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Investor Day
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(SLIDE 1.)

Thank you Nick.

Good morning, Ladies and Gentlemen, and welcome to our fourth Investor Day. Thank you for being here with us or joining via the audio webcast.

(SLIDE 2.)

Over the course of today and tomorrow, we will outline the core components of our business model, which hold great promise for our shareholders and our broader stakeholder base.

Specifically, we will continue to lead the combustible product category, leveraging the great strengths of our existing business to deliver against our current growth algorithm.

We also aim to become the undisputed leader of the Reduced-Risk Product category with the highly ambitious objective of having RRPs ultimately replace combustible products to the benefit of adult smokers, society and our company.

When I spoke to you just over two years ago at our last Investor Day, we had yet to launch the first city-wide test of our Reduced-Risk Products. Today, we have already converted almost one million adult smokers to our RRPs. We are more confident than ever that these products have the potential to fundamentally transform our business. From a financial perspective, we expect RRPs to become accretive to our bottom line in 2018 and enhance our growth algorithm thereafter.

We will demonstrate that we are very well positioned to deliver against these two fundamental strategic engines given our innovation pipeline, commercial, regulatory and fiscal capabilities, manufacturing footprint and, above all, our organizational readiness and commitment.

(SLIDE 3.)

Today, I will first provide a brief update on our 2016 diluted earnings per share guidance.

I will then discuss the strong outlook for our combustible product portfolio, which provides more than 100% of our profit today, whilst financing the development and deployment of our RRP portfolio, and remains a critical component of our value creation equation.

I will then provide a high-level perspective on our strategy regarding Reduced-Risk Products, as well as their implications for the company and our future growth prospects.

After I finish, Werner will outline our portfolio strategy related to the combustible business.

Manuel and Mirek will then provide additional detail on the scientific substantiation and regulation of our Reduced-Risk Products, our overall portfolio and commercialization approach for them and our very promising results thus far.

Later today, you will also hear our Regional Presidents discuss how both our combustible product and RRP initiatives are being implemented at the market-level.

Tomorrow, Jacek will open with a review of our financials before we proceed to general Q&A.

(SLIDE 4.)

Before turning to the forward looking agenda, it is worth recapping PMI's track-record of solid underlying growth.

In 2015, we delivered currency-neutral adjusted EPS growth of 12% vs. 2014, despite the suspension of our share repurchase program. Our currency-neutral net revenues and adjusted Operating Companies Income growth rates in 2015 of 5.8% and 6.6%, respectively, also fell solidly within our target ranges.

In particular, last year, the EU returned to positive adjusted ex-currency OCI growth for the first time since 2009 as PMI shipment volumes were almost flat thanks to a more stable total industry and our own market share gains. Asia also returned to modestly positive adjusted ex-currency OCI growth, despite conventional cigarette share weakness in Japan and down-trading and price discounting in Australia. EEMA and LA&C continued to deliver currency neutral net revenues and OCI growth above our overall company targets as robust pricing and share gains more than offset total industry volume declines in those Regions.

Moreover, on a compound annual basis, we have delivered similarly strong results over the last five years, which is a testament to the long-term power of our business model.

Currencies have clearly been a major headwind over the past few years and have depressed our reported results compared to our underlying growth. However, these headwinds have started easing this year, a trend that we hope will continue into 2017.

(SLIDE 5.)

As you have seen in our press release this morning, we have narrowed our 2016 EPS guidance range and also revised it to reflect the latest currency spot rates.

The company's 2016 full-year reported diluted EPS is now forecast to be in a range of $4.53 to $4.58, at prevailing exchange rates, versus the range of $4.45 to $4.55 previously announced on July 19th, this year.

The estimated full year negative impact of currency now stands at approximately $0.35 per share, implying currency-neutral adjusted diluted EPS growth of approximately 10.5% to 11.5% versus our 2015 adjusted diluted EPS of $4.42.

As context for this very strong projected EPS performance, we have seen certain unanticipated challenges this year, but also a number of positive developments.

