Philip Morris ČR a.s.

2018 Business Results as Presented at The Annual General Meeting With Shareholders Held on April 26, 2019

May 13, 2019

Árpád Könye (Chairman of the Board of Directors)

Ladies and Gentlemen, welcome to our Conference Call with analysts of Philip Morris CR a.s.

I wish to review our results in 2 parts:

1. Our Business Performance,
2. Our progress with our Reduced Risk Products

We continued to have a very robust performance in 2018 with our net revenues up by 16.2% versus the prior year on the back of favorable pricing of our combustible portfolio and growing sales of *HEETS* and *IQOS*.

Our operating income was up by 9.5% mostly due to favorable pricing on combustible products and Earnings per share are up by 9.1% - slightly lower growth versus Operating Income due to higher income tax expenses.

Our results in the Czech Republic

Our combined market share was down by 0.7 ppts, where our cigarette portfolio decline was driven by competitive price increase lagging, but significantly compensated by higher revenues, income and *HEETS* share reaching 2.6%. The 2.6% is a national average for 2018 but as we've focused on big cities, our share was also more favorable, reaching 10% in Prague for instance by the end of 2018.

We've had a combined shipment volume of 82 mio less versus 2017, driven by our conventional portfolio, whereas *HEETS* have grown by 460 mio from 72 mio in 2017 to 532 mio in 2018. The majority of the conventional decline was due to cannibalization of *HEETS* of our own conventional brands as well as loss of share to competition due to competitive price lagging.

As I've mentioned, our income was boosted mostly by combustible cigarette price increases and in 2018 we increased by another CZK 4 per pack of 20 cigarettes. This was more than CZK 2 / pack above the excise tax pass-on impact.

As we did not have excise tax enacted yet on *HEETS*, we kept pricing at the introductory level of CZK 100 for 20s and CZK 900 for the bundle of 10 packs in our own retail, representing a 10% discount for the consumer. In other retail outlets this represents recommended retail selling prices.

The 2016-18 excise tax roadmap has expired with no excise increase in 2019. We are awaiting a new 3 or 4 year excise tax road map starting on the 1st of January, 2021. Currently the government has put forward a proposal with a significant increase – from CZK 12 – 14 / 20s pass-on as of January 1, 2020 as a one-year tax plan. We are eagerly awaiting what support it will have in the Parliament.

Important thing is that as of April 1, this year, the Heated tobacco products are taxed on the principle of “lower tax for lower risk”, thus the government is demonstrating full support for harm reduction.

Illicit trade in the Czech Republic has been almost negligible for the past number of years at just above 3%. However, it has jumped quite significantly over the past year – essentially doubling. Most of the illicit trade come from Ukraine and Belarus due to increased smuggling and increasing number of foreign workers on the back of increased working visa quotas. There is an estimated 500,000 foreign workers in the Czech Republic, which naturally brings cross-border legal as well as illegal trafficking of cigarettes.

Whereas this trend contributes to a positive impact on the official cigarette market size, it is worrying when we look forward to an excise tax driven price increase of more than 13% as of next January.

Performance in Slovakia

We have managed to grow our share positively by 1.6 ppts on the back of *HEETS* predominantly, which reached 3.7% share for 2018, growing by 3.3 ppts versus 2017.

In contrast, cigarettes declined by 1.7 ppts mostly due to cannibalization from *HEETS*.

Our 2018 combined volume was up by 154 mio in 2018 driven by *HEETS* which was up by 238 mio from 32 mio in 2017 to 270 mio in 2018. The decline of 84 mio in conventional volume is due to cannibalization of *HEETS* of our own portfolio of brands.

We have continued to lead pricing in 2017 and 2018 with separate increases of 10 Euro cents per pack of 20 cigarettes, in each year, whereas we have kept the price of *HEETS* flat at 3.5 Euro per pack. This increase was precipitated for the excise tax increase of 8 Euro cents per pack as of February 1, 2019.

With the current excise tax roadmap expiring this year, we are awaiting a new 3 or 4 year plan with effective date starting as of February 1, 2021.

Now let’s have a look at our Reduced Risk Product performance in the Czech and Slovak Republics.

During 2018 we have registered 165,000 new converted users in the Czech Republic, for a total of 226,000 registered users and 81,000 new converted users in Slovakia for a total of 111,000 registered users.

These conversions come from various channels from e-commerce, *IQOS* shops or independent tobacconists, but the vast majority came from our B2C field-force where we’ve engaged over 400 temporary & contracted agents.

In 2019 and onwards we expect to further expand both our footprint as well as the consumer experience we offer in our Direct Retail network.

