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2014  
INVESTOR DAY

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## Investor Day – Operations Lausanne, June 26, 2014

Antonio Marques

*Senior Vice President, Operations*

Philip Morris International



# Agenda

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- Operations Overview
- Focused Innovation
- Performance and Sustainability
- Cost Management
- Organizational Engagement
- Conclusions



# Operations Objectives

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- Manufacture superior quality products in a safe, cost effective and sustainable manner
- Contain annual cost of goods sold increases in the range of 1% to 3%, excluding currency, volume/mix and costs related to RRP's, through supply chain management, productivity improvements and cost savings
- Drive innovation to enhance margins and gain market share



# Operations Scope

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- People (over 55,000):
  - 17,000 in machine-made operations
  - Nearly 27,000 in hand-rolled operations in Indonesia
  - Over 11,000 in fixed manufacturing and support functions
- Cigarette volume: 913 billion units
- Over 4,000 products on market
- COGS: \$10.4 billion (61% of PMI's total cost base)

# PMI Operates Cigarette and Non-Cigarette Manufacturing Facilities Worldwide



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**53**

Manufacturing  
Facilities



**23**

Third-Party  
Manufacturers

**38**

Third-Party  
Operators



**1**

RRPs Manufacturing  
(under construction)

Note: 2013 year-end. Reduced-Risk Products ("RRPs") is the term we use to refer to products that have the potential to reduce individual risk and population harm  
Source: PMI Operations



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**Focused Innovation**



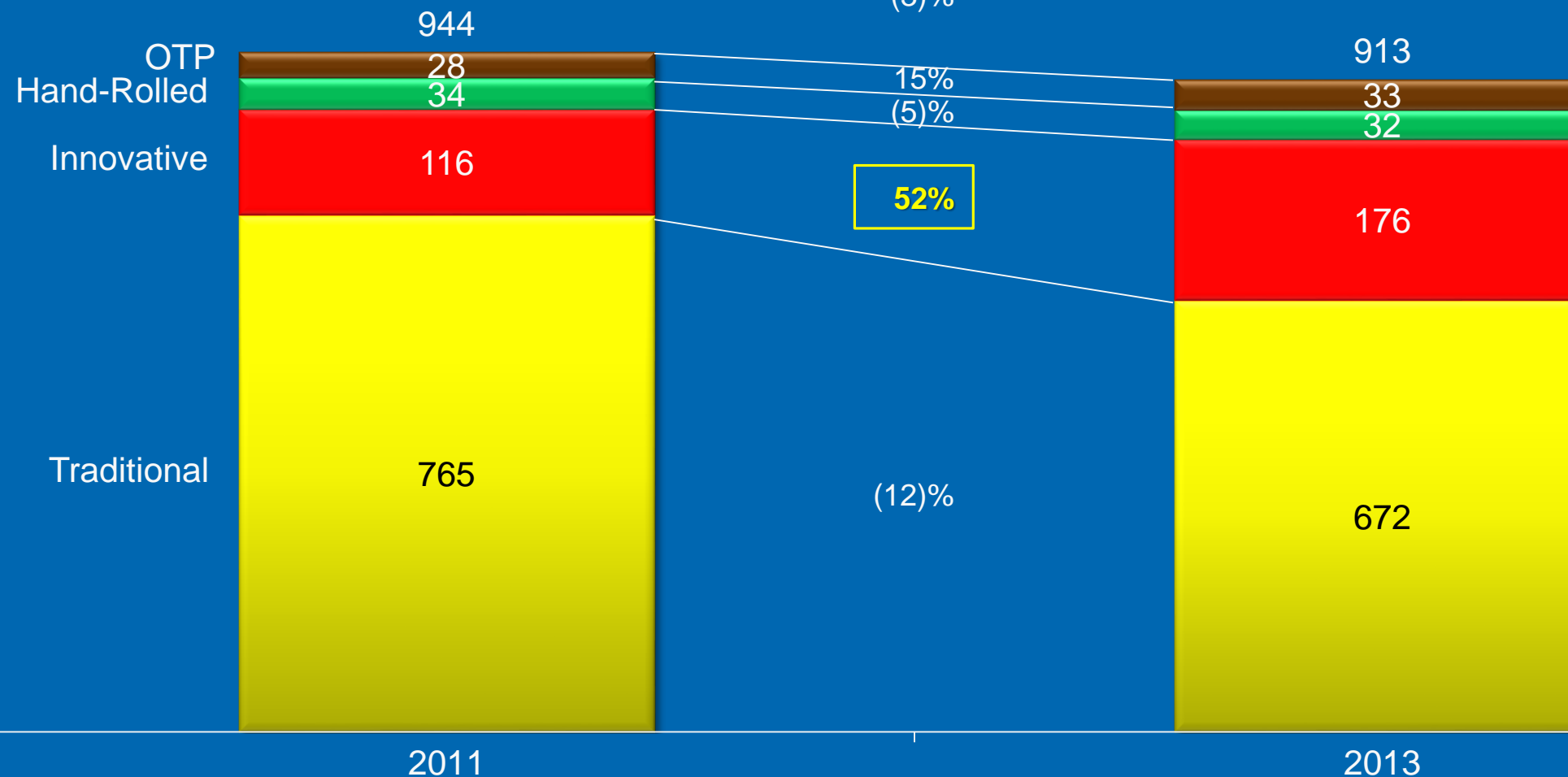
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# Volumes of Innovative Formats are Growing

(units billion)

(% change)

(3)%



Note: Volume includes TPMs. Traditional format: Pack type: Box, Round-Corner Box and Soft / Diameter: Regular / Length: Regular Size, Long Size, King Size and 100mm. OTP include primarily tobacco for RYO and MYO cigarettes, pipe tobacco, cigars and cigarillos converted into cigarette equivalent. 2011 sales volume were restated to reflect the new conversion rates for OTP. Totals may not add up due to rounding

Source: PMI Financials

# Focused Innovation

- Component pipeline:
  - Derived from adult smoker insights
  - Six-month cycle of concept evaluation
  - Continuously filled and refined pipeline with rolling 2-5 year horizon



- Product pipeline:
  - Rigorous concept evaluation of component combinations
  - Best concepts selected for pilot test in lead markets
  - Enables rapid deployment of relevant innovation to multiple markets
  - Continuously filled and refined pipeline with 1-3 year horizon



# Specification Rationalization Program

- Supports focused commercial approach to sales and elimination of unnecessary complexity in production
- Global program for specifications and POM rationalization:
  - More than 500 products delisted or morphed
  - Over 300 new introductions
  - Net 6% reduction in global product portfolio
  - 7% reduction in blends
  - 12% reduction in filter specifications
- Minimum target of 5% reduction per year (2014-2016)

# PMI Continues to Deliver Innovation

## Chesterfield Progressive Line



## Marlboro Eco Zip Pack



# PMI Continues to Deliver Innovation

## Parliament Carat



- Innovative premium proposition
- 90mm cigarette with 7.0mm diameter
- "Bevel edge" pack
- *Diamond cut* copy line on inner frame

# PMI Continues to Deliver Innovation

## Marlboro Premium Black

- Innovative "SmartSeal" pack
- Successful GCC launch
- Further roll-out planned



## New Packing Technology to Address Format Complexity

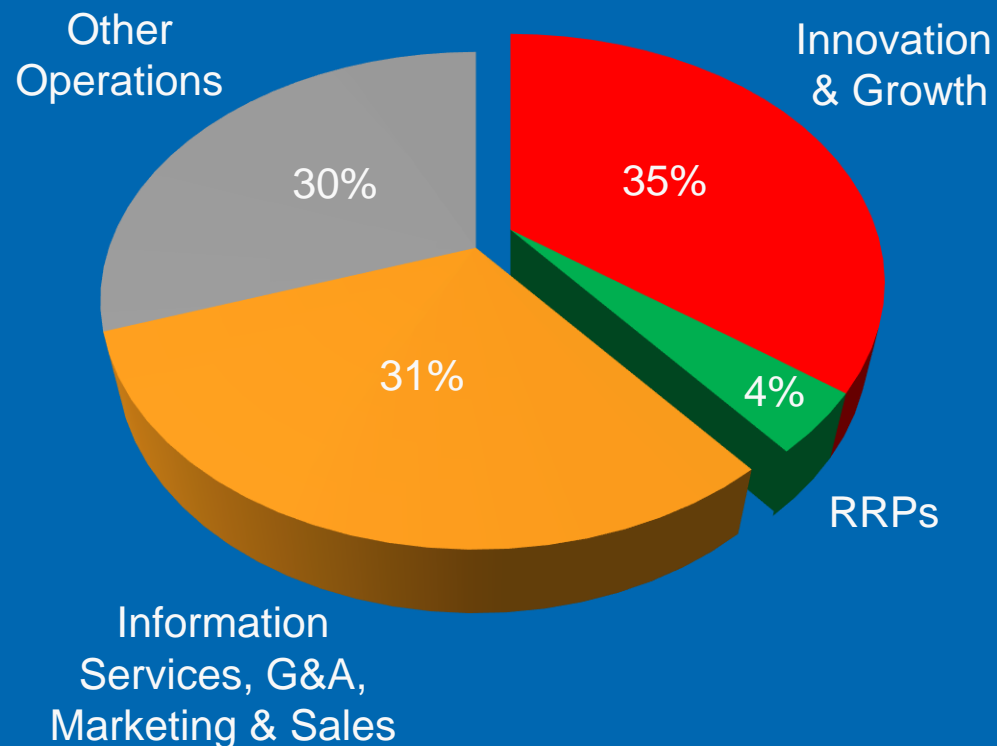
- Investment in flexible packing machines to accelerate the launch of innovative packs into the market



