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Philip Morris International
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Izmir

Good morning ladies and gentlemen. My name is Turhan Talu. I am the Managing Director of PMI's Turkish affiliates, which collectively we refer to as Philip Morris Turkey. It is my pleasure to welcome you to my country and specifically to our state-of-the-art manufacturing facility here in Torbali. We are honored to be with you at the invitation of J.P. Morgan to talk to you about the successful development of our business in this important market.

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

Let me introduce my team, which runs the largest fast moving consumer products company in Turkey. Present here this morning are Matthias Knoop, Director Operations, Taner Kerman, Director Finance and IS, and Oebel Harmsma, Director Business Development and Planning. Tonight in Istanbul you will meet the rest of the management team: namely Ilker Kaytanci, Director Marketing, Onur Pehlivan, Director Sales and Distribution, Bisharah Baroudi, Director Corporate Affairs, Cliff Rumbold, Director Human Resources, and Cagatay Erten, Senior Counsel.

To give you a perspective on the magnitude of the Turkish cigarette market, we estimate it to be the fifth largest market by volume in the world, excluding the USA and China.

During my presentation, I will share with you some basic facts about our country, including economic developments, and provide you with an overview of the tobacco industry. I will then talk about consumer preferences and describe the key strategies we have in place to further reinforce our leadership position in this important market. After some concluding remarks, I will be happy to answer your questions.

With a growing population of 72 million people, Turkey is positioned between Germany, the most populous country in the EU with 82 million people, and France, with 64 million people. More than half the population is below the age of 30, and 75% of the population lives in urban areas. Average GDP per capita reached just over \$10,000 in 2008, but there are large disparities between the Western and Eastern parts of the country, due to differences in economic development. Turkey aspires to become a member of the European Union, but the time line to reach such membership remains unclear. Many of the reforms adopted by the Turkish Parliament over the last few years have this goal in mind. Turkey is governed by the AK Party, which captured around 40% of the votes in recent municipal elections.

Turkey's economic growth has been very strong this decade and its economy now ranks as the world's 15th largest. However, with the global financial crisis, GDP growth slowed to 1.1% last year and the economy is forecast to contract this year by 3.6%, due to weak export markets and slowing domestic demand. The strictly regulated Turkish banking system has weathered the storm well and discussions are underway on a new IMF standby agreement. Turkey has successfully overcome economic crises several times in the past, and we are confident it will do so again, though the economic recovery is expected to be gradual.

The most important concern about the economy in Turkey is rising unemployment. This is having some impact on the demand for consumer products, including cigarettes. While the premium segment remains resilient, we have seen some consumer down-trading from the mid-price segment to the low-price segment. The government has recently announced a new economic stimulus package with specific job-creation programs to try and address this issue. One of the benefits of the current economic downturn is that inflation, once a chronic problem in Turkey, has steadily declined to a level of 5.2% in May this year.

The Turkish Lira remained stable through the third quarter of 2008. With the deepening of the global financial crisis, and the flight from emerging markets to the perceived "safer" environment of the USA and the Dollar, the Turkish Lira came under pressure and depreciated rapidly starting in October last year. Since peaking at 1.80 Lira to the Dollar on March 10th, the Lira has appreciated somewhat and has recently been trading in a narrow range of 1.50 to 1.60.

PMI is in an excellent position to prosper in this challenging economic environment. We are the market leader in the Turkish cigarette market with a market share of 42.4%, and have a superior sales and distribution network. We have successfully developed a very broad portfolio, with strong brands in all the profitable price segments. In spite of several new competitive launches in the past few years, we have maintained a share of over 90% in the more profitable premium segment, which has remained resilient during the current economic crisis.

We reached this leadership position after nearly twenty years of patient building. PMI entered the Turkish market in the late 1980's when the monopoly of state-owned Tekel was lifted. Led initially by *Marlboro*, but with a portfolio that was extended step by step to all the price categories in the blended segment, PMI gradually improved its position in the Turkish cigarette market and overtook Tekel to become the market leader in 2005.

Initially the only international competitor present in Turkey with a local factory was RJR International. The last ten years, however, has seen the establishment by BAT, European Tobacco, Imperial, Gallaher and KT&G of local manufacturing facilities in Turkey.

After two unsuccessful efforts in 2003 and 2004, the Government put up Tekel's cigarette business for sale again in 2008, and BAT won the privatization tender with a bid of \$1.72 billion. At the time of the acquisition, Tekel had a market share of 25.8%, six manufacturing facilities, of which 3 were operational, and two years of tobacco leaf stock. Its leading brands were *Tekel 2001*, *Samsun* and *Tekel 2000*. The market share of BAT's brands stood at 8.8% at the time of the acquisition of Tekel, giving it a combined share thereafter of 34.6%.

