

Driving operational excellence

We believe that acting with integrity and preventing unlawful and unethical behavior is essential to our long-term success. We strive to go beyond mere compliance in our operations and across our value chain. Our efforts to drive operational excellence are reflected in the way we manage our ethics and compliance program, market our products responsibly, engage with stakeholders, approach corporate tax and data privacy, uphold human rights, tackle illicit tobacco trading, and implement responsible business practices in our supply chain. In this section we provide an update on our performance and key developments in 2017 for each of these topics.

Ethics & Compliance

Our Ethics & Compliance program and our culture of ethical business conduct provide a strong foundation as we transform our business. Honesty, respect, and fairness are core values which unite and guide us at PMI. They are integral to our company culture and the basis of our Code of Conduct (also referred to internally as our Guidebook for Success).

We believe that a strong compliance culture is achieved through a combination of elements: 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 appropriate conduct, an understanding of how and why people behave in certain ways, followed by a diligent and fair investigation process for suspected misconduct and proportionate disciplinary action.

The Guidebook for Success, together with its supporting Principles & Practices, covers the following core risk areas: competition law; conflicts of interest; environment, health, safety, and security (EHS&S); 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.

Last year, we revised our Code of Conduct and related Principles & Practices to provide even more clarity and guidance to employees, especially as smoke-free products become core to our business. We outlined specific requirements for scientific integrity and for marketing reduced-risk products, reflecting the transformation of our company.

Awareness of, and commitment to, our Guidebook for Success is implemented through training for 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 third-party-operated

Compliance training ('000)	2015	2016	2017
Competition law	7.79	6.54	5.98
Compliance overview	51.00	112.15	53.16
EHS&S	7.57	9.39	7.50
Employment	11.52	10.59	11.37
Fiscal & trade	22.71	14.35	5.87
Government relations	19.00	12.22	12.31
Information protection	8.96	7.57	42.82
Intellectual property	10.26	4.48	3.26
Marketing	44.27	45.00	33.16
Records management	9.61	15.23	9.94
Other compliance	0.85	0.84	0.63
Total number of training¹	193.54	238.36	186.00

¹ 2015 and 2016 training numbers have been updated to include live trainings that were conducted during these years but reported late, after the publication of our 2016 Sustainability Report.

Compliance Helpline available 24 hours a day, seven days a week, in all languages spoken at PMI. Although anonymous reporting is available, approximately two-thirds of the people who reported suspected misconduct gave their name.

In 2017, we reviewed 714 allegations of which approximately 30% were referred to other departments, and 40% were substantiated as misconduct across all areas of our Code of Conduct. Of these, the top two categories were theft and fraud against the company, representing approximately half of the cases, and workplace integrity and employment, representing approximately one quarter of the cases. Nearly two-thirds of employees whose misconduct was substantiated left the company, approximately one-third received written or verbal warnings or financial penalties.

In 2017, we provided around 186,000 Ethics & Compliance-related training through different channels to employees and relevant third parties. Approximately half of the training was live and half was online. Three-quarters was given to employees and one quarter to third parties. As our Code of Conduct refresher training is conducted in even years, the number of trainings decreased in 2017.

Our VP and Chief Ethics & Compliance Officer oversees our Ethics & Compliance program. Adherence to our Principles & Practices is monitored by the Internal Controls function along with the independent Corporate Audit department, which reports directly to the Board's Audit Committee.

The Ethics & Compliance function runs annually an integrated risk assessment together with our Corporate Audit and Internal Controls teams, which look at risks across the company.¹²

Looking ahead: Maintaining a strong compliance culture

As our company transforms, we must be mindful of new challenges. A continued commitment to a strong culture of ethical business conduct, including anti-corruption, is essential. In particular, we plan:

- A company-wide employee survey on our compliance culture in 2018 to gain insights into areas for further improvement; and
- The global roll-out of our revised Code of Conduct.



Employees attend a training session at PMI's Operations Center in Lausanne, Switzerland

Driving operational excellence

Our performance: Ethics and compliance	2015	2016	2017
Number of compliance trainings ('000) ¹	193.54	238.36	186.00
Ratio of employees trained versus third parties trained (%)	77/23	76/24	75/25
Number of reports of suspected misconduct	753	792	714
Number of substantiated claims	279	292	317

¹ 2015 and 2016 training numbers have been updated to include live trainings that were conducted during these years but reported late, after the publication of our 2016 report.

Responsible marketing

One area where many 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 combustible products is based on the following key principles, which are applied across the world without exception:

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

To proactively invite discussion with stakeholders about opportunities to improve our approach, we have provided a complete overview of our marketing principles for combustible products with this report. See Annex 1.

