

# Report of the Board of Directors for the year ended December 31, 2022

Philip Morris ČR a.s., an affiliate of Philip Morris International Inc. ("PMI"), is the largest manufacturer and marketer of tobacco products in the Czech Republic, providing adult smokers with popular international and local brands such as *Marlboro*, *L&M*, *Chesterfield*, *Petra Klasik*, and *Sparta*. It is also a distributor of PMI's smoke-free tobacco products, *HEETS* with *IQOS* device, tobacco heating system, *TEREA* with *IQOS ILUMA* device, tobacco heating system, *IQOS VEEV* with *VEEV* pods, an e-vapor product, as well as the KT&G-licensed brands, *Fiit* with *lil SOLID* device, in the Czech Republic.

Philip Morris ČR a.s. holds a 99% interest in Philip Morris Slovakia s.r.o., registered in Slovakia, the largest distributor of cigarettes in Slovakia. Philip Morris Slovakia s.r.o. is also distributor of PMI's smoke-free tobacco products, *HEETS* with *IQOS* device, tobacco heating system, *TEREA* with *IQOS ILUMA* device, *IQOS VEEV* with *VEEV* pods, an e-vapor product, as well as the KT&G-licensed brands, *Fiit* with *lil SOLID* device, in Slovakia.

The report of the Board of Directors is based on the consolidated financial statements of Philip Morris ČR a.s. and Philip Morris Slovakia s.r.o., prepared in accordance with International Financial Reporting Standards as adopted by the European Union.

## Consolidated Financial Results

While our performance in 2022 was impacted from a challenging operating environment, including the war in Ukraine and supply-chain and global inflationary pressures, the high interest rate environment also allowed us to benefit from extraordinary cash pool remuneration to overall deliver a net income increase vis a vis 2021.

We enjoyed a continued growth of sales of reduced-risk products<sup>1</sup> thanks to the growing *IQOS* adult user base<sup>2</sup>. Our total *IQOS* adult users<sup>3</sup> in both countries combined, reached approximately 860 thousand, of which approximately 590 thousand adult users have switched to *IQOS* and stopped smoking.<sup>4</sup>

Consolidated revenues, net of excise tax and VAT, grew by 11.0 % or CZK 2.1 billion (vs. prior year) to CZK 20.9 billion. The growth was primarily driven by higher sales of heated tobacco units<sup>5</sup>, *IQOS* and *lil SOLID* devices, and favorable pricing on our combustible portfolio<sup>6</sup> (CZK 3.3 billion), partially offset by lower combustible portfolio volume (CZK 0.9 billion) and currency impact (CZK 0.3 billion). Excluding the impact of currency, consolidated revenues, net of excise tax and VAT, increased by 12.4 %.

Profit from operations of CZK 4.2 billion decreased by 2.8 % (vs. prior year) due to higher business investments also impacted by inflation. Excluding the impact of currency, profit from operations decreased by 1.4 %.

Finance income increased significantly by CZK 0.4 billion (vs. prior year) due to higher-cash pool remuneration given the current high interest rate environment.

Net income of CZK 3.6 billion increased by 3.4 % (vs. prior year), reflecting the items noted above.

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<sup>1</sup> Reduced-risk products ("RRPs") is the term we use to refer to products that present, are likely to present, or have the potential to present less risk of harm to smokers who switch to these products versus continuing smoking. RRP's are in various stages of development, scientific assessment, and commercialization. RRP's are smoke-free products that contain and/or generate far lower quantities of harmful and potentially harmful constituents than found in cigarette smoke.

<sup>2</sup> Sources: *IQOS* adult user panel, Philip Morris ČR a.s. and Philip Morris Slovakia s.r.o. internal estimates.

<sup>3</sup> Estimated number of *IQOS* adult users that used PMI heated tobacco products (*HEETS*, *TEREA* and *Fiit*) over the past seven days.

The above *IQOS* user metrics reflect Philip Morris estimates, which are based on consumer claims and sample-based statistical assessments with an average margin of error of +/-5% at a 95% Confidence Interval. The accuracy and reliability of *IQOS* user metrics may vary based on individual market maturity and availability of information.

<sup>4</sup> Estimated number of *IQOS* adult users, whose daily individual consumption of heated tobacco products represents the totality of their daily tobacco consumption in the past seven days, of which at least 70% are PMI heated tobacco products (*HEETS*, *TEREA* and *Fiit*).

<sup>5</sup> Heated tobacco units is the term we use to refer to heated tobacco consumables, which include *HEETS*, *TEREA*, as well as the KT&G' licensed brands, *Fiit*.

<sup>6</sup> Combustible portfolio includes cigarettes, cigarillos, tobacco for make-your-own cigarettes and volume tobacco for make-your-own cigarettes.

## Business in the Czech Republic

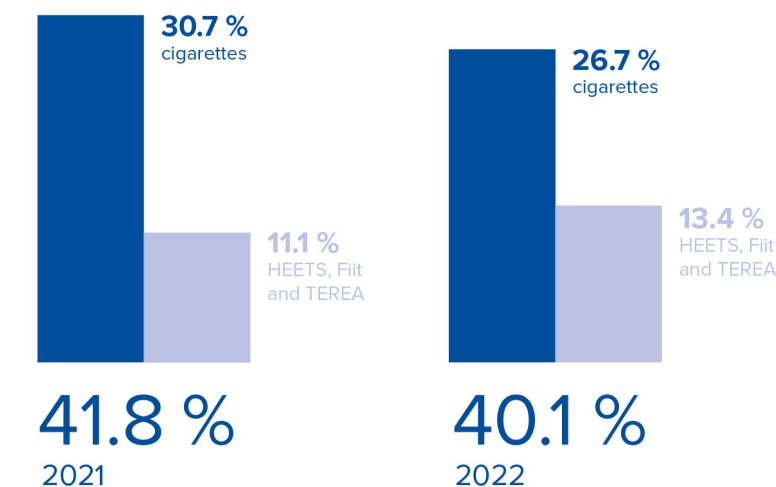
Philip Morris ČR a.s. revenues, net of excise tax and VAT, grew by 13.4 % to CZK 12.7 billion (vs. prior year). The growth was primarily driven by higher sales of heated tobacco units, *IQOS* and *lil SOLID* devices, and favorable pricing on our combustible portfolio (CZK 2.2 billion), partially offset by lower combustible portfolio volume (CZK 0.7 billion).