In the first category, we had the very sizeable excise tax-driven price increases and related total market decline in Argentina, as well as a surge of illicit trade in Pakistan. We also were impacted by macro-economic and political instability in North Africa generally, compounded by the relatively low acceptance of *Marlboro 2.0* in Algeria that we are addressing as we speak. A weaker economy in the Philippines exacerbated volume declines at the low end of the market, which were already under pressure due to the tax-driven price increases there.

On the positive side, especially from a net revenues perspective, we experienced better than anticipated EU volumes, continued recovery of illicit trade and better pricing in Turkey and, importantly, higher *iQOS* volume.

In addition, our temporary share weakness in Russia and Indonesia has been fully in line with our projections as we judiciously balanced pricing and OCI growth versus market share in these countries.

We also continue to forecast pricing equivalent to approximately 6% of net revenues and total cost increases of 1%, excluding currency but including the incremental investment in the scientific substantiation and commercialization of RRPs this year.

(SLIDE 6.)

Until 2018, we will continue to target annual currency-neutral net revenues and adjusted OCI growth of 4%-6% and 6%-8%, respectively, and annual currency-neutral adjusted EPS growth modestly above our target OCI results in the absence of share repurchases.

Currently, our share repurchase capacity remains highly constrained within our single-A credit rating due to the adverse impact of currency on our credit metrics over the past three years. This obviously limits the financial leverage between OCI growth and EPS growth in our algorithm in the near-term.

These growth ranges include our very significant ongoing investments in the commercial development and geographic expansion of RRPs. On the back of higher volumes from these efforts, we expect RRPs to approach break-even OCI as of 2017 and to start contributing positively to our OCI as of 2018. At that time, we will revisit our growth algorithm metrics to reflect the incremental volume, market share and margin potential of RRPs.

Directionally, however, I reconfirm today our target of 30 to 50 billion of incremental volume from RRPs, net of switching from our existing adult consumers, which would generate potential additional OCI of $0.7 billion to $1.2 billion by 2020. Based on our RRP results thus far, I am increasingly confident that we will be close to the upper end of this range.

(SLIDE 7.)

I will now spend a few minutes discussing the excellent fundamentals of our combustible product portfolio which underpin our optimism for the future.

Cigarette industry volume declines have been stabilizing around our current forecast range of 2.0% to 2.5% in recent years, following a nadir of just over 3% in 2013.

We have a broad and balanced geographic footprint, which nonetheless provides opportunities to expand organically or via business development into new territories.

Our leading global brand portfolio has solid long-term market share momentum and was further strengthened by the *Marlboro* Architecture 2.0 roll-out. Our robust innovation pipeline targets each of the major industry growth segments, and we are over-indexed in all of these segments today. We continue to enhance our Commercial Approach, leveraging state-of-the-art tools to improve the effectiveness of our commercial organization and prepare for the further expansion of RRPs. These in turn drive our strong pricing power.

Limited cost increases and rigorous efforts to generate productivity savings are helping to drive margins higher. Finally, we have a highly motivated and talented organization.

(SLIDE 8.)

Let us now look more closely at total cigarette industry volume trends.

For 2017 and beyond, we expect total cigarette industry volumes outside China and the U.S. to continue to decline at a rate of approximately 2.0% to 2.5% per year, excluding the impact of smoker conversion to RRPs.

This forecast is in line with the actual and expected declines for 2015 and 2016, respectively, and is based on longer-term societal trends, demographics and expected excise tax changes.

This also reflects the fact that we will be lapping both recently stronger volumes in OECD markets, due to generally more stable macroeconomic conditions and reductions in illicit trade there, as well as atypical, tax-driven declines in some non-OECD markets. Nonetheless, we anticipate declines will be more balanced between these markets going forward relative to the 2010 to 2014 period, when OECD decline rates were several times higher than those in non-OECD markets, primarily due to macroeconomic weakness in the EU Region.

(SLIDE 9.)

The mix of market declines is particularly important for us as both our market share and profitability are more skewed towards OECD markets. Concretely, market share being constant, a one percentage point decline in total industry volumes in OECD markets has more than two times the financial impact of a similar decline in non-OECD markets for us.

(SLIDE 10.)

