Remarks by Martin King

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Investor Day

Lausanne, June 22, 2012

(SLIDE 1.)

Thank you, Nick. Good morning, ladies and gentlemen.

(SLIDE 2.)

In today's presentation I will cover the world of PMI Operations, including the strategies and processes that we have adopted to continually enhance our product quality, cost efficiency, cash flow, the development and engagement of our employees and to support our drive for innovation. I will end with some key takeaways.

(SLIDE 3.)

Let me begin with an overview of the function.

(SLIDE 4.)

Our products are manufactured in 56 facilities around the world, of which 45 are machine-made cigarette manufacturing facilities. The 11 remaining facilities produce hand-rolled cigarettes, other tobacco products, or process semi-finished products for our cigarette manufacturing facilities.

In addition, we have agreements with 21 third-party manufacturers and with 38 third-party cigarette hand-rolling operators in Indonesia.

(SLIDE 5.)

I will now highlight some recent initiatives that represent our proactive strategy to optimize our manufacturing footprint.

Our acquisition of the International Tobacco and Cigarette factory in Jordan provides us with our first wholly-owned manufacturing presence in the Middle East. In Korea, we have constructed a greenfield manufacturing facility to support our growth in this key market.

In Europe, we have restructured our operations in Greece, Holland, Portugal and Switzerland as part of our strategy to continuously improve our manufacturing efficiency.

Similarly in Latin America, we have closed our Uruguayan cigarette factory and our cast leaf plant in Venezuela. In May this year, we announced the consolidation of our operations in Mexico into our Guadalajara facility.

Additionally, we have completed the consolidation of manufacturing facilities in the Philippines as part of our business combination with Fortune Tobacco Corporation and, in Indonesia, we are consolidating some smaller factories into our Sukorejo and Karawang facilities while expanding our capacity to meet the growing demand in this strategic market.

(SLIDE 6.)

This slide represents the growth in total tobacco sales volume by production source from 2009 to 2011. The increase in our Asia Region mainly represents the inclusion of PMFTC in the Philippines and the continued growth of our business in Indonesia.

In our European Union Region, the volume sourced from our European factories has declined, but, as I mentioned, we have restructured our operations accordingly.

The efficiency and flexibility of our manufacturing footprint is such that we are able to adapt rapidly to changing market needs.

(SLIDE 7.)

Operations employs over 50,000 people worldwide, with some 20,000 working in our machine-made cigarette operations and nearly 18,000 working directly in our hand-rolled operations in Indonesia. Combined, they represent about 75% of our labor force. The remaining 25% are employed in fixed manufacturing and other areas, which includes leaf processing, product development and our Operations Center in Switzerland.

(SLIDE 8.)

We continue to focus on performance, automation and efficiency as evidenced by our improved labor productivity.

The chart on the right shows our cigarettes per average headcount ratio in our European Union Region facilities which continues to improve despite the shift in volume to Asia.

(SLIDE 9.)

Perhaps the best recent example of our supply chain agility was our production ramp-up for Japan last year which Matteo discussed yesterday. As a reminder, in response to our principal competitor's supply chain disruption, we were able to activate 11 factories, six of which had never manufactured product for Japan before. The air freight of more than 16 billion units involved 222 charter flights and 848 commercial flights, the use of three airports and the lease of six temporary bonded warehouses. Despite the significant increase in demand for our products, the challenge of producing and shipping on a very tight schedule, and the national distribution challenges in Japan, our overall product availability and service level to the trade during this period remained at an outstanding 99%.

(SLIDE 10.)

Over the past three years, we have experienced growth in a wide range of products, including traditional cigarette formats consisting of standard king size cigarettes in soft, flip-top and round-corner packs, and non-traditional formats primarily made up of slim and super slim cigarettes and a variety of novel pack formats. Worth noting is the growth in OTP, reflecting our focus on that category.

(SLIDE 11.)

Our total cost of sales in 2011 was approximately $10.7 billion.

