CFO's Presentation

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Slide 1 – Opening Remarks

Welcome back everybody, it is good to see you this afternoon. So, you have heard from André, Mirek and Jacek, and I think you heard loud and clear that we have very high expectations, we are very excited about the future prospects for PMI, and we are successfully transforming our business and our organization to reach those higher expectations, and we are doing it from a strong base. My job is to offer some additional financial context, to what you have already heard, and to put it into terms, from an investor's perspective.

Slide 2 – Agenda

I am going to start with our 2018 business outlook, which remains intact and provides us with a strong platform from which to grow throughout the next few years. Then, I will spend the bulk of my time on our realistic three-year targets, through 2021. And, they are based on continued strength of our combustible tobacco business, and portfolio, the higher growth prospects for our RRP opportunity, and stepped up pace and focus on cost efficiencies, to deliver for the investors and to help the transformation. And then, I am going to close with why I believe that we will have better business performance in 2019 across a broad array of measures.

Slide 3 – 2018: Revising and Narrowing EPS Guidance for Currency-Related Items

Earlier today, we announced that we are revising and narrowing our EPS guidance for two currency-related items. The first item is the currency that we are used to seeing, which is that our negative currency for the year, which we had seen at the last guidance of 7 cents, is now 12 cents unfavorable, and that's driven by the Turkish Lira. There are a few other currencies moving in there, but the bulk of it is the Turkish Lira and I think everybody is familiar with the issues there. And, there is a second currency related item, which is with regard to Argentina, and if you recall in July 1, we announced that we were going to highly inflationary accounting for Argentina, and we will now start using the US dollar as the functional currency for the Argentine affiliate. So, since that time, since we gave guidance in July, the Argentine Peso has moved from around 28 exchange rate to the US dollar, and it's now around 38 when we calculate these numbers. And, that is no longer carved out as currency, so it shows up in our ex-currency growth rate. That impact is about 6 cents per share, and that translates to about 1.2 percentage points, earnings per share drag on an ex-currency basis.

That explains why we took this in two steps. We updated the currency to 12 cents and then on the Argentina issue, we narrowed the range from 8% to 10%, to 8% to 9%, and that accounts for that 1.2 percentage point drag, which is in the ex-currency number, if you will. Both of these steps, both of these impacts are currency related, but they are handled in slightly different ways due to the change from Argentina. If we hadn't changed the inflationary accounting standard for Argentina, it would all be in currency and we would just be giving you the 12 plus 6 cents earnings per share impact, and it would be 18 instead of the 12. But, because of this change, we have had to split it. We have 12 in the ex-currency, and the 6 cents, or 1.2 percentage points, is the narrowing of the range, downward. I hope that is clear because it can be a little bit confusing.

Slide 4 – 2018: PMI Outperforming Industry Volume DeclineLooking further at the 2018 outlook, Jacek already mentioned the volume picture. We are outperforming the industry volume decline; we expect about 2.5% decline in the total industry, this is heated tobacco units and cigarettes worldwide, excluding China and the US, and we expect PMI to come in at around 2%, on the same basis. And also, we are seeing some positive trends in the industry volume; European Union and Turkey are two to call out, and obviously if those trends continue, we see that we may end up a bit more on the positive side on these two numbers, or less decline on these two numbers, because we have some good share in the European Union and in Turkey. Now, obviously we are seeing the mix of cigarettes being more negative, and heated tobacco units adding positively to these numbers.

Slide 5 – 2018: Reaffirming PMI HTU Volume Outlook

I am reaffirming our heated tobacco unit volume outlook, so these numbers are exactly what I gave you in the second quarter call, which is shipments of 41 to 42 billion units, in-market sales of 44 to 45 billion units, the difference of course being the distributor inventory volume changes where we are reducing distributor inventory volumes in Japan by about 4 billion, offset by 1 billion positive as we grow our volumes in a number of geographies around the world. And, that is also to keep in mind against a 13 billion inventory increase last year, which gives you the difference between the shipments in IMS for last year. So, I would reiterate that our in-market sales growth from 23 billion units in 2017, to around 44 to 45 billion units in 2018, is very nearly doubling. So, we have very good growth momentum within the heated tobacco unit volume that you are seeing.