The *IQOS* adult user base<sup>7</sup> increased to around 570 thousand adult users.

The total combined market of cigarettes and heated tobacco units remained stable at 17.3 billion units (vs. prior year), reflecting the higher border sales compared to the same period in 2021 caused by COVID-19 anti-pandemic lockdowns measures in 2021 fully offset by decline in the domestic market. The total cigarette market has decreased by an estimated 4.9 % to 14.5 billion units primarily driven by switching to smoke-free alternatives and underlying decline in combustible consumption.

The estimated combined market share of Philip Morris ČR a.s. decreased by 1.7 share points (vs. prior year) to 40.1 %. On cigarettes the decrease of 4.0 share points is mainly driven by the switching to smoke-free alternatives, however also impacted by production constraints arising from the war in Ukraine, and the discontinuation of the *Philip Morris* brand and its merger into *Chesterfield*. On heated tobacco units, the growth of 2.3 share points reflects the consumer driven market dynamics to look for smoke-free alternatives.

## Market share in the Czech Republic (%)



Source: Philip Morris ČR, a.s. internal estimate based on a monthly tabulation of cigarette sales data by PwC

Combustible portfolio shipments (cigarettes and fine-cut tobacco, combined) of Philip Morris ČR a.s. decreased by 0.7 billion units (vs. prior year) to 4.8 billion units, reflecting lower market share, while our heated tobacco consumables shipments increased by 0.4 billion units and reached 2.3 billion units in the same period.

*IQOS VEEV* and *VEEV* pods, the electronic cigarette by *IQOS*, have had an immaterial impact on the financial results, albeit already demonstrating positive consumer feedback.

<sup>7</sup> Sources: *IQOS* adult user panel, Philip Morris ČR a.s. and Philip Morris Slovakia s.r.o. internal estimates.

# Business in Slovakia

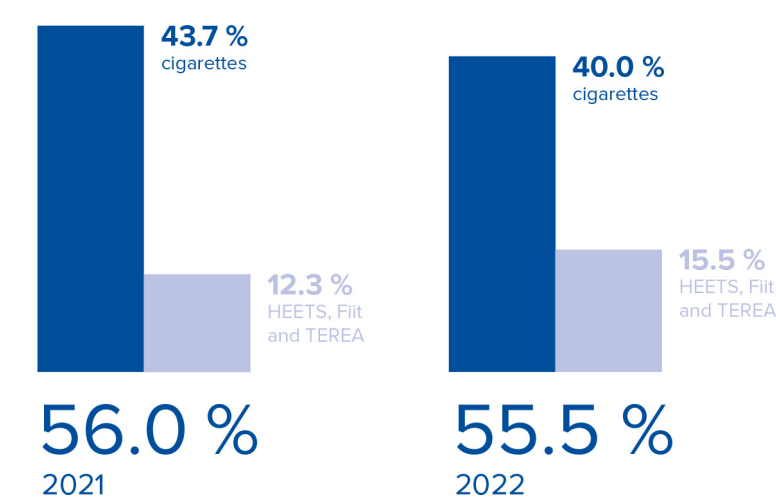
Philip Morris Slovakia s.r.o. revenues, net of excise tax and VAT, increased by 7.2 % (vs. prior year) to EUR 233 million. The growth was primarily driven by higher sales of heated tobacco units, *IQOS* and *ili SOLID* devices, and favorable pricing on our combustible portfolio (EUR 44 million), partially offset by lower combustible portfolio volume (EUR 6.8 million) and unfavorable pricing on heated tobacco units (EUR 4.5 million).

The *IQOS* adult user base<sup>8</sup> increased to an estimated 290 thousand adult users.

The total combined market of cigarettes and heated tobacco units has increased by an estimated 1.3% (vs. prior year) to 7.4 billion units. The total cigarette market has decreased by an estimated 3.2 % to 6.2 billion units primarily driven by switching to smoke-free alternatives and underlying decline in combustible consumption.

The combined market share of Philip Morris Slovakia s.r.o. decreased by 0.5 share points (vs. prior year) to 55.5 %, On cigarettes the decrease of 3.7 share points is mainly driven by the switching to smoke-free alternatives, and similarly to Philip Morris ČR a.s. also impacted by production constraints arising from the war in Ukraine. On heated tobacco units the growth of 3.2 share points reflects the consumer driven market dynamics to look for smoke-free alternatives.

## Market share in Slovakia (%)



Source: Philip Morris ČR, a.s. internal estimate based on a monthly tabulation of cigarette sales data by PwC

Newly launched *IQOS VEEV* and *VEEV* pods, the electronic cigarette by *IQOS*, have had an immaterial impact on the financial results, albeit already demonstrating initial positive consumer feedback.

Domestic combustible portfolio shipments of Philip Morris Slovakia s.r.o. slightly decreased by 0.2 billion units (vs. prior year) to 3.0 billion units, whereas heated tobacco consumables shipments increased by 0.2 billion units (vs. prior year) to 1.1 billion units.

<sup>8</sup> Sources: *IQOS* adult user panel, Philip Morris ČR a.s. and Philip Morris Slovakia s.r.o. internal estimates.