What has happened to the competitive landscape since then? PMI has continued to gain share, growing from 40.8% in the first quarter of 2008 to 42.4% in the first quarter this year. BAT has seen its post-acquisition share decline to 32.1%. JTI has maintained a good momentum in the Turkish market, mainly thanks to *Winston*, gaining 2.4 share points to reach 18.3% in the first quarter of 2009. Meanwhile, both European Tobacco and Imperial remain minor players with market shares of 3.6% and 3.4% respectively.

This evolution has taken place in an industry which is maturing, but which is expected to remain resilient given the demographics of Turkey that I mentioned previously. In 2008, industry volume reached 107.2 billion units, broadly in line with its level five years previously.

Let me now move to the Turkish adult consumer characteristics before discussing key consumer preferences. Smoking incidence is estimated to be 35.5%, with 48.8% among adult males and 22.0% among adult females. Estimated average daily consumption is 18.9 cigarettes, with male smokers consuming an average of almost 21 cigarettes a day and female smokers around 15.

Let me now turn to the four key consumer tendencies that are prevalent in the Turkish cigarette market and which have played a central role in our product and brand portfolio strategy. There has been a switch from the once predominant preference for traditional oriental cigarettes to an overwhelmingly American-type blended market.

Concurrently, a predominantly Soft Pack market, first in the King Size format and later in 100's, has become a mainly King Size Box market, though 100mm soft pack products still account for nearly one in five cigarettes, a segment where PMI remains over-indexed with a segment share of 63.2%.

Turkey remains a predominantly full flavor market, with this segment accounting for 82.5% of the market in the first quarter of 2009. However, lighter-tasting segments are growing slightly, albeit off a low base.

Another key development is the rapid increase over the last five years in the demand for charcoal-filtered cigarettes. The charcoal-filtered segment today represents just over 31% of the market and PMI has achieved a share of over 75% of this segment.

This growth has been fuelled in particular by the increasing popularity of recessed charcoal-filtered products. This segment reached 16.4% in the first quarter of 2009, up from 11.7% in the first quarter last year.

This segment was pioneered by PMI's premium brand *Parliament*, which remains the leading brand in the segment. More recently, we launched low-price *Lark* Recessed Blue and these two brands have enabled us to obtain more than 60% of this fast-growing segment.

In terms of price segments, the Turkish cigarette market can be divided into four: premium, mid, low and cheap. The premium segment continues to perform well. It is a sizeable segment with 20.7% of the market in the first quarter of this year, 1.6 share points ahead of the same period last year, and only slightly down on the fourth quarter of 2008. The growth of the premium segment has occurred at the expense of the mid-price segment, which is down by 1.8 share points year-on-year. As mentioned, there are considerable income disparities in Turkey, and purchasing power remains low for many Turkish consumers. The low and cheap price segments continue to represent a combined 54.7% share of the market.

PMI has a strong presence in all price categories, except for the cheap-price segment, where margins are thin, with notably *Parliament* and *Marlboro* in premium; *Muratti* and *L&M* in mid; and *Lark* and *Bond Street* in the low-price segment.

Our two main competitors, BAT and JTI, have a presence across all four price segments, but neither has a strong position in the premium segment. European Tobacco and Imperial are mainly competing at the low end of the market.

Looking at the mix of our portfolio by price segment, compared to BAT and JTI, we have a good balance, with 45.2% share in premium, 26.5% in mid and 28.3% in the low-price segment. BAT, in contrast, has over 90% of its volume in the least profitable price segments and JTI is dependent on mid-price *Winston* for 63% of its volume.

How do we build our business? We seek to achieve profitable growth through eight key strategic initiatives. Today, I will focus on four of the eight: the fiscal environment, our brand portfolio management, our sales and distribution focus and organizational readiness.

The other four strategies that we are pursuing are a reasonable regulatory framework that will be the foundation for the future; using information technology to enhance productivity; cost reduction initiatives to enhance unit margins and keep overheads under firm control; and a focus on production excellence.

Let me start with the fiscal environment. Turkey today has a modern excise tax structure for cigarettes, which is inspired by, but not fully aligned with, the European Union. The structure has been in effect since August 2005. The excise tax, or special consumption tax as it is called in Turkey, is levied at an ad valorem rate of 58%, and there is a Minimum Excise Tax (or “MET”), which is adjusted periodically. Based on the latest MET increase, any cigarette that retails at TL 3.53 will pay the MET. On top, there is Value Added Tax (or “VAT”), which is levied at a rate of 18% of the retail selling price.