We have also developed marketing practices for our smoke-free products portfolio: our Good Conversion Practices (GCPs) for Smoke-Free Products, which are summarized to the right.



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 combustible products 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 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 consumer choice for smokers who wish to continue to use tobacco and nicotine.



A pack of Marlboro with a graphic health warning in Germany

Interacting with governments

Some of our critics have voiced concerns about the way we interact with governments. Our Code of Conduct and Compliance Principles & Practices govern these interactions, which are conducted transparently, with integrity, and in adherence with local laws. We strive to 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.¹³

While confident about our practices, we want to be more proactive in addressing concerns raised. With this report we are making available and inviting feedback on our principles for engagement with governments and public organizations. See Annex 2.

Our approach to corporate tax

PMI is committed to conducting business in compliance with all applicable tax laws, and it has established tax standards intended to ensure compliance with those laws. Legal obligations and societal expectations require that our transactions are based on sound tax strategies and that we act in good faith in all dealings with tax authorities and other stakeholders.

Our approach to tax is based on the following:

- We comply with local rules and regulations;
- Business decisions are not determined by tax considerations alone;
- We pay tax commensurate with the activities we perform and substance we have in a particular country;
- We are open and transparent with tax authorities in the countries where we do business;
- We do not engage in aggressive tax planning, and we do not have in place any contrived tax structures; and
- We do not operate “letter box” companies.

PMI has implemented governance arrangements which set out clear accountabilities for the management of tax compliance risks and tax planning. PMI's tax strategy is to maintain a comprehensive, effective, and practical risk management program, shared best practices, a structured and documented control framework, appropriate planning, and coordinated decision making.

To achieve this objective, we have developed mandatory practices which include:

- Roles and responsibilities: Clear definition of roles and responsibilities are formalized in each PMI affiliate in accordance with PMI's Tax Compliance Program.
- Escalation and involvement of PMI Tax Department: In accordance with PMI's policies, PMI affiliates consult with the PMI Tax Department on all important transactions, including recurring or new transactions, business structures or operations with other PMI affiliates or unrelated parties, and determine positions, exposures or actions regarding material, non-routine tax or customs matters. Where there is sufficient uncertainty over the tax treatment of a particular transaction or there is a potentially significant impact, external advice is obtained.
- Tax reporting and procedures: PMI's Tax Standards and Guidelines are designed to ensure that effective and predictable tax compliance and control measures are in place. In accordance with these policies, all tax filing obligations must be accurately completed on a timely basis and in accordance with applicable laws and regulations.
- Documentation and tax records: In accordance with PMI's policies, PMI affiliates are responsible for the appropriate creation and retention of all relevant tax records.
- Monitoring and reviewing business activities: Business structures and transactions are continually monitored and reviewed by all PMI affiliates for tax compliance.

Dealing with tax authorities

PMI conducts all transactions on an arm's-length basis in accordance with current OECD principles, and we support greater transparency between tax payers and tax authorities.

When it is relevant and feasible, we have upfront conversations with tax authorities in the countries where we operate to minimize uncertainty on both sides. For example, tax rulings do provide a higher level of certainty not just for us but also for the tax authorities.

However, tax rulings are not the only means of securing transparency and certainty. For example, in Australia we are part of the Lead Relationship Manager Program, and in the Netherlands we joined the Horizontal Monitoring Program. Both programs promote ongoing and transparent relations between tax payers

and tax authorities. In the U.K., PMI interacts in an open and real time manner with Her Majesty's Revenue and Customs (HMRC), and we conduct an annual Business Risk Review with HMRC at which key tax issues and business changes with a potential U.K. tax impact are discussed.

Data protection

In recent years there has been increasing public awareness of privacy issues and greater scrutiny by stakeholders of how companies approach data privacy. Global data protection laws have become more prevalent and rigorously enforced. In anticipation of the new EU General Data Protection Regulation (GDPR), PMI has developed its Global Privacy Program (GPP) to establish a new global standard for data privacy across markets and functions throughout PMI. The GPP has been developed over a period of 18 months by a multidisciplinary PMI team and is based on an internationally recognized and established privacy management system. The program is designed to support PMI functions and affiliates within the EU to achieve GDPR compliance and to embed policies and practices that facilitate a fully compliant approach to data privacy. Outside the EU, the GPP sets the GDPR as PMI's global standard, ensuring that the whole PMI organization is aligned to a high standard of privacy practice.