## Manufacturing Services

Revenues from manufacturing services increased by 8.4 % (vs. prior year) to CZK 2.4 billion mainly due to higher export production volume impacted by suspended PMI operation in Kharkiv.

## Impact of Russia's invasion of Ukraine

The war in Ukraine impacted Philip Morris ČR a.s. primarily in the first half of the year, but indirect effects continue to affect our operations.

The direct consequences include measures related to the suspension of production at one of PMI's plants in Kharkiv, Ukraine while the Kutná Hora plant took over part of its capacity. The increase in production volumes compensated for short-term production shortfalls caused by material supply problems and, thanks to a high degree of flexibility, we were able to achieve a record high full-year production overall.

In connection with conflict in Ukraine, our company provided material and financial humanitarian aid to the refugee assistance center in Kutná Hora. The funds, totaling CZK 6.7 million, were used to support the education and integration of Ukrainian refugees in the Czech Republic and were used to purchase burn treatment equipment for a hospital in Kharkiv.

However, in the context of the war in Ukraine, like other industrial companies, we are facing a sharp rise in energy and other inputs prices. Natural gas is Kutná Hora's main source of thermal energy and although energy prices were fixed for 2022, we expect them to increase significantly in 2023. Thus, we have invested over CZK 10 million in other energy sources. This should enable us to maintain continuity of production and will allow us to continually reduce the energy burden on our operations.

The war in Ukraine has affected the supply of products to the market. The aforementioned production disruptions, which affected not only our factory in Kutná Hora but also PMI's other production facilities, resulted in short-term unavailability of certain products on the market during Q1-Q3, totaling approximately 5 % of our cigarette shipments and 3 % of our heated tobacco shipments (some of which was also caused by the disruption of global trade chains due to measures related to the COVID-19 pandemic). Situation stabilized during Q4, and we are not observing further negative effects coming from Ukraine war in terms of supply.

While rapidly rising energy and other commodity prices have had and continue to have a significant impact on household purchasing power, we did not experience a significant impact on demand for our products during 2022, nor did our company face any significant employment issues as a result of the war in Ukraine. Similarly, there were no significant cyber security events or threat increases related to the Russia-Ukraine conflict.

## Excise Tax

In the Czech Republic, Act no. 609/2020 Coll. amending certain tax acts and certain other acts amended also Act no. 353/2003 Coll on excise taxes. This amendment came into force on February 1, 2021. This amendment introduced a three-year calendar of tobacco excise tax increases for years 2021 to 2023. In 2022, the specific component of the cigarette excise tax rate increased by CZK 90 to CZK 1,880 per 1,000 cigarettes and in 2023, it increased again by CZK 90 to CZK 1,970 per 1,000 cigarettes. The minimum tax rate increased by CZK 160 to CZK 3,360 per 1,000 cigarettes in 2022 and it increased by CZK 160 to CZK 3,520 per 1,000 cigarettes in 2023. The ad valorem component of the cigarette excise tax remains unchanged (at 30 %). The excise tax rate on fine-cut tobacco increased by CZK 140 to CZK 2,860 per 1 kg of tobacco in 2022 and it increased by CZK 140 to CZK 3,000 per kg of tobacco in 2023. The excise tax rate on heated tobacco products increased by CZK 139 to CZK 2,860 per kg of tobacco in 2022, and it increased by CZK 140 to CZK 3,000 per kg of tobacco in 2023. The above-mentioned excise tax increases are accompanied by a three-month retail sell-by-date anti-forestalling regulation applicable to cigarettes and a six-month retail sell-by-date anti-forestalling regulation applicable to heated tobacco products.

In Slovakia, Amendment to Act no. 106/2004 Coll. on Excise Duty on Tobacco Products was adopted and published as Act no. 390/2020 Coll. introducing a three-year fiscal roadmap from 2021 to 2023. As of February 1, 2022, the specific component for cigarettes increased from EUR 74.60 per 1,000 cigarettes to EUR 79.60 per 1,000 cigarettes, the minimum excise tax rate for cigarettes increased from EUR 116.50 to EUR 124.30 per 1,000 cigarettes. The ad valorem tax rate for cigarettes remained unchanged at 23 %. The fine-cut tobacco excise tax rate increased from EUR 89.30 per 1 kg to EUR 95.30 per 1kg and the excise tax rate for smokeless tobacco products increased from EUR 132.20 per 1 kg of tobacco to EUR 160 per 1 kg of tobacco. There was another tax increase as of February 1, 2023. The specific excise tax rate for cigarettes increased to EUR 84.60 per 1,000 cigarettes, the minimum excise tax rate for cigarettes therefore, increased to EUR 132.10 per 1,000 cigarettes, the fine-cut tobacco excise tax rate increased to EUR 101.30 per 1kg and the

excise tax rate for smokeless tobacco products increased to EUR 187,80 per 1 kg of tobacco. The excise tax increases are accompanied by a two-month retail sell-by-date regulation for cigarettes, six months for fine cut tobacco and three months for smokeless tobacco products.

## Strong and Effective Regulation

Philip Morris ČR a.s. and Philip Morris Slovakia s.r.o. support comprehensive regulation of tobacco and nicotine containing products based on the principle of harm reduction.

Technological and scientific developments of recent years make it possible to shift the tobacco and nicotine market towards a future in which cigarettes will be replaced by less harmful, smoke-free alternatives offered to those adult smokers who would otherwise continue to smoke. In this context, sensible, risk-based regulation of smoke-free tobacco products, combined with effective restrictions on combustible products, such as cigarettes, can help address the harm caused by smoking more effectively – and faster – in combination with traditional regulatory measures.

Regulations should continue to dissuade people from starting to smoke combustible products or use nicotine products and encourage cessation. But it is equally clear that millions of men and women will continue to smoke, and they should have access to better alternatives than cigarettes and information on them.

