducted during the 2015 crop season in two different regions in Turkey (Tavas and Mugla, where two different suppliers source tobacco for PMI). These assessments found that child labor remains present, confirming the findings of our internal monitoring system, which identified stringing and harvesting as two hazardous activities in which children are involved in these regions. In light of these findings, our suppliers have developed an action plan which also includes the introduction of “vento”

machines, as these replace the use of stringing and require much less labor, thereby reducing the risk of child labor.

According to our internal data collection, the number of child labor issues related to stringing has declined from 480 in 2015 to only one instance in 2016. To mitigate the risk of children potentially shifting to other hazardous tasks on the farm (and replacing one problem with child labor with another), the existing community program offering after-school activities was expanded to reach three cities and six villages in the Aegean region. This has seen **school enrollment figures rising substantially in the past year, increasing from 82 children in 2015 to 526 children in 2016.**¹

Since the beginning of the program, CU has conducted 21 ALP assessments in 15 countries covering nearly 67,000 farms and interviewing farmers, workers, and family members on over 1,000 contracted farms. Although we are fully aware that we face many complex challenges in our tobacco supply chain around the world, **we hope that our efforts and transparency can help to improve cooperation among stakeholders in this sector and act as a catalyst for change in raising the bar on labor standards in agriculture.**

¹ https://www.pmi.com/resources/docs/default-source/pmi-sustainability/cu_third_party_assessment_aot_turkey.pdf?sfvrsn=a766b3b5_4



CU third-party assessments of ALP program implementation (2016):

Eight reports published covering six countries:

1. Colombia
2. Indonesia
3. Mozambique
4. Poland
5. Tanzania (2 suppliers)
6. Turkey (2 suppliers)

Human Rights Watch (HRW) research on Child Labor in Indonesia

Our first Communication on Progress to the UNGC included information on HRW's research and report released in May 2016¹ highlighting the issue of children's exposure to hazardous work in smallholder tobacco farming in Indonesia. Since then, we have continued open and constructive dialogue with HRW and other relevant stakeholders as part of our efforts to tackle this systemic issue. In February 2016, we published a third-party assessment report on the implementation of our ALP program in Indonesia (Lombok region), including detailed information about the progress made and challenges we faced in addressing child labor, as well as our local supplier's action plan to address issues identified in the report.

In Indonesia there are around 550,000 tobacco farmers in diverse locations in the country, and our suppliers have signed direct contracts with approximately 28,000 farmers (2016). Given the size of the country and fragmented nature of production units, another typical feature of tobacco production in Indonesia is the multi-layered supply chain. After the farm, tobacco goes through a number of "poolers," "intermediaries" and "middlemen" before reaching the final buyer, making it virtually impossible for suppliers to gain visibility into conditions of production. We believe that the single most important aspect creating a positive impact in reducing child labor has been to progressively move away from the multi-layered supply chain and to implement the Integrated Production System (IPS) in Indonesia, where our suppliers contract farmers (or farmer groups) directly. This is the only way to gain visibility into farm practices and make tangible and sustainable improvements to the production conditions on farms, while

mitigating risks and addressing issues through the implementation of our ALP program. Expansion of our IPS approach is a complex process that requires major investments in resources and infrastructure, entails a significant financial risk (due to "side-selling" into traditional channels and the difficulty of enforcing contracts), and is conditioned by our limited leverage with stakeholders (in 2016, tobacco sourced through IPS represented less than one quarter of the total crop in the country). Notwithstanding, our local affiliate (HM Sampoerna) has continued working with our suppliers to expand the proportion of our tobacco purchases made through the IPS in Indonesia, which we envision will reach 76% and 86% of our volumes in 2017 and 2018, respectively. In 2016, our IPS purchases remained at approximately 60% (similar to 2015), affected by severe weather events that negatively impacted yields of contracted farmers.

In 2016, our suppliers hired an additional 15 trained agronomists and field technicians (FTs) in Indonesia to support farmers in the day-to-day implementation of the ALP program, bringing the total number of FTs to 237 in the country. These FTs regularly monitor farms and take action to address problematic practices, such as children helping with tasks on the farm considered to be hazardous work. One example is the distribution of approximately 220,000 "clip sticks" (194,000 in 2015), which are a more efficient way of preparing the tobacco leaves for curing replacing a task oftentimes performed by farmers' children. This initiative is being coupled with off-farm programs for school-aged children during the harvest season. From the 2,348 children enrolled in 25 schools in 2015, these programs reached 4,800 children enrolling in 50 schools in 2016.

¹ Human Rights Watch report, "The Harvest is in My Blood: Hazardous Child Labor in Tobacco Farming in Indonesia. May 24th, 2016: <https://www.hrw.org/report/2016/05/24/harvest-my-blood/hazardous-child-labor-tobacco-farming-indonesia>

A survey conducted before and after the implementation of the program gathered feedback directly from the participants and reduced by approximately 43% the involvement of children in tobacco growing.

Other programs aimed at eliminating child labor include high school scholarships in tobacco-growing communities, which have increased from 953 students in 2015 to 1,535 students in 2016, and vocational training for more than 1,000 people on income-generating activities, a child's right to education and safe working and living conditions on farms.

Our suppliers also provided personal protective equipment (mask, gloves, long-sleeved shirt and boots) and training to contracted farmers in Indonesia and promoted an ALP roadshow in six tobacco-growing regions to raise awareness about the program and deliver training. From 1,421 participants in 2015, the initiative reached more than 3,000 participants in 2016, which includes 1,196 farmers, 993 farmers' wives, and 880 workers.

Due to the geographical spread of our tobacco-growing supply chain in Indonesia, we commissioned CU to conduct a second assessment for our supplier sourcing tobacco in a different location, in Lumajang. Preliminary information showed

that levels of awareness about the ALP program are 96% among farmers and 86% among family members, and only 43% among hired workers. **Although CU did not find any children hired by contracted farmers or child family members helping out on contracted farms, the supplier's internal monitoring data continue to show this is an area of risk.** This finding reinforces our belief that combining and cross-checking data from both our internal monitoring systems and external audits enable us to overcome blind spots in our ALP program approach. We plan to release the CU assessment report for this region and our supplier's action plan before the end of 2017 once the supplier action plan is finalized.



Tobacco growers in Brazil
© Sarah Hazlegrove, Tobacco People

Our supply chain – Metrics

Metrics	Coverage	2014	2015	2016	Goals	Status Check
Coverage of supplier communication on Sustainability (% of total spend) ¹	Non-tobacco materials and services	N/A	N/A	93	>90	On Track
% of tobacco purchased by direct contract (by our affiliates or our suppliers) ²	Tobacco supply chain – total purchases	87	88	88	>90	On Track
Systematic monitoring of labor practices (% coverage) ²	Tobacco farmers supplying PMI affiliates or our suppliers via direct contract	N/A	32.5	72	100	On Track
Number of contracted farms within the scope of external assessments by year ³	Tobacco supply chain	23,870	11,043	7,508		
Number of supplier locations assessed	Tobacco supply chain	5	6	5	>5	On Track

1 In the remaining 10%, no individual supplier represents more than 0.1% of the total annual spend.

2 Data relates to crop seasons which may span more than one calendar year.

3 The number of farms within the scope of assessment varies according to the crop-size and number of contracts in a given supplier location. The initial focus of this program was on countries with larger crops and locations where PMI or our suppliers had a bigger number of contracts, which explains the relatively lower number of farms under the scope of assessments conducted in 2016.



Freedom of Association for migrant workers in our tobacco growing supply chain

In the United States of America and specifically in North Carolina – the largest tobacco-growing state – there have been expressions of concern from stakeholders regarding farm worker intimidation as it relates to the right to associate and organize. The Farm Labor Organizing Committee (FLOC), along with other stakeholders, have raised such concerns at our annual meetings of shareholders, noting the prospect of worker intimidation by farm labor contractors. In our ALP Code, we have made an unequivocal commitment to Freedom of Association rights, and we take these allegations seriously. We have taken action to ensure specific allegations are investigated and resolved, in cooperation with our suppliers and in dialogue with worker's representatives. Further, we have launched concrete initiatives to advance fair and humane working conditions for migrant workers. While 75% of the farms contracted by our suppliers are abridged by a collective bargaining agreement between FLOC and the North Carolina Growers Association (NCGA) that includes a grievance mechanism, more needs to be done to ensure all workers fully enjoy their rights. We remain in dialogue with all stakeholders to achieve this goal.

Managing our environmental footprint

The world's changing climate more than ever calls for respect of the environment, and this is something all our employees and business partners can help with.

From the farms where tobacco is grown, to our production facilities, distribution networks, retail trade, and the roughly 150 million consumers of our products, **environmental sustainability is key for our long-term business success.**

Effective environmental management across our operations and value chain goes beyond compliance with the applicable laws and regulations; it is central to the security of raw material supplies, promotes efficiency and savings, and minimizes environmental impacts.

Our environmental management strategy follows a two-pronged approach:

1. Minimizing our impact on the environment through carbon footprint and water use reduction, waste minimization and other mitigation initiatives.
2. Understanding and adapting to potential future business impacts of major environmental trends, such as climate change and water scarcity. We undertake risk assessments to quantify the impacts of these trends along our value chain. Based on the results, we develop management and adaptation strategies.

