Philip Morris International Inc.
Form 10-Q
October 25, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
(Mark One)

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2016
OR

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to
Commission File Number 001-33708
Philip Morris International Inc.

(Exact name of registrant as specified in its charter)

Virginia	13-3435103
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

120 Park Avenue New York, New York	10017
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (917) 663-2000

Former name, former address and former fiscal year, if changed since last report

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No þ

At October 21, 2016, there were 1,551,349,890 shares outstanding of the registrant's common stock, no par value per share.

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In this report, "PMI," "we," "us" and "our" refer to Philip Morris International Inc. and its subsidiaries.

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PART I – FINANCIAL INFORMATION
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Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(in millions of dollars)
(Unaudited)

	September 30, 2016	December 31, 2015
ASSETS		
Cash and cash equivalents	$ 4,884	$ 3,417
Receivables (less allowances of $42 in 2016 and $58 in 2015)	3,100	2,778
Inventories:		
Leaf tobacco	2,765	2,640
Other raw materials	1,566	1,613
Finished product	3,155	4,220
	7,486	8,473
Deferred income taxes	450	488
Other current assets	654	648
Total current assets	16,574	15,804
Property, plant and equipment, at cost	12,698	11,767
Less: accumulated depreciation	6,565	6,046
	6,133	5,721
Goodwill (Note 5)	7,646	7,415
Other intangible assets, net (Note 5)	2,578	2,623
Investments in unconsolidated subsidiaries (Note 15)	986	890
Other assets	1,660	1,503
TOTAL ASSETS	$ 35,577	$ 33,956

See notes to condensed consolidated financial statements.
Continued

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Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Balance Sheets (Continued)
(in millions of dollars, except share data)
(Unaudited)

	September 30, 2016	December 31, 2015
LIABILITIES		
Short-term borrowings (Note 11)	$ 710	$ 825
Current portion of long-term debt (Note 11)	2,417	2,405
Accounts payable	1,573	1,289
Accrued liabilities:		
Marketing and selling	638	640
Taxes, except income taxes	4,376	5,121
Employment costs	812	903
Dividends payable	1,623	1,589
Other	1,177	1,438
Income taxes	875	970
Deferred income taxes	57	206
Total current liabilities	14,258	15,386
Long-term debt (Note 11)	26,960	25,250
Deferred income taxes	1,376	1,543
Employment costs	2,556	2,566
Other liabilities	744	687
Total liabilities	45,894	45,432
Contingencies (Note 9)		
STOCKHOLDERS' (DEFICIT) EQUITY		
Common stock, no par value (2,109,316,331 shares issued in 2016 and 2015)	—	—
Additional paid-in capital	1,934	1,929
Earnings reinvested in the business	30,305	29,842
Accumulated other comprehensive losses	(8,889)	(9,402)
	23,350	22,369
Less: cost of repurchased stock (557,969,121 and 559,972,262 shares in 2016 and 2015, respectively)	35,492	35,613
Total PMI stockholders' deficit	(12,142)	(13,244)
Noncontrolling interests	1,825	1,768
Total stockholders' deficit	(10,317)	(11,476)
TOTAL LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY	$ 35,577	$ 33,956

See notes to condensed consolidated financial statements.

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Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Statements of Earnings
(in millions of dollars, except per share data)
(Unaudited)

	For the Nine Months Ended September 30,	
	2016	2015
Net revenues	$55,764	$55,537
Cost of sales	6,892	6,990
Excise taxes on products	36,050	35,135
Gross profit	12,822	13,412
Marketing, administration and research costs	4,563	4,628
Amortization of intangibles	56	62
Operating income	8,203	8,722
Interest expense, net	690	781
Earnings before income taxes	7,513	7,941
Provision for income taxes	2,110	2,276
Equity (income)/loss in unconsolidated subsidiaries, net	(72)	(69)
Net earnings	5,475	5,734
Net earnings attributable to noncontrolling interests	219	110
Net earnings attributable to PMI	$5,256	$5,624
Per share data (Note 7):		
Basic earnings per share	$3.38	$3.62
Diluted earnings per share	$3.38	$3.62
Dividends declared	$3.08	$3.02

See notes to condensed consolidated financial statements.