## Tobacco Products Directive

Across the EU, the Tobacco Products Directive (2014/40/EU) entered into force on May 19, 2014 and became applicable in the EU Member States as of May 20, 2016. In the Czech Republic, Act no. 180/2016 Coll. amending Act no. 110/1997 Coll. on foodstuffs and tobacco products and other related laws together with Decree no. 261/2016 Coll., which transpose the EU Tobacco Products Directive, came into force on September 7, 2016.

The legislation introduced new rules on – among others – the manufacturing, presentation and sale of tobacco and related products, including certain rules for the commercialization of e-cigarettes and novel tobacco products, such as a pre-launch notification requirement. In addition, the new legislation includes other measures such as enlarged, combined health warnings covering 65 % of the main surfaces of cigarette packs and roll-your-own tobacco, as well as dedicated health warnings for other types of tobacco and related products, enhanced reporting obligations, a ban on tobacco products with characterizing flavors (currently applicable to cigarettes and roll-your-own tobacco), and a new set of requirements related to the tracking and tracing of tobacco products in order to enhance the effectiveness of illicit trade prevention. Cigarettes with a menthol characterizing flavor, including menthol capsules, were allowed to be marketed in the Czech Republic until May 20, 2020. Tracking and tracing requirements came into force on May 20, 2019 for cigarettes and roll-your-own tobacco, and will come into force on May 20, 2024 for other tobacco products.

Furthermore, the Tobacco Products Directive regulates e-cigarettes as consumer goods rather than as medicinal products. If e-cigarettes qualify as medicinal products, other EU rules will apply.

On November 23, 2022, Commission Delegated Directive 2022/2100 ("Directive 2022/2100"), of June 29, 2022, amending Directive 2014/40/EU of the European Parliament and of the Council as regards the withdrawal of certain exemptions in respect of heated tobacco products, entered into force.

Directive 2022/2100 extends the prohibition on placing on the market of tobacco products flavorings in any of their components, such as filters, papers, packages, capsules or any technical features allowing modification of the smell or taste of the tobacco products concerned or their smoke intensity, which already exists for cigarettes and roll-your-own tobacco, to heated tobacco products.

The new provisions must be transposed into Act No. 110/1997 Coll., on food and tobacco products, and into Decree No. 261/2016 Coll. by July 23, 2023, with the entry into force on October 23, 2023.

In Slovakia, the Tobacco Products Directive was transposed to the Slovak national legislation by Act no. 89/2016 Coll.<sup>9</sup> on the manufacture, labelling and sale of tobacco products and related products and on the amendment and supplement to selected laws, effective as of May 20, 2016.

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<sup>9</sup> Act no. 89/2016 Coll. of November 25, 2015 on the manufacture, labelling and sale of tobacco products and related products and on the amendment and supplement to selected laws.

The new provisions of the Directive 2014/40/EU of the European Parliament and of the Council in regards of the withdrawal of certain exemptions in respect of heated tobacco products must be transposed into Act no. 89/2016 Coll. on the manufacture, labelling and sale of tobacco products and related products and on the amendment and supplement to selected laws, with the entry into force on October 23, 2023.

Cigarettes with a menthol characterizing flavor, including menthol capsules, were allowed to be marketed in Slovakia until May 20, 2020.

Tracking and tracing requirements entered into force on May 20, 2019 for cigarettes and roll-your-own tobacco. Other tobacco products will be subject to tracking and tracing as of May 20, 2024.

## Single-Use Plastics Directive

EU Directive 2019/904 ("Single-Use Plastics Directive" or "the Directive") on the reduction of the impact of certain plastic products on the environment came into force on July 2, 2019, throughout the EU Member States. EU Member States, including the Czech Republic and Slovakia, were obliged to transpose its provisions into national legislation by July 3, 2021. In the Slovak Republic the Directive was transposed into national law effective December 1, 2021. In the Czech Republic, the draft law was approved by both chambers of the Parliament of the Czech Republic and subsequently signed by the President of the Republic in August 2022, effective October 1, 2022.

The objectives of the Single-Use Plastics Directive are to prevent and reduce the impact of certain plastic products on the environment, in particular the aquatic environment, and on human health, as well as to promote the transition to a circular economy, with innovative and sustainable business models, products and materials, thus also contributing to the efficient functioning of the internal market.<sup>10</sup>

In order to achieve its objectives, the Directive introduces various measures for various types of goods. In the area of our business, the Directive concerns tobacco products with filters and filters marketed for use in combination with tobacco products. Specifically, under the Directive, Member States were required to introduce marking requirements on product packaging<sup>11</sup>, and implement Extended Producer Responsibility Schemes, which requires producers to contribute to costs associated with the cleaning and collection of littered tobacco post consumption waste in public, as well as to cost for awareness-raising measures designed to inform consumers to correctly dispose of cigarette butts and thereby reduce litter. Measures are being implemented gradually in several stages.