In the Czech Republic, *HEETS* are now available in more than 8,100 points of sales and *IQOS* devices in 550 tobacconists. More importantly, 4,600 retail staff or 52% of smokers were converted to *IQOS* in 2018. These retailers are our biggest ambassadors to convert their smoker clientel to *IQOS*.

In Slovakia, *HEETS* are now available in more than 5,400 points of sales and *IQOS* devices in 300 tobacconists. More importantly, 1,000 retail staff were converted to *IQOS*, who equally have become active *IQOS* ambassadors

We have consistently very high success rate of conversion of consumers who decide to make a switch from cigarettes to *IQOS*. 73% in Czech Republic and 76% in Slovakia are converted from those who switch with 19-22% in the journey to full conversion. Only 5% of those who purchase *IQOS* decide to abandon the conversion and stay with cigarettes. These are very comforting numbers demonstrating a huge vote of confidence from the consumers on *IQOS*, *HEETS* and the proposition of an alternative, better choice product to cigarettes.

Distribution model

For Combustible products, PM CR a.s. acts as entrepreneur for both Czech and Slovak Republics. As Entrepreneur we bare all risks associated with the sales of these products.

PM Slovakia acts as limited risk distributor for combustible products based on a distribution agreement signed with PM CR a.s.

On the front of Reduced Risk Products, the entrepreneur is PMP SA, a swiss based PMI Inc subsidiary.

Both PM CR a.s. and PM Slovakia s.r.o. have signed separate distribution agreements with PMP SA based on which they distribute RRPs in the respective countries.

The Enterpreneur bears full risks, investment & costs related to the Research and Development of the product, has the ownership of intellectual property rights as well as takes the hit of absorbing of all costs associated with such ownership

The Limited risk distributor is guaranteed margin. This margin is remuneration for commercialization on revenues from sale. The return is proportionate to the risk for the distributor – that is why it’s called a “limited risk distributor” and this risk is significantly lower versus the Entrepreneur. Hence the margin is also significantly lower in this business model and this pricing methodology is fully compliant with generally accepted arm´s length principles. So, in short: Lower Risk equals Lower Control resulting in significantly Lower Profit

We have outlined this in our Annual Report as well as follows:

Our profitability, and consequently, the amount of our dividend payout reflects our dual role of being a full risk entrepreneur of combustible portfolio products and a limited risk distributor for reduced-risk products.

Our remuneration for commercialization of reduced risk products is based on a set margin on revenues from sales. As a limited risk distributor, we do not own intellectual property rights for reduced-risk products and therefore do not absorb all the costs or bear the risks associated with such ownership. As our return is proportionate to our risk for commercializing reduced-risk products, the impact of the sales volume variances of such products on our profitability is limited.

Consequently, if over the longer-term the current adult consumer preference for reduced-risk products continues while the decline of combustible product accelerates and is not compensated for by any additional pricing that we implement, we do not expect that over time the additional profit generated from increased sales of reduced-risk products will necessarily fully offset the decreasing profits generated from the sales of combustible portfolio products.

So what does all that mean for us going forward? First it is imperative that we acknowledge that there is a sustainability issue at hand.

On the one hand, there is a real call for reducing demand for combustible tobacco. Smoking related diseases are perceived by the WHO as “the biggest public health threat the world has ever faced”. Subsequently, there is a constantly increasing call from international institutions such as the WHO or the UN to implement stringent regulations on the supply and demand of tobacco products.

On the other hand, there is an increasing demand for smokeless products. There is a growing consensus among experts and public health officials about the positive role of reduced-risk nicotine products such as e-cigarettes and heated tobacco products. This tobacco harm-reduction approach should lead into future differentiated regulatory and fiscal frameworks encouraging consumers to switch from cigarettes to reduced-risk alternatives. We see endorsement of this trend on both the global and local levels. Here in the Czech Republic the excise tax levels for heated tobacco products are set significantly lower than cigarettes due to their significantly lower health risk. With public endorsement we have a stronger call for legal age smokers to switch and I am pleased to state that the results of our *IQOS* commercialization in both the Czech and Slovak Republics demonstrably prove this increasing consumer demand for better alternatives.

Taking the direction towards a smoke-free future is not only a great opportunity for us globally, it is the only opportunity we have. PMI has invested USD 6 bio into the development and scientific assessment of our smokeless product portfolio, with the global focus on developing reduced risk products that represent a satisfactory alternative for adult cigarette smokers. The smoke-free world is happening – weather consumers, decision-makers, Tobacco Control Activists, Financial Analysts, or competitors agree with or not. It is a fact! There are only two questions:

First - how fast will the shift take from combustible cigarettes to smoke-free alternatives?