PMI has gained market share over the last five years in both OECD and non-OECD markets, with the majority of this growth coming from our international brands, including *Marlboro*.

Although our total August year-to-date market share is down by 0.5 percentage points compared to the same period in 2015 for the reasons I explained previously, we have plans in place to address the few specific markets driving this result and the great strength of our portfolio makes us confident that we will maintain our cigarette market share growth trends in the years to come.

(SLIDE 11.)

Indeed, over the last five years, we extended our leading position in all major growing segments such as premium, menthol, low tar and slims.

As I mentioned earlier, Werner will discuss specifically how our innovation pipeline will allow us to continue to grow in these important segments.

(SLIDE 12.)

While we have the highest overall international market share, and the most balanced geographic share base in the tobacco industry, we still have the potential to extend our reach through expansion into white-space territories, particularly in EEMA and Asia.

Our Regional Presidents will cover some of these initiatives later in the day.

(SLIDE 13.)

Let me now return to the subject of pricing and its ongoing sustainability.

Since 2010, pricing as a percent of net revenues has been remarkably stable, with an average pricing variance of 6.4%, and a low and high of 5.7% and 7.0%, respectively. We continue to expect a pricing variance in 2016 of around 6%, as originally projected and broadly in line with this historical average.

(SLIDE 14.)

Pricing in aggregate dollar terms over this time has been well-balanced between OECD and non-OECD markets, as well as across our Regions, and is consistent with our overall volume footprint.

(SLIDE 15.)

On a percentage basis, pricing in non-OECD countries has outpaced that of OECD countries given the generally higher inflation and increases in disposable income, as well as lower absolute price points, in those markets.

Across both market groups, we have sustained these price increases while governments have also benefited from higher revenues through excise tax increases in excess of these levels, particularly in non-OECD countries, such as Russia and the Philippines.

As a matter of reference, absent changes in excise tax levels, our net ex-factory price increases translate, on average, into annual retail price increases of 3% to 4%, which trigger little or no price elasticity and are therefore sustainable.

(SLIDE 16.)

We remain vigilant in pursuing productivity and cost savings initiatives to support our growth algorithm and our long-term strategic priorities.

For 2016, we continue to anticipate total ex-currency cost increases of approximately 1% in comparison to 2015. This is driven by a decline in costs in the combustible product portfolio offset by higher expenses related to RRPs.

Going forward, we continue to target total cost increases in a range of 1% to 3%, including incremental costs related to the continued roll-out of RRPs.

Obviously, to the extent we gain incremental share via RRPs, there will be COGS expenses related to these volumes which are not included in this target, but these are clearly accretive to our profitability. I will provide additional color on the composition and evolution of our RRP costs later in the presentation.

(SLIDE 17.)

In summary, the combination of stable total industry volume declines, continued market share gains, sustainable pricing and cost containment initiatives should allow us to deliver results comfortably within our target ranges.

While our results remain highly dependent on the key parameters I have discussed, we view these sensitivities as manageable in the context of our overall business.

(SLIDE 18.)

Before discussing RRPs in more detail, it is worth highlighting, at a high level, some of the opportunities and complexities of the RRP business model vis-à-vis that of combustible products.

Despite all of the challenges that have faced the tobacco industry historically, the underlying business model and drivers have remained relatively stable over time. Total long-term industry volume trends are relatively predictable. Regulations are stringent, but well-defined, with periodic additional restrictions proving manageable. Tax structures and trade margins are stable in the clear majority of markets. Pricing remains attractive and sustainable. Modest share gains are achievable, within the context of relatively well-defined marketing and innovation corridors, and we have a highly talented, experienced and well-oiled organizational machine to deliver against our targets.

Overall, we would characterize it as an attractive, but linear growth model, with predictable upside and downside boundaries in any given period, as our historical results and current growth algorithm demonstrate.

(SLIDE 19.)

The advent of RRPs introduces some additional variables into the equation, which are somewhat less range-bound and predictable given the emerging nature of the category, but also offer great upside potential.