Extended Producer Responsibility ("EPR") Scheme for tobacco products with filters and filters marketed for use in combination with tobacco products was necessary to implement in the EU Member States by January 5, 2023. In the Czech Republic the effective date for EPR for producers of tobacco products with filters was set to January 1st, 2023. In Slovakia the effective date for EPR for producers of tobacco products with filters was set to December 1, 2024. In order to ensure the collective fulfillment of the obligations of manufacturers of tobacco products with filters and filters placed on the market for use in combination with tobacco products in the territory of the Czech Republic, the company Philip Morris ČR a.s., in accordance with the requirements of Act No. 243/2022 Coll., became one of the founders of joint-stock company NEVAJGLUJ a.s. (hereinafter referred to as "NEVAJGLUJ") with a stake of 24%. Appropriate steps were initiated to register the company NEVAJGLUJ in the commercial register. Subsequently, NEVAJGLUJ will apply to the Ministry of the Environment of the Czech Republic for authorization to operate a collective system (EPR scheme), which will also include a proposal for the method of calculating the reimbursement of the costs of municipalities for ensuring activities associated with the cleaning and collection of littered tobacco products with a filter after their consumption in public spaces. However, the Decree on the Implementation of certain provisions of the Act on the reduction of the impact of certain plastic products on the environment, which should contain the Form for applying for the issuance of authorization to operate a collective system, through which the application is submitted, has not yet been published. We anticipate that the authorization could be granted to NEVAJGLUJ by the end of the first half of 2023 at the latest. Therefore, the information on the scope of specific costs which Philip Morris ČR a.s. will have to bear in relation to this measure is not known until the publication of the 2022 Annual Financial Report. Further information will be provided in the 2023 Mid-Year Financial Report.

## Expected economic and financial situation

Over the last years, the COVID-19 pandemic and the containment measures the governments implemented have been the key factor impacting the economic situation in both the Czech Republic and in the Slovak Republic. Such measures resulted in a substantial slowdown in economic activity as well

<sup>10</sup> Article 1 of the Directive 2019/904 of June 5, 2019 on the reduction of the impact of certain plastic products on the environment.

<sup>11</sup> Despite the then absence of a local transposition law, as of the second half of 2021, based on Commission Implementing Regulation (EU) 2020/2151, which has a direct effect in local legal systems, a product packaging with the printed inscription "Plast ve filtru" / "Filter obsahuje plasty" has been gradually introduced to the Czech and Slovak markets.

as changes in consumption patterns that continue to impact our business, most notably our tourist channel in 2022, which is yet to recover to the pre-pandemic levels.

According to the data from the Czech Statistical Office, the gross domestic product in year 2022 increased by 0.4%<sup>12</sup> versus prior year. This represented only a modest growth and it has also been observed on the overall strength of the nicotine market demand.

The conflict in Ukraine impacted not only the already fragile supply chains following the COVID-19 pandemic, but it also contributed to inflation growth. These factors impacted some of our suppliers as well as put additional inflationary pressure on our costs. Its impacts have been observed mostly in the second half of the year, putting additional pressure on consumer spending due to rising cost of energy and housing and therefore we expect annualization in 2023.

Sales of *IQOS* devices and *HEETS* have grown strongly. In 2022, we introduced *IQOS ILUMA* technology, that brings unparalleled experience and convenience as well as addresses some of the most vocal requests of our consumers. We continued further expansion of the *IQOS VEEV* e-cigarette portfolio, and we have continued to expand *HEETS* and *Fiit* smoke-free tobacco products to attract and further grow our adult consumer base. Our business will remain exposed to consumer down-trading to cheaper cigarettes and other nicotine-delivery alternatives, further exacerbated by the worsening economic outlook and its impact on consumer spending and potentially on increases of illicit trade.

After significant excise tax rates increases in 2020 and 2021, in 2022 a relatively modest increase in tobacco excise tax rates has been implemented, resulting in modest price increase in most of the tobacco product categories with minimal adverse impacts on the demand. Given the current economic situation significant increases in excise tax rates (as seen in 2020 and 2021) could lead to additional decline of domestic demand for cigarettes, an increase of cross-border purchases of Czech consumers in countries with cheaper cigarettes, a decline of purchases of foreign tourists in the Czech Republic, or to an increase in demand for illicit products.

Regarding the current policy rate from the Czech National Bank, we expect that the tightening cycle is approaching its end, but CNB should keep current policy rate at least by the third quarter of 2023 depending on the overall macro-outlook.

We also remain committed to continuing to implement our planned productivity initiatives to manage our cost base and maximize the return on our investments.

## Risks Related to Our Business and Industry

The following risk factors should be read carefully in connection with evaluating our business and the forward-looking statements contained in this 2022 Annual Financial Report. Any of the following risks could materially adversely affect our business, our operating results, our financial condition, and the actual outcome of matters as to which forward-looking statements are made in this 2022 Annual Financial Report.

- Natural disasters, pandemics including COVID-19, economic, political, regulatory, acts of war including the impact and consequences of Russia's invasion of Ukraine or threats of war, or other developments could disrupt our supply chain, manufacturing capabilities or distribution capabilities. Despite our business continuity plans and other safeguards in place, our business, operations and financial results will depend on numerous continuously evolving factors that we may not be able to accurately predict.
- Due to the unpredictability and volatility of energy prices expected in 2023, it is difficult to assess their impact on our cost base and profitability. Also, the supplies could curtail our production if we are unable to compensate with other energy sources.
- The impact of these risks also depends on factors beyond our knowledge or control, including the duration and severity of the outbreak, its recurrence in our key markets, actions taken to contain its spread and to mitigate its public health effects, and the ultimate economic consequences thereof.

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<sup>12</sup> Source : [https://www.czso.cz/csu/czso/gdp\\_national\\_accounts\\_ekon](https://www.czso.cz/csu/czso/gdp_national_accounts_ekon)