Slide 6 – 2018: Revising Net Revenue Growth Target

We are also revising the net revenue growth target for the Argentina issue; once again while this is an ex-currency growth number, the Argentina impact isn't carved out as currency, so that impact on the net revenues is about 0.7 percentage points for the full year. So, that accounts for our revision from 3 to 4 range, down to the 3% approximate number we are giving you now. We have talked about the fact that our pricing is intact; we continue to see very favorable pricing on the combustible business this year, of about 7% combustible pricing over combustible net revenues. We are seeing the good RRP volume growth in this number, and obviously it is partly offset by the cigarette volume decline that comes both from the decline of the overall cigarette consumption but also the conversion of consumers to reduced-risk products, our heated tobacco units. We expect the IQOS devices to account for approximately 20% of our RRP net revenues in this number, just to give you some context.

Slide 7 – 2018: Net Revenue Growth Phasing for H2

I want to update you on our net revenue growth phasing, particularly as it relates to the second half. In the first half, we had net revenue growth of 8.3% over 2017, so we are now updating the phasing to show that in Q3 we expect about a 2% increase over the prior year, and that in Q4, against a very difficult comp of nearly 19% growth last year, we expect a 5% decline to get you to the full-year forecast of 3 percentage points. And, keep in mind again the inventory impacts in Japan are impacting the second half because last year the increase of inventories was Q3 and especially Q4, whereas this year we are bringing inventories in

Japan down. Mostly, it will be taken care of in Q3. There might be a little bit in Q4 if we have not completed it by then.

Slide 8 – 2018: Strong Cash Flow Despite Unfavorable Currency

We are reiterating our strong cash flow despite unfavorable currency. Operating cash flow, we continue to target $9 billion, and capital expenditures will also come in at the same 1.5 billion number that I gave you already at the second quarter call. And, that $1.5 billion in capital expenditure is also reflecting some higher efficiencies in our spending, which I will get to in a little bit.

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Let me now turn to the 2019 to 2021 growth targets. We have good momentum coming out of 2018 in the core business, the combustible business, and the broad geography of growth, and we are looking forward to some success in the next three years.

Slide 10 – 2019-2021: PMI Compound Annual Growth Targets

André already gave you the key metrics of net revenues of at least 5% compound annual growth, ex-currency, and adjusted diluted earnings per share of at least 8% compound annual growth, ex-currency.

Slide 11 – 2019-2021: Industry Volume In-Line with Historical Trends

This is built on an assumption of industry volume being in-line with historical trends. Again, this is cigarettes and heated tobacco units. The five-year CAGR from 2013 to 2018 is about down 2.5%, and we are forecasting or using in our targets, the assumption that it is between 2% and 3%. So, right in line, very realistic, with what we have seen in the last few years. Obviously, the shift between cigarettes and RRPs within this number will continue, as people convert to heated tobacco units.

Slide 12 – 2019-2021: Net Revenue Growth Target

Let me build up a little bit, the building blocks for our net revenue growth target. It's driven by continued strong pricing. Over the last few years, if you put it together, it is about a 6.5% on combustible pricing on combustible net revenues, and that assumption remains intact in here. We expect higher volume for IQOS devices and heated tobacco units, partly offset by the lower cigarette volume, which again reflects the switching to RRPs, as well as the overall decline in the use of cigarettes, absent even switching to RRPs. Net, of course, of market share gains, you heard about keeping our eyes on the ball, as Jacek said, with conventional business, so we still have us gaining market share, not only from heated tobacco units, but making sure that we continue to defend and remain very competitive with conventional products. The strong pricing outlook is supported by a broadly rational tax environment, globally, and of course our leading brand portfolio. And, the product innovation capability, the innovation machine that you heard from Mirek, allows us to remain positioned at the forefront of the growing RRP category. So, these are the building blocks for our at least 5% net revenue growth.

Slide 13 – 2019-2021: Stable Unit Cost of Goods Sold

Now, while we are very focused on the topline and building revenue growth, we are also focusing on managing our costs. A big chunk of our costs, about 60%, or $10 billion in 2017, is in the cost of goods sold area. We have very stable unit costs for all of the three main areas; cigarettes, heated tobacco units and devices, even with the introduction of the new devices, we are continuing to reduce our production costs on the 2.4 Plus and we will come down the cost curve with the 3.0 and 3.0 Multi as we build volume. We have good economies of scale, we have limited input cost pressures and we continue to work on overall costs and efficiencies within this area of the business. Part of our transformation and part of our ability to keep growing net revenues is to find cost efficiencies and make sure that we are driving our business towards investing and spending in the best possible way to ensure our growth.