One of the key elements of the GPP is the introduction of greater central governance for data privacy, through data privacy leads (for markets and functions), a central privacy office team (a collaboration of External Affairs and the Information Protection & Governance group (IPG)) and the Data Protection Governance Board, which reports twice per year into the Corporate Risk Governance Committee. The GPP also mandates practices that the GDPR introduces or enhances, in areas such as data privacy impact assessments, awareness and training, privacy compliance assessments, personal data inventories, and data subject rights. Additionally, many existing data protection approaches have been reviewed and strengthened, such as the principle of transparency and the management of third-party risks.



A contract farmer
in Santa Catarina, Brazil

Human rights

Our Commitment

In 2017, we published PMI's Human Rights Commitment,¹⁴ which is the basis of our Human Rights program. Our Commitment is the result of internal cross-functional consultations and external stakeholder dialog, and it reflects our commitment to the United Nations Guiding Principles on Business and Human Rights.

In addition, a range of policies and programs addresses our value chain or specific groups, such as tobacco workers and children. Amongst those, our Responsible Sourcing Principles (RSP)¹⁵ and Implementation Guidance apply to all suppliers doing business with PMI and establish our expectations in the areas of human rights and labor rights, the environment, and business integrity.

Our Good Agricultural Practices (GAP) program¹⁶ applies to farmers contracting with PMI or our suppliers and includes Agricultural Labor Practices (ALP) covering the topics of child labor, fair treatment, income and work hours, forced labor, safe work environment, freedom of association, and compliance with the law. Affiliates and suppliers contracting tobacco farmers are committed to implementing the ALP program and the ALP Code¹⁷ and to working with us and our tobacco farmers on continuously improving living and working conditions on farms.

Human Rights Roadmap to implement our commitment

In 2017, we developed our Human Rights Roadmap to identify the practical steps required to integrate our Human Rights Commitment throughout our global operations and value chain. As part of this exercise, each functional area has developed a human rights action plan focused on the most salient risks to rights-holders.

Our Commitment to respect 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.

The Roadmap includes three core elements:

Embedding a culture of respect

The foundation of our Human Rights program is the commitment of PMI's senior management to instilling a culture of respect for human rights throughout our operations. Our employees and business partners need to have a practical understanding of human rights risks and of our expectation to have PMI's Commitment embedded throughout our operations and value chain. We aim to achieve this through ongoing training on business and human rights. Last year, we developed a Human Rights e-learning module, available to all our employees. In addition, we are developing tailored functional training sessions to ensure a more in-depth understanding of what human rights mean for individual functions, as well as concrete steps and actions expected from them.

Human rights due diligence

Human rights due diligence is the cornerstone of our human rights program. Over the last several years, we have developed due diligence processes for labor rights in our tobacco supply chain, EHS&S risks throughout our operations, and integrity risks across our value chain. Our ambition is to scale up these processes in the years to come and develop new ones as needed to integrate due diligence processes covering all human rights risks across our entire value chain. This is a vast undertaking, and we will build on the existing foundations already put in place across our organization.

As part of the ALP program, we disclose detailed reports of country-specific external assessments¹⁸ conducted by an independent third party (Control Union Certifications) trained and overseen by Verité, a not-for-profit organization specializing in labor and human rights issues, with action plans to address findings.

We also intend to conduct a pilot human rights impact assessment (HRIA) in collaboration with experts and in consultation with relevant stakeholders. Through our HRIA, we expect to gain a better understanding of the actual and potential human rights impacts at site level. The results will inform our approach moving forward as well as our program design and implementation.

Human rights grievance mechanisms

Providing access to effective grievance mechanisms in line with the Guiding Principles is a core element of our approach. We believe that everyone in our supply chain should have the appropriate means to voice concerns and seek help when needed. That's why we strongly support a culture of speaking up and ask suppliers, in our RSP, to provide workers with easily accessible means to raise concerns and to protect them from retaliation. Properly implemented, such mechanisms are one of the most efficient methods for ongoing due diligence and effective remediation.

As we move forward, we will continue looking into ways to provide access to grievance mechanisms throughout our operations and supply chain.

Between 2011 and 2016, approximately 630,000 migrants arrived in Italy by sea.¹⁹ Many stayed in the south of the country to work in the agricultural sector, which is labor intensive. Given the imbalance in demand and supply of labor in that sector, employment costs are low. The competition among migrant workers for jobs increases their vulnerability to labor rights abuses.

Against this backdrop and considering the company's sourcing of tobacco from this part of Italy, PMI began working with the International Organization for Migration (IOM) in 2015. Since then, PMI has been supporting a project entitled "Terra Munda",²⁰ which focuses on gaining insights into labor rights abuses and the various challenges facing migrant workers in agriculture in Southern Italy.