- Consumption of combustible tobacco products continues to decline. This decline is due to multiple factors, including increased taxes and tax-driven pricing, governmental actions, the diminishing social acceptance of smoking, and the continuing prevalence of illicit products.
- Significant increases in cigarette-related taxes may disproportionately affect our profitability and make us less competitive versus certain of our competitors. Increases in cigarette taxes are expected to continue to have an adverse impact on our sales of cigarettes, due to resulting lower consumption levels, a shift in sales from manufactured cigarettes to other (cheaper) combustible products', or to illicit products such as contraband, counterfeit, and "illicit whites".
- We face intense competition, and our failure to compete effectively could have a material adverse effect on our profitability and results of operations. We compete primarily based on product quality, brand recognition, brand loyalty, taste, innovation, packaging, service, marketing, advertising and retail price. We are subject to highly competitive conditions in all aspects of our business. The competitive environment and our competitive position can be significantly influenced by weak economic conditions, erosion of consumer confidence, competitors' introduction of lower-price products or innovative products, higher tobacco product taxes, higher absolute prices and larger gaps between retail price categories, and product regulation that diminishes the ability to differentiate tobacco products.
- We may be unable to anticipate changes in adult consumer preferences or to respond to consumer behavior influenced by potential economic downturns. Our tobacco business is subject to changes in consumer preferences, which may be influenced by local economic conditions. To be successful, we must:
  - promote brand equity successfully;
  - anticipate and respond to new consumer trends;
  - ensure that our products meet our quality standards;
  - develop new products or acquire distribution rights to these in order to broaden brand portfolios;
  - improve productivity;
  - educate and convince adult smokers to convert to our smoke-free nicotine products;
  - ensure effective adult consumer engagement, including communication about product characteristics and usage of smoke-free nicotine products;
  - provide excellent customer care;
  - ensure adequate production capacity to meet demand for our products; and
  - be able to protect or enhance margins through price increases.
- In periods of economic uncertainty, adult consumers may tend to purchase lower-priced brands, and the volume of our premium-price and mid-price brands and our profitability could be materially adversely impacted as a result.
- We may be unable to successfully commercialize reduced-risk products, we may be unable to successfully introduce new products, promote brand equity or we may be unable to develop strategic business relationships. Future results are also subject to the lower predictability of our reduced-risk product category's performance.
- 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 the current consumer preference trend towards reduced-risk products continues and volume declines of combustible portfolio products accelerate, we do not expect that over time the additional profit generated from increased sales of reduced-risk products will offset the decreasing profits generated from the sales of combustible portfolio products.
- We lose revenues as a result of counterfeiting, contraband and cross-border purchases. Large quantities of counterfeit cigarettes are sold in the international market. We believe that *Marlboro* is the most heavily counterfeited international cigarette brand, although we cannot quantify the revenues we lose as a result of this activity. In addition, our revenues are reduced by contraband and legal cross-border purchases.



- Our ability to grow profitability may be limited by our inability to introduce new products or improve our margins through higher pricing and improvements in our brand mix. Our profit growth may suffer if we are unable to introduce new products successfully, to raise prices or to improve the proportion of our sales of higher margin products.
- Our ability to implement our strategy of attracting and retaining the best talent may be impaired by the decreasing social acceptance of cigarette smoking. To be successful, we must continue transforming our culture and ways of working, align our talent and organizational design with our increasingly complex business needs, and innovate and transform to a consumer-centric business.

We, as well as our business partners, use information systems to help manage business processes, collect, and interpret data and communicate internally and externally with employees, suppliers, consumers, customers and others. Some of these information systems are managed by third-party service providers. We are continuously evolving our approach to business continuity planning and backups to provide appropriate business resilience, particularly considering the increasing cyber threat landscape. Nevertheless, failure of these systems to function as intended, or penetration of these systems and systems owned and operated by our business partners by parties intent on extracting or corrupting information or otherwise disrupting business processes, could place us at a competitive disadvantage, result in a loss of revenue, assets, including our intellectual property, personal or other sensitive data, result in litigation and regulatory action, cause damage to our reputation and that of our brands and result in significant remediation and other costs. Failure to protect personal data, respect the rights of data subjects, and adhere to strict data governance and cybersecurity protocols could subject us to substantial fines and other legal challenges under regulations such as the EU General Data Protection Regulation. As we are increasingly relying on digital platforms in our business, and as privacy laws in the jurisdictions in which we do business are introduced or become more stringent, the magnitude of these risks is likely to increase.

## Sustainability and Social Responsibility

Sustainability is core to the transformation of PMI, Philip Morris ČR a.s. and Philip Morris Slovakia.s.r.o.

The PMI Group's approach to sustainability is focused on developing strategies that can successfully address environmental, social and governance issues. As part of the global assessment of the importance of topics related to sustainability (Sustainability Materiality Assessment), certain topics were identified as priority. PMI's strategy embodies the notion of two distinct views of social and environmental impact from two different angles – the impact generated by our products (what we produce - Product impact) and the impact generated by our business operations (how we produce it - Operational impact). Our ambition is to be a true leader in sustainable business practices. It also represents an opportunity for growth and our strongest competitive advantage.

The biggest and most pressing negative externality that PMI's strategy tries to address is the health effects of cigarette smoking. This is the most important contribution we can make to public health and is a cornerstone of the PMI group's purpose and business strategy, as our long-term and overarching goal is a smoke-free future. Through ground-breaking research, PMI has developed a range of smoke-free products that are enjoyable for adult smokers and have the potential to significantly reduce health risks when compared to smoking cigarettes. We are working to achieve a smoke-free future and replace cigarettes with these less harmful alternatives completely. Even though our product, and transformation of our business as such, is at the center of our sustainability efforts, we cannot omit other pillars – driving operational excellence, managing our social impact, and reducing our environmental impact.

In the Czech Republic and Slovakia, we are aligned with the global approach. In 2022 we went through local validation of the global Sustainability Materiality Assessment to tailor the local strategy to local circumstances and needs. For us, sustainability means creating long-term value while minimizing the negative externalities associated with our products, operations and value chain and maximizing the positive impact we have on the world around us. We will disclose more information concerning the local validation and finetuning the local sustainability strategy in local sustainability brochure which is expected to be published in the second half of 2023.

We understand that maximizing shareholder value is no longer acceptable as a company's sole purpose. We recognize the importance of creating value for a diverse group of stakeholders, including employees, customers, suppliers, and communities.