Leaf and direct materials were the key cost drivers. Tobacco leaf represented 35% of the total and direct materials represented 27%. The remaining 38% was made up of employee-related costs, third-party manufacturing costs, depreciation, and shipping and distribution which, for 2011, included the additional costs related to Japan, principally airfreight.

(SLIDE 12.)

I will now share with you the key elements of our procurement strategies, starting with leaf.

(SLIDE 13.)

This chart shows our leaf purchases in 2011 by type of tobacco. Typically, Virginia tobacco represents the largest portion of our purchases accounting for 50% of the total. Burley tobacco, used in our American blend cigarettes, is our second largest variety and constituted 31% of the total, followed by Oriental tobacco at 9%. Sun-cured tobacco, mainly used in our kretek cigarettes in Indonesia, represented 6% of the total.

(SLIDE 14.)

We are not overly dependent on any single source for our tobacco supply. Maintaining an appropriate geographic balance in our tobacco sourcing is important both for the specific individual taste characteristics of each origin and to reduce our exposure to bad weather and potential economic risks.

(SLIDE 15.)

In addition to our diversified geographic sourcing, our leaf procurement model has evolved in line with our strategy to increase purchases of leaf tobacco directly from farmers. This map illustrates the successful implementation of that strategy. Now 35% of our leaf is sourced through vertical integration.

(SLIDE 16.)

Let me remind you of our achievements in Brazil.

In the second quarter of 2010, we signed separate agreements with Alliance One and Universal Leaf in Brazil under which both suppliers assigned to PMI a total of approximately 17,000 farmer contracts, equivalent to approximately 50% of our tobacco purchases in the country, or approximately 10% of our 2011 worldwide leaf requirements.

The remaining 50% of our purchases in Brazil remain unchanged, with Alliance One and Universal continuing to supply tobacco to PMI from their own contracted farmers in the country. These agreements took our worldwide level of leaf sourced through vertical integration to the 35% I just mentioned.

The new structure works similarly to our operation in the United States for US-sourced tobacco where we enter into direct contracts with the farmers and purchase green leaf directly from them. Alliance One and Universal Leaf continue to process the resulting tobacco for PMI in their facilities. The first year of operation in Brazil was successful and the second year crop is currently being delivered.

(SLIDE 17.)

Our vertical integration agreements in Brazil are the foundation of more direct involvement with our farmers. As a result, we are better able to align leaf supply and demand and gain more control of product quality and integrity upstream in the supply chain. This, in turn, drives cost efficiency, predictability and transparency and, perhaps most importantly, enhances our ability to positively impact the long-term sustainability of tobacco growing communities.

(SLIDE 18.)

This slide shows the supply and demand trends in the global leaf market, including China. These trends have been relatively stable in the last three years since the shortage in 2008.

(SLIDE 19.)

Our leaf purchase price evolution per kilogram shown here includes mix, currency and volume.

After a substantial increase in 2008, average prices for tobacco, in line with supply and demand, have remained stable on a global basis, and our latest estimate for 2012 is a moderate increase broadly in line with inflation and equal to 2010 levels.

(SLIDE 20.)

Our leaf purchase price is reflected on our balance sheet in the year we purchase the crop. However, our cost of sales is impacted when we use that specific crop in our blends, as illustrated on this chart. On average, we mix three different crop years to ensure blend consistency, with about 11% of any given crop used in the same year it is purchased and the remainder split between the second and third years.

(SLIDE 21.)

Our leaf strategy to address the challenging dynamics of the tobacco market is based on three elements:

First, securing availability of volumes while maintaining our high quality standards and predictability of prices;

Second, promoting the growth of high quality tobacco under conditions that help protect the environment and promote sustainable crops; and

Third, our commitment to implementing a strong, comprehensive Agricultural Labor Practices, or “ALP”, Code within our tobacco growing supply chain.

(SLIDE 22.)

We remain committed to achieving safe and fair working conditions and to progressively eliminating child labor and other labor abuses on all farms from which we source tobacco.

During 2011, we started implementing our ALP Code in every country where we source tobacco.