A preliminary assessment was conducted in 2016 to establish the most pressing needs of migrants living in informal settlements in the regions of Campania and Apulia. It identified shortcomings in four priority areas:

- Decent accommodation and housing;
- Vocational training and job placement opportunities;

- Legal counseling and awareness of existing social services; and
- Italian language classes.

As a result of the findings, IOM developed two sets of interventions to address the exploitation of migrant workers and to protect their rights under the umbrella of the Terra Munda program.

Firstly, two teams of dedicated IOM staff were established on the ground and assisted migrants living in informal settlements by:

- Providing social orientation and legal counseling to vulnerable migrant workers living within informal settlements;
- Identifying the most vulnerable cases (including victims of trafficking or exploitation, unaccompanied children, etc.) and referring them to relevant authorities for necessary assistance;
- Gaining the trust of the local migrant communities and monitoring their emerging needs; and
- Providing cultural and linguistic support.

By December 31, 2017, these teams had supported over 5,200 individuals in 14 months.

Secondly, a comprehensive vocational training program was developed in collaboration with PMI Italy, its partners and suppliers as well as a number of local NGOs and institutions to support the integration of 19 migrants. Over a six-month period, these individuals participated in a remunerated training program, which included accommodation and transport to and from the workplace, counseling, Italian language courses, and workplace safety and security training.



I had never grown tobacco before, maybe it exists in Africa but I didn't know. I was excited to learn new ways of growing crops. I am also grateful because I have learned how to interact with Italians in the workplace, in the city, and in public places. Now I feel that I can fight for my rights and look for a job on my own.

– A beneficiary from Senegal

Tackling illicit tobacco trade and related crimes

According to the United Nations Office on Drugs and Crime, transnational organized crime is an annual business of USD 870 billion.²¹ It is not just luxury goods that are counterfeited or smuggled and sold illegally. Cigarettes are among the most illegally trafficked goods in the world. Criminals are increasingly attracted to the high profits and minimal risks associated with illegally trafficking tobacco products.

Fighting illicit trade in tobacco products, including preventing the diversion of our own products, is a key component of our sustainability program. It is within our best interest, that of our customers and shareholders, but also of governments to safeguard the legitimate supply and purchase of tobacco products.

Yes, the problem of illegal trade impacts our business, but the effects stretch far beyond our bottom line. Fighting illicit trade links directly to combating corruption, contributing to improving human rights, labor rights, and environmental standards, principles that organizations involved in illicit trade ignore or violate.

Awareness continued to increase in 2017 that illegal tobacco trade is not a victimless crime and that it links to the funding of terrorism and other serious crimes.

This was reflected in many forums including some in which PMI participated, such as the Helsinki Commission hearing held in the U.S.,²² an event held by the Business Council for International Understanding in Panama²³ and the Financial Times round-table discussion on Combating Illicit Trade in the United Kingdom.²⁴

For us, this challenge means continuing to invest time, effort, and resources in maintaining the integrity of our supply chain, protecting our consumers, and working with governments and other partners to tackle the systemic causes of illicit trade.

Our efforts focus on three main objectives:

- Effective measures to secure our supply chain and prevent the illegal diversion of our products;
- Support for regulation and public-private partnerships to stop illicit trade; and
- Investment in research, training, and education to raise awareness and tackle the issue.

The categories of illegal tobacco trade



Contraband

Genuine tobacco products that are produced for lawful distribution in their market of intended destination but illegally diverted into a different market.



Illicit whites

Tobacco products that are generally legally produced in a market and which are smuggled into another market where they have limited or no legal distribution.

FAKE

Counterfeit

Tobacco products that have been manufactured without the permission of the trademark rights holder.



Under declaration

Tobacco products that are produced and distributed in the same country, a portion of which is not declared to the domestic tax authorities.



Smuggling is a much more diffuse and difficult criminal activity to tackle – and this is where many criminals have found safe haven. Cross-border smuggling, by definition, introduces jurisdictional challenges. The capacity to operate beyond national borders is an important advantage for organized criminal groups, which can quickly change their modus operandi or trafficking routes.

– Marc Firestone, President External Affairs & General Counsel – U.S. Congressional hearing, July 2017

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

We are committed to ensuring that our products are sold legally in the markets for which they are intended. Collaboration and market-responsible actions, such as tracking and tracing or volume monitoring, are key to fighting the diversion of our 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.

Under the guidance of our Anti-Diversion Governance Committee, we continuously refine our Principles & Practices to ensure our tools are applied systematically across PMI.²⁵

In 2017, we also adopted a risk-based approach and classified markets into risk categories to focus our resources and controls where they are most needed. Our updated Know Your Customer policy includes mandatory actions for markets exposed to higher risk of product diversion, such as yearly customer due diligence and monthly volume monitoring, or an assessment of tracking and tracing controls. For example, our affiliate in Ukraine introduced the monitoring of retailer purchases for specific brands and compared volume requested versus market-specific dynamics, ensuring that deliveries of our brands are continuously assessed.