This excise tax structure, as well as cigarette retail price increases, has generated a steady increase in government revenues. In 2008, the special consumption tax on tobacco products accounted for 6.5% of the total taxes collected, with about half of this amount coming from PMI. When all other forms of taxation are included, we estimate taxes levied on PMI represented just over 4% of total government revenues last year.

This tax structure has helped us to maintain acceptable price gaps and the affordability of our brands. Because the MET level is periodically adjusted, retail prices at the bottom of the market have increased at a higher rate, thereby offering us an opportunity to slightly reduce relative price gaps over time. The price gap between *Marlboro* and BAT’s *Samsun*, has narrowed by almost half to 92%. At the same time, the price gap between *Marlboro* and *Winston* has narrowed by 7 percentage points.

I will now turn to the second of our strategic initiatives, portfolio management. We seek to have a balanced portfolio with strong brands in the three price segments that provide attractive margins. We have two very strong brands in the premium segment with a combined segment share of over 90%. These are *Marlboro*, our iconic flagship brand, which stands for flavorful enjoyment, and *Parliament*, which stands for sophistication and refinement.

Our strategy in premium is to further reinforce our segment leadership with *Marlboro* through the leveraging of international innovation initiatives adapted to the local market, whilst reinforcing and maintaining the relevance of the brand's solid base, and with *Parliament*, through a consumer relevant evolution.

Our premium brand volume shipments in the first quarter of this year were up nearly 4%, compared to the same period in the previous year, thanks to the strong performance of *Parliament*.

Our leading brand family is *Marlboro*, which is the most aspirational brand amongst adult smokers, and remains strong in spite of the economic crisis. *Marlboro*'s market share was 10.7% for the first quarter of the year, slightly down from 11.1% in the first quarter of last year.

According to a Brand Equity Study we conducted last year amongst adult smokers in Turkey, *Marlboro* remains the most liked cigarette brand in the market and is the brand with the strongest brand equity.

Over the last couple of years, PMI has significantly increased its innovation efforts behind *Marlboro*. These new initiatives are helping to energize the brand family, and we have several new innovative ideas in the pipeline. Along with a Young Adult Smoker share for *Marlboro* that is well above its overall smoker share, these initiatives make us optimistic about the future of our leading brand in Turkey.

Parliament has been performing well for a number of years, thanks to the introduction on a regular basis of consumer-relevant product and pack enhancements. As a result, the brand's market share has grown from 3.6% during the first quarter of 2004 to 8.4% five years later.

Our current *Parliament* line-up in the market, is composed of King Size Box and 100mm soft variants, super slims and the luxury *Parliament Reserve*. Turkey is one of the four main markets that has been driving the strong growth of *Parliament* on a global basis.

We also have two strong brands in the mid-price segment with *Muratti*, which stands for distinctive elegance, and *L&M*, which pioneered the concept of affordability among international brands in Turkey.

In the mid-price segment, we will seek to reinforce our presence through stronger sales support nation-wide for *Muratti* and by positioning *L&M* for future growth, whilst nurturing the traditional *L&M* line-up.

Muratti, launched in Turkey in 2003, rapidly became an important brand and achieved a market share of 5.1% in the first quarter of this year.

Muratti has a distinctive elegant style and a 16.5% share of the growing charcoal filter segment in the first quarter of this year. *Muratti* is particularly strong in eastern parts of Turkey and in the urban areas around Istanbul, with regional market shares of up to 8.3%. Our goal is to expand the brand further in its strongholds and develop it on a national basis.

L&M has been declining in the Turkish market due to an aging smoker profile, the price sensitivity of many of its smokers, as well as an increased consumer preference for smoother-tasting cigarettes, which is underscored by the growth in the charcoal filter segment. To address these challenges, while maintaining the current *L&M* smoker base, we launched *L&M Mark* last year. It has a multi-chambered filter with charcoal to provide a smoother taste, and a more modern and elegant box packaging. *L&M Mark* retails at the more affordable price of TL 3.25, compared to the traditional *L&M* at TL 3.60.

L&M Mark achieved a 1.0 share point in the first quarter of this year, helping to slow the decline of the *L&M* brand family. Furthermore, our General Consumer Tracking Survey shows that *L&M Mark* is attracting Young Adult Smokers, auguring well for its future success.

Completing our portfolio, we have *Lark*, perceived as the “premium” of the low-price segment, and *Bond Street*, which is one of PMI’s main international low-price brands.