For instance, while the volume trend for RRPs is clearly positive and incremental to our business, the precise speed of conversion by adult smokers will be difficult to forecast in the initial years. Regulatory and tax regimes are new and evolving territory for all stakeholders, but hold great potential to accelerate conversion.

We have the opportunity to realize material changes in market share, but will need new approaches to marketing and commercialization to maximize switching.

Manufacturing, supply chain and logistics for the product are more complex, especially with introduction of electronic devices, but remain manageable. Pricing also becomes a more sophisticated exercise as it needs to balance the higher costs of innovation, scientific assessment, regulatory compliance, and the initial phases of commercialization and manufacturing whilst, over time, extending the RRP offering to lower price segments to further encourage switching. Given the breadth of our RRP portfolio and related pipeline, we believe we have ample room to operate. Clearly a lower tax burden than cigarettes is a rational regulatory decision in this context.

Product innovation and scientific research and substantiation are absolutely paramount in the category and we will continuously look both internally and externally to maintain a vibrant product pipeline and related ecosystems.

Finally, the organization must adapt to deal with the above with a high degree of agility, collaboration and entrepreneurial spirit.

Overall, there is the potential for companies that succeed in managing these factors to achieve exponential growth in the category. We believe we understand all of these parameters well and can be very successful in this environment.

(SLIDE 20.)

I will use my remaining time today to cover a few key topics related to the RRP journey in more depth, namely:

- Why RRPs are a fundamental component of population harm reduction efforts and why regulators should approach them as such;

- Why maximizing harm reduction requires an integrated portfolio approach to RRPs;
- How our commercialization progress to date, while still early, gives us confidence in the long-term potential of these products;
- What actions by us, and by the regulators, are required to accelerate switching to these products and how our actions will show our full commitment to regulators, the public health community and other stakeholders;
- How the further market penetration of RRPs will be financially accretive to PMI; and
- The implications of our vision for the organization.

(SLIDE 21.)

RRPs are a critical component of harm reduction as experience has shown that existing and contemplated regulatory measures are only likely to have a modestly positive impact on aggregate population harm, as they do not fundamentally change underlying consumption patterns.

In fact, according to the WHO, assuming the current regulatory regimes remain in place there will be a reduction in smoking prevalence from approximately 22% to 19% by 2025, implying the absolute number of smokers will remain unchanged at approximately 1.1 billion due to population increases. The risk of disease to the population under this scenario, across age cohorts, is illustratively represented here by the dotted line.

(SLIDE 22.)

The WHO's stated ideal scenario is to adopt additional restrictive measures, to be defined, in an effort to further reduce prevalence rates to approximately 16% by 2025. This implies a reduction in the number of smokers to approximately 900 million by that time, thus changing the illustrative health impact curve by approximately 20%, as depicted by the solid line in this slide.

(SLIDE 23.)

It is well established from years of epidemiological data that the risk of smoking related disease decreases from the time a person quits, and that the pace of reduction is more rapid the earlier they quit, as illustrated by the green lines on this chart.

(SLIDE 24.)

For this reason, the gold standard for harm reduction, as defined by the U.S. Institute of Medicine, is to demonstrate that the effects on adult smokers who switch to RRPs are very close to those observed in people who quit smoking, as illustrated by the yellow lines here.

Therefore, if we can encourage a meaningful portion of adult smokers to rapidly switch to RRPs that meet this standard, it is likely to create a significant additional population health benefit relative to current regulatory efforts.

It is our sincerest hope that this logical principle will be embraced by the vast majority of regulators and the public health community, including the WHO and NGOs. We are very much encouraged by the growing number of preeminent public health advocates that already support the principle of tobacco harm reduction through products and science.

(SLIDE 25.)

Certainly, overall population harm reduction is dependent on more than just the potential risk reduction for the individual smoker.

Changes in population harm are also a function of the impact of RRPs on initiation and quitting rates, the extent to which smokers that have quit may relapse and, very importantly, full conversion and dual usage rates.

All of these represent logical and very legitimate questions to address. Many can be answered with significant confidence prior to commercialization, while some can only be accurately quantified through a robust and transparent post-market surveillance plan. Such post-market surveillance is also necessary to monitor and act on behavioral changes, confirm pre-market clinical data and establish epidemiological data on RRPs over time, and is therefore a critical component of longer-term RRP substantiation.