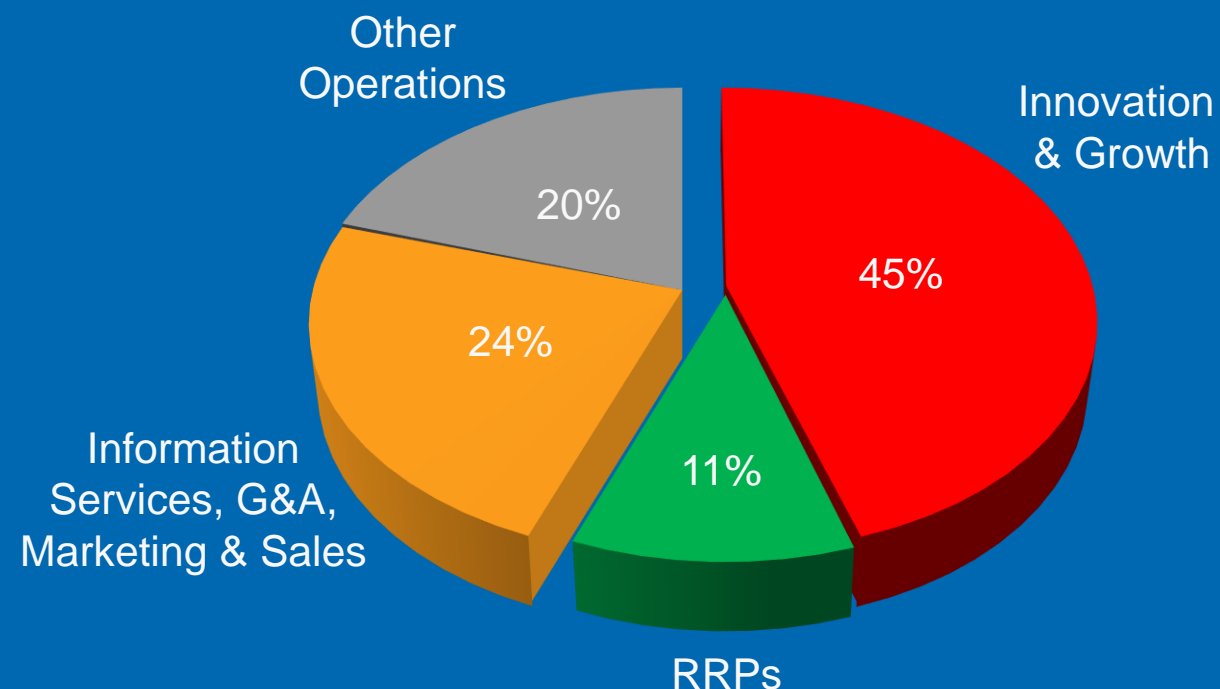


# Capital Investments to Support Innovation, Growth and RRP

2011 PMI CAPEX



2013 PMI CAPEX



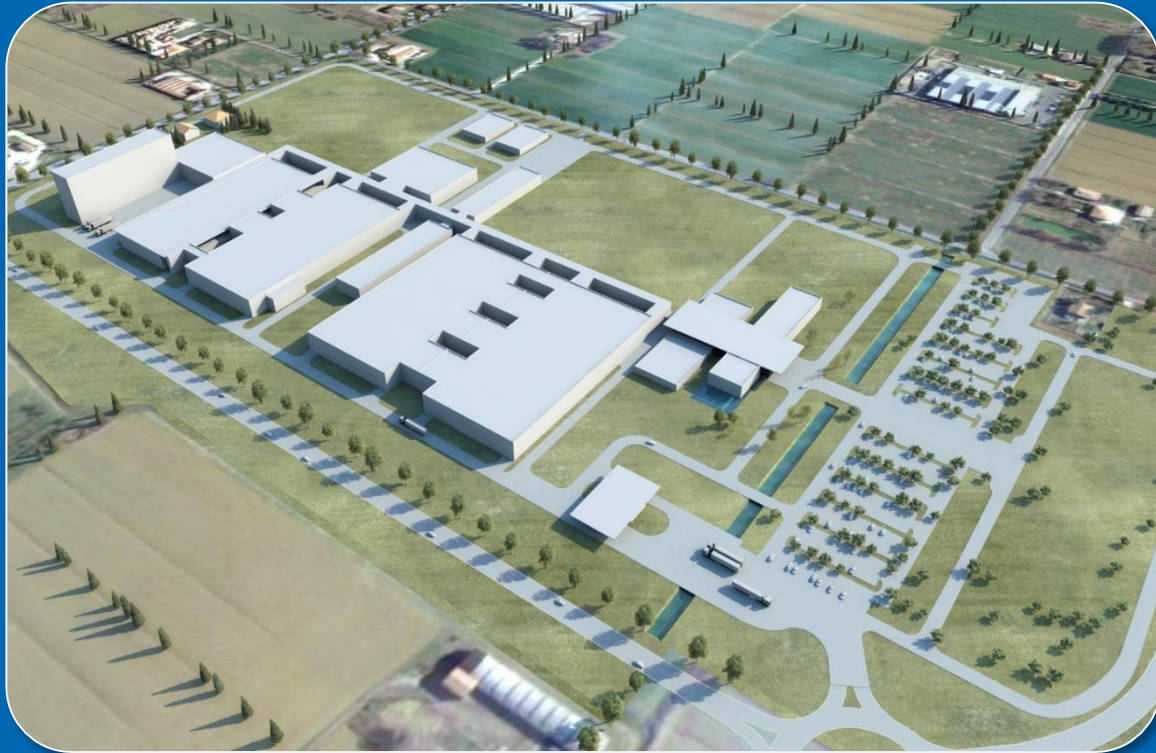
Note: Other Operations includes ongoing maintenance and replacements, as well as investments made to meet regulation or compliance-driven initiatives. Reduced-Risk Products ("RRPs") is the term we use to refer to products that have the potential to reduce individual risk and population harm.

Source: PMI Financials



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# RRPs Footprint in Bologna, Italy



- Bologna home to our state-of-the-art filter factory and the first RRP's pilot plant
- Region provides great infrastructure
- Access to qualified workforce



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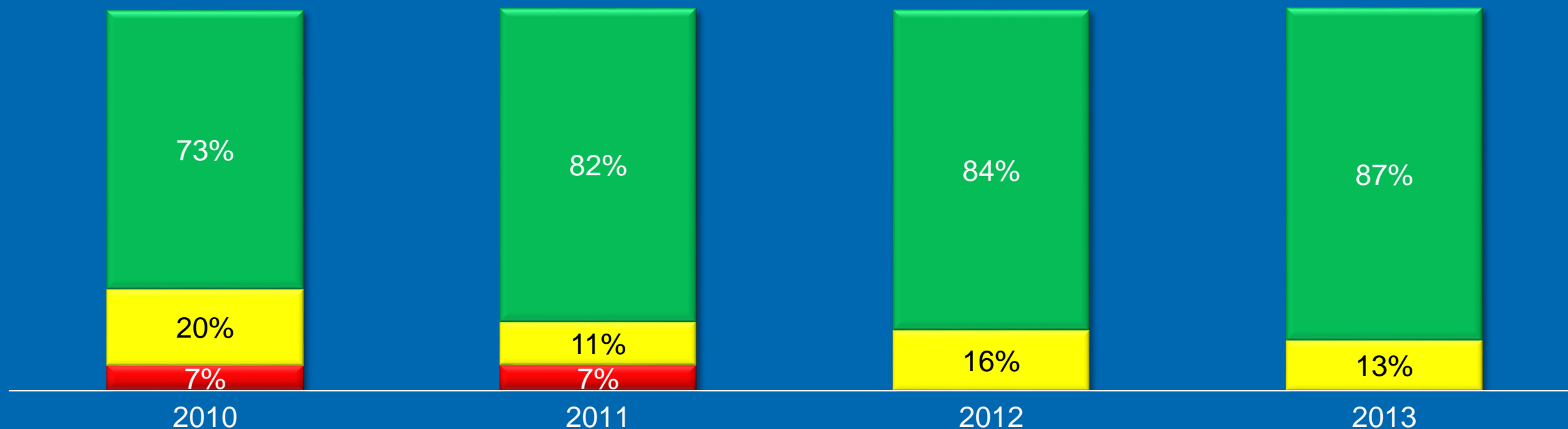
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## Performance & Sustainability



# PMI Outperforms Competition: Visual Quality in Key Markets

% of Audited Markets



**Green:** PMI outperforms competition

**Yellow:** PMI is statistically not different than competition

**Red:** Competition outperforms PMI

# Our Commitment to Our People: Outstanding Safety in Manufacturing



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Lost-Time Injury Rate / 200,000 hours





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## Our Commitment to Sustainability: Tobacco Production

- Achieve safe and fair working conditions on all farms from which PMI sources tobacco
- Progressively eliminate child labor and other labor abuses
- Training sessions provided to more than 3,700 field technicians and ALP code communicated to almost 98% of our 500,000 farmers
- While we are pleased with our results so far, much more remains to be done
- First two progress reports are published on PMI's website

# Our Commitment to Sustainability: Food Production

- Program to encourage smallholder tobacco farmers to grow food crops
- Increase farmer productivity in both tobacco and food
- Promote minimum 2:1 ratio (2kg of food : 1kg of tobacco)