Our most important low-price brand remains the charcoal-filtered *Lark*. It provides great taste in attractive packaging at a very affordable price. The brand has been gradually gaining share over the last three years and the growth has significantly accelerated since the launch of *Lark Recess Blue*.

Lark reached a first quarter 2009 market share of 8.6%. As you can see here, the growth was fuelled by *Lark Recess Blue*, which captured a 2.6% market share in March, just six months after its launch. Most of these smokers are in-switchers from competitive brands.

Over the last ten years, we have successfully broadened our portfolio so that today we offer Turkish adult consumers attractive choices in all the three main profitable price categories.

This has enabled us to capture slightly more than our representative share of the mid-price segment and a significant share of the low-price segment, while maintaining our over 90% share of the most profitable premium segment.

I will turn now to our third key strategy: sales and distribution. Let me start by describing how this works. We have three methods of distribution in Turkey: direct distribution by our own sales force (also known as “DSD”), predominantly in urban areas; a network of exclusive zonified distributors (also known as “EZD’s”); and key accounts (or “KA’s”). PMI directly distributes around a quarter of its volume in five district centers covering the main cities. The rest of the country is supplied through a network of 93 EZDs, and these account for 69% of our volume. Finally, key accounts, represent 7% of our sales. Our sales and distribution are carried out by some 2,000 people, 650 directly employed by PM and 1,350 by the EZD’s.

We have restructured our sales architecture as a toolbox aimed at improving our competitiveness in rural and low-end outlets, the so-called “heartland” of the traditional Tekel (now BAT) brands, and building further on our leadership in urban areas. The toolbox includes flexible payment methods, distribution capabilities, new product launches and adult consumer engagement initiatives.

An important element of the toolbox is our micro-financing initiative. We launched this initiative in our direct delivery area. This initiative provides a fixed weekly credit line to all our direct delivery retailers. The credit is arranged through a large local bank. This allows outlets that have limited liquidity, but have volume growth opportunities, to purchase additional PMI products. It is an innovative approach, as PMI’s sales force collects money on behalf of the bank, effectively creating a system of bank guaranteed credit sales that is administered centrally. Importantly, it also eliminates the need for the retailer to go to the bank. This initiative was launched to coincide with the current squeeze on trade working capital and financing, in turn receiving positive coverage in the media.

Another pillar of our sales architecture is our consumer engagement initiative. The objective of the initiative is to provide adult consumers with factual product information. We do this through our sales force as well as through a specially trained Sales Support Team in select cities.

In order to monitor the results of our sales architecture, we set a base line and developed a score card to track market leadership by province. This was the picture in June 2008.

The diligent use of our sales architecture has enabled us to increase our market share by 1.3 points to 42.5% in March of this year compared to June of last year. We increased the number of cities in which we are the market leader from 38 to 61.

I will conclude the overview of our key strategies with the initiatives we have taken to enhance organizational readiness. We have a large organization of over 1,500 people, nearly all of whom are local nationals. 90% are employed in the key business areas of manufacturing, marketing and sales, and the rest in administrative functions.

In 2007, we launched two programs designed to increase our agility and sustain our growth. These are known as “culture shift” and “speed-to-win”. The main goals were to increase empowerment and drive the taking of responsibility lower within the organization, and to encourage more open communication.

Separately, with our “employer value profile” initiatives, we have focused on talent recruitment and retention, people and career development, and the careful tracking of individual performances. Our organization in Turkey has become an important talent source for PMI globally. Today, some thirty former members of my team work around the world, in such positions as Vice President Operations, Director Sales and Director Marketing to name a few. We have achieved sustained market credibility as a career-oriented employer.

Before turning this session over to your questions, let me finish with some concluding remarks. Turkey is a very large and profitable cigarette market. We have successfully tapped into the increased consumer preference for American blended, box packaging, and charcoal filter cigarettes, particularly with a recessed filter. In spite of new market entries, we have maintained a share of the premium segment of over 90% with *Marlboro* and *Parliament*, and we have developed a well balanced portfolio, which also includes *Muratti*, *L&M* and *Lark*. Our superior brands and sales and distribution infrastructure have enabled us to further reinforce our market leadership. We gained a further 1.6 share points in the last twelve months to reach a market share of 42.4% in the first quarter of 2009. New initiatives have enhanced our speed-to-market. We are very proud of our talented organization and the career development opportunities that exist in Turkey and within the global PMI family. Finally, we have a state-of-the-art manufacturing facility that we look forward to showing you later this morning, which produces top quality products and is very efficiently run.

I will now be happy to take your questions.