However, if a product does offer the likelihood of a substantial reduction in individual risk compared to continued smoking, the goal of regulation should be to realize that benefit for individual smokers while minimizing possible unintended consequences, thereby maximizing the overall net benefit to society.

(SLIDE 26.)

In determining the likelihood that the individual risk reduction can be realized, there needs to be a focus on adult smoker acceptance and switching, which of course depends on the attributes of the product itself.

This chart illustrates conceptually where our current portfolio of RRPs and the current generation of e-vapor products are likely to be situated along the continuums of both reduction in exposure and probability of adoption by smokers.

As we have seen, while the current generation of e-vapor products has high trial rates, we estimate that the rate of full adoption is low and that there is a significant amount of dual usage. However, the high rate of trial, and absolute number of smokers who have switched to e-vapor products, suggests there is the potential to increase adoption with product improvements.

In contrast, we are experiencing full or predominant conversion rates of 60% to 70% on *iQOS*, clearly indicating that heat-not-burn products such as *iQOS* have a significant role to play in the individual consumer journey and overall population harm reduction effort.

(SLIDE 27.)

Even if overall adoption rates vary between offerings, adult smokers will inevitably gravitate towards different product solutions based on a variety of personal considerations, including taste and satisfaction, ritual and perceived proximity to tobacco and/or smoking.

Consequently, we see the need for a comprehensive portfolio approach to the category and our platforms are designed to address a range of different audiences and usage occasions.

Platforms 1 and 2 currently provide the highest level of taste and satisfaction compared to cigarettes. From a smoker's perspective, Platform 1 is a modern, progressive offering, but the ritual is initially more complex. The Platform 2 ritual is more familiar and may initially address a more conservative consumer base.

Both Platforms 3 and 4 allow interested adult consumer groups to distance themselves from smoking to a greater extent from a taste and perception standpoint due to the absence of tobacco. For Platform 3, the nicotine satisfaction is the same as cigarettes with a taste profile that is less complex than that of Platforms 1 or 2. For Platform 4, as Mirek will show later, we are releasing the first version of the next generation products we are developing. The new aerosolization technology ensures manufacturing and aerosol consistency, better addresses consumer acceptance issues that impact the e-vapor category today and, because manufacturing is fully automated, will enjoy lower costs than current wick and coil technology.

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While addressing these varied preferences, we will also seek to generate cross-platform manufacturing and supply chain efficiencies as well as synergies from a consumer engagement standpoint.

For instance, the tobacco for both our Platform 1 and Platform 2 heat-not-burn products is manufactured via the same primary process and equipment.

Furthermore, our mid-term goal is to utilize a standard electronic heating device across Platforms 1, 3 and 4, allowing the adult user to vary the consumable depending on the occasion and further increasing the cross-productivity of the platforms.

All of our electronic platforms also provide the opportunity for us to create digital ecosystems that enhance the overall consumer experience and are based on common infrastructures, with content tailored as appropriate.

Finally, and importantly, we will build trust and loyalty in the overarching technology and science through an integrated branding strategy, which Mirek will explain.

As RRPs are increasingly adopted by adult smokers, consumer preferences and the competitive environment are also likely to evolve. Hence the need for a holistic approach to innovation, including the continuous improvement of existing platforms, as well as the creation of new ones.

(SLIDE 29.)

Let me now turn for a moment to our RRP commercialization progress, which Mirek and the Regional Presidents will address in great detail.

Simply put, nearly 1 million adult smokers have already been converted to *iQOS*. Stop to consider that for a moment – they represent almost 1 million people who have quit smoking and now have a potentially lower risk of smoking-related disease compared to continued smoking – and we are still in very, very early days.

(SLIDE 30.)

Since our initial city tests in late 2014, we have learned a tremendous amount about the consumer conversion journey and we are learning more every day. Critically, consumer understanding of the product, and commitment to exclusively use it for one week, preferably two, are key elements. General product awareness and availability are necessary, but not sufficient, for full conversion.