Slide 14 – 2019-2021: Targeting Over $1 Billion in Cost Efficiencies

We are stepping up the pace of our cost efficiencies and we are targeting over $1 billion in annualized efficiencies by the end of the period, compared to our current operating cost base. Some of this is in stepping up our efforts within areas that are already performing well, and where we already have some initiatives around manufacturing performance, better asset utilization, the productivity initiatives. We have been doing pretty good initiatives in those areas, but we will see a stepped up pace and a renewed drive to make sure we are getting every possible efficiency. Added to that is an approach with the project based organization model, where we can better see our costs and better prioritize our initiatives because we are organized more by projects, and we can quantify and justify the individual projects against our transformation goals and our initiatives. Underlining it all is a new zero base budgeting initiative, where we will take our cost base and look at it with great granularity, using data, and analyze where we are spending our money, and particularly look at the areas where we have been spending money in a legacy way, and figure out how we can be more efficient and more effective, in order to generate cost savings and cost efficiencies, that we can use, either to invest in driving more revenue growth or bridge with greater leverage towards our earnings per share growth with operating margin improvements. We are very focused about these efficiencies in the cost area, and we believe that this is a key part of driving our transformation; it is not a separate initiative or distraction; this is a way for us to make sure that, as a company, we are investing in the future properly and we are transforming the business from the cost side as well as all the other initiatives that you saw from the other presenters.

Slide 15 – 2019-2021: Adjusted Diluted EPS Growth Target

That brings us to the earnings per share growth target, and this growth target assumes an income tax rate in line with where we are right now, which is 24%, and it also assumes relatively stable net interest expense to the already lower net interest expenses that we are seeing this year versus previous years. I will get into the detail of that in a minute. It also assumes no share repurchases in this plan and in these metrics, but I will address this topic as well.

Slide 16 – 2019-2021: Continued Cash Flow Growth

We expect operating cash flow to continue to grow, broadly in line with net earnings. We are very focused on managing our working capital judiciously, and we will target further improvements. We anticipate our annual capital expenditures to be lower than they have been in the last few years, at around $1.2 to $1.3 billion, and I think that at times, depending on how much efficiency we gain in the way we invest for the future, we could see our capital expenditures even slightly below that range, in some of the years of the plan.

Slide 17 – 2019-2021: More Efficient Manufacturing Investment

This better investment efficiency around manufacturing, in the area of RRPs, most of our investments are in heated tobacco unit manufacturing, although in the plan period we will have investments in support of the other platforms, and to date, we have invested in the Bologna Greenfield site, and we are now starting to more and more have full and partial, especially partial conversions of existing cigarette manufacturing facilities, to produce heated tobacco units. This gives us greater flexibility with our workforce, the ability to manage the decline in cigarettes when you introduce IQOS and heated tobacco units into a market, with the increased needs in the markets for the heated tobacco units. This gives us greater flexibility, greater efficiency, less need to expand buildings, buy additional buildings, etc. We have gotten quite a bit better in the manufacturing of heated tobacco units, in the area of waste, in the area of uptime, we are making significant strides. So, I believe some time ago, we gave you a rule of thumb number that it took about $20 million of capex for every billion heated tobacco units capacity, and where we are headed right now, it is more like $16 million for every billion. That is a pretty substantial improvement and we foresee that we will continue to drive the efficiencies of uptime and waste in those areas, as well as look for better designs and approaches to reduce costs. We are getting better at the overall use of capital and I think that explains some of our revised Capex numbers going forward.

Slide 18 – Improving Leverage Metrics

Let me cover the capital structure that will support our growth targets. So, our net debt to adjusted EBITDA ratio continues to decline, from a high of about 2.2 times in 2015, through the first half of this year, we are down below two. Nonetheless, our current debt multiples are outside the ranges, above the ranges, associate with our current credit rating. And you see over there, examples of Moody's and S&P, they have slightly different calculations, but our multiples are outside the ranges that they would normally associate with the mid-single A rating that we have. S&P and also Fitch have revised their outlook this year for us, from negative to stable ...