## Food / Tobacco Ratio

	<u>2014 Estimate</u>	<u>2016 Minimum Target</u>
Malawi	2.9	
Mozambique		2.0
Kenya	3.0	
Philippines		2.0

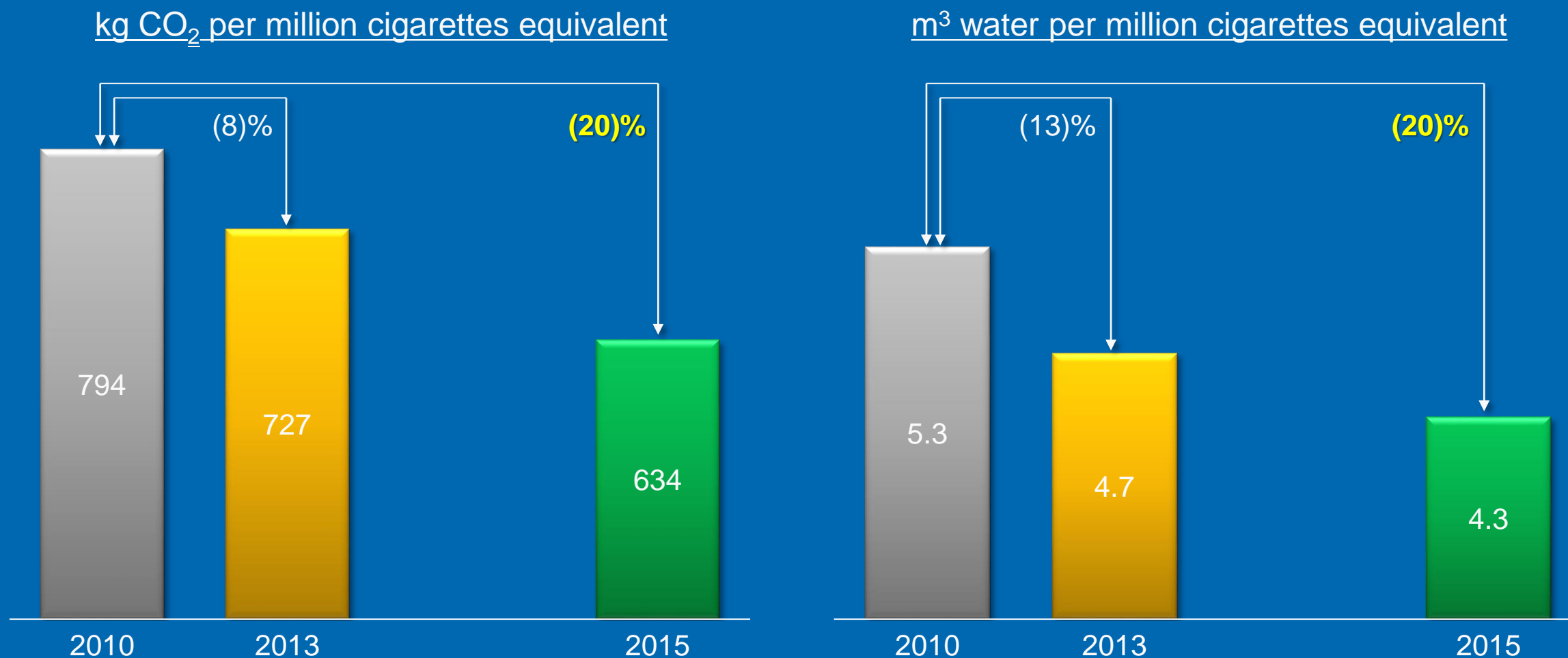


## IPS helps improve production of food





# Our Commitment to Sustainability: Manufacturing Environment



**On track to achieve 2015 targets**



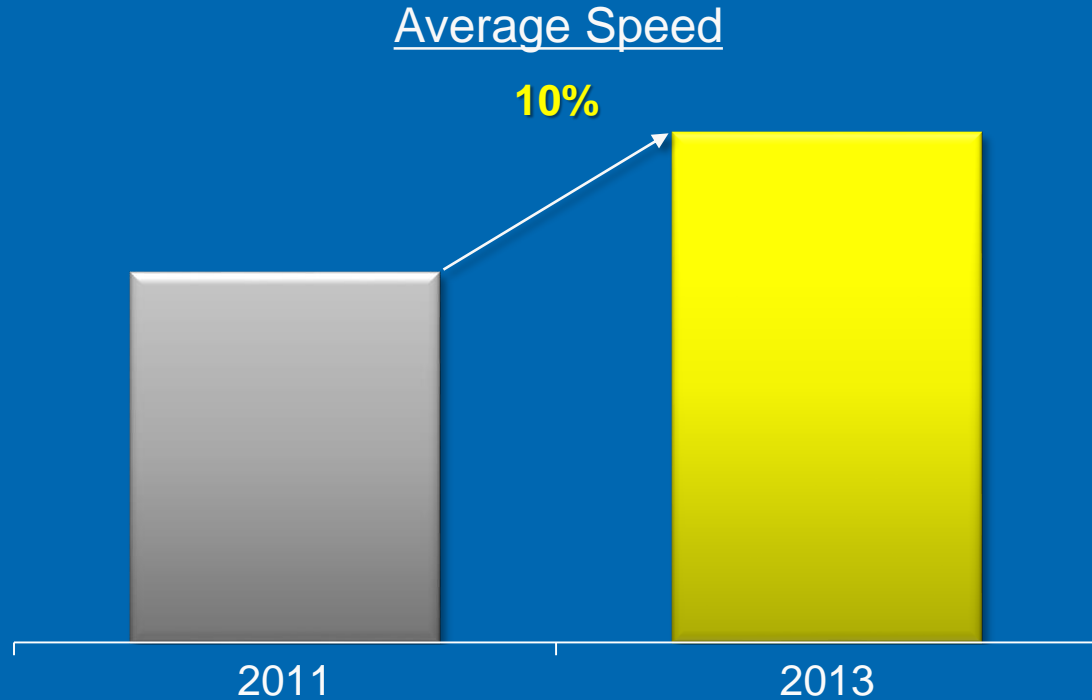
# Our Commitment to Sustainability: Climate Change

## Carbon Disclosure Project S&P/Global 500 Tobacco Sector Results

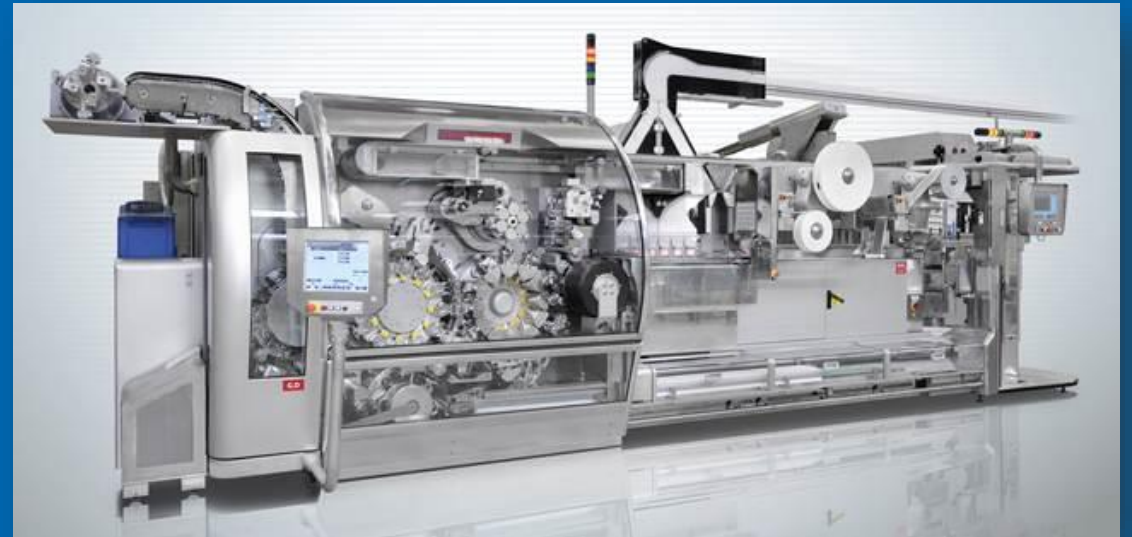
	<u>2012 Disclosure</u>	<u>2013 Disclosure</u>
<b>PMI</b>	<b>91%</b>	<b>97%</b>
JT	83%	96%
BAT	86%	94%
Imperial	75%	83%
Altria	71%	75%
Reynolds	63%	70%