## Product impact

### Purposefully phasing-out cigarettes and maximizing the benefits of smoke-free products

Smoke-free products adult user base data and progress on smoke-free shipment are available in the Business in the Czech Republic and Business in Slovakia sections of the Board of Directors Report on page 28-29.

We commercialize science-based smoke-free alternatives, making them available at both markets, and we continue to increase the total number of adult users switching from cigarettes to smoke-free products.

Furthermore, we support the strict enforcement of laws that set a minimum age to purchase tobacco products and work closely with retailers and other partners to implement youth smoking prevention programs. In 2022, Philip Morris Slovakia s.r.o. continued to support Youth Access Prevention (YAP) program “Age Matters”, launched in 1998. The objective of this program is to prevent the access of minors to tobacco products by encouraging retailers to comply with minimum age legislation for purchasing tobacco products. In 2022, Philip Morris ČR a.s. continued to implement Youth Access Prevention (YAP) program at retail points-of-sales (POS) of tobacco / nicotine-containing products in the Czech Republic. The YAP Project is focused on cooperation with our trade partners and their staff. The YAP Project consists of several phases - e.g., amendments to the contracts with trade partners, POS staff training, or distinct labelling of retail location with sticker indicating the prohibition of sales of tobacco and nicotine-containing products to minors. The aim of the Project is also to provide the POS staff some tips how to refuse to sell tobacco and nicotine-containing products to minors; and inform minors by a sticker at the entrance of the retail location that the above-mentioned products will not be sold to minors in the shop. At PMI, we are convinced that youth should not use tobacco or nicotine-containing products, and we adhere to this conviction in our activities. Therefore, we intend to continue the YAP program. The importance we attach to the protection of minors from tobacco and nicotine was also evidenced by a letter from the company's chairperson and the CEO, Andrea Gontkovičová, to tobacco and nicotine products' retailers. It confirmed repeatedly the company's commitment to protecting minors and emphasizes the role of retailers in preventing young people's access to tobacco and nicotine products.

### Post-consumer waste reduction

As part of the product sustainability strategy, in 2022 we continued the Device Take Back program (IQOS electrical equipment) within our Direct Retail IQOS stores in the Czech Republic and Slovakia. Customers can bring in any of the smoke-free electronic devices by IQOS, that they no longer want or can no longer use. We will take care of the device and hand it over for recycling within the framework of the PMI CIRCLE project.

In the first half of 2022, we have recently launched a Consumables Take Back pilot project intended for the collection of used tobacco sticks in selected Direct Retail IQOS stores in the Czech Republic and Slovakia. The goal of the pilot project was to secure enough material to investigate the material utilization of used tobacco sticks containing a bio-plastic filter made of cellulose acetate and/or polylactic acid (PLA). The company began to cooperate with two Czech universities on the analysis of material recyclability. After an unprecedentedly successful acceptance by customers, the pilot project was expanded to a nationwide format in the fall of 2022. Collection bags are available to customers free of charge in most Direct Retail IQOS stores. Customer may pick the collection bag up, put the used tobacco sticks in it and, after filling the bag, return it to a special collection box at any of our Direct Retail IQOS stores.

## Operational Impact

### Inclusion & Diversity

We are a Top Employer and have been certified both a Top Employer Czech Republic and Top Employer Slovakia for the eighth consecutive year. We are also an EQUAL-SALARY Certificate holder. This prestigious certification is awarded by the Swiss EQUAL-SALARY Foundation in collaboration with the Geneva University and the consulting firm of PwC as an independent means of certifying the equal compensation of women and men for the same work positions. Since 2019, Philip Morris ČR a.s. is also a signatory of the Czech Diversity Charter. Philip Morris Slovakia s.r.o. is a Slovak Diversity Charter signatory since 2017. Together with other businesses involved, we are committed to developing a tolerant working environment, irrespective of age, religion, gender, sexual orientation, or health status. In October 2022, we were awarded Top responsible large company 2022, by the organization Byznys pro společnost (Business for Society).

### Manufacturing – Environmental impact

Philip Morris ČR a.s. has been continuously striving to reduce the environmental impact of its activities over the long term. For example, it is taking steps to reduce its energy and water consumption when it is economically and technologically feasible. For the Kutná Hora factory, the source of innovations in this area are also projects of other plants within the PMI Group, shared by the Knowledge Transfer Package.

In the field of climate protection, our factory in Kutná Hora has achieved significant success. In August 2022, it successfully passed an external audit and received repeatedly a certificate confirming carbon neutrality within the framework of emissions, under the direct operational control of Philip Morris ČR a.s. Kutná Hora manufacturing plant.

We are also aware that water is a renewable yet limited local resource, which we all share and that is critical to life on the planet. Water stewardship for us is about reducing water use, promoting water recycling, protecting watersheds, and promoting sustainable water management in collaboration with stakeholders. We aim to optimize water consumption in our operations, reduce the water footprint of our products, and adequately treat the wastewater produced in our factories.

Already in 2021, the Kutná Hora manufacturing plant successfully passed a rigorous external audit focused on water management. The audit confirmed that we have been reducing the consumption of water in the long term and treating it sustainably at our production plant. Kutná Hora factory was therefore awarded AWS standard certificate (Alliance for Water Stewardship). It thus became historically the second factory in the Czech Republic to be awarded the AWS standard certificate<sup>13</sup>. During the autumn of 2022, manufacturing plant successfully passed the surveillance audit which verified that we still comply with the commitments to AWS standard.

The Kutná Hora manufacturing plant was re-certified by external entities as per ISO 14001 (Environment), and ISO 45001 (Health and Safety). In terms of safety, the factory achieved four consecutive years without safety incidents resulting in LTIs (Lost Time due to Injuries).