Through life-cycle and other assessments along our value chain we understand our main areas of impact and therefore where to set priorities. **These main areas include tobacco farming for carbon footprint reduction and water stewardship action and product end-of-use for action on litter and waste. We also need to manage new areas of impact due to the increasing use of electronics and batteries in our products.** We have established global improvement programs that currently cover:

- Environmental management and related standards for our factories and facilities;

- Value chain carbon reduction, climate change impacts and CDP reporting;
- Energy and water management;
- Agricultural environmental practices; and
- Product and post-consumer waste.

In this section, we provide an update on our activities in 2016 related to these key areas. These efforts demonstrate how we are embedding the UNGC's Principles 7, 8 and 9 into our sustainability strategy and how these activities contribute towards advancing the SDGs, notably SDG12 on Responsible Consumption and Production.

Climate change – a science-based approach

Climate change, one of the biggest challenges facing humanity today, requires global collective action. Following the adoption of the Paris Climate Agreement in 2015, there is widespread understanding of what needs to be done to protect the planet. PMI supported the Agreement and we are playing our part in delivering on the necessary action.

In 2016, we made progress in reducing our environmental impact across our value chain - in our factories (where our carbon footprint is relatively small compared to other industries), as well as beyond the factory gates. That includes looking at both our upstream supply chain activities (currently focusing on tobacco farming) and downstream, following our product and packaging environmental impacts to end-of-use. We also developed a set of ambitious targets based on climate science to guide and inform our climate change programs as part of our culture of continuous improvement.

CDP leadership for the third year in a row

Every year we report on the status of our activities and progress to CDP, the leading international not-for-profit organization assessing companies' efforts on climate change. **Out of over a thousand of the world's largest companies assessed by CDP last year, PMI's operational carbon footprint is nearly 90% lower than the average, and PMI is listed in the top 9% of companies, recognized in CDP's "Climate A List" for consistently taking**

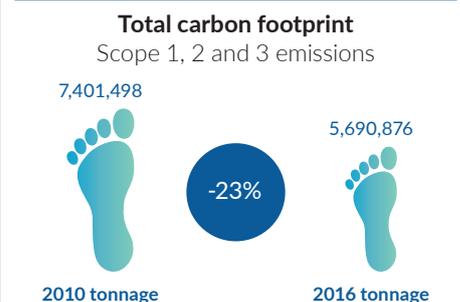
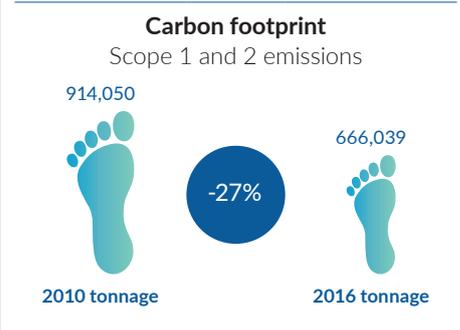
comprehensive action to reduce greenhouse gas (GHG) emissions and mitigate climate change, and for the transparency of our disclosures.

Science-Based Targets

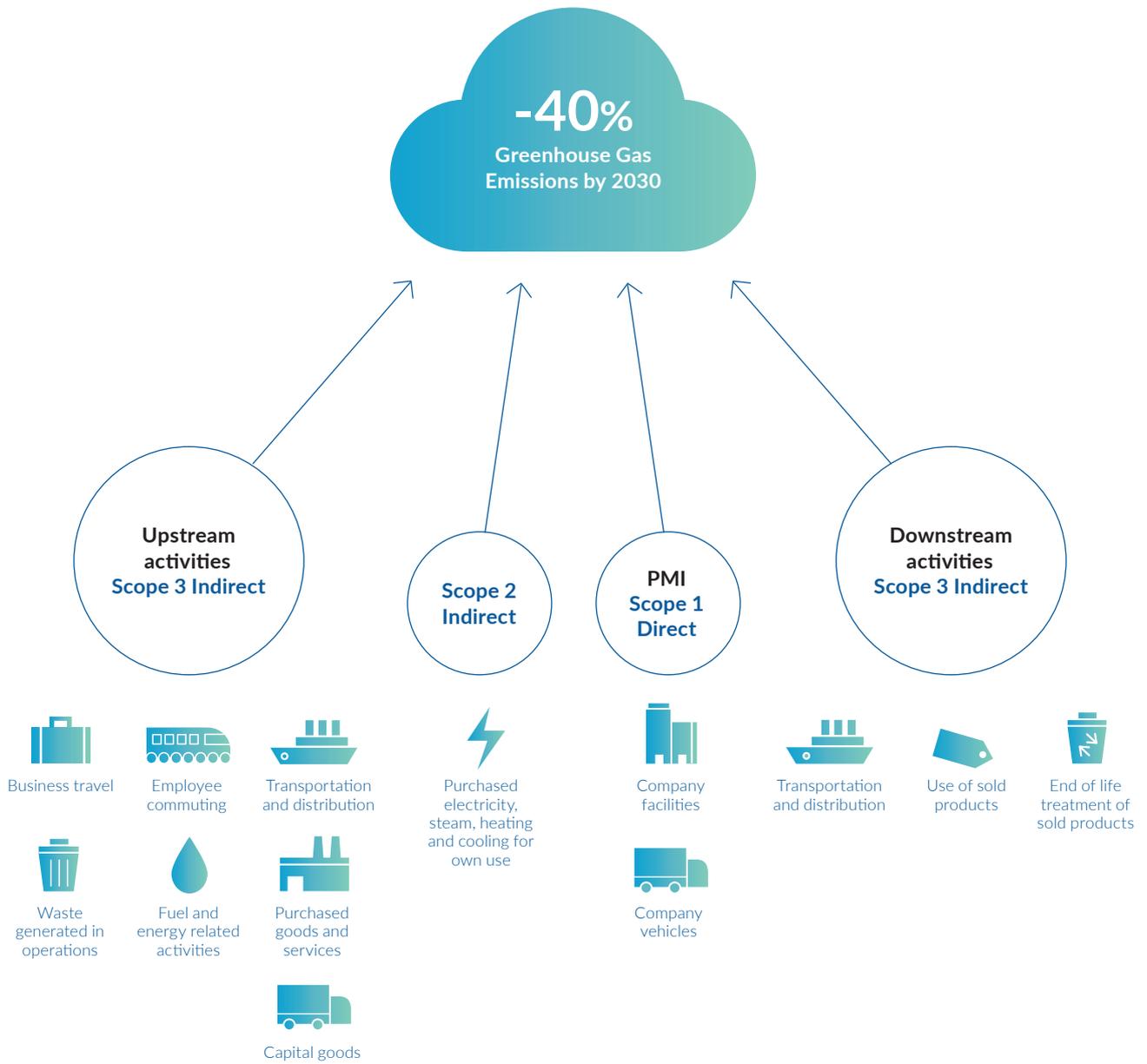
PMI supported the call for a price on carbon in the Paris Climate Agreement and committed to develop science-based targets. Our targets have been recently recognized by the Science-Based Targets initiative and demonstrate how PMI can contribute to keeping global warming below 2°C based on pre-industrial levels.

We have set our performance baseline as 2010. Against that baseline we have a longstanding commitment to reduce our emissions intensity (GHG emissions per million cigarettes equivalent) by 30% by 2020 across the whole of our value chain.

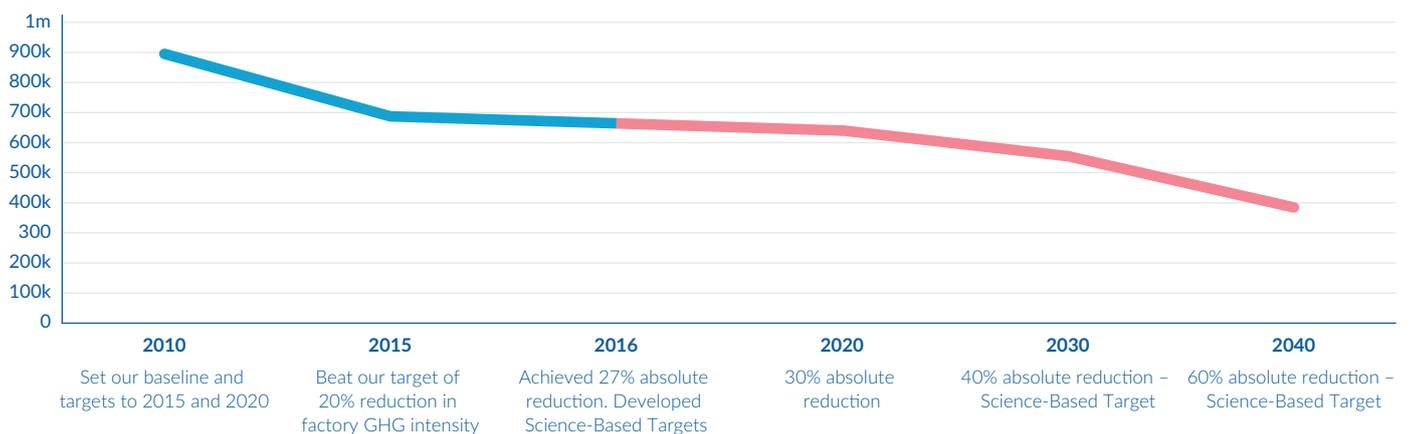
In addition, we have now developed Science-Based Targets. These address our absolute emissions reduction. By 2030 we will reduce absolute GHG emissions by 40% across both our own operations and value chain, and by 2040 we will reduce by 60% for our own operations. We are well underway with a 23% absolute reduction in GHG emissions achieved in 2016.