# Facilities Equipped with Latest Technology

## Renewal and increased productivity of manufacturing equipment



- Next generation high-speed lines





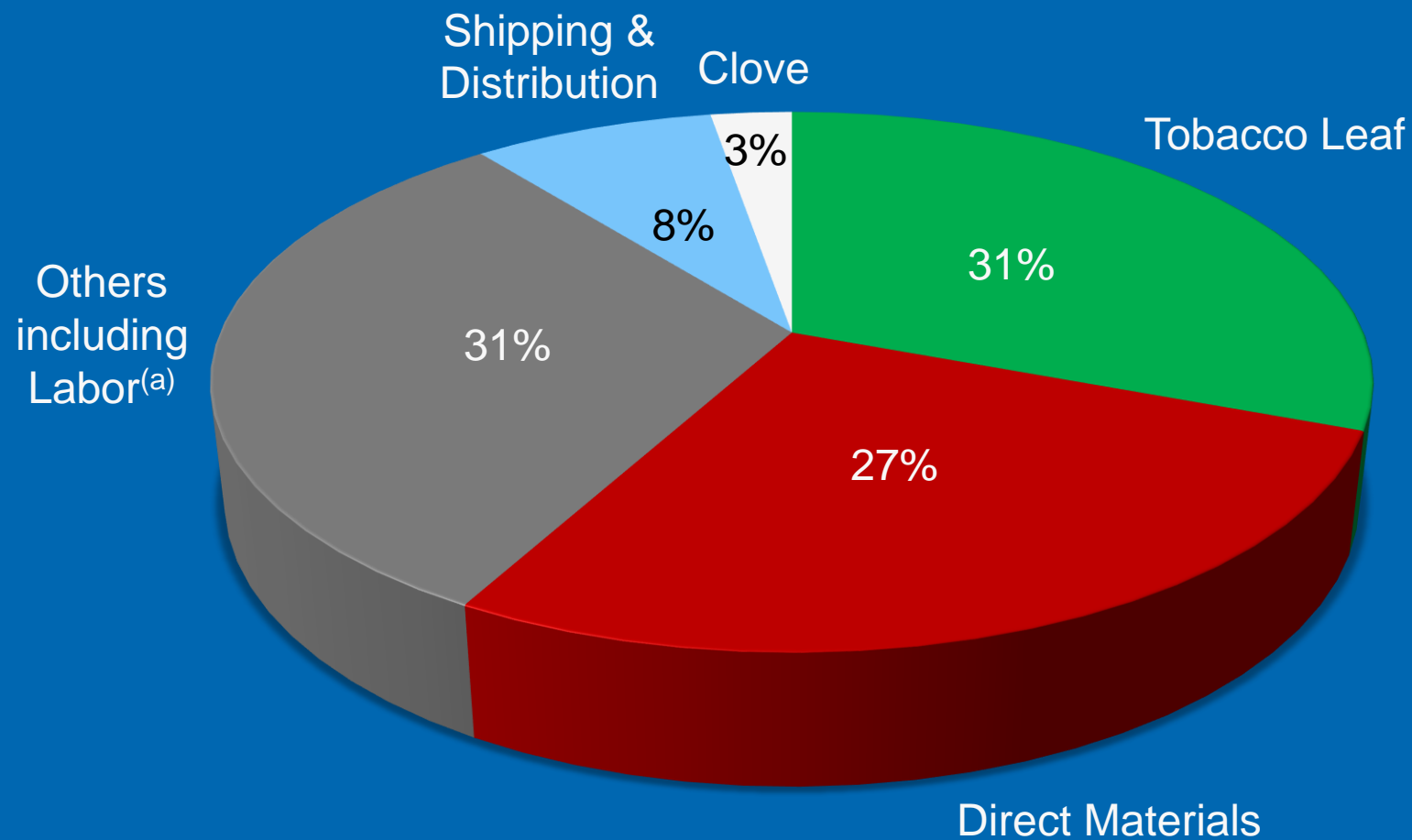
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## Cost Management



## Cost of Goods Sold



COGS (2013): \$10.4 billion

(a) Conversion, fixed manufacturing expenses and other costs  
Source: PMI Financials



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# Tobacco Strategy

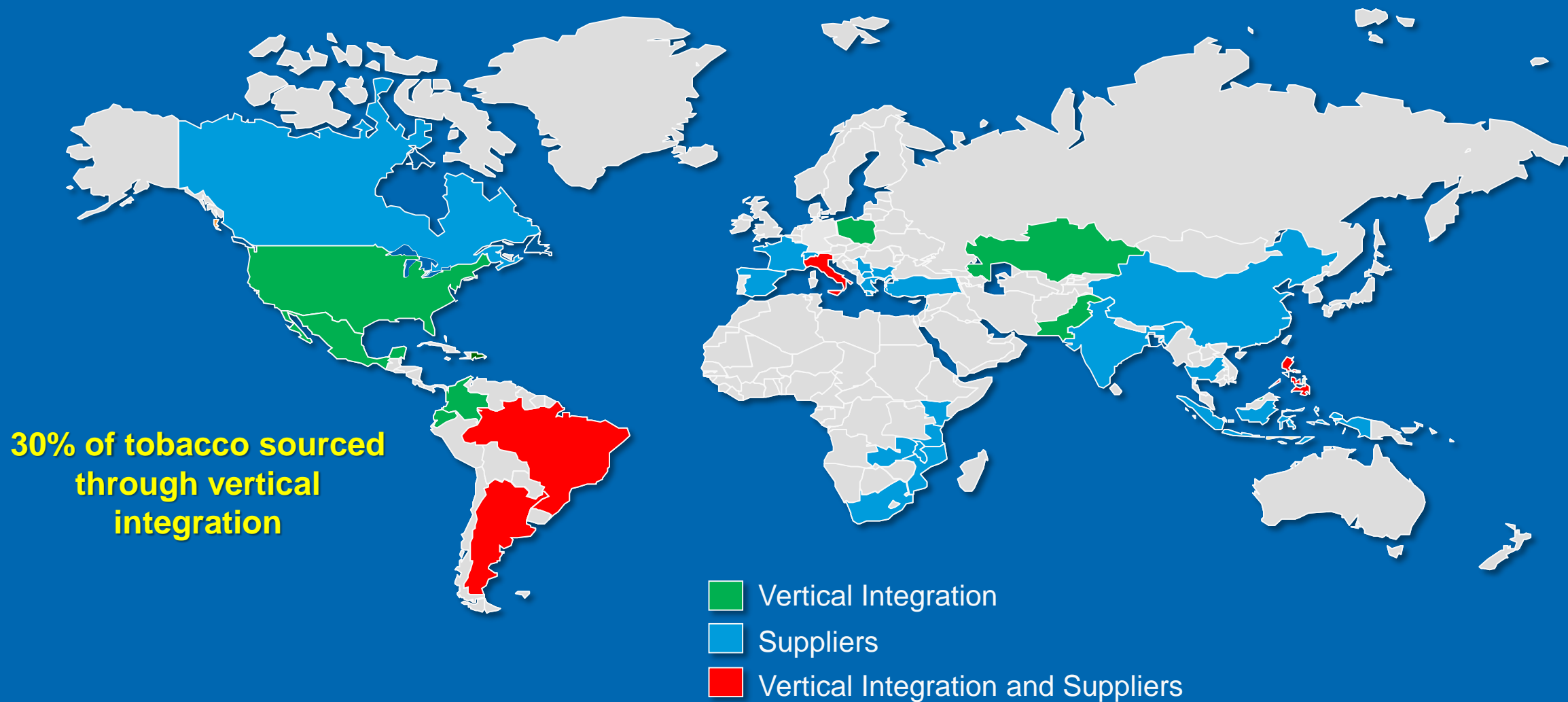
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- Secure quality tobacco at predictable prices
- Drive programs which make tobacco production sustainable while increasing farmer income
- Develop more innovative and efficient production approaches



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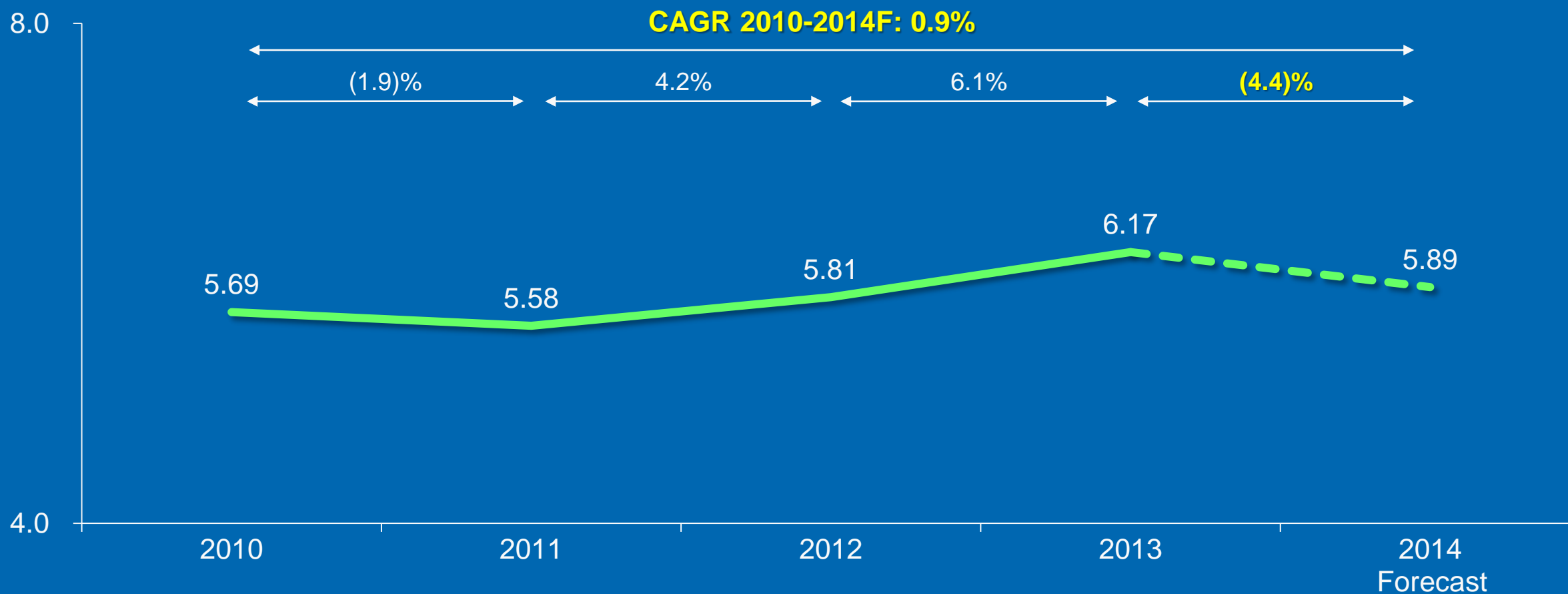
# 2013 Tobacco Sourcing Model