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Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Statements of Earnings
(in millions of dollars, except per share data)
(Unaudited)

	For the Three Months Ended September 30,	
	2016	2015
Net revenues	$19,935	$19,422
Cost of sales	2,432	2,383
Excise taxes on products	12,953	12,495
Gross profit	4,550	4,544
Marketing, administration and research costs	1,554	1,566
Amortization of intangibles	19	19
Operating income	2,977	2,959
Interest expense, net	220	247
Earnings before income taxes	2,757	2,712
Provision for income taxes	764	748
Equity (income)/loss in unconsolidated subsidiaries, net	(35)	(20)
Net earnings	2,028	1,984
Net earnings attributable to noncontrolling interests	90	42
Net earnings attributable to PMI	$1,938	$1,942
Per share data (Note 7):		
Basic earnings per share	$1.25	$1.25
Diluted earnings per share	$1.25	$1.25
Dividends declared	$1.04	$1.02

See notes to condensed consolidated financial statements.

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Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Statements of Comprehensive Earnings
(in millions of dollars)
(Unaudited)

	For the Nine Months Ended September 30,	
	2016	2015
Net earnings	$5,475	$5,734
Other comprehensive earnings (losses), net of income taxes:		
Change in currency translation adjustment:		
Unrealized gains (losses), net of income taxes of $131 in 2016 and ($286) in 2015	544	(2,266)
Change in net loss and prior service cost:		
Net losses and prior service costs, net of income taxes of $3 in 2016 and $- in 2015	(10)	—
Amortization of net losses, prior service costs and net transition costs, net of income taxes of ($27) in 2016 and ($37) in 2015	164	166
Change in fair value of derivatives accounted for as hedges:		
Gains (losses) recognized, net of income taxes of $31 in 2016 and ($3) in 2015	(184)	30
(Gains) losses transferred to earnings, net of income taxes of ($6) in 2016 and $11 in 2015	19	(79)
Total other comprehensive earnings (losses)	533	(2,149)
Total comprehensive earnings	6,008	3,585
Less comprehensive earnings attributable to:		
Noncontrolling interests	239	62
Comprehensive earnings attributable to PMI	$5,769	$3,523

See notes to condensed consolidated financial statements

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Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Statements of Comprehensive Earnings
(in millions of dollars)
(Unaudited)

	For the Three Months Ended September 30,	
	2016	2015
Net earnings	$2,028	$1,984
Other comprehensive earnings (losses), net of income taxes:		
Change in currency translation adjustments:		
Unrealized gains (losses), net of income taxes of $84 in 2016 and $44 in 2015	6	(849)
Change in net loss and prior service cost:		
Net losses and prior service costs, net of income taxes	—	—
Amortization of net losses, prior service costs and net transition costs, net of income taxes of ($10) in 2016 and ($13) in 2015	54	56
Change in fair value of derivatives accounted for as hedges:		
Gains (losses) recognized, net of income taxes of $1 in 2016 and $3 in 2015	(11)	(36)
(Gains) losses transferred to earnings, net of income taxes of ($3) in 2016 and $3 in 2015	16	(13)
Total other comprehensive earnings (losses)	65	(842)
Total comprehensive earnings	2,093	1,142
Less comprehensive earnings attributable to:		
Noncontrolling interests	89	20
Comprehensive earnings attributable to PMI	$2,004	$1,122

See notes to condensed consolidated financial statements

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Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Statements of Stockholders' (Deficit) Equity
For the Nine Months Ended September 30, 2016 and 2015
(in millions of dollars, except per share amounts)
(Unaudited)