## Social contributions (Philanthropy)

For more than 30 years, Philip Morris ČR a.s. has been contributing significantly to charitable projects across a wide range of organizations and specializations. Four principal areas of support were chosen: education; care for carers; chance for a quality life; and environmental issues. Moreover, during the year 2022, our assistance was aimed at mitigating the consequences of disasters or efforts to prevent them, whether it was an ongoing coronavirus pandemic or impact of the armed conflict in Ukraine.

Our traditional long-term partners, implementing their projects with our financial support, include, among others, the Slunce pro všechny Endowment Fund and the Livia and Václav Klaus Endowment Fund, in the field of projects focused on education.

A remarkable program is the support of innovations in the development and use of alternative communication, implemented by the Regional Charity Červený Kostelec, organization with the only inpatient facility in the Czech Republic, caring for people diagnosed with multiple sclerosis in the Home of St. Joseph in Žireč City.

Another important long-term partner is the Charter 77 Foundation, not only in supporting the elderly or the seriously ill people, but also in helping to prevent the spread of coronavirus and mitigate the effects of the COVID-19 pandemic that afflicts the world for several years already. The Charter 77 Foundation has also become our partner in an effort to help refugees from Ukraine who find refuge in the Czech Republic. Our support was directed towards the education of Ukrainian children, financial assistance to schools and school facilities program to adapt to new conditions and facilitating the integration of newcomers from Ukraine into our society. We allocated CZK 5.6 million for this program.

In the field of the environment, we have been cooperating with the POD HORAMI association for several years, which is focused on education of children in the field of environmental care, theoretically and in practice. We also financially supported the organization BENEDIKTUS z.s. in order to build a rainwater retention system in their gardens and orchards. In 2022, we financially supported the establishment of an educational trail near the village of Suchdol (Kutná Hora district), connected with the planting of a fruit alley. Our employees personally helped to plant this avenue. We also support the spread of education about the protection of birds and nature in general in Moravia, with the association RADIBUDKY.cz. And last but not least, we contributed CZK 1 million in 2022 to the restoration of the municipal forest in Hodonín City, which was destroyed by a tornado in June 2021. The restoration of the municipal forest was completed in early 2023.

We are very happy and proud that our support helps both at the national and local level, and thus we can contribute to better and more sustainable living conditions for many people.

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<sup>13</sup> The first AWS-certified factory was the Coca-Cola HBC production plant in 2020.

In Slovakia, once again in 2022, we provided a grant to the PONTIS Foundation for the project Raising the Roof, through which the funds are used for the foundation's educational project – OPEN FUTURE, for the largest volunteer event Our City, and are also re-granted to various organizations – Vagus, Homeless Theater, Black White Horse, Cvernovka Foundation. The project is focused on solving the problem of homelessness as a state of extreme exclusion from society. This issue requires the maintenance of existing professional assistance projects, which give people a real chance to stand on their own feet again and the possibility of finding adequate housing, and also solves the public's perception of this issue.

Philip Morris Slovakia s.r.o. annually organizes clothes collections for disadvantaged people throughout Slovakia and participates in the volunteer program Our City, organized by the PONTIS Foundation. In 2022, we immediately responded to the crisis in Ukraine by helping refugees from Ukraine as much as possible. We provided financial support to the organizations People in Need and the Association of Christian Youth Communities, which help refugees. We also supported foundations in the most affected regions of Slovakia, which are located near the border with Ukraine, namely the Foundation of the Košice Self-Governing Region and the Foundation of the Prešov Self-Governing Region for Family Support. Many Philip Morris Slovakia s.r.o. employees were helping refugees at the border. We managed to supply our Ukrainian colleagues who remained in Ukraine with food, medicine and clothing. We helped Ukrainian colleagues and their families who came to Slovakia by internal donation, providing psychological help or purchasing food and basic supplies.

Further non-financial information will be included in the separate Integrated Report 2022 of Philip Morris International Inc., which is going to be published in May 2023 and is accessible at [www.pmi.com/sustainability](http://www.pmi.com/sustainability).

## Forward-Looking and Cautionary Statements

This report and related communications contain, and Philip Morris ČR a.s. may from time to time make, written or oral forward-looking statements, including statements contained in filings with the Czech National Bank or other authorities, in reports to shareholders and in press releases and investor webcasts. You can identify these forward-looking statements by use of words such as “strategy,” “expects,” “continues,” “plans,” “anticipates,” “believes,” “will,” “estimates,” “intends,” “projects,” “goals,” “targets” and other words of similar meaning. You can also identify them by the fact that they do not relate strictly to historical or current facts.

Philip Morris ČR a.s. cannot guarantee that any forward-looking statement will be realized, although we believe we have been prudent in our plans and assumptions. Achievement of future results is subject to risks, uncertainties and inaccurate assumptions. Should any known or unknown risks or uncertainties materialize, or should underlying assumptions prove inaccurate, actual results could vary materially from those anticipated, estimated or projected. Investors should bear this in mind as they consider forward-looking statements and whether to invest in or remain invested in Philip Morris ČR a.s. securities.

## Statutory Declaration of Persons Responsible for the Philip Morris ČR a.s. Annual Financial Report

We confirm that to the best of our knowledge, the financial statements and consolidated financial statements gives a true and fair view of the assets, liabilities, financial position, and financial results of Philip Morris ČR a.s., and its consolidated group and the annual report and consolidated annual report within the meaning of the Act on Accounting, contains a true summary of the development and results of Philip Morris ČR a.s. and the position of Philip Morris ČR a.s. and its consolidated group, together with a description of the principal risks and uncertainties faced.

**In Kutná Hora on March 27, 2023**



**Andrea Gontkovičová**

Chairperson of the Board of Directors  
Philip Morris ČR a.s.



**Anton Stankov**

Member of the Board of Directors  
Philip Morris ČR a.s.