Once smokers have gone through this one to two week period of acclimating themselves to the modest, but nonetheless present, differences in ritual and taste, they are very likely to remain loyal to the offering and recommend the product to other adult smokers.

Therefore, a very important component of the commercialization activity mix is quality time spent with individual consumers in the right venues to fully explain the *iQOS* characteristics and initial hurdles, ensure that consumers who buy the product commit to use it for the two-week period and, post-purchase, help the consumers in their conversion journey.

This requires a very significant amount of consumer engagement resources on the ground, but it is highly effective. We have, therefore, redesigned our commercialization programs around this key objective and are rapidly increasing our related field capabilities in the launch markets.

(SLIDE 31.)

This phase of commercialization is required until we reach a critical mass of consumers, or approximately 2% to 3% smoker share in a given geography.

Once this occurs, we see a noticeable acceleration of smoker adoption due to increased normalization and broader awareness as well as word-of-mouth testimonials and net promotion by converted users, who are typically the best positioned, and have the most credibility, to help other smokers adopt the product.

(SLIDE 32.)

Indeed, despite our bullish projections at the time of the national roll-out a year ago, the pace of conversion once we achieved this critical mass in Japan surprised us. Since June of this year, we have been rationing the number of *iQOS* devices sold in the market. Without this step, the demand for *HeatSticks* would have likely exceeded our current manufacturing capacity.

We are cognizant that this is a major inconvenience and disappointment for those Japanese smokers who want to adopt *iQOS*, but it avoids the unacceptable scenario of consumers who have switched to *iQOS* facing *HeatStick* shortages. We are currently air freighting *HeatSticks* to Japan as soon as they can be released from production and have accelerated our investment in manufacturing capacity, so that by the end of Q1 next year these constraints will be addressed and we can fully unleash the product's potential.

(SLIDE 33.)

Despite these limitations, we are continuing to lay the groundwork for future growth. By the end of this year we will be present in a total of 20 markets, although we have necessarily limited the geographic scope within certain markets to selected cities temporarily. We have plans to expand *iQOS* to an additional 10 to 15 markets in 2017 after these constraints have eased.

We also expect all of our other platforms to be in city tests over the course of 2017.

(SLIDE 34.)

Importantly, given the volatility of volume forecasting, we are building sufficient flexibility in the manufacturing footprint to address surges going forward. Jacek will provide related details for *iQOS* and the other platforms, but under our current plans we will be in a position to actually produce more than 32 billion *HeatSticks* in 2017 up from 7 billion this year. On this basis, the 2017 year-end installed capacity will be 50 billion units. We have also secured the ability to add approximately 4 billion units of capacity per month as of the beginning of 2018 with around 12 months' lead-time. In general, every one billion of incremental *HeatStick* capacity will require $16 million to $18 million of investment. Sufficient *iQOS* device capacity will also be available.

Total capital expenditures for 2016 and 2017 are expected be $1.2 billion and $1.5 billion, respectively, reflecting the capacity increase. Subsequent capital expenditure levels will depend on consumer demand dynamics based on the parameters mentioned previously. We have to remain flexible bearing in mind that the returns from these investments are highly attractive. Once the equipment is installed and qualified, the cash flow from the incremental volume produced provides a positive return on the investment in a matter of months.

(SLIDE 35.)

Before moving on, I would like to directly address the question of whether *iQOS* in Japan is a "one-off" phenomenon.

In short, it is not, and *iQOS's* progress in other launch markets is also very promising. While Mirek will show additional detail on the related conversion rates, device penetration levels, *HeatStick* offtake figures and other data that support this conclusion, let me provide some context.

As we saw in Japan, until critical consumer mass is reached and growth becomes more clearly exponential, the pace of conversion is rather slow and linear. The specific speed is very much correlated with the level of prevailing marketing restrictions and consumer engagement resources committed, and is facilitated by national expansion. It is therefore difficult to accurately predict the slope and duration of this part of the representative s-curve in a particular new launch market. Our target is to reach this critical mass within 12 to 24 months of launch, especially when we roll-out nationally in a given market.