# Tobacco Leaf Purchase Price Evolution

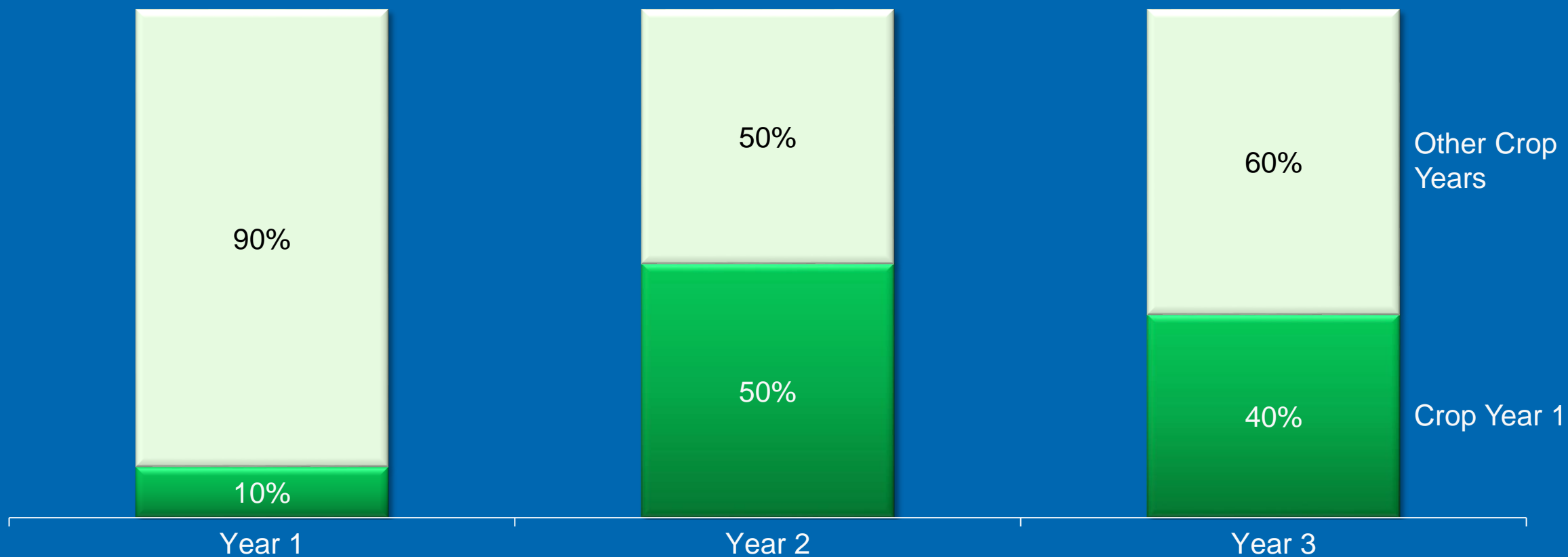
Tobacco Leaf Price Evolution (average \$ per packed kg)





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# Tobacco Leaf Crop Usage Illustration



# The Kretek Cigarette

- Kretek: a blend of tobacco and clove

Tobacco



+

Clove

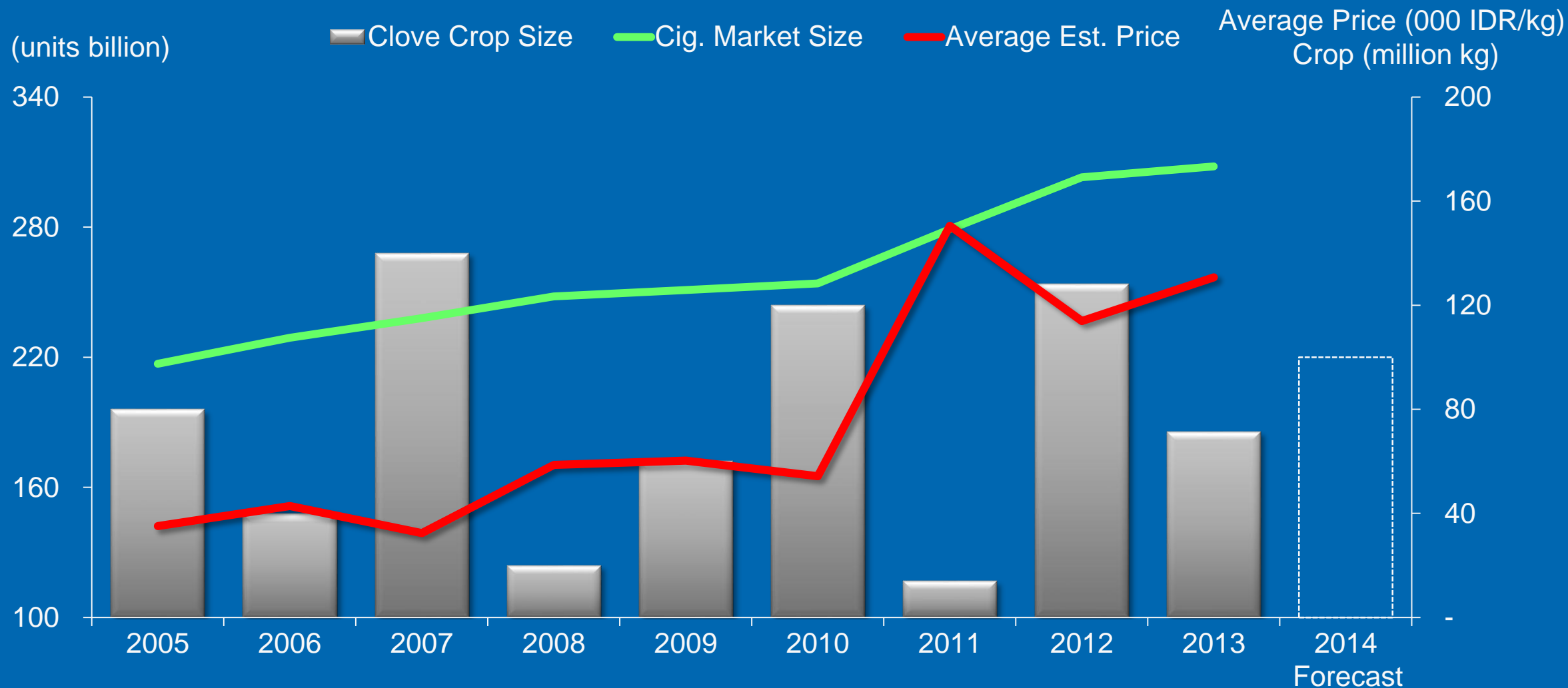


- Accounted for 93% of the Indonesian tobacco industry in 2013



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# Clove Crop and Price vs. Cigarette Market Evolution



# Clove Supply Key Strategies

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## Short-term:

- Extend network of technical assistance and buying centers with field technicians to work with farmers
- Improve yields through introduction of GAP and use of fertilizers
- Increase clove plants distribution to farmers

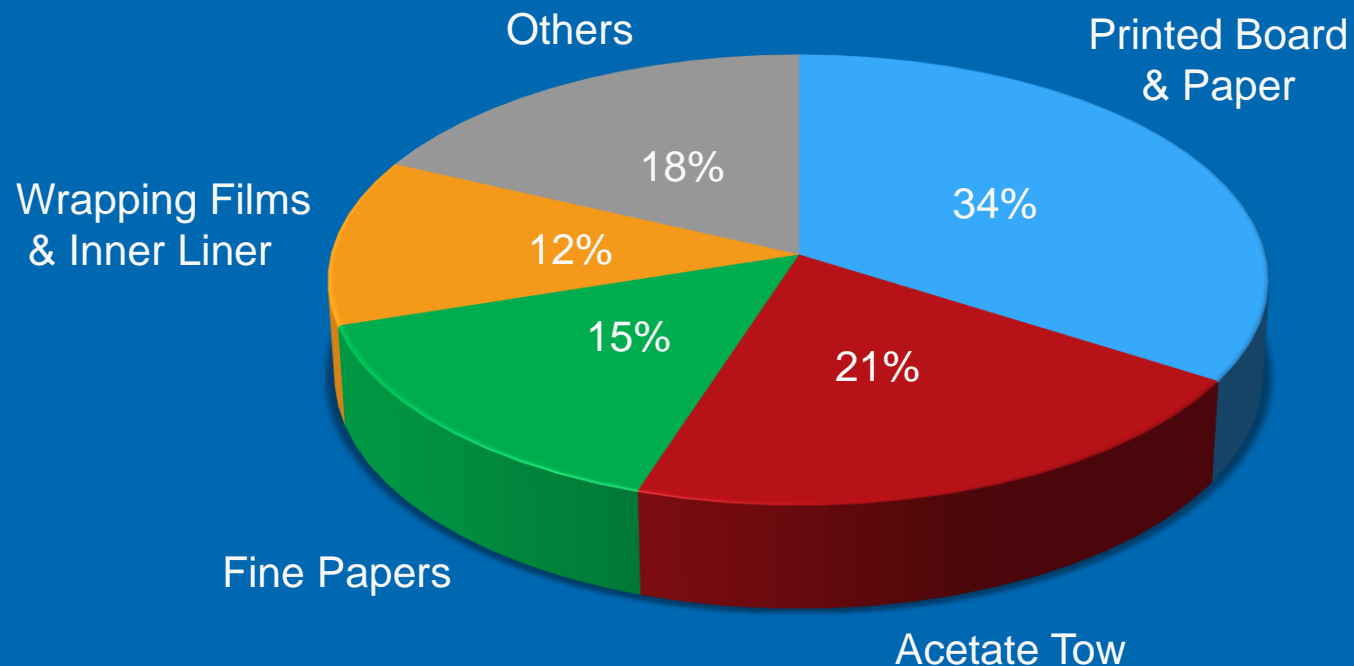
## Long-term:

- Application of innovative technologies for industrial clove production



## Direct Materials Categories

- Three main categories represent 70%
- 2013 spend: approximately \$2.8 billion





## Direct Materials Strategy

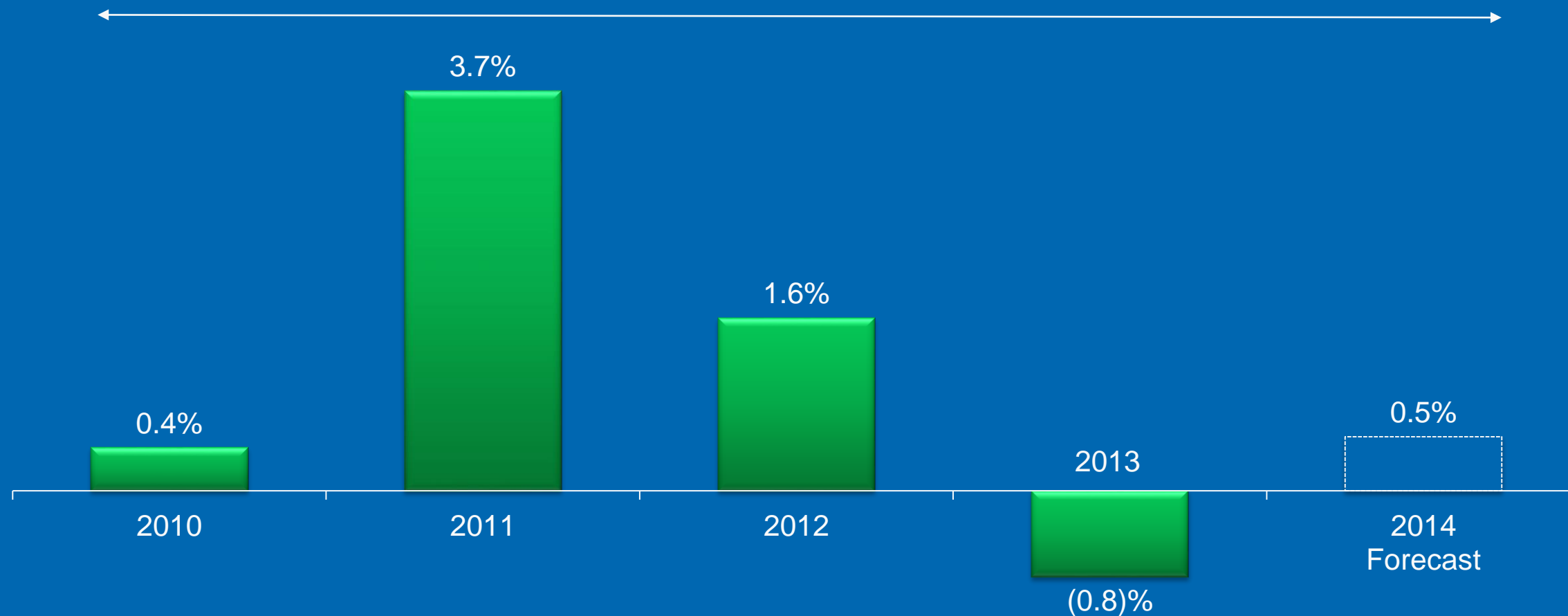
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- A competitive supplier base across the categories
- Economies of scale
- Centrally managed
- Viable and balanced supply chain base across all regions
- Anticipation of implications of regulation and industry volume evolution



# Direct Materials Price Index Evolution

CAGR 2010-2014F: 1.2%





# Supply Security

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- Comprehensive risk evaluation and mitigation:
  - Addresses the global footprint including warehousing and logistics
  - Integral part of the annual strategy cycle
- Business continuity:
  - Business continuity plans in place for identified risks
  - Special situations management system for potential risks



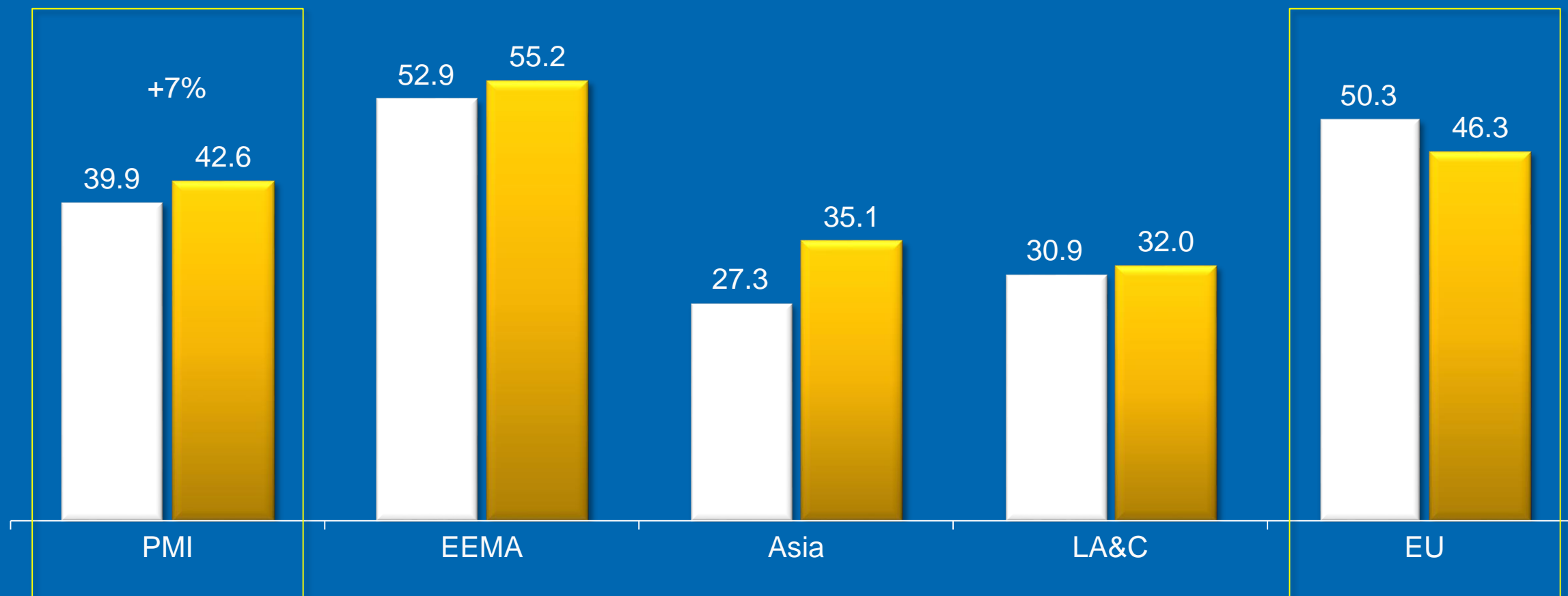
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# Labor Productivity of Machine-Made Cigarettes and OTP Production

(units million)

## Machine-Made Cigarettes and OTP Production per Headcount

2011 2013



Note: OTP was converted to cigarette equivalent  
Source: PMI Operations



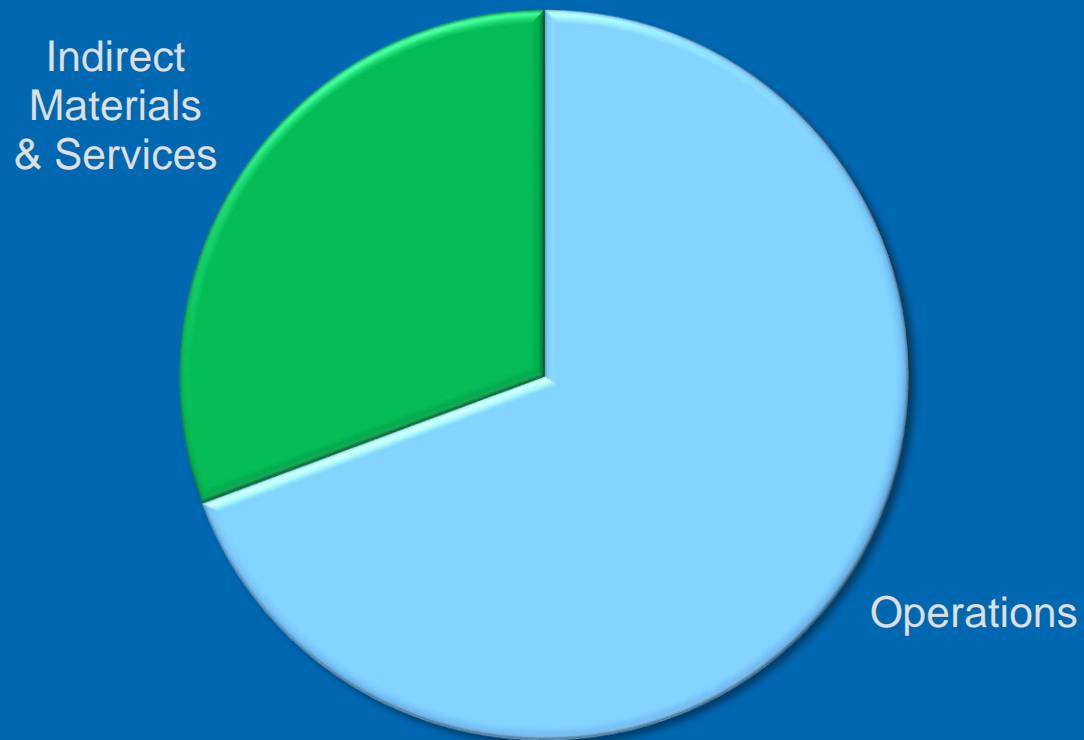
# Manufacturing Facilities Footprint Optimization (2012-2014)