Tracking and tracing keeps track of product shipments. It helps determine where products have been diverted from their legitimate supply chain. In our business environment, we deploy tracking and tracing at the master case (10,000 cigarettes, 500 packs), carton (200 cigarettes, 10 packs) and pack levels.

Further details can be found in our Anti-Diversion Governance Committee Progress and Outlook Report 2016-2017.²⁶

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

Tracking



Tracing

Support for regulation and public-private partnerships to stop illicit trade

PMI welcomes regulation and partnerships to help address illicit trade. Over the years, our supply chain controls have been improved through cooperation with regulators and governmental agencies with whom we have specific commitments and obligations.

In addition to supporting the ratification of the World Health Organization's Framework Convention for Tobacco Control (FCTC) Protocol to Eliminate Illicit Trade in Tobacco Products, we also support regulations which extend beyond national borders covering regional organizations such as 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.

PMI remains committed to anti-diversion practices through bilateral cooperation agreements with governments and local customs authorities in the form of Memoranda of Understanding (MoU). These MoUs have resulted in the continued exchange of information and technical training for law enforcement officers. In 2017, PMI signed 10 MoUs, bringing the total to more than 50 MoUs, with governments in 48 countries.²⁷

Thanks to the framework set by our MoUs and the exchange of information with authorities, 76 illegal factories producing counterfeit PMI brands were dismantled in 2017 by law enforcement agencies, of which 48 were based in Poland. We estimate that in Poland alone we helped to avoid the sale of four billion counterfeit cigarettes. Had the illegal factories not been dismantled, the estimated tax loss in the EU markets would have been around EUR 1 billion.²⁸



The key to combating illicit trade is sharing information between different agencies, whether they be border guards, coast guards, police, customs, security services or tobacco manufacturers.

– Howard Pugh, Europol – Stopillegal, January 2017

Investment in research, training, and education to raise awareness and tackle the issue

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

To gain a better understanding of the size, nature, trends, and actors typifying the illicit tobacco trade, PMI applies a research methodology based on the collection of empty cigarette packs (Empty Pack Survey or EPS).

In 2017, Empty Pack Surveys were conducted in 79 countries. In total, 117 surveys were commissioned to external parties, around 70% thereof with other tobacco manufacturers.²⁹

Maghreb report 2016

In 2017, for the first time, we studied the illicit tobacco trends in the Maghreb region in cooperation with KPMG. In addition to KPMG's proprietary analysis of the magnitude of the illicit tobacco trade, the report also includes a more

qualitative analysis by the Royal United Services Institute for Defense Studies (RUSI), which highlighted the dynamics behind the illicit trade in cigarettes and other diverted products in this region.



Raising awareness among the general public

Accessible and transparent communication on the illicit trade of tobacco products is key for PMI. In 2017, we launched stopillegal.com. The objective of this site is to inform the general public on the magnitude of illicit trade, its drivers and consequences, as well as to share PMI's Principles & Practices on this issue.

Education and training to authenticate PMI legal products

PMI works with law enforcement agencies in countries worldwide, investing in education and technical training as another key part of our anti-illicit strategy. In 2017, we trained more than 700 members of law enforcement agencies in 15 countries on how to differentiate between counterfeit and authentic packs of PMI cigarettes.

PMI IMPACT: Combating illegal trade together

Launched in 2016, PMI IMPACT is the first-of-its-kind global funding initiative to support public, private, and non-governmental organizations in implementing effective solutions against illegal trade and related crimes. PMI has committed USD 100 million for this program. In the initiative's

first round, a total of 32 projects from 18 countries was selected. The implementation of all these projects is now underway and will be reported upon at www.PMI-Impact.com.

The second funding round of PMI IMPACT, which opened in September 2017, called for projects that address different forms of illegal trade and

related crimes, such as money laundering, corruption, and organized crime. PMI IMPACT has received 157 applications across 56 countries globally, which are currently being assessed by an independent Expert Council.