Second - who are the industry players to make it happen?

And, believe me… There is no other way how to maintain our strong business in CZ and SK longterm than strategically focusing on smokeless products based on the public health experts’ endorsement and consumers’ increasing demand for them! We capitalize on PMI’s investments in research and development as well as massive scientific assessment. To support the growth of this new category, we will transition the company, over time, to align resources from our cigarette business to our smoke-free business. The transition will take time and depends not only on our efforts but also on whether other stakeholders embrace the public health opportunity these products offer. Our smoke-free business is new and requires a new and complex commercialization, heavy investment and is resource intensive to reach critical mass, swiftly and effectively. As we move forward, this has changed our manufacturing, sales, marketing, including our own local business model.

Smoke-free products are not only the right thing to do for smokers and society, but they also make solid business sense as the only alternative solution for our company, our employees and our investors, all of you as our shareholders.

Is there an alternative business model where we are the entrepreneur? Quite simply - NO! The cost of investment is simply prohibitive, R&D, scientific programs, device development, etc. – impossible to conceive the magnitude of resources it would require. So, the smartest thing to do is to be the limited risk distributor and the first mover in our markets to establish ourselves as the category owners.

Will this result in lower profit? Yes it will – for the foreseeable future. Instead of outstanding dividends, it will yield strong, respectable dividends. AND – it will yield these on the long-term, sustainably, where we can confidently grow our market share with increased pricing power. I would have difficulty making these claims if we only relied on our declining cigarette business in a declining industry without a future perspective. So, yes our business is bright, however in a transitional phase.

Q&A session

1. Can you provide detailed information about business model of *IQOS*/*HEETS* – margins, etc.?

   For combustible portfolio, we act as an entrepreneur with full risk & rewards profile.

   For reduced risk products, and as we did not develop and would not be able the finance such development of the platforms, including clinical studies, we had to enter into a distribution agreement with Philip Morris Products S.A.

   Consequently, we receive a distribution margin, which is – considering the risk profile of such arrangement to Philip Morris CR a.s. – materially lower.

   Nonetheless, the margin earned on sales of RRPs is in line with industry benchmarks for such arrangements that were used across comparable industries.

2. The actual business model of *IQOS*/*HEETS* – will it change after some period of time? After you finish introducing it on the market?

   We don't foresee any changes to the distribution agreement at this point in time. We are building the business and for the time being this is the model that we operate on and we have nothing to state otherwise.

3. What are your expectations about future sales of *HEETS*? What is your target market share in 2019 / in longer-term?

   It is our policy not to publish forecasts and estimates as to the future results but we can certainly confirm that we are here with our long term commitment to stand by and to realize a smoke-free future as quickly as possible and this is the clear focal point of our business so the vision of our company in Czech Republic and Slovak Republic as well.

4. Taxation of HNB products: Will the new excise tax on HNB products impact your margin or is it just a pass-through cost for PMCR?

   It's a pass-through cost. Our compensation – as distributor for RRPs – is set on the basis of a margin from revenues from sales, net of excise taxes.

5. Planned increase in excise taxes in the CR from 2020: I calculate that a 10% increase in taxes would lead to CZK 6-7/pack increase. Representatives of tobacco companies reportedly claim

it would be CZK 10-12/pack. Can you elaborate on that? Do you expect to pass on most of the increase on to customers or do you expect impact on your margin?

The current proposal as shared by the Ministry of Finance for public consultation could possibly lead into an estimated retail selling prices increase in the range of CZK 11-13 per pack of 20 cigarettes to remain margin neutral for producers as well as distributors.

And whereas we cannot comment on the future in-market price developments as it entails a significant number of factors, including those which are beyond our control and influence. But in general, it's our strategy to pass the excise tax increase fully onto the consumer.

6. Volumes: What % decline of the tobacco market and what % decline for your shipments would you expect in the case of 10% excise tax increase in the CR?

   Such an increase in excise taxes will certainly have a sizable impact – decline – in the industry size to the benefit of illicit trade and other cheaper tobacco and nicotine alternatives, including fine cut tobacco as well.

   We do not want to speculate with regards to the size of the impact as we lack sufficient comparable experience in the Czech Republic in similar circumstances.

7. Dividend policy: Do you expect to stick to more or less 100% dividend payout ratio in future or do you expect lower payout due to investments in e.g. working capital or higher payout to optimize you overcapitalized balance sheet?

   We cannot comment on the actual payout ratio, however – in general – shareholder return is one of the main focal points of our business strategy.

8. HNB products: What level of cannibalization do you expect from HNB's in the next two to three years? What was the net EBITDA impact from HNB sales in 2018 (i.e. positive distribution margin less the cannibalization effect)?