It is worth recalling that at this time last year, we had still only achieved a 0.8% offtake market share with *HeatSticks* in Nagoya, our first test city in Japan, nearly a year after the initial launch there. Fast forward to today, and our offtake share in Nagoya in mid-September 2016 was 5.2%, in line with our stellar overall share in the market. While not a proxy, it is also worth mentioning that more than 80% of the smokers in this building have switched to *iQOS*.

Although effort and investment, as well as I would say some patience, are required in this initial phase, the reward is great once we reach the upward part of the conversion curve. But even this part is likely to be different from market to market, which highlights the complexity of the volume, resource and capacity planning equation. Organization flexibility is critical here.

(SLIDE 36.)

Given the enormous potential of RRPs to significantly and rapidly improve the health trajectories and daily quality of life of more than one billion smokers worldwide, and at the same time enhance our business growth, we will continue to encourage all adults who would otherwise continue to smoke to switch to RRPs.

This is an all-encompassing effort ranging from educating smokers that combustion is the key problem in cigarettes, to deploying all commercial tools available to us under current regulatory regimes, to committing all necessary human and financial resources to this endeavor.

(SLIDE 37.)

But regulators, the public health community, and civil society at-large also have a key role to play in advancing consumer understanding and adoption of these products. Their potential actions can range from embracing the very principle of harm reduction based on scientific substantiation of products, to establishing regulatory frameworks that foster the appropriate development and commercialization of RRPs by all competitors, to a number of what I would call supply and demand measures.

On the demand side, or how regulators manage incentives, actions could consist of the elimination of, or to be pragmatic lower or risk-differentiated, excise taxes for RRPs as well as a balanced framework for consumer communication and public use that reflects the product benefits, and/or official encouragement by the relevant Health agencies for smokers to switch.

Supply side measures, where regulators more directly manage outcomes, could potentially be envisaged at the right stage of maturity of the RRP category.

(SLIDE 38.)

I fully recognize that there is skepticism and a deficit of trust in our determination to lead the effort to achieve a combustion free world as soon as possible. Although we cannot change the past, we can certainly change the future and transform our company.

We are committed to the transparent sharing of our RRP science for independent third party verification of both our product technologies and risk assessment results. As Manuel will explain, this effort is already underway, but much more can be achieved with broader stakeholder participation.

By early next year, we will announce a set of KPIs demonstrating the resources we are putting behind the category as well as the level of top management and organizational commitment to it. We will then regularly publish these KPIs in a clear and verifiable manner so that we, and the broader stakeholder base, can measure our progress.

(SLIDE 39.)

Before moving to RRP economics, I will provide a brief update on the status of our *iQOS* regulatory submissions.

We are on track to submit our first Modified Risk Tobacco Product application to the U.S. FDA by the end of this year, and we also plan to submit a premarket tobacco product application early next year.

As a reminder, the MRTP Application governs whether *iQOS* can be marketed in the U.S. as either a modified exposure, or a modified risk, product. The FDA is targeting a one year timetable for review of MRTPs once the relevant application is accepted. However, this timing is subject to their discretion.

The PMTA, on the other hand, if approved, allows *iQOS* to be marketed in the U.S. without claims. By statute, the FDA must make a determination on a PMTA within 180 days of the application being submitted.

Turning to the EU, the majority of member states have now transposed the latest Tobacco Products Directive (TPD2) that created the “Novel Tobacco Products” category. The TPD2 requires companies to notify member states of their intent to commercialize Novel Tobacco Products. To this end, we have filed scientific submissions with the EU and several Member States regarding *iQOS*.

Overall, our focus remains on having regulatory frameworks established which govern the substantiation, and approval, of claims related to RRPs in the EU and elsewhere.

(SLIDE 40.)

Let me now turn to the economics of *iQOS* and why our goal of converting adult smokers to RRPs not only benefits these consumers and society, but also our company and shareholders.