Our performance: Tackling illicit tobacco trade	2015	2016	2017	2018 goal
Keeping full coverage for tracking and tracing – master case level ¹	100%	100%	100%	100%
Tracking and tracing – % of sold packs with unique code applied	53%	67%	75%	85%
Extending Memoranda of Understanding (MoU) with law enforcement agencies/governments – number of countries	6 additional	5 additional inclusive of SELEC (11 countries)	10 additional	5 additional
Regional studies and country analysis to improve awareness of illicit trade – % of global cigarette consumption covered	25%	25%	25%	27%
Training for law enforcement agencies to monitor diversion of PMI products – number of law enforcement officers trained	507 across 15 countries	2,176 across 14 countries	717 across 15 countries	At least 500 across 10 countries
Number of views on stopillegal.com ('000) ²	n/a	n/a	18	90

- 1 Full coverage equates to 95% tracking and tracing in our supply chain (excluding Kretek business). 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.
- 2 Data for period July 16, 2017 – December 31, 2017 (the website was launched in 2017).



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

Responsible supply chain

Our business has a significant, global supply chain organized by five main categories. We have a large agricultural supply chain, ranging from tobacco growers – in both developed and developing countries – to producers of other agricultural products, such as clove, menthol and guar gum. Another part of the supply chain consists of manufacturers of direct materials used to produce cigarettes and other tobacco products, such as acetate tow (for cigarette filters) and paper (both cigarette paper and packaging materials). Key to our business are also the manufacturers of machines for our cigarette and heated tobacco products factories, a highly specialized industry. A recently added part of our supply chain consists of the manufacturers of electronic devices for heated tobacco products and e-cigarettes. Finally, we work with thousands of suppliers of goods and services that are not specific to the tobacco business, but essential for any business, such as office equipment, company cars, and consultancy.

As a responsible business, we want to understand and continuously address potential sustainability issues in our global supply chain, ranging from environmental impacts to labor abuses or corruption. We are working with business partners to proactively identify, manage, and reduce risks, and create shared value. We see this as a fundamental part of upholding our commitment to sustainability and, in particular, to the UN Guiding Principles on Business and Human Rights.

Responsible Sourcing Principles (RSP)

Initially, in the wake of stakeholder concerns, we focused on addressing labor and other risks in the places where we source tobacco. In 2011, we developed the Agricultural Labor Practices (ALP) program – a key pillar of our broader Good Agricultural Practices (GAP) program – with the help of Verité, a leading not-for-profit organization specializing in labor and human rights issues.³⁰ This program has been rolled out globally: Every farmer with whom PMI or our leaf suppliers have a direct contract has a contractual obligation to implement the ALP program.

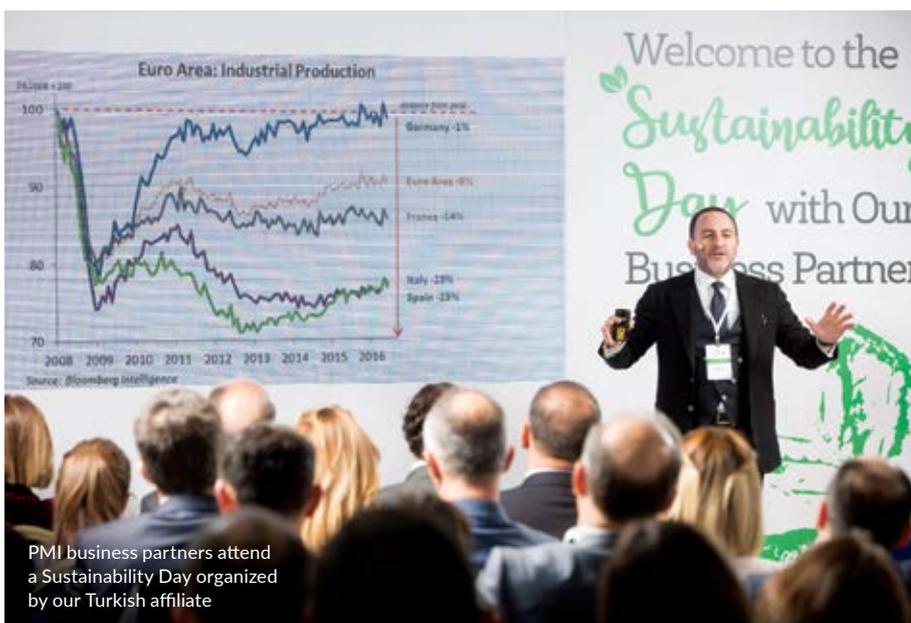
In 2017, we released our Responsible Sourcing Principles³¹ and Implementation Guidelines, which established the foundation for a more comprehensive and systematic approach to addressing supply chain sustainability beyond our agricultural supply chain. The RSP provides PMI's expectations in the areas of human rights and labor rights, the environment, and business integrity, and applies to all suppliers doing business with PMI, except for tobacco farmers, who must follow our GAP/ALP program. The RSP program was developed in consultation with external stakeholders, who are experts on human rights and sustainability, and with a selected group of key suppliers.