Scope of our Science-Based Targets



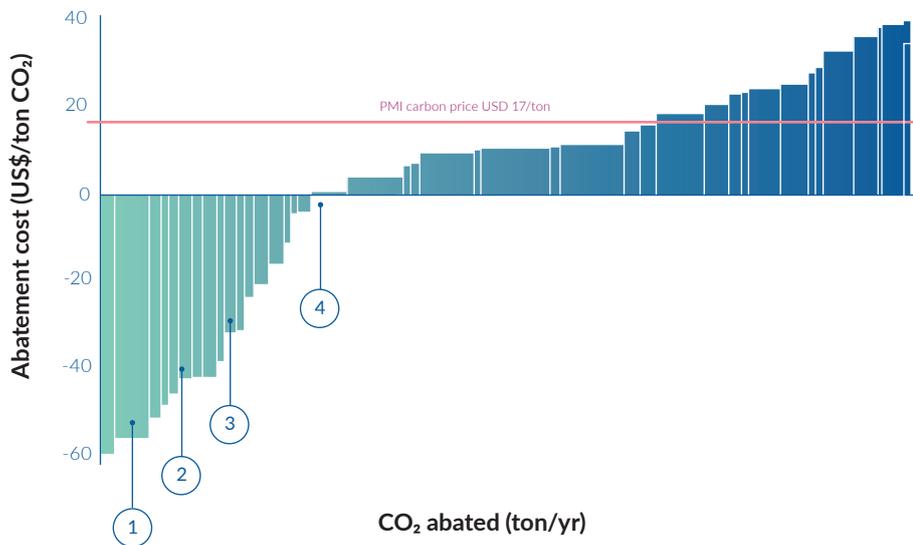
Absolute GHG Emissions: Scope 1 and 2 – results and targets



Marginal Abatement Cost Curve

Projects to be implemented in 2017-2018

1. High efficiency Cogeneration plant in Mexico
2. Solar Photovoltaic Plant in Senegal
3. Solar Photovoltaic Plant in Philippines
4. Biomass Boiler in Switzerland



+70
projects assessed

+USD 8m
to be invested in 2017-2018

+11,500
CO₂ tons expected to be reduced

The programs to achieve our targets are comprehensive – covering initiatives such as purchasing greener electricity, greener fuels, eco-design into new facilities, and fuel efficiency in our vehicles as well as in our manufacturing processes. We have taken an innovative approach to identify which projects to implement using a Marginal Abatement Cost Curve (MACC). Through the MACC, we compare and rank all of our greenhouse gas reduction projects globally based on their cost-effectiveness in reducing emissions. By using this approach, we expect to achieve the optimal emission reductions within a set global budget to enable meeting our targets. We used the MACC work to calculate the internal price on carbon that would be necessary to drive projects forward in line with our reduction targets for 2020. For us that price is currently USD 17 per ton, but it will certainly change as we progress through our targets. On a day-to-day basis we continue to focus on our energy management program and use the MACC to refresh and enhance our list of initiatives. Going forward, we also intend to expand such programs to consider our supply chain.



“The adoption of science-based targets by PMI is an ambitious step for our company. I’m really proud that my daily work on energy-saving projects supports our efforts to reduce our environmental impact and contributes to achieving these targets.”

INES SOFIA ROMAO
ENGINEER, OPERATIONS
NEUCHÂTEL, SWITZERLAND

Water: a precious resource in need of proper stewardship

Water is fundamental to growing tobacco and operating our factories; it’s essential that we don’t just seek to reduce what we use but also act as a water steward. That means responsibly using the water we need without negatively affecting the needs of others by:

- Understanding how much water we need and using it optimally;
- Not negatively impacting the quality of water resources;
- Ensuring access to safe Water, Sanitation and Hygiene (WASH) in all our facilities;
- Respecting the vulnerability of water resources we use and the role of those resources in the wider community;
- Seeking partnerships to improve our water management practices; and
- Continuously improving these practices through our Good Agricultural Practices program in our tobacco supply chain.

Water is not a major input to tobacco product manufacturing, but we continue to look for opportunities to improve our water management practices. In 2016, our factories used less than 4m³ of water for every million cigarette equivalent; this reflects a 26% improvement in water efficiency since 2010.

During 2016 we undertook a high level climate change risk assessment across our value chain and used the Water Resources Institute (WRI) aqueduct tool¹ to identify our factories located in areas with relatively high risk water stress or drought. We then added the total consumption and local cost of water to this assessment and prioritized those factories located in higher water stress areas as well as those that are larger water users. This resulted in the creation of a shortlist of 12 sites where we will focus extra attention to reduce our water-related impacts, by promoting water-use reduction activities and looking at water catchments both upstream and downstream of our facilities, as part of wider water stewardship action. Starting in 2017, we will pilot the adoption of a standard for water stewardship in our factory in Brazil, using the opportunity to learn how such standards could also support our tobacco supply chain work. We’ll report on our plans to move forward with water stewardship next year.

1 <http://www.wri.org/our-work/project/aqueduct>

Water reduction efficiency in our factories

We seek continual reduction in our water use across manufacturing facilities and focus on achieving improvements in water efficiency, conservation and reusing or recycling water where possible.

In 2016, PMI implemented a number of other initiatives to reduce water use and increase water recovery, allowing us to save 260,000m³ of water and approximately USD 975,000 compared to 2015.

For example, in our Quebec facility, we have decreased water consumption by over 81% since 2010. The implementation of closed-loop cooling systems were instrumental in achieving these results.

In our Berlin factory, we implemented a comprehensive awareness-raising campaign to encourage water-saving initiatives, helping us to save 32,000m³ of water in 2016, equivalent to a 15% reduction versus 2015.

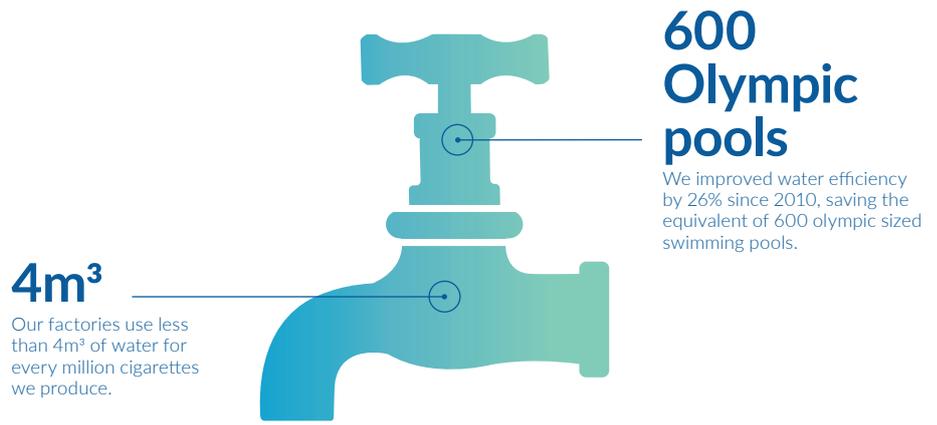
Water use in tobacco growing

More than half of global tobacco crops around the world are rain fed, do not require supplementary irrigation other than at the seedling stage, their overall water requirements are similar to other crops.

Building on our overall water stewardship strategy, we have identified principles for water stewardship specifically for our tobacco supply chain, which cover three pillars: (i) Preservation, (ii) Engagement and (iii) Innovation; these principles will be implemented through our GAP program.

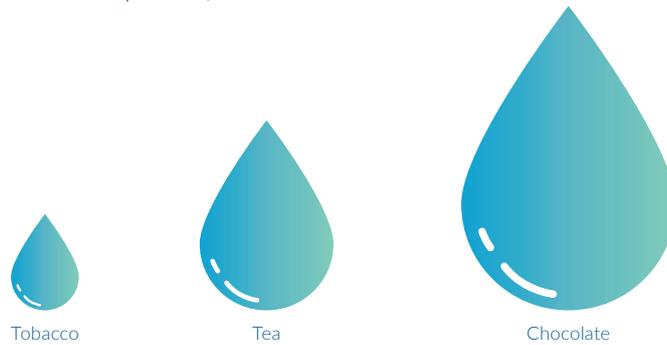
2017 is the foundation year for our water stewardship strategy. Between 2018 and 2020 we will assess local water-related risks and build knowledge of best practices through pilot projects.