First and foremost, *HeatSticks* have higher average net revenues potential than cigarettes, driven by three factors:

> Firstly, today *HeatSticks* are a premium offering, which we believe is important during the initial adoption phase to build category credibility. Nevertheless, adult smokers are also in-switching from below premium price segments.
>
> Secondly, as *iQOS* is rightly perceived by consumers as a completely new product category, and not as a cigarette line extension, the percentage of adult smokers of our own cigarette brands who adopt the proposition is in-line with, or only modestly above, our cigarette share in our launch markets. This implies potential market share gains which represent pure incremental margin. This dynamic holds true when variants of the proposition will be made available to more price-sensitive consumers as the enlarged base will, by and large, offset the lower unit margins.
>
> Finally, in many markets the fiscal authorities do recognize the fact that *HeatSticks* are not cigarettes. Consequently, *HeatSticks* are currently excise taxed either under a new category or as other tobacco products, which have a lower excise tax burden than cigarettes. Given the fact that, on average, excise tax yields on cigarettes are three times net revenues, a reduction in their level can have a material impact on unit margins. Clearly, over time, RRPs should constitute a separate fiscal category and, if taxed, the tax level should reflect their risk profile compared to cigarettes and be an integral part of the demand side measures used to accelerate switching, encourage continuous innovation and ensure scientific rigor.

In addition, the cost of producing *HeatSticks* at scale is broadly in-line with that of our conventional cigarettes, such that the incremental net revenues translate into higher marginal contribution levels.

In the near-term, these benefits are partially offset by the ongoing cost of our R&D and scientific substantiation efforts, certain central RRP activities and fixed manufacturing expenses. Clearly, we also have some incremental launch costs as we enter new territories. Finally, we currently offer an introductory discount for the *iQOS* devices that results in net revenues that are somewhat lower than the device costs. This is helpful at the initial phase of commercialization, but is unlikely to be necessary once we reach broader adult smoker acceptance.

If we look at our overall RRP expenses, the fixed component, including R&D, central overheads and fixed manufacturing, is expected to be almost half of the total in 2016. This is currently absorbed by initially modest sales volume, but will decrease in relative terms soon.

(SLIDE 41.)

To put the revenue opportunity into perspective, our cigarette portfolio has average net revenues of approximately $36 million per billion units in the 20 initial RRP launch markets.

If we assume that *HeatSticks* are priced in line with the cigarette average and that 40% of the *HeatStick* volume is sourced from our smokers, i.e., approximately 10pp above our average market share, net revenues would increase by $21 million for every 1 billion *HeatSticks* sold due to the incremental share gains.

If *HeatSticks* are premium priced, net revenues would increase by $30 million versus the base, as we would benefit from both increased share and up-trading by our own consumers.

All of these scenarios assume excise tax rates for *HeatSticks* in line with cigarettes. To the extent *HeatSticks* are taxed 10% below cigarettes, this would result in a further $12 million difference versus the cases shown here.

(SLIDE 42.)

The advent of RRPs holds great promise for PMI, but at the same time has significant implications for our organization. RRPs will continue to necessitate ongoing changes in our way of working to handle the evolution of our business model. We learn every day and fast dissemination of this knowledge is a challenge in its own right.

The judicious management of human and financial resources, whether incremental or reallocated from the cigarette business to RRPs, is of paramount importance. We are pursuing the dual objective of achieving critical mass in RRPs as soon as possible whilst harnessing the strength of our existing business in this critical initial period. The approach is market-specific, as each country has different regulatory, consumer, competitive and portfolio characteristics that dictate the relative level and intensity of activities for the two categories. I believe we have a firm grasp of the situation, but it will require great vigilance and careful management to strike the right balance for several years to come.

More than ever, our business requires sharp focus, agility, entrepreneurship, and fundamental transformation of many existing processes and behaviors, while we continue to preserve the core qualities and standards which have made PMI so successful.

The task is certainly enormous, but the size of the prize is worth every effort and I am confident that we will be up to the challenge as we have always been.

(SLIDE 43.)

Thank you very much for your time.

I am sure you have a number of questions, and Jacek and I will return tomorrow for Q&A after you have heard the rest of the presentations.

I am now going to turn the microphone over to Werner to discuss our combustible marketing, innovation and commercial programs.

Thank you again.