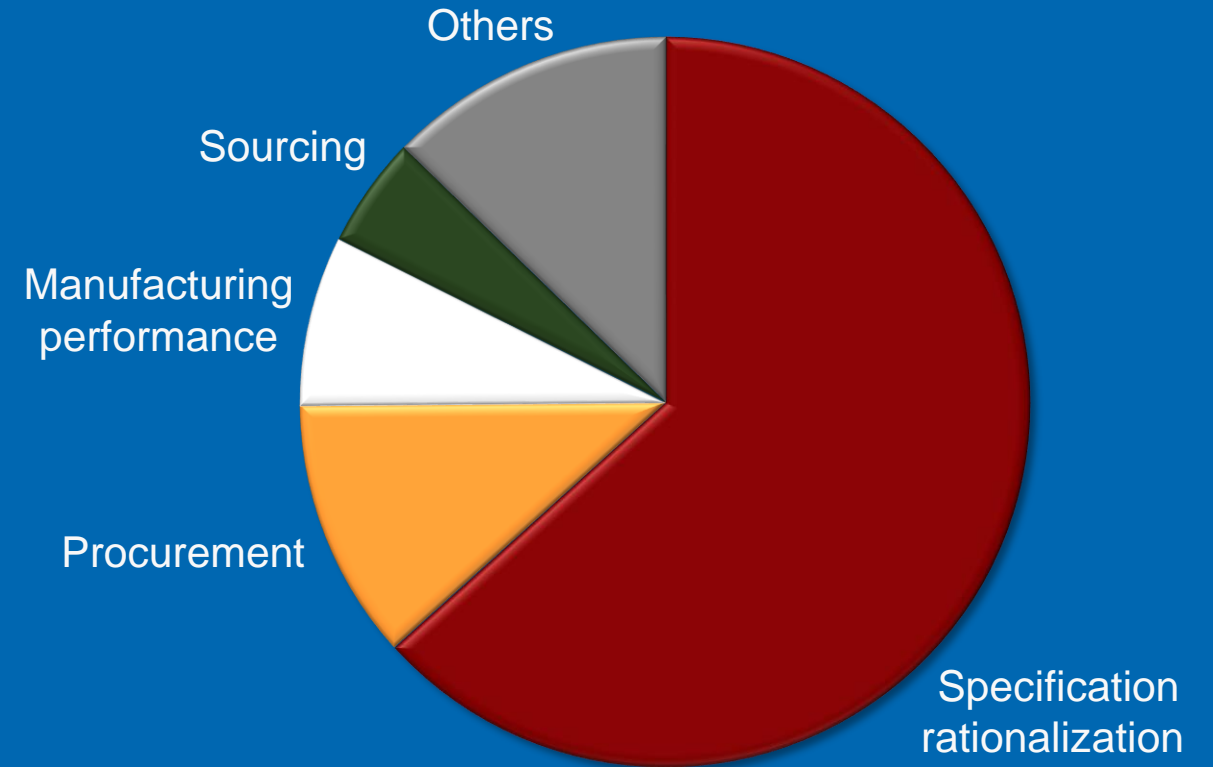
# 2013 Gross Productivity and Cost Savings over \$300 million (Pre-Tax)



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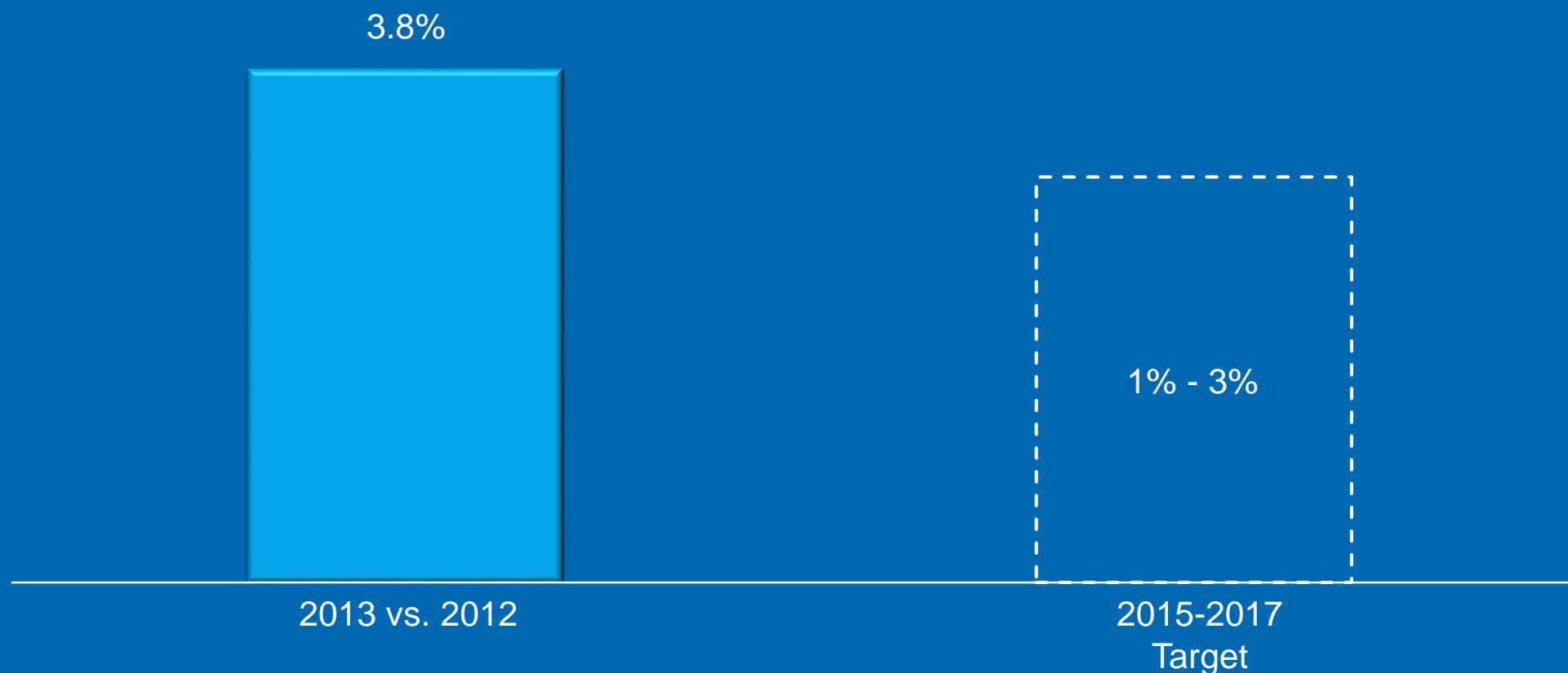
Total



Operations Contribution



## Target Annual COGS Increase in the Range of 1% to 3%



Note: 2015-2017 target excludes Reduced-Risk Products ("RRPs") related costs. RRP is the term we use to refer to products that have the potential to reduce individual risk and population harm. 2013 vs. 2012 cost of goods sold variance excludes the impact of currency movements (\$95 million) and changes in volume/mix (\$266 million)

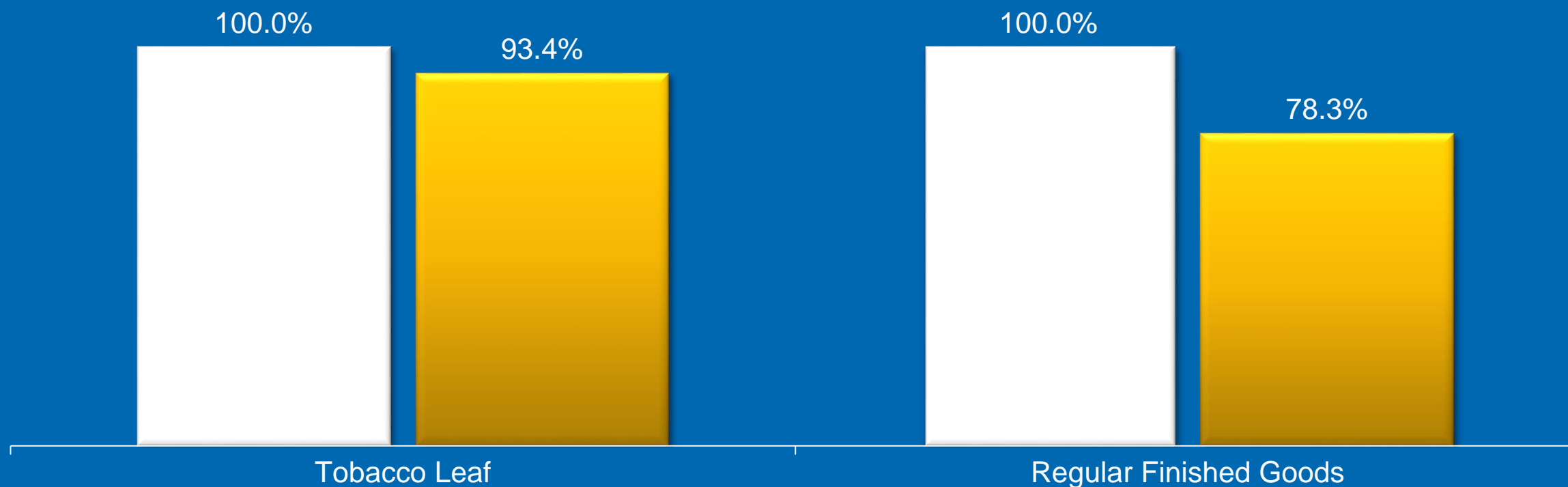
Source: PMI forecasts



# Inventory Duration Development

## Year-End Inventory Duration

■ 2010 ■ 2014 Forecast





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## Organizational Engagement