Slide 19 – 2019-2021: Leverage Strategy

… and that is based on our leverage strategy and our commitment to restore our leverage multiples to the ranges that they look for, for their credit ratings. We were also helped by last year's corporate tax reform in the US, and that gives us greater flexibility on cash repatriation and our capital structure optimization, so that helped the overall picture. We do believe that our current rating is important to our financial policy; it provides us with financial flexibility while still making significant investments behind RRPs. It also helps us of course with our interest rates and our interest costs. We will consider share repurchases, once our leverage is comfortably within the debt multiples associated with our current strategy. So, based on our growth targets, we expect to be within the range, later in the plan period, subject obviously to currency moves. Now, a number of investors have asked and talked about the question of whether we should be buying back our shares now, earlier than this, and we have certainly listened to that, heard it, looked very closely at the situation. I understand the question, because with our dividend above 5%, and being able to borrow at relatively low rates these days, it does make sense to buy back shares and we would like to be in a position to buy back our shares. Weighing it out, essentially what we are looking at is that, if we go earlier with our share repurchase, before we are inside the leverage ranges, we would lose our credit rating, and that would mean that we would pay higher interest rates, and have higher interest expense for years to come. We are weighing out a short-term benefit of starting earlier and getting the positive effects of share buy backs, against the longer-term negatives of paying higher interest rates and having less financial flexibility in an uncertain world, in a rising interest rate environment. This is essentially the board's decision and these are the two factors they have to weigh out.

Slide 20 – Well-Laddered Bond Portfolio

In support of our leverage strategy, we have built a well-laddered bond portfolio. So, in any given year, we do not have more than $4 billion coming due, as is the case in 2019 and 2020, so we are in a good position to execute our overall strategy…

Slide 21 – Debt Financing at Increasingly Attractive Terms

… and we also have the debt maturities which are around ten years, which support that strategy. Our overall financing costs continue to come down; we are at about 2.5% for 2018, and our overall interest expense is down about 20%, we estimate, for 2018 versus 2017, and as I mentioned before, we expect that benefit to carry forward into the plan period with this capital structure plan.

Slide 22 – Generously Rewarding Shareholders over the Long Term

We continue to generously reward our shareholders over the long term. Dividends are the primary way of returning cash. Our total dividend per share has increased nearly 150% since the spin in 2008. We expect the dividend payout ratio to come down gradually over the time period in the plan, as our net income grows, as you saw in our objectives.

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Let me wrap up with a few remarks and thoughts about our positive outlook for 2019.

Slide 24 – 2019: Anticipate Better Business Performance

We do anticipate better business performance, and there are a couple of key tangible factors that support that. First of all, you see the better volume performance for combustible products and it is coming through each quarter, and we are doing well in the combustible business. We lapped the Saudi adverse impact of the 2017 excise increase or implementation of excise, which happened in the middle of 2017, so we are just now going to see the benefits of it in the back half of 2018, but 2019 will be fully behind us. That was a pretty significant impact; it was about three earnings per share growth points drag, the total impact of Saudi, so that is nice to have that behind us, and you saw from Jacek's presentation, the trends where we are starting to recover a bit in the market, as compared to the previous periods.

We also believe we will have lower incremental RRP investments, compared to 2018. I think André and Jacek both addressed this, from the point of view that we are getting more efficient, that we have already built some fixed assets that will help support larger volumes of heated tobacco units, without having to increase in line with the scale. We will continue to invest in RRPs but we will also take a very hard look at our costs and have a renewed and focused initiative around the zero-based budgeting and around the productivities in the operations area as well, and look across all of our cost areas, to try to make improvements as we move forward. That will have some impact in 2019, but that impact will build throughout the plan period.

Japan, we have dealt with the heated tobacco inventory and reduced it this year, and so we have put that behind us, and we have a number of initiatives, as Jacek explained, to address the situation in Japan and to get us to a better picture and growth. We have a good base going forward into 2019. Of course, IQOS in general, we have balanced growth across a broad range of geographies; you saw the number of markets in which IQOS is growing, very nicely, EU, Russia, and this adds to our overall momentum and critical mass going forward. We are very much looking forward to 2019.

Slide 25 – Concluding Remarks

I want to conclude with a couple of thoughts; first of all, I think you saw from all the presentations that we remain steadfast in our commitment to a successful transformation to a smoke free future. Our 2018 business outlook is intact, we expect better performance in 2019, so we have a good base and we have good momentum moving forward. We have set achievable three-year currency-neutral compound annual growth targets. And, obviously as our transformation succeeds, we can see some upsides as we succeed across the portfolio. All of this will allow us to generously reward shareholders over the long term. Following today's presentations, we hope you share equally in our confidence for the future growth of PMI. Thank you very much.

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