Over 2,600 field technicians in 30 countries received in-depth training on all elements of the program, including child labor and forced labor prevention and safe work environment requirements. These technicians are now in the process of communicating the Code requirements to over 500,000 farmers.

We are very encouraged by the positive feedback we have received from a wide range of stakeholders, including our main international suppliers and local and international labor rights organizations such as Verité, with whom we continue to work closely.

During the summer, we will publish on our website a progress report with information on the different components of the program, describing in detail the content of the program, what we have accomplished to date, the challenges we face, and our objectives going forward.

(SLIDE 23.)

I will now make a few remarks about clove supply and pricing.

This chart shows annual crop sizes and corresponding prices from the year 2000, including our crop size forecast for this year. The clove crop has a highly cyclical pattern that is influenced by many variables such as weather conditions, crop size patterns from previous years and the standard of clove tree maintenance. Market prices follow this pattern and have increased during short crop years. This year, we are expecting a relatively large crop and, as a consequence, anticipate that prices will decline from their record levels in 2011 which, as you can see, was a particularly short crop year.

(SLIDE 24.)

Our clove strategy is based on a three-pronged approach.

First, securing optimal volumes during large crop years.

Second, driving yield improvements through technical assistance at the farmer level. Studies have shown, for example, that effective agricultural practices, combined with good maintenance of the clove trees, can significantly increase yields. At recent market prices, there is a strong incentive for farmers to increase production by improving yields and by more thoroughly harvesting existing trees.

Third, continuing to encourage the increased growing of clove. We achieve this strategy through initiatives such as our tree seedling program which has led to the distribution of 3.6 million clove trees to farmers since 2006 with plans for a further ten million to be distributed over the next five years. It is worth noting, however that this is a very long-term strategy, in light of the fact that clove trees have a long growing period, producing a first crop only after approximately seven years, and taking more than 20 years to reach full production.

(SLIDE 25.)

I will now turn to our direct materials procurement.

Three main categories represented 72% of our direct materials purchases in 2011, which totaled approximately $2.8 billion.

The largest category, representing approximately 35% of our spend, was printed board and paper, which is used to manufacture our packs, cartons and bundles. The second largest category, representing 21% of the spend, was acetate tow, which is the key component of cigarette filters. The third category, representing 16% of the spend, is fine papers, which consists of all the different paper types necessary to manufacture cigarette rods and filter rods, and to join them together to make a cigarette.

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Key challenges in direct materials procurement come from increasing complexity, driven by the growing requirements for innovation in our brand portfolio and the related need for new and specialized materials.

Aligning the supply base footprint in Asia with the manufacturing volume shift also represents a challenge.

Although direct materials price increases are in line with inflation, menthol is facing price volatility and acetate tow has a relatively tight capacity. Both of these factors represent specific challenges for our direct materials procurement strategy.

(SLIDE 27.)

The four components of that strategy are:

First, securing volume availability and supply timeliness to continuously improve our speed-to-market;

Second, securing cost efficiency and predictability in all categories, including exploring available opportunities to source materials in low-cost countries;

Third, building alliances and partnerships with strategic suppliers. This includes entering, where appropriate, into long-term agreements to provide business predictability; and

Fourth, reinforcing our collaboration with suppliers to support innovation as part of our drive to develop new products.

(SLIDE 28.)

One of our supply success stories in 2011 was our flawless implementation of the Reduced Cigarette Ignition Propensity, or “RCIP”, standard in the European Union, where we were able to convert over 200 billion cigarettes for EU markets to the new specification. We continue to work on related projects to improve adult smoker satisfaction with RCIP products, while meeting the mandated functionality.

We also secured our supply of RCIP paper through multi-year commitments with four suppliers, and we successfully managed the transition with no out-of-stock.

(SLIDE 29.)

In 2011, PMI’s indirect materials and services spend was approximately $5.6 billion.

Although 65% of these expenses were non-Operations related, the indirect materials and services category is a significant and growing contributor to our overall PMI productivity program.