Water efficiency



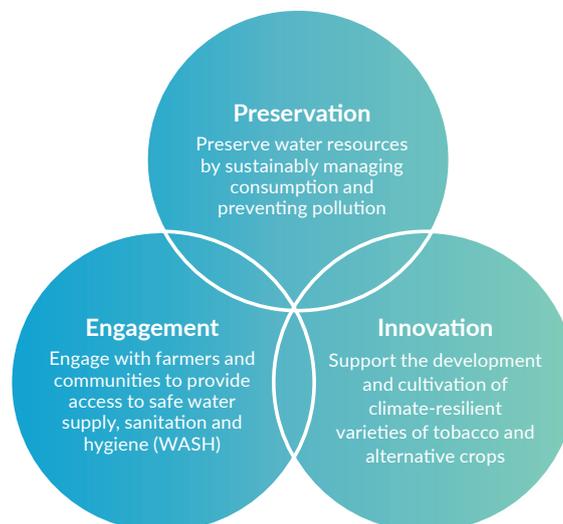
Putting tobacco's water footprint into context

Tobacco growing and manufacturing take around one third of the water required to make the same amount of tea or one sixth that of coffee or chocolate (per weight of finished product).¹



¹ Estimation based on PMI water use data for manufacturing and "The green, blue and grey water footprint of crops and derived crop products" M. M. Mekonnen and A. Y. Hoekstra, 2011. (<http://wfn.project-platforms.com/Reports/Mekonnen-Hoekstra-2011-WaterFootprintCrops.pdf>)

Principles guiding our water stewardship approach in our tobacco supply chain



Managing our environmental footprint on the farm

The environmental pillar of our **Good Agricultural Practices (GAP)** program supports farmers in applying best practices, from training programs on land stewardship and management, to the safe and responsible application of agrochemicals, water stewardship, waste management, and use of novel techniques, such as biomass fuels for more carbon efficient tobacco curing on farms.

As part of mitigating our environmental impacts, we have set ourselves ambitious targets to continuously improve and address the farm level impact of the tobacco we buy. To meet our science-based targets, we committed to reduce our absolute GHG emissions across our value chain, which includes tobacco growing. In fact, reductions of the on-farm footprint are the largest contribution to meeting our value chain targets.

One of the main tobacco types used in our products is Virginia flue-cured tobacco (hereafter, referred to as Virginia), which is cured in heated barns and thus requires an energy source. Our target is to lower GHG emission intensity of this curing

process by 70% (per kg of cured tobacco) by 2020, compared to a 2010 baseline. In 2016, the GHG emissions related to our purchases of Virginia tobacco were 14% less than 2010. To achieve our 2020 target, strategic initiatives are being implemented to:

- Improve curing barn efficiency: we plan to improve combustion efficiency, ventilation or controls of 30,000 flue-cured barns by 2020, resulting in a further 10% GHG emissions reduction of the targeted 70%. In 2016, approximately 15,000 barns were improved in Mozambique, Pakistan, Philippines and Tanzania.
- Increase the use of renewable and traceable curing fuel sources, such as wood and other biomass sources, and eliminate coal usage for tobacco flue-curing. Based on current plans, 70% of our flue-cured tobacco purchases should be cured with renewable fuel sources by 2020. In 2016, approximately 21% of our Virginia purchases were still cured with coal. Plans have been developed to replace coal with agricultural waste pellets, green electricity produced by hydro-power plants and sustainable firewood in China, Colombia and Poland. In the other main countries from which

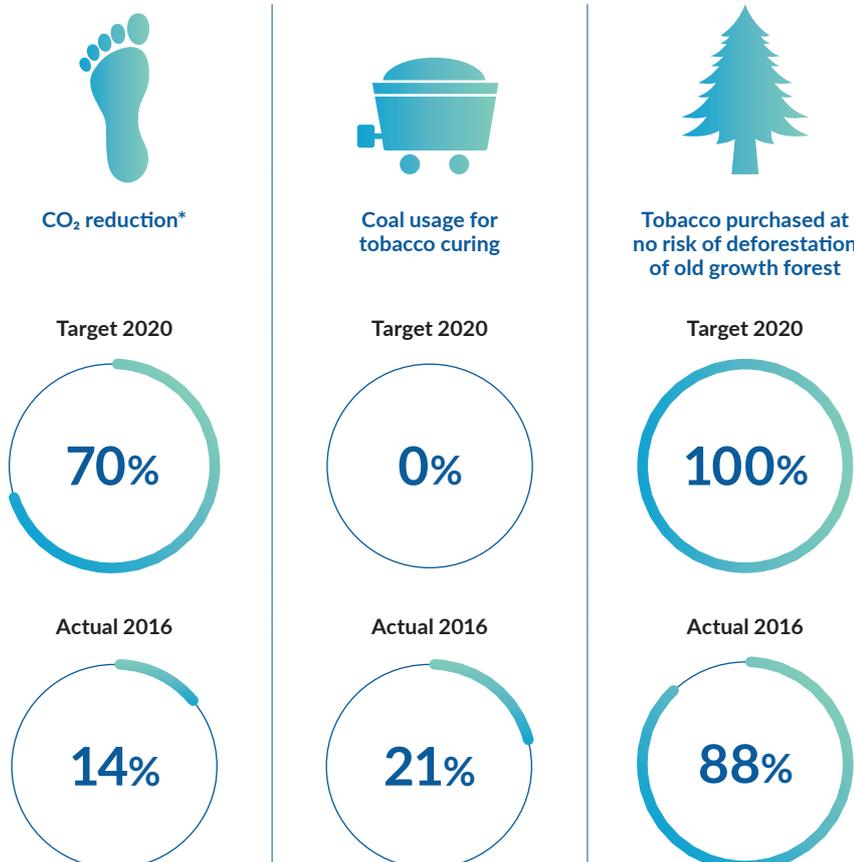
we source Virginia tobacco, we will also increase the use of sustainable curing fuel sources by developing reforestation programs for firewood and switching to biomass fuels such as olive pits, forest and wood by-products and sustainable palm oil kernel shells.

In 2016, PMI affiliates and suppliers planted approximately 29 million trees in Brazil, Indonesia, Pakistan, Philippines, Malawi, Mozambique and Tanzania. In 2017 and 2018, our GHG emissions related to tobacco flue-curing are expected to decrease rapidly through a significant increase in usage of renewable and traceable firewood coming from sustainably managed tree plantations (140 million trees planted between 2000 and 2015). As part of our precautionary approach, we do not assume that fuelwood is from sustainable sources unless we have proof – and we calculate our carbon footprint accordingly, using a “full carbon” emission factor for fuel wood that we are not sure is renewable.

Responsible management of chemicals for crop protection

We have established an Integrated Pest Management (IPM) program to help us achieve responsible management of chemicals for crop protection and to reduce risks to the health and safety of farmers and farm workers alongside minimizing our environmental impact. This aims to reduce the use of chemicals for crop protection (Crop Protection Agents (CPAs)) and eliminate those that are most hazardous. We partner with a leading international not-for-profit organization, the Centre for Agriculture and Biosciences International (CABI), which applies its scientific expertise to help us implement this approach. In 2014 and 2015, we worked with CABI to establish the baseline for our global program and implemented country-specific action plans for eight pilot countries. In addition, we made significant progress toward our goal to eliminate the use of WHO TOX1 CPAs¹ in the production of all the tobacco we purchase by crop year 2018 and met our goal to eliminate all CPAs listed in the Montreal protocol or Stockholm Convention. We have also made substantial progress in reducing Highly Hazardous Pesticides (HHP) residues as per 2016 FAO/WHO guidelines towards achieving our target to eliminate the use of all HHPs by crop year 2020 through promoting alternative and less toxic CPAs and biopesticides.

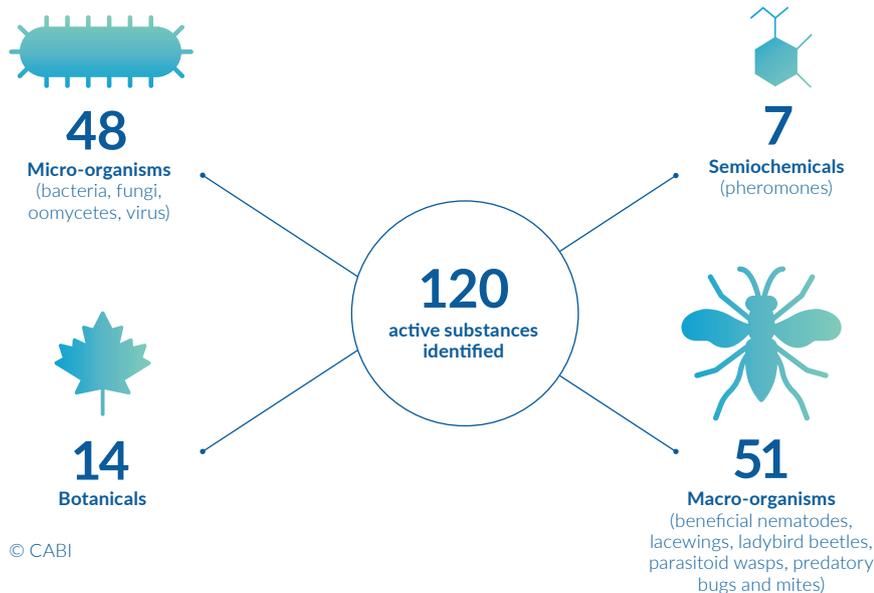
PMI targets for 2020 to improve environmental performance in our tobacco supply chain



*CO₂ emissions intensity reduction from tobacco-curing process compared to 2010 baseline.