Ensuring our Responsible Sourcing Program starts on the right foot

In 2017, we started to roll out the RSP, communicating directly with global partners covering 99% of our total spend on global vendors by December 2017. We also engaged with a number of suppliers to clarify questions related mainly to the implementation of these principles.

We launched the RSP in three of our five regional procurement clusters, starting with Sustainability and RSP Awareness sessions with regional and country procurement management, followed by the development of comprehensive supplier communication plans. During 2017, we translated the RSP into 13 languages to accommodate local requirements.

To further foster engagement with supply chain partners, we regularly reach out to groups of suppliers to discuss topics that are of common interest, and sustainability is now firmly on the agenda of these events. For example, with our Turkish affiliate we organized a supplier sustainability day with the participation of the managing director and senior management. The coverage of the workshop represented over 60% of our direct and indirect procurement spent in the country.



It was a great pleasure for me to meet with you and your colleagues at such a meaningful seminar. I honestly believe and see that both companies, PMI and BillerudKorsnas, are in the same lane to achieve sustainability targets and it is very nice to see both companies are having full focus on this critical and responsive issue.

– A workshop participant

PMI business partners attend a Sustainability Day organized by our Turkish affiliate

Governance

During 2017, we strengthened our governance model. In addition to the existing Supply Chain Sustainability Coordinators for Global Suppliers, we extended the network to include regional Sustainability Coordinators in each of our five procurement clusters. We also increased operational support for sustainability with dedicated resources at our European Service Center.

Organizational training

The integration of the RSP into our organization is fundamental to achieving buy-in and understanding. During 2017, a comprehensive e-learning was developed in consultation with external experts in human rights, the environment, and business integrity. We plan to roll out the e-learning in 2018 to various target groups worldwide. Our objective is to train procurement personnel as well as other relevant functions within our company.

Conflict minerals due diligence

During 2017, we continued to strengthen 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 adjoining countries. We included Conflict Minerals as one of the principles in our RSP.³¹ We communicated to both EMS suppliers for IQOS about our expectation that they should increasingly source minerals from smelters or refiners that are certified as “conflict free” by available third-party sources.³²

Managing risk as we develop our electronics supply chain

We are increasingly expanding a new and complex supply chain that includes electronics manufacturing. Electronics suppliers are new partners to PMI and are often in geographies where we have not previously done significant procurement of direct materials (mainly China and Southeast Asia) and where human rights issues have been flagged. 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 tier 2 suppliers and below.

Our focus so far has been on our main smoke-free product IQOS. In 2016, PMI worked with Verité to carry out a comprehensive assessment of the labor management systems, starting with one of our electronics manufacturing services (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 migrant workers, who make up a significant percentage of the supplier’s labor force. During 2017, PMI and Verité worked together with the EMS supplier to address the gaps that had been identified. In addition to regular reporting, the assessment team conducted a further on-site visit to discuss and validate the improvement measures; the supplier has made progress in addressing the gaps and topics like recruitment fees, and working conditions have been addressed.

In addition, we started to map out the IQOS supply chain to identify human rights risks down to third-tier suppliers. We have now identified the suppliers with the highest inherent risk, and during 2018 we will start to work towards getting a better understanding of these suppliers and how to manage risks.

We also took 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. Subsequently, we also conducted a full sustainability review, led by Verité, of the selected supplier to gain a more in-depth understanding of its status and seek alignment with our RSP early on. The results of the review showed that the supplier was very well aligned with our RSP, and minor gaps identified are being addressed.

Good Agricultural Practices (GAP)

We source around 90% of our tobacco through direct contracts with over 350,000 tobacco farmers in 28 countries worldwide. PMI has direct contracts with 23,000 of these farmers. The other 332,000 have direct contracts with over 20 third-party suppliers with whom PMI has direct contractual relationships. Around 2,800 trained agronomists, employed by PMI and our suppliers, provide support to contracted farmers throughout the tobacco-growing season to improve overall conditions and production, visiting farms regularly throughout the crop season.

Direct contracting is critical to enable us and our tobacco suppliers to work collaboratively with farmers and to drive the systematic implementation and monitoring of our standards. It also benefits 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 provides better assurance that there is a buyer for the crop;
- Farmers can access crop inputs, such as seeds, at a lower cost than market price;
- Removing middlemen reduces transportation costs or other non value-added fees charged to farmers; and
- The contract can be used by the farmer as collateral for credit or other financing arrangements.