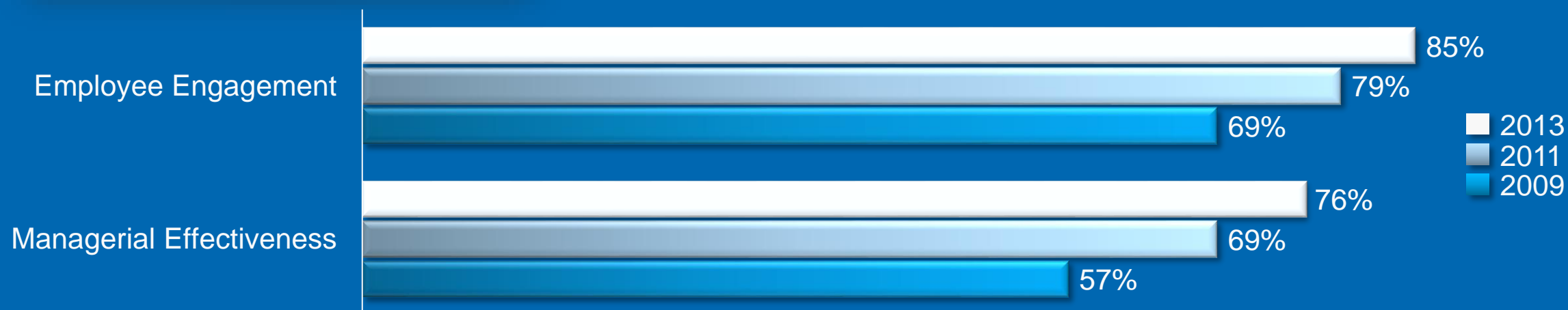
# Operations Performance and Engagement



OPEN is the way we conduct business in Operations

## Employee Opinion Survey Results: Progression

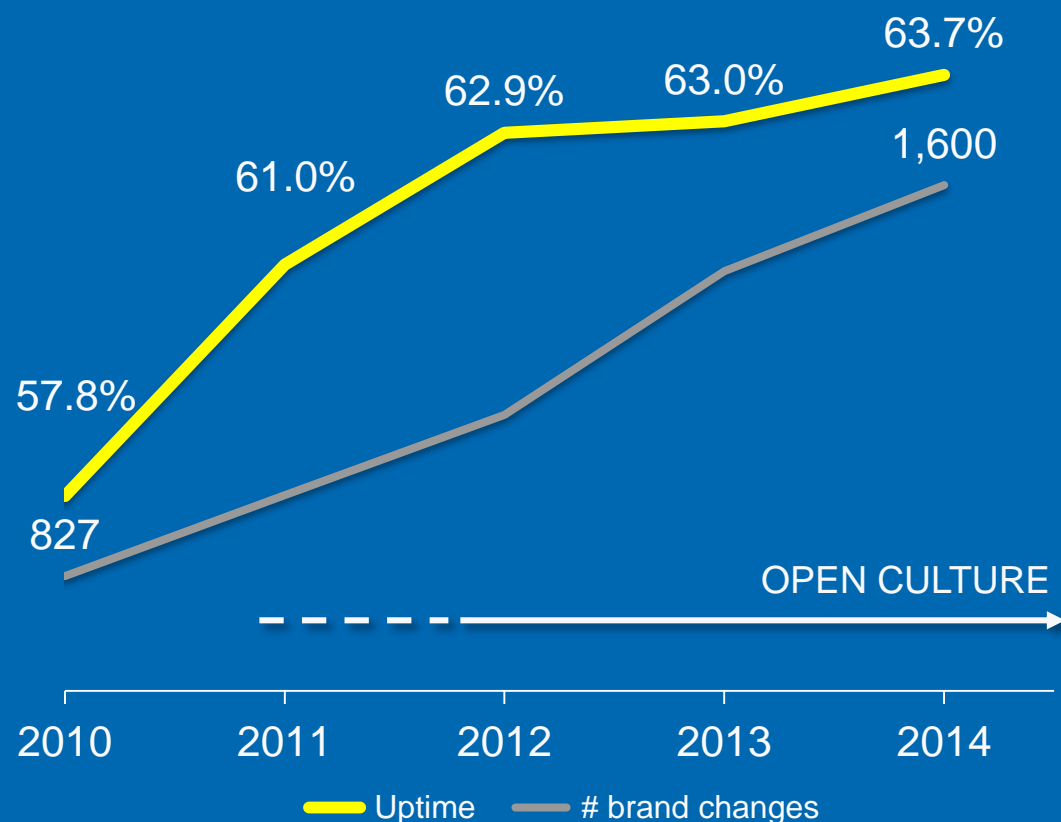
Operations Population (% favorable)



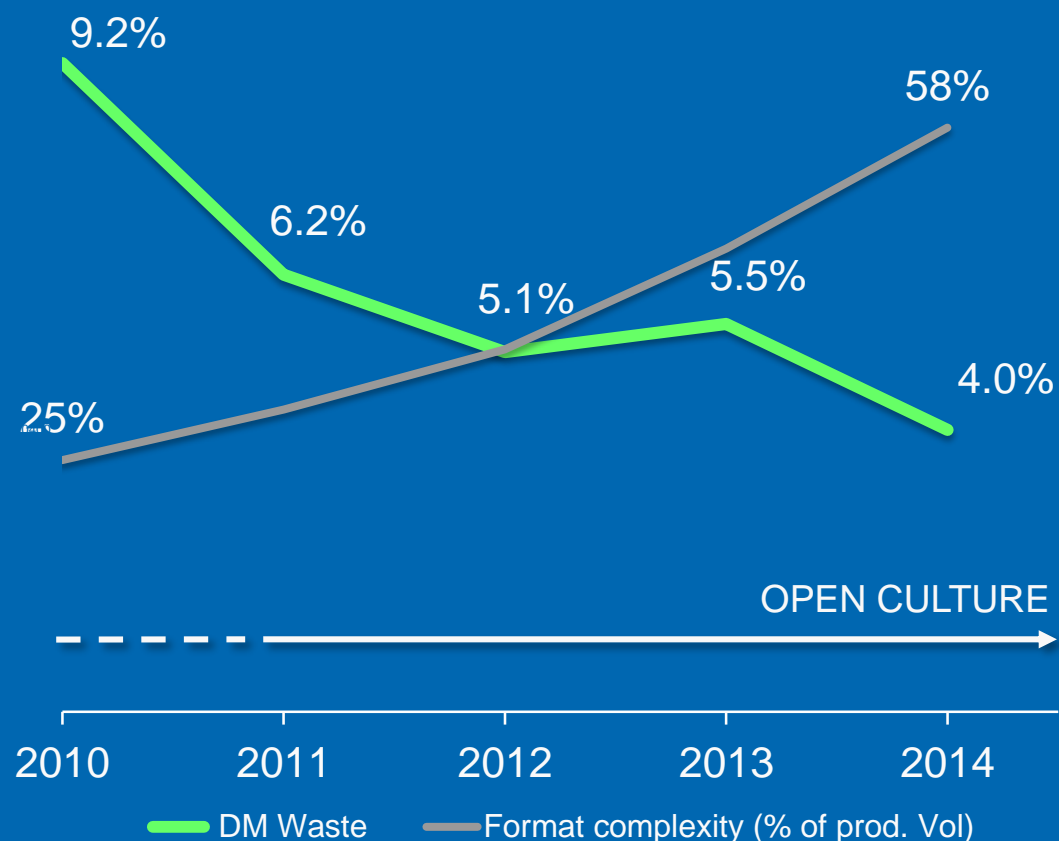


# OPEN Drives Performance

Portugal:  
Equipment Performance Improvement



Intertaba (Italy):  
Direct Material Waste Evolution





# Conclusions

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- Leverage our superb workforce
- Maintain industry leadership in safety, quality and sustainability
- Innovate to enhance portfolio, margins and gain market share
- Build capacity to fulfill RRP's demand
- Contain annual cost of goods sold increases in the 1% to 3% range excluding currency, volume/mix and costs related to RRP's



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## Investor Day – Operations Lausanne, June 26, 2014

Questions & Answers



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Reconciliation of non-GAAP measures included in this presentation to the most comparable GAAP measures are provided on our website at: [www.pmi.com/2014InvestorDay/RecSlides](http://www.pmi.com/2014InvestorDay/RecSlides)

Glossary of Terms: [www.pmi.com/2014InvestorDay/Glossary](http://www.pmi.com/2014InvestorDay/Glossary)