Our strategy is to strengthen the capabilities within the organization and to create more efficient processes that can be expanded to the rest of the company to deliver ongoing productivity.

(SLIDE 30.)

In 2011, PMI comfortably surpassed its annual gross productivity and cost savings target of $250 million. The company’s pre-tax target for this year is $300 million with approximately 70% coming from Operations and the remainder from other areas of the company.

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Our operations productivity initiatives are part of our continuous effort to manage costs.

We are focused on the identification of new productivity initiatives and have created a mindset where it is part of everyone’s job to identify, propose and implement productivity opportunities, both large and small. The major areas of our contribution are blend and specification rationalization, procurement, tobacco processing technology, and continuous improvement in manufacturing performance.

Our overall target this year is to offset more than 50% of Operations cost increases with the benefits of our productivity contribution. As a result, we expect our net cost increase in 2012 will be lower than that in 2011.

(SLIDE 32.)

I will now turn to the opportunities we have identified in our supply chain.

(SLIDE 33.)

As part of PMI's commitment to continuously improve its working capital, Operations is focused on significantly reducing our finished goods and leaf inventories.

To support this effort, we have implemented systems and processes designed to create visibility and transparency across the supply chain. These enable us to integrate, collaborate and synchronize with supply chain partners. In the leaf supply chain, they enable us to manage buffer stocks according to the criticality of specific tobacco leaf grades.

(SLIDE 34.)

During the 2009 to 2011 period, we substantially reduced inventories as shown on this chart. Going forward, we will continue to deliver improvements while maintaining and enhancing customer service levels in finished goods, and keeping adequate leaf stocks to guarantee quality and security of supply.

(SLIDE 35.)

The reduction in finished goods inventory is driven by regular inventory improvements, whereas forestalling inventory has remained fairly constant.

(SLIDE 36.)

SCIPIO, the acronym for our key supply chain initiative, is a process and software-based system aimed at linking demand and supply planning while providing visibility across the supply chain, including inventories. For example in Germany, following the implementation of SCIPIO, we reduced our regular finished goods inventory duration by approximately 20% which represents about $85 million at today's inventory value.

We have organized the implementation in three waves, targeting first those markets and affiliates where we have the highest potential benefit. To date, we have already rolled out our SCIPIO initiative in 26 factories and 107 markets covering 74% of our total global tobacco volume. By the end of 2013, we plan to extend the coverage to 85%.

The process has been complemented by inventory diagnostics, demand planning and forecasting, and strengthened Sales and Operations Planning processes.

(SLIDE 37.)

Another area of focus for Operations is capital expenditure controls. In the past three years, capital expenditures have remained broadly in line with depreciation while, in the future, we do expect increases as we expand production in markets such as Indonesia, further modernize our equipment base, and start to ramp up our manufacturing efforts related to Next Generation Products.

(SLIDE 38.)

For example, our high-speed investment program focuses on the acquisition of new generation equipment over the next three years which can produce up to 20,000 cigarettes per minute.

This will allow us to better use our assets while applying the cascading concept, installing machines in our manufacturing facilities that produce high volumes and moving the released equipment to other factories to proactively create a pool of equipment that will aid our innovation, quality, speed-to-market, and productivity.

(SLIDE 39.)

I will now describe our contribution to PMI's leadership in innovation and product quality.

(SLIDE 40.)

We have established a rigorous process that begins with identifying adult smoker preferences and concludes with product verification, including a six-month cycle of concept evaluation. This process not only enables us to ensure that the best concepts are selected for development, but also guarantees a continuously filled and refined pipeline of innovative products.

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Our specification rationalization program supports the focused commercial approach to sales.

This program consists of three pillars:

First, "Focus," which aims to "develop once, deploy widely";

Second, "Master," which looks for smart solutions to balance complexity and flexibility; and

Third, "Minimize," which reduces or eliminates the unnecessary complexity that adds no value for the adult smoker.

Our specification rationalization program targets a 20% reduction in unique specifications, such as cut filler codes, tipping papers and filters, by 2014.