Since 2016, we have assessed conformity of our tobacco leaf suppliers, as well as of our own tobacco leaf operations, to our GAP standards through the industry-wide Sustainable Tobacco Program (STP) that is independently managed by AB Sustain, an independent supply chain management company, and includes:³³

- Annual self-assessments performed by tobacco suppliers via the online STP portal and reviewed by AB Sustain; and
- On-site reviews conducted by AB Sustain auditors with visits to a sample of contracted farmers, as well as a thorough review of tobacco suppliers' policies, procedures, and documentation demonstrating the level of STP implementation. One of the outcomes of the formal assessment is an independent performance rating against all STP criteria.

In 2017, on-site reviews were conducted in eight countries, making a total of 16 countries reviewed over two years.

Our GAP program focuses on three areas, with mandatory implementation for all tobacco farmers with whom PMI or our leaf suppliers have direct contracts:

1. Improving working conditions on the farm (see pages 48-53)

The Agricultural Labor Practices (ALP) program focuses on promoting and monitoring good labor practices, including health and safety conditions, terms of employment, and preventing and eliminating child and other labor abuses.

2. Minimizing the impact of tobacco farming on the environment (see pages 56-60)

GAP promotes environmentally sustainable practices, including curing barn improvements, the use of more sustainable tobacco-curing fuel sources to reduce greenhouse gas emissions, the elimination of highly hazardous Crop Protective Agents (CPA), the promotion of bio-pesticides and the overall reduction of CPA use, biodiversity management and reforestation, as well as water, soil, and waste management.

3. Making tobacco farming more profitable

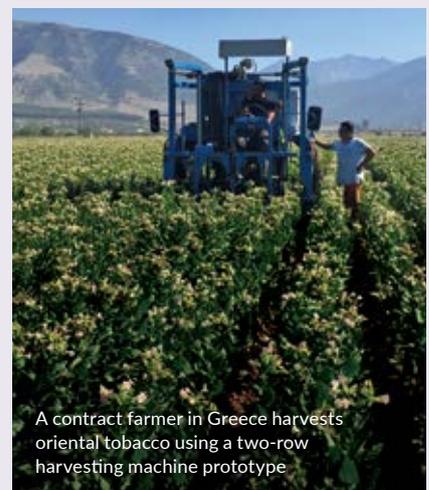
Tobacco is a valuable crop that helps strengthen food security and nutrition and allows farmers to generate significant income, particularly in the case of smallholder farms. Promoting practices and technologies to improve farmers' yields and crop quality, and to reduce labor requirements, leads to a higher income for the farmer. It also frees up land for alternative crops, thereby helping to create an additional source of income. Our program also includes assistance to farmers in growing these alternative crops.

Reducing hardship at work and improving efficiency in Greece

Tobacco growing is labor intensive. As such, efficiency improvements are crucial for optimal production. Initiatives to reduce the number of working hours required to grow the crop range from mechanization, curing preparation, to packing simplification. 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, labor scarcity and an aging farmer population in Greece are concerns for long-term sustainable tobacco production. PMI initiated a project to find a less-labor-intensive

method for harvesting oriental tobacco, which represents around 45-50% of total labor requirements in tobacco harvesting in Greece. In previous years, different prototypes of harvesting machines were tested, and in 2017, working with tobacco suppliers, we tested two row-harvesting machine prototypes in Greece operating on 40 hectares of a land. The feedback from both tobacco suppliers and their contracted farmers has been positive. In addition to increasing harvesting efficiency, we see mechanized harvesting of oriental tobacco as a way to mitigate labor-related issues, such as child labor.



A contract farmer in Greece harvests oriental tobacco using a two-row harvesting machine prototype



A tobacco farm worker in Nayarit, Mexico

Our performance: Agricultural supply chain ¹	2015	2016	2017	Goal
Tobacco purchased through direct contract by our leaf operations or our tobacco suppliers (%)	88	88	90	>90
Number of tobacco supplier locations (countries) assessed by AB Sustain	n/a	8 (22% of purchased tobacco)	8 (33% of purchased tobacco)	Every tobacco supplier every three years
Systematic monitoring of labor practices (% coverage) ^{2,3}	32.5	72.0	77.0	100
Cumulative number of tobacco supplier locations (countries) assessed by Control Union since 2013 (ALP topics) ³	13	15	19	24 countries by 2020
Number of contracted farms in the scope of Control Union assessments per year (ALP topics) ^{3,4}	11,043	7,508	6,433	

1 Data relate to our total tobacco supply chain, except when explicitly mentioned in footnotes.

2 Data relate to crop season, which may span over more than one calendar year.

3 Data cover approximately 90% of our sourced tobacco.

4 According to our methodology, these assessments cover different countries and tobacco suppliers every year. Depending on the geography and typical farm size in different countries, the number of farms covered by the assessments will vary. The variation in the number of farms assessed over the last three years does therefore not reflect a reduction in the scope of the assessments.