1 http://www.who.int/ipcs/publications/pesticides_hazard_2009.pdf

Identifying and promoting use of natural agents to combat pests in tobacco plants

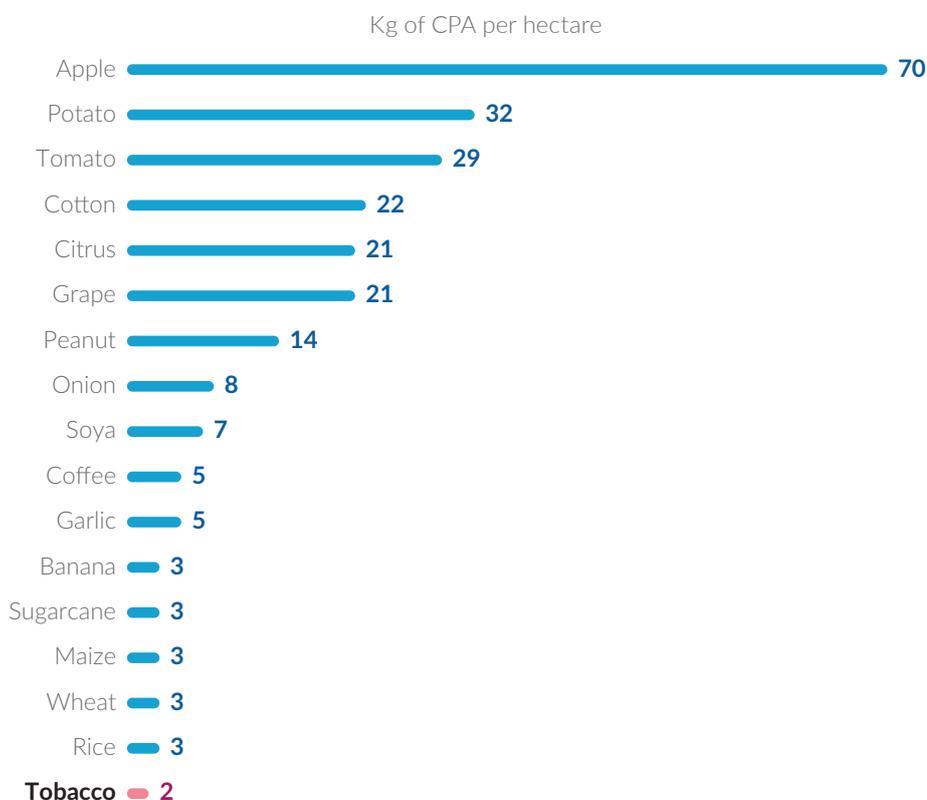


Progress on Integrated Pest Management in 2016

- 8,700 farmers and 450 field technicians were trained in the eight pilot countries.
- An online application (Tobacco IPM toolbox APP, available for iOS and Android), a dedicated website² and an online training manual³ were developed and are freely available for anyone involved in integrated pest management in tobacco.
- A biopesticide database of 120 active substances has been created based on a market survey of 20 countries where tobacco is grown. It identifies biopesticide active substances that target tobacco pests and lists the commercialized products currently available that contain them. This database helps our affiliates and suppliers to identify the most promising biopesticides and test their substitution over synthetic substances.

Putting the usage of crop protection agents (CPA) in tobacco into context

In Brazil, the second-largest producer of tobacco worldwide, a comparative analysis¹ found the usage of CPA in tobacco to be the lowest among the country's main crops (Brazil is also one of the world's biggest exporter of agricultural products).



1 Translated and adapted from Sinditabaco (Brazil's Interstate Tobacco Industry Union). Available here: <http://sinditabaco.com.br/en/socio-environmental-programs/gestao-ambiental/reducao-uso-de-agrotoxicos/>

2 <https://www.tobaccoipm.com>

3 <http://www.cabi.org/cabebooks/>

Product waste

We have a waste management program in our factories to reduce, reuse, and recycle before any disposal of waste in landfill.

In 2016 we continued to achieve an 87% recycling rate in our factories and are now focusing on reducing waste which is sent to landfill or for incineration without energy recovery. Currently, over 95% of our total factory waste is recycled, composted or sent for energy recovery.

However, a bigger challenge lies in the waste resulting from the use of our products.

Littering

Littering of consumer goods is an issue of concern to society in many parts of the world and is linked to two main drivers: consumer behavior and the availability of waste disposal infrastructure.

Cigarette butts are among the most frequently littered items. In natural environments, cigarette butts decompose slowly, leach smoke residues and risk being accidentally ingested by animals. Smokers should avoid littering and dispose of their cigarette butts responsibly. At this point, we believe that after stubbing, disposal with general waste is the most efficient way of dealing with cigarette butts, and in many countries this results in energy being recovered from the waste.

We can play an important role in raising awareness and encouraging consumers not to litter and have done so over many years in different countries around the world, including both information campaigns and the distribution of portable ashtrays. However, in 2016 we assessed the littering situation in different countries and recognized that there is an opportunity to be more consistent in our work over the long-term and that littering is an increasingly important topic in many places. We also recognized that understanding behavioral drivers for littering and the triggers that can change those behaviors is key to solving the issue. These drivers and “behavioral nudges” vary by country, culture and demographic, and an adaptable approach is needed. We can achieve more by working with others – industry peers, anti-littering organizations and authorities - and realize that there is a need to share best practices across cultures and geographies to make a real difference. We have revised our strategy to guide our efforts and will scale up anti-littering activities with a toolbox of best practices for our affiliates to use when developing and supporting local anti-littering campaigns. We also believe that more should be done to monitor littering and consumer behavior and to measure the results of different anti-littering campaigns so that their effectiveness is better understood.

Possible applications for recycled material from IQOS heated tobacco units

Components of IQOS heated tobacco units include cellulose acetate (CA), a bio-based polymer produced from wood pulp; polylactic acid (PLA), a bio-based polymer mainly produced from corn starch; tobacco and the wrapping paper. The CA and PLA polymers can be extracted from the used units to pure recycled material that can potentially be used in several applications. PMI will use these recycled materials in our future IQOS retail fixtures, and we are also exploring other options for their use, such as eyewear, fabrics and textiles, 3D printing, and other solutions to create potential new markets for this type of post-consumer waste.



Frames for sunglasses



Fabrics and textiles



3D printing



Material for IQOS retail fixtures



Accessories



A prototype machine for purchase and recycling of heated tobacco units; fixtures in background made with materials recycled from heated tobacco units

Recycling after consumer use

With the growth of smoke-free products such as IQOS, we want to ensure that the entire life-cycle of these products is managed sustainably. Heated tobacco units for IQOS do not burn and carry less odor than cigarette butts. First observations suggest that these consumables have a lower propensity to be littered than conventional cigarettes and furthermore a sustainable recycling approach can be envisioned.



However, our objectives go beyond regulatory compliance. We aim to recover materials with second use potential, educate consumers on their responsibilities for proper disposal, and provide better options to our consumers for recycling and device disposal. Recovery schemes are being developed and will be deployed in every country to ensure that consumers can return their device for sustainable disposal at end of use. For example, this system is already implemented in our largest market for **IQOS, Japan, where returned devices are recycled to recover valuable metals, nickel and cobalt.**

In addition to supporting the recovery of our devices, we believe it is essential to evaluate the environmental impact of the product. To achieve this, we conduct life-cycle assessments on the environmental impact of IQOS, including both the device and consumables. Preliminary results show that 1) the use of less tobacco for heated tobacco units, and 2) the new electronic devices, are the two main drivers of their difference in environmental impact compared to cigarettes. These assessments allow us to prioritize programs to address the most relevant steps in our value-chain, from innovation and product development to end-of-use and disposal.



Logistics center for recovery and recycling of used devices in Japan

In 2016, we developed a pilot awareness and recycling campaign for heated tobacco units in our Operations Center, Factory and R&D facility in Switzerland. In the first 10 weeks from April 2017, we collected 100,000 IQOS heated tobacco units – estimated 50% of consumption – to be recycled into fixtures for our retail environment.

We will analyze the results from this pilot and report next year on our recycling plans for heated tobacco units in those countries where IQOS is available.

Electronic waste

The heated tobacco units for IQOS are used with an electronic device, composed of a holder and a pocket charger. Wherever IQOS devices are sold, they can also be returned. Returned devices are then disposed of responsibly. The disposal and treatment of electronic waste has legal requirements which vary from market to market. Before the launch of IQOS in any given market, a thorough regulatory assessment of the landscape of electronic waste disposal and treatment is performed and shared with our local teams. In each case, regulations regarding electronic waste are strictly followed.



© Sarah Hazlegrove, Tobacco People

Looking ahead

Our business transformation brings new challenges but also significant opportunities for environmental sustainability. Our long-term targets on environment, including our science-based targets, have been developed taking into account the changes in our business (including both new product manufacturing and market place factors). The areas of particular importance are:

Changes in factories and manufacturing processes – while we embed new processes, the efficiency of our energy and water use may worsen until both knowledge and economies of scale improve.

– We will measure and understand the environmental impact of our new product manufacturing processes at our site in Bologna, Italy, including implementing our energy metering and targeting program. We already know that our new processes may use more water. For this reason, we are initiating projects to reduce energy and water consumption in this factory.

– With new factory processes comes the opportunity to design-in efficiency and low environmental impact from the start. We are developing new design plans for utilities and renewable energy supply for our new sites where we will manufacture heated tobacco units, integrating the learnings from our experiences in Bologna.

A new electronics supply chain – with the use of batteries, plastics and printed circuits.

- We are identifying potential partners to make the production process for our electronic devices more efficient.
- We are focusing on incorporating the environment into product design, using components that can be recovered or recycled, and working with experts to develop the best technologies to reuse materials.