(SLIDE 42.)

Over the last three years, Operations has been playing an important role in the success of the new *Marlboro* architecture which Fred discussed yesterday.

In the Flavor line, we have supported 153 launches and revamps where we used a tactile surface treatment and included features like the sliding lid pack.

In the Gold line, we have supported 265 launches and revamps where we also used a tactile surface treatment and expanded it to other formats such as slims and super slims.

In the Fresh line, we have supported 79 launches and revamps where we developed tailored menthol blends incorporating new filter technologies such as thread and capsules. We have also expanded our range of menthol offers.

(SLIDE 43.)

We continue to deliver innovation.

In 2011, we supported 41 new launches of capsule products providing different alternatives for adult smokers such as Fresh-to-Fresh, Hybrid, Capsule + Carbon Filter and various tar level alternatives.

We also introduced a new concept for adult smokers to personalize their product, developing a twistable filter that enables the adjustment of taste intensity.

In a first within the tobacco industry, new technology was introduced into our packaging using a three dimensional-effect Fresnel lens, providing a high quality, high impact design for the adult smoker.

(SLIDE 44.)

Continuously improving product quality is one of our most important responsibilities. This slide shows one of our internal quality metrics, the Market Visual Quality Index, which measures the visual quality of our products. The index compares our pack and cigarette quality to that of our competitors across a wide range of parameters.

We have enhanced the process by centralizing the quality assessment in one laboratory so as to avoid any variability between laboratories, thereby increasing the reliability of results. Our sample covers 89% of our total cigarette volume.

As of the end of 2011, our results show that PMI outperforms its competitors in markets representing 80% of the volume. Our most recent data shows that products in two of the three markets that make up the 2% of cases where competition outperforms us, shown in red on this pie chart, have advanced to the orange section, meaning their quality is statistically no different to our own.

(SLIDE 45.)

Let me now explain our Environment, Health and Safety, or “EHS,” programs.

(SLIDE 46.)

Our EHS performance over the past two years has been improving across key metrics, despite the fact that we increased our measurement scope and expanded our vehicle fleet through acquisitions in countries where EHS conditions are operationally challenging. In 2010, we reset our performance baseline and established targets to reduce our impact on the environment and to improve workplace health and safety in a sustainable manner.

With respect to safety performance, our manufacturing lost time injury rate has improved against our 2010 baseline, and we will continue to work to achieve a world-class safety performance in all our manufacturing facilities, targeting over 30% improvement by the end of this year.

In our markets, the fleet crash rate has also been improving, and during the next few years we will continue to focus on further improving our vehicle fleet safety record to achieve world-class standards.

(SLIDE 47.)

Energy and water consumption, CO_2 and recycling rates in our manufacturing facilities have all continued to improve, in line with our ambitious targets to improve the first three of these environmental metrics by 20% by 2015 versus our 2010 baseline, and to improve the recycling rate over the same period to 85%. We are on track to achieve these targets.

(SLIDE 48.)

I will now briefly describe our employee development initiatives.

(SLIDE 49.)

The Operations Performance and Engagement program, or "OPEN," is our strategy to fully engage our 50,000 employees.

OPEN focuses on three areas:

First, empowering and developing the people and the organization;

Second, standardizing processes using "Lean" techniques; and

Third, generating a continuous improvement culture.

OPEN continues to show good results in our key performance metrics and, more importantly, in the engagement of our people.

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Let me conclude with a few key takeaways.

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Going forward, we will continue to focus on maintaining cost leadership in the tobacco industry through the implementation of our plans in leaf and direct materials, and through a relentless focus on productivity.

We will further integrate our supply chain and reduce our inventories, which will continue to deliver improvements against PMI's working capital targets.

We will continue our product development efforts to maintain and reinforce our industry leadership in innovation, and we will continue to deliver the best quality products.

Last, but not least, we will develop and engage our people to meet our current and future business challenges.

Thank you for your interest. I will be happy to answer your questions.