   The growth of HEETS is more than half coming from cannibalisation of our combustible portfolio.

   We do not provide estimates and forecasts as to our future performance expectations.

9. Do you plan to invest in HNB production in foreseeable future (say in 3 years)?

   As mentioned by some members of the board in their prior public appearances, we would very much welcome production of HEETS in our Kutna Hora factory in future under the manufacturing services agreement. At present, there are no such discussions taking place or we are not aware of such discussion.

10. Do you still see a room for higher revenues from manufacturing services? What is your spare production capacity for exports?

    Higher revenues from manufacturing services would require additional capacity-related investments. Our Kutna Hora factory is flexible and able to accommodate more combustible products' production or the start-up of HEETS production upon the decision of Philip Morris International. We don't have any preview to such discussions.

11. OPEX: Do you plan to increase number of employees? Can you see a pressure on wages in Kutna Hora, should we expect margin decline due to growing OPEX in 2019?

    The current employment in the factory is at optimal level. With the expansion of either production and/or growth of our RRP business, we have to adjust our people resources to support our future growth.

    We continuously follow market surveys with our objective to always remain competitive in our compensation to our employees.

12. CAPEX: Apart from potential HNB production, do you have any investment plans on top of standard maintenance CAPEX in 2019?

    There are no such major capital investments discussed by the board of directors at present.

13. How does the cash generation of the business changes as the company sells more heat-not-burn products?

    Both, combustible and RRP businesses operate – in terms of profit-to-cash conversion, or cash generation – in a very similar way, therefore there's no material change with expansion of heat-not-burn products.

14. What investment are you having to make in marketing these products.

    The majority of the incremental investments behind RRPs in 2018 were linked to conversion of legal age smokers to IQOS by so called IQOS coaches (the 400+ agents that I have mentioned before in my review) combined with increased visibility and engagement activities with legal age smokers at the traditional point of sales of tobacco products. As a result the expenditures have increased by more than CZK 1 bio. from 2017 to 2018.

15. What's going on with working capital and where it should normalise at? What levels of inventory do you think you need to hold?

    If you're referring to the material increase of receivables and decrease in cash on hand at the end of 2018, these were linked to suspension of receivables' factoring as we tried to minimise the year-end cash balance to avoid incremental costs that bank charges to their clients due to mandatory bank & financial stability programme. Individual banks' contribution is established based on the amount of deposits the bank holds at year-end.

    As of the inventories increase (2018 vs. 2017), we can expect these to continue to increase in the coming years as we continue to expand RRP, although likely at a slower pace we witnessed in 2018. The exact rate of increase is however difficult to forecast at this point in time.

16. What is the average increase in prices for this year, is it similar as last year CZK 2/pack or is it different?

    This year we had no tax increase so as a result we had no forced price increase and as it is our policy that we do not talk about pricing and we have to always follow the general situation on the market.

17. Incremental ROE of the new business - what is the final incremental investment, total capital employed and total likely profitability. How different or similar the incremental profitability as a whole is likely to be for the RRP related lower risk business from PMCR´s point of view.

    As it was mentioned the business model for the distribution of the combustible business in the Czech Republic as well as the RRPs are from the capital employed point of view very similar and we have a third line of business that is the manufacturing services which we also touch upon so it is very difficult to give you an exact forecast and we do not have them on hand unfortunately either.

18. How different in magnitude the overall profitability, ROE, ROCE on incremental basis might be the RRP business?

    As we convert more users to the reduced-risk alternative obviously there is going to be significantly lower return from the business but as to the magnitude for the coming quarter or year it is very difficult to predict, basically it involves a lot of factors like how quickly we can convert adult smokers to the RRPs and what kind of pricing power we can effectively exercise in market and I would not like to speculate at this point in time about the results. As we said as a limited risk distributor we have significantly lower risk associated with this new business venture and the entrepreneur PMP SA bears all the risks, all the investments and all liabilities so the remuneration that we get from commercializing the RRPs in the Czech and Slovak Republics are proportionate with that risk level which is significantly lower.

19. What is the proportion of marketing costs on revenues from RRPs.

    We are not able to give you the exact number as we do not track the segment of RRPs separately we track the overall marketing and distribution expenses for the total business because the resources are often shared. You can see the overall increase in the consolidated financial statements. The vast majority of the increase which we have witnessed from 2017 to 2018 of over CZK 1 bio. is associated with the commercialization of IQOS.

20. Is the number of CZK 1 bio. plus sustainable?

    We are building the business so we expect a robust growth obviously in a vision of realizing a smoke-free future so with the growth we expect to extend our support and activities so we expect the costs will also increase in future as well.