Implementing the Social and Natural Capital Protocols into our decision-making

As part of our work as a member of the World Business Council for Sustainable Development (WBCSD), we are implementing the natural capital concept into our management decision-making processes. We began work in 2016 to develop a methodology that fits with both the Social and Natural Capital Protocols and are already seeing potential application in our project selection for energy efficient processes in manufacturing. Our adoption of a price on carbon is part of that work. We will also review the potential application of the Social and Natural Capital Protocols in our agricultural supply chain as well as how the Social Capital Protocol can be applied to the implications of smoking, and will report back on our overall progress in next year's report.

For the first time our products consume electricity, so building in design for energy efficiency is important.

– We are investigating more efficient batteries and improving the efficiency of components, for example, increasing the number of recharging cycles.

New post-consumer waste – where possible, electronics and consumable products need to be designed for recycling. Disposal programs need to be put in place, along with consumer awareness initiatives.

– We will continue to use life-cycle assessment to prioritize, guide and inform our activities. In the long-term, our goal is to design products that contribute to “closing the loop” wherever it makes sense. We aim to minimize inputs and to recycle, reuse and even upcycle waste into other products, as part of the circular economy.

Managing our environmental footprint – Metrics

Metrics	Coverage	2014	2015	2016	Goals	Status Check
% of manufacturing facilities certified to ISO 14001	PMI factories	91	93	93	100	Note 1
CO ₂ (Scope 1 and 2) – metric tons	All PMI facilities	746,286	691,044	666,039		
CO ₂ (Scope 1 and 2) – % reduction since 2010	All PMI facilities	18	24	27	30 by 2020 40 by 2030 60 by 2040	On track
Total (Scope 1, 2 and 3) – % reduction since 2010	PMI Value Chain	N/A	N/A	23	40 by 2030	On track
CO ₂ from factory operations – kg per million units of product equivalent	PMI factories	661	603	614		Note 2
Water use – thousand m ³	PMI factories	3,886	3,654	3,394		
Water use m ³ per million units of cigarette equivalent	PMI factories	4.35	4.05	3.95		Note 3
Total Waste – metric tons	PMI factories	133,488	127,361	130,077		
% of Waste that is recycled	PMI factories	85	87	87	Target of 85% achieved	Complete
% of Waste that is disposed to landfill or incineration without energy recovery	PMI factories	6.5	5.6	4.8	<5%	Note 4
Vehicle CO ₂ emissions (gCO ₂ per km driven)	PMI fleet	230	215	227		Note 5
% of purchased tobacco without detection of any WHO TOX1 Crop Protection Agents (CPAs)*	Tobacco supplied to PMI – from our affiliates or our suppliers	93	94	96	100% by crop year 2018	On track
% of purchased tobacco without any detection of other identified HHP residues†	Tobacco supplied to PMI – from our affiliates or our suppliers	65	69	78	100% by crop year 2020	On track

* 2016 data is provisional.

† 2016 data is provisional. HHPs are Highly Hazardous Pesticides, classified as per FAO/WHO Guidelines published in 2016 (<http://www.fao.org/3/a-i5566e.pdf>).

Note 1 – Newly acquired or built factories have begun the certification process. Due to the potential for new factories to be developed we may not reach 100% but that remains our goal.

Note 2 – In 2016 there was a slight increase in the amount of CO₂ emitted per unit of product manufactured; this was due to process changes resulting in a temporary increase in manufacturing complexity.

Note 3 – At the end of 2015 we beat our target to improve our water use efficiency by 20% compared to 2010. We are now developing a broader water stewardship strategy and will communicate new water-related targets in due course; in the meantime we aim to continue improving our water use efficiency year on year.

Note 4 – On achievement of our target to recycle at least 85% of our factory waste in 2015, we have switched our focus to minimizing the amount of waste that goes to landfill or incineration without energy recovery – “Disposal Ratio”.

Note 5 – In 2016 there was a slight increase in the amount of CO₂ emitted per km driven by our fleet. This was due to a change in emission factors used for previously reported biodiesel and inclusion of some vehicles that had not been captured in prior years.

Next steps

In our first UNGC Communication on Progress (CoP), June 2016, we provided an insight into our business in the context of the UNGC Principles and briefly described our ambition to replace cigarettes with smoke-free products.

The report was received with much interest, but also with skepticism. Many of our critics wanted more details on our plans to understand whether we are aligning actions with words.

We therefore decided to focus a substantial part of this second UNGC CoP on our ongoing business transformation and report on the concrete steps we have taken to make our vision of a smoke-free future a reality. In addition, we provided more detail on our social and environmental sustainability programs and shared program updates. Over the last year, we published our Responsible Sourcing Principles, which regard our non-tobacco supply chain, and our Good Conversion Practices, which codify our marketing and sales principles when commercializing smoke-free products. Furthermore, we published our human rights commitment.

In our next UNGC CoP report, we will include updates on the following topics:

- Our number one priority is clear: succeed in switching adult consumers who would otherwise continue smoking to our smoke-free product portfolio. We will provide an update on the business transformation metrics, while highlighting progress and challenges to achieve our smoke-free vision.
- In the present report, we publish an overview of our marketing principles for combustible tobacco products and our Good Conversion Practices for smoke-free products. We look forward to stakeholder feedback.

– Open and transparent dialogue with all stakeholders is fundamental to achieve a smoke-free future as soon as possible and in a responsible way. As mentioned in this report, some critics have expressed concerns about our lobbying practices, and we are looking for feedback on the principles for engagement with government and public organisations.

– We are at the initial stages of developing a comprehensive human rights action plan. This is another focus area on which we seek to work with external stakeholders.

– We began work on the application of the Social and Natural Capital Protocol in our project selection for energy efficient processes. Our adoption of a price on carbon is part of that work. We will also provide an update on the application of the Social Capital Protocol to the implications of smoking.

We look forward to hearing from you as we work to improve the sustainability of our business and contribute to the UN Sustainable Development Goals. As highlighted by our CEO, we invite you to help guide us.

Please provide your feedback to: sustainability@pmi.com

Additional information

Forward-Looking and Cautionary Statements

See page 68

Business Transformation Metrics – Independent Assurance Report

See page 69

Overview of marketing principles for combustible products

See page 70

Overview of engagement principles

See page 73

Cross reference to UNGC Principles and relevant SDGs

See page 75



Forward-Looking and Cautionary Statements

This report contains projections of future results and other forward-looking statements. Achievement of future results is subject to risks, uncertainties and inaccurate assumptions. In the event that risks or uncertainties materialize, or underlying assumptions prove inaccurate, actual results could vary materially from those contained in such forward-looking statements.

Pursuant to the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995, PMI is identifying important factors that, individually or in the aggregate, could cause actual results and outcomes to differ materially from those contained in any forward-looking statements made by PMI. PMI’s business risks include: excise tax increases and discriminatory tax structures; increasing marketing and regulatory restrictions that could reduce our competitiveness, eliminate our ability to communicate with adult consumers, or ban certain of our products; health concerns relating to the use of tobacco products and exposure to environmental tobacco smoke; litigation related to tobacco use; intense competition; the effects of global and individual country economic, regulatory and political developments, natural disasters and conflicts; changes in adult smoker behavior; lost revenues as a result of counterfeiting, contraband and cross-border purchases; governmental investigations; unfavorable currency exchange rates and currency devaluations, and limitations on the ability to repatriate funds; adverse changes in applicable corporate tax laws; adverse changes in the

cost and quality of tobacco and other agricultural products and raw materials; and the integrity of its information systems. PMI’s future profitability may also be adversely affected should it be unsuccessful in its attempts to produce and commercialize reduced-risk products or if regulation or taxation do not differentiate between such products and cigarettes; if it is unable to successfully introduce new products, promote brand equity, enter new markets or improve its margins through increased prices and productivity gains; if it is unable to expand its brand portfolio internally or through acquisitions and the development of strategic business relationships; or if it is unable to attract and retain the best global talent. PMI is further subject to other risks detailed from time to time in its publicly filed documents, including the Form 10-Q for the quarter ended June 30, 2017. PMI cautions that the foregoing list of important factors is not a complete discussion of all potential risks and uncertainties. PMI does not undertake to update any forward-looking statement that it may make from time to time, except in the normal course of its public disclosure obligations.

Annex 1:

Business Transformation Metrics – Independent Assurance Report

To the Board of Directors of Philip Morris International Inc.

We have been engaged to perform assurance procedures to provide reasonable assurance on the Business Transformation Metrics reporting of Philip Morris International Inc. and Subsidiaries ('PMI').

Scope and Subject matter

Our reasonable assurance engagement focused on the Business Transformation Metrics of PMI for the financial years ended December 31, 2016, December 31, 2015 and December 31, 2014 included in the United Nations Global Compact Communication on Progress 2016 Report:

- The application of the internal financial reporting guidelines for the preparation of the Business Transformation Metrics described on page 27;
- The internal reporting system and procedures to collect and aggregate the Business Transformation Metrics data; and
- The data and information in the Business Transformation Metrics table, in all material aspects, on page 26.

The prospective data in the Estimate and Aspiration columns for 2017 and 2025 are not subject to this assurance report. Consequently, we do not express any conclusion on this data.

Criteria

The reporting criteria used by PMI are described and disclosed on page 27 and in the internal financial reporting guidelines. These define those procedures, by which the Business Transformation Metrics data are internally gathered, collated and aggregated.

Board of Directors' Responsibilities

The Board of Directors of PMI is responsible for both the subject matter and the reporting criteria as well as for the entire reporting process of the selected information in accordance with the criteria. This responsibility includes the design, implementation and maintenance of related internal control relevant to this reporting process that is free from material misstatement, whether due to fraud or error.

Our Responsibility

Our responsibility is to perform a reasonable assurance engagement to express an opinion on positions in the related Business Transformation Metrics table on page 26. We planned and conducted our engagement in accordance with International Standard on Assurance Engagements (ISAE 3000) (revised) 'Assurance engagements other than audits or reviews of historical financial information'. That standard requires that we comply with ethical requirements and plan and perform our procedures to obtain reasonable or limited assurance whether the related Business Transformation Metrics summary was prepared, in all material aspects, in accordance with the reporting criteria.

Our Independence and Quality Control

We have complied with the independence and other ethical requirements of the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants, which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

Our firm applies International Standard on Quality Control 1 and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

Summary of work performed

Our assurance procedures included the following work but are not limited to:

- Reviewing the application of the internal financial reporting guidelines.
- Interviewing PMI representatives responsible for the internal reporting and data collection.
- Test a sample of data from PMI operations in Switzerland, Japan and the UK concerning the completeness, accuracy, consistency and classification as smoke-free products.
- Inspecting relevant documentation on a sample basis, including PMI policies, management reporting structures and documentation.
- Reviewing and assessing the management reporting processes for Business Transformation Metrics data and consolidation and their related controls.

We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our assurance conclusions.

Reasonable assurance conclusion

In our opinion,

- The internal financial reporting guidelines are applied in all material aspects as described on page 27;
- The internal reporting systems to collect and aggregate the Business Transformation Metrics data are functioning as designed and provide an appropriate basis for the reporting; and
- The data and information disclosed in the Business Transformation Metrics table on page 26 give a fair picture of PMI's smoke-free products' performance.

Lausanne, September 12, 2017

PricewaterhouseCoopers SA

Richard Thomas

Raphael Rutishauser

Annex 2:

Overview of marketing principles for combustible products

What we do

Our Guidebook for Success (Code of Conduct) and internal Practices and Policies, including the PMI Marketing Code, reflect our commitment to market our products responsibly, in compliance with applicable laws, only to adult smokers, and providing accurate information. This is a summary of those standards, as they are set forth on different internal documents. Our brands are among the most valuable in the world. We put our creativity and innovation into developing and maintaining brand value. At the same time we know that tobacco products create health risks to consumers. This is why it is so important to market our products responsibly and only to adult smokers. At PMI we have to ensure that our employees and agents only engage in responsible sales and marketing practices.

How we do it

The Marketing Code contains our minimum global standards that apply to all sales and marketing activities of PMI relating to Combustible Tobacco Products. We apply these standards voluntarily when there is no applicable law or when the applicable law is less strict. As Combustible Tobacco Products represent the largest part of our business today, the Marketing Code provides a solid foundation for responsibly selling and communicating these products.

The top priority for PMI is to develop and market smoke-free products that are a better choice for smokers than continued smoking and have the potential to reduce the risks of smoking-related diseases. These innovative smoke-free products, like heat-not-burn, are subject to different marketing and sales rules, namely the “Good Conversion Practices”.

While we are moving with speed to make our vision of a smoke-free world a reality, we must acknowledge that the majority of our business today is traditional combustible cigarettes. At PMI, we operate under Responsible Marketing Principles. These principles, as defined below, embody our Company’s commitment to engage in responsible marketing directed only to Adult Smokers.

Responsible marketing principles

1. We market and sell our combustible tobacco products to adult smokers only

What do we mean?

We sell Combustible Tobacco Products and compete for market share among Adult Smokers who have chosen to smoke. We do not seek to influence any adult consumer’s decision about whether or not to smoke.

Our standards

- We must not use images that have particular appeal to minors, including youth-oriented celebrities or cartoons. We must not use models who are or who clearly appear to be under the age of 25.
- We must only place Advertising in media channels, venues or events that are not directed to minors and whose audience is reasonably estimated to be at least 75% adults. Advertising on television, in radio broadcasts, or in cinemas should only appear in the later evening hours.
- We must not place Advertising on the front or back cover of a printed publication for general circulation or general circulation to the trade.

- We must not use outdoor Advertising that exceeds 35 square meters in total size, either individually or in deliberate combination with other Advertising, unless we can do so responsibly in light of existing local circumstances (e.g., where most of the billboards available for placement of Advertising exceed 35 square meters in size).
- We must not place outdoor Advertising where the Advertising is readable from facilities attended or frequented primarily by minors. Outdoor Advertising should not be placed within 100 meters of such facilities.
- Company activities involving engagement and interaction with consumers, whether offline or online via digital media, such as events or Direct Communication, must be directed only to age-verified Adult Smokers, subject to specific age verification process.
- Premiums must be designed for adults and must not have particular appeal to minors. We may brand smoking-related premiums such as ashtrays and lighters. If premiums are not smoking-related, the branding, if any, must not be visible to others when the premium is used.
- We may sell and deliver Combustible Tobacco Products directly only to age-verified Adult Smokers residing in the country of intended sale.
- We may offer free Combustible Tobacco Products in limited quantities (typically no more than one pack) only to age-verified Adult Smokers as part of product trial, switch-selling or swapping activities. We must not engage in switch selling until after the initial purchase has occurred.

2. We warn consumers about the health effects of our combustible tobacco products

What do we mean?

Smoking causes serious disease and is addictive. We warn consumers about the health effects of smoking.

Our standards:

- All Advertising and Consumer Packaging must have health warnings, even if the law does not require these warnings. If the law does not require or specify health warning content and appearance, we must ensure that health warnings are clear and conspicuous.
- If there is a legal requirement to print yields, we may voluntarily print tar, nicotine and/or CO yield numbers on Advertising and on Consumer Packaging in addition to yield labeling required by law, as long as we also print the following statement in a clearly legible typeface and size: “The amount of tar, nicotine and/or CO you inhale will vary depending on how you smoke the cigarette.”

3. Our marketing must be honest, accurate and transparent

What do we mean?

All of our marketing and sales activities must respect applicable laws, global standards of decency, and the local culture and practices prevailing in the country where the activities will be implemented.

Our standards:

- Product or brand-related statements must be accurate and not misleading, including about the health risks of smoking. All product-related claims require adequate substantiation.

– PMI employees or contractors who interact with consumers, including in the context of Unbranded platforms or campaigns, must make it clear that they are working for a tobacco company.

– We must not pay to include the use of Combustible Tobacco Products, a Combustible Tobacco Product brand name or items bearing a Combustible Tobacco Product brand name in movies, entertainment programs or theatrical productions, on television or radio, on the Internet or in any other production (e.g., video games).

– Standard brand presentation (i.e., brand name, trademark and/or logo) must predominate in all Consumer Packaging designs. We must not use Advertising visuals on Consumer Packaging. Any text placed on the external part of Consumer Packaging must be factual, brand-related and/or product-specific, and not Advertising copy.

4. We respect the law and also ensure that:

– All persons, such as hosts, hostesses, brand ambassadors and trend experts, acting on behalf of the Company to engage with Adult Smokers must be of legal age to purchase Combustible Tobacco Products and at least 19 years old. We must ensure that it is clear to Adult Smokers that these persons are acting on behalf of the Company. We must also adequately monitor their activities for compliance with these principles and practices.

– All written communications with Trade Partners must clearly state “For Trade Only. Not for Distribution to Consumers.” Advertisements in publications intended for general circulation to the trade must have health warnings in black text on a white background, occupying no less than 10% of the total area of the advertisement.

5. Implementation

We have a robust process for ensuring that our Marketing Code is implemented at the market level. The Affiliate Head is accountable for compliance with these principles and practices, and must ensure that the affiliate uses a robust and substantive review and approval process, such as a Brand Marketing Review. All activities subject to these principles and practices must be (i) approved by the Affiliate Head and the Affiliate Head of Marketing and/or Sales and (ii) reviewed by the Affiliate Law and Corporate Affairs Departments. All decisions taken during the review process must be documented.

6. Training

All Company employees who are directly involved in marketing and sales activities must receive training on these principles and practices. All third parties who are substantively involved in marketing and sales activities on behalf of the Company must be trained on the parts of these principles and practices that are relevant to their activities. The Affiliate Heads, the Regional Marketing & Sales Heads and the Marketing Code Program Owner are accountable to implement these trainings for all employees in and third-parties contracted by their respective organizations.

Definitions

Advertising – any branded commercial communication aimed at promoting a PMI Combustible Tobacco Product to Adult Smokers, regardless of the medium.

Adult Smoker – a consumer of Combustible Tobacco Products who is of legal age to purchase such products and is at least 18 years old.

Company or PMI – Philip Morris International Inc. and its direct and indirect subsidiaries.

Consumer Packaging – packaging, wrapping, bundles or any materials in which Combustible Tobacco Products are offered for sale to Adult Smokers.

Combustible Tobacco Products – cigarettes and other combustible tobacco products, such as “roll your own”, “make your own”, pipe tobacco, cigars, cigarillos, and cigarittos.

Direct Communications – Company communications to an Adult Smoker that are not intended for the general public, including communications via one-to-one consumer engagement, direct mail, electronic mail, telephone, short-messaging, and Company consumer websites.

PMI Marketing Council – the PMI Senior Vice President Marketing and Sales, the Senior Vice President Corporate Affairs and the Vice President & Associate General Counsel responsible for Brand Building.

Smoke-Free Products or Reduced Risk Products (RRPs) – 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. We have a range of RRP's in various stages of development, scientific assessment and commercialization. These products are not Combustible Tobacco Products and because they do not burn tobacco, they produce far lower quantities of harmful and potentially harmful compounds than found in cigarette smoke.

Trade Partner – any representative of a retail outlet, legal age meeting point (LAMP), or other business that is involved in the sale of Combustible Tobacco Products.

Unbranded – without a name, trademark, logo or indicia of a Combustible Tobacco Product brand.

Who must follow the marketing code

This Marketing Code applies to Philip Morris International Inc. and its direct and indirect subsidiaries, collectively referred to as Philip Morris International, PMI, or the company. Compliance with the Marketing Code is mandatory for all PMI employees and anyone doing business on behalf of PMI.

Annex 3:

Overview of engagement principles

Our framework

Our Guidebook for Success (Code of Conduct) and several Principles & Practices set out detailed standards for engaging with governments and public organizations or third parties generally, doing external communications or public statements, making contributions or providing financial support to certain projects, giving gifts or providing entertainment to third parties, and recording and reporting such expenses.

This document does not replace those standards, but it describes their basic tenets and summarizes their spirit. It also provides a means for PMI to tell the public what is important to PMI when interacting with governments and public organizations, and allows PMI to invite feedback on these fundamental tenets.

Key points to remember

- Communication and respectful exchange of informed, substantiated, and reasoned ideas is the best way to achieve regulatory and fiscal frameworks beneficial to the societies they apply to.
- We think it is our responsibility to share our knowledge and expertise with governments, authorities and public organizations.
- The merit of PMI's ideas, the rigor and validity of its scientific conclusions, the verifiability of its facts and the integrity of its employees should be the only means through which PMI advances its positions and communicates them to governments, public organizations and opinion leaders.
- Corruption, bribery, influence-trafficking, misleading information, secrecy about issues that are material to a decision, and dishonesty in general are not acceptable forms of doing business at PMI.

What we do

- PMI's research and development activities follow rigorous scientific standards. When it comes to our Reduced-Risk Products, PMI makes its findings public and invites external review.
- PMI scientists are committed to those rigorous standards.
- PMI only communicates to governments and public organizations product information that has been substantiated by such rigorous scientific methods.
- The positions PMI publicly advocates for, and the arguments supporting such positions, are consistent with PMI's internal positions and do not overlook any information that PMI may internally have that might be material to PMI's audience.
- PMI's positions on regulation of its products, taxation, harm-reduction, employment, safety, and a vast array of important topics result from self-critical, respectful internal debate that considers not only business objectives but also, among other things, PMI's legal obligations, societal expectations, human rights, long-term environmental effects, and consumers' rights to full and accurate information.
- We believe that regulation and taxation of tobacco and nicotine products should be consistent with their different risk profiles. We make our views known through our website, the media, and communications to governments such as through public consultations and other available platforms.
- We do not bribe or try to inappropriately influence other people's objectivity.

- We have strict standards governing how we provide gifts and entertainment to government officials, members of public institutions and private individuals. We comply with those standards.
- We have strict rules concerning what contributions are appropriate, what due diligence is required before making them, what disclosures are in order and, when needed, how to maintain the independence of those that receive such contributions. The same applies to our membership in external organizations. We comply with these rules.
- We require third parties interacting with governments, public institutions or other audiences on our behalf to refrain from engaging in bribery or in other forms of inappropriate influence. We make our internal standards known to them and monitor their compliance therewith.
- We require third parties interacting with others on our behalf and communicating about PMI's positions on topics such as harm-reduction, product regulation, taxation and others, to disclose their relationship with, and any financial support they receive from, us so that their audience has access to the information material for them to make a decision or adopt a view.
- We keep accurate and complete financial records of all expenses incurred in interacting with government officials, public organizations and any other third party.
- We communicate honestly and respectfully, internally and externally.

- We market and sell our products according to the following principles:
 - We do not market or sell to minors, non-smokers or non-users of nicotine products.
 - Consumption of combustible tobacco products is harmful to health.
 - Non-combustible products are not risk-free.
 - People concerned about the risks associated with any of our products, should quit.
 - Any positions or messages communicated or advocated for with governments or public organizations are consistent with, and respectful of, these principles.
 - We comply with reasonable, legal governmental requirements to provide information to authorities.
- We communicate institutionally and do not allow the use of personal email accounts, or other means that might be misleading, for company communications or the transmittal of PMI information.
 - We do not seek to gain access to, nor discuss with governments or other third parties, confidential information of others, including our competitors. We comply with anti-trust regulations.
 - Our Compliance help-line and Department are available to anyone wanting to report suspected violations of our Guidebook for Success or Principles & Practices. Reports can be made anonymously. PMI respects and protects the identity of those that raise concerns. PMI does not tolerate retaliation of any kind against good-faith reporting.

Annex 4:

Cross reference to UNGC Principles and relevant SDGs

Theme	UNGC principle/sdg	Section/pages	Comments
Human rights	Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights.	“The guiding principles on business and human rights” Pages 38-39.	Human Rights topics are covered generally throughout this report, but we describe our commitment and overall approach in this dedicated section.
	Principle 2: Businesses should make sure that they are not complicit in human rights abuses.	As above	As above
Labor	Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining.	“Our people” Pages 40-46. Specifically, “Labor relations” Page 42.	This Principle is also covered by the work in our supply chain. It is part of our Agricultural Labor Practices code and is also included in our Responsible Sourcing Principles.
	Principle 4: Businesses should uphold the elimination of all forms of forced and compulsory labor.	“Our people” Pages 40-46. “Our supply chain” Pages 47-55.	Forced or compulsory labor is not allowed under our Employment Principles and Practices. We believe the main area where we can act to support this UNGC Principle is in our supply chain – this forms part of our Agricultural Labor Practices code and is also included in our Responsible Sourcing Principles.
	Principle 5: Businesses should uphold the effective abolition of child labor.	“Our people” Pages 40-46. “Our supply chain” Pages 47-55.	Child labor is not allowed under our Employment Principles and Practices. We believe the main area where we can act to support this UNGC Principle is in our supply chain – this has been a key focus of our Agricultural Labor Practices code for many years and is also included in our Responsible Sourcing Principles.
	Principle 6: Businesses should uphold the elimination of discrimination in respect of employment and occupation.	“Our people” Pages 40-46. Specifically, “Diversity and inclusion” Pages 40-41.	This Principle is also covered by the work in our supply chain. It is part of our Agricultural Labor Practices code and is also included in our Responsible Sourcing Principles.

Theme	UNGC principle/sdg	Section/pages	Comments
Environment	Principle 7: Businesses should support a precautionary approach to environmental challenges.	“Managing our environmental footprint” Pages 56-65. Specifically Pages 56 and 62-65.	We highlight our science-based targets and carbon price for carbon footprint reduction, our use of lifecycle assessment to guide our work and our implementation of concepts from the Natural Capital Protocol.
	Principle 8: Businesses should undertake initiatives to promote greater environmental responsibility.	“Managing our environmental footprint” Pages 56-65.	We have implemented initiatives across our own operations and supply chain (currently focusing on our agricultural supply chain), which are described in this dedicated section.
	Principle 9: Businesses should encourage the development and diffusion of environmentally friendly technologies.	“Managing our environmental footprint” Pages 56-65. Specifically Pages 58 and 60-65.	We highlight our Marginal Abatement Cost Curve approach, our progress on Integrated Pest Management, including a biopesticides database, and our work to find possible applications for recycled material from IQOS heated tobacco units.
Anti-corruption	Principle 10: Businesses should work against corruption in all its forms, including extortion and bribery.	“Acting with integrity” Pages 30-37. “Our supply chain” Pages 47-55.	We highlight our Compliance program, our specific safeguards for interactions with government officials and our efforts to tackle the illicit tobacco trade and related crimes. This Principle is also covered by the work in our supply chain.
Sustainable development goals	Overview of SDGs	“Our approach to sustainability” Pages 5-6.	We describe how our work relates to the SDGs. While all SDGs are relevant to us, we have highlighted SDG 3 as most important and 2, 8, 12 and 16 as other goals where we believe we can make a substantial contribution.
	SDG 3: Ensure healthy lives and promote well-being for all at all ages.	“Our business transformation” Pages 8-27.	Whilst our biggest contribution is in replacing cigarettes, we also highlight our work on health and well-being for our employees on pages 43-45.
	SDG 2: End hunger, achieve food security and improved nutrition, and promote sustainable agriculture.	Good Agricultural Practices and crop diversification, Pages 49-50.	We describe our approach to sustainable agriculture, which can help further food security.
	SDG 8: Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all.	“Our people” Pages 40-46. “Our supply chain” Pages 47-55.	We describe our employment principles, which are also reflected in our approach to supply chain sustainability.
	SDG 12: Ensure sustainable consumption and production patterns.	“Managing our environmental footprint” Pages 56-65. “Our business transformation” Pages 8-27.	We connect our environmental work together under SDG 12 rather than separately linking it to SDG 6 on clean water, SDG 7 on energy, SDG13 on climate action, SDG 14 on life below water and SDG15 on life on land.
	SDG 16: Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels.	“Acting with integrity” Pages 30-37.	We describe our efforts to tackle the illicit tobacco trade and related crimes.



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