	PMI Stockholders' (Deficit) Equity						
	Common Stock	Additional Paid-in Capital	Earnings Reinvested in the Business	Accumulated Other Comprehensive Losses	Cost of Repurchased Stock	Noncontrolling Interests	Total
Balances, January 1, 2015	$—	$ 710	$ 29,249	$ (6,826)	$ (35,762)	$ 1,426	$ (11,203)
Net earnings			5,624			110	5,734
Other comprehensive earnings (losses), net of income taxes				(2,101)		(48)	(2,149)
Issuance of stock awards		(36)			146		110
Dividends declared ($3.02 per share)			(4,695)				(4,695)
Payments to noncontrolling interests						(142)	(142)
Purchase price activity for subsidiary shares from noncontrolling interests (Note 16)		109				10	119
Balances, September 30, 2015	$—	$ 783	$ 30,178	$ (8,927)	$ (35,616)	$ 1,356	$ (12,226)
Balances, January 1, 2016	$—	$ 1,929	$ 29,842	$ (9,402)	$ (35,613)	$ 1,768	$ (11,476)
Net earnings			5,256			219	5,475
Other comprehensive earnings (losses), net of income taxes				513		20	533
Issuance of stock awards		8			121		129
Dividends declared ($3.08 per share)			(4,793)				(4,793)
Payments to noncontrolling interests						(187)	(187)
Other		(3)				5	2
Balances, September 30, 2016	$—	$ 1,934	$ 30,305	$ (8,889)	$ (35,492)	$ 1,825	$ (10,317)

See notes to condensed consolidated financial statements.

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Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(in millions of dollars)
(Unaudited)

	For the Nine Months Ended September 30,	
	2016	2015
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES		
Net earnings	$5,475	$5,734
Adjustments to reconcile net earnings to operating cash flows:		
Depreciation and amortization	548	561
Deferred income tax provision	50	102
Asset impairment and exit costs, net of cash paid	(26)	(220)
Cash effects of changes:		
Receivables, net	(398)	175
Inventories	1,245	588
Accounts payable	180	170
Income taxes	(259)	(58)
Accrued liabilities and other current assets	(985)	(1,268)
Pension plan contributions	(80)	(62)
Other	178	271
Net cash provided by operating activities	5,928	5,993
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES		
Capital expenditures	(734)	(636)
Investments in unconsolidated subsidiaries	(26)	(24)
Other	(183)	272
Net cash used in investing activities	(943)	(388)

See notes to condensed consolidated financial statements.

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Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows (Continued)
(in millions of dollars)
(Unaudited)

	For the Nine Months Ended September 30,	
	2016	2015
CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES		
Short-term borrowing activity by original maturity:		
Net repayments - maturities of 90 days or less	$(55)	$(86)
Long-term debt proceeds	3,536	1,539
Long-term debt repaid	(2,072)	(1,228)
Repurchases of common stock	—	(48)
Dividends paid	(4,759)	(4,665)
Sale (purchase) of subsidiary shares to/(from) noncontrolling interests (Note 16)	5	119
Other	(215)	(92)
Net cash used in financing activities	(3,560)	(4,461)
Effect of exchange rate changes on cash and cash equivalents	42	(433)
Cash and cash equivalents:		
Increase	1,467	711
Balance at beginning of period	3,417	1,682
Balance at end of period	$4,884	$2,393

See notes to condensed consolidated financial statements.

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Philip Morris International Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Note 1. Background and Basis of Presentation:
Background
Philip Morris International Inc. is a holding company incorporated in Virginia, U.S.A., whose subsidiaries and affiliates, and their licensees, are engaged in the manufacture and sale of cigarettes, other tobacco products and other nicotine-containing products in markets outside of the United States of America. Throughout these financial statements, the term “PMI” refers to Philip Morris International Inc. and its subsidiaries.
Basis of Presentation
The interim condensed consolidated financial statements of PMI are unaudited. These interim condensed consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles and such principles are applied on a consistent basis. It is the opinion of PMI’s management that all adjustments necessary for a fair statement of the interim results presented have been reflected therein. All such adjustments were of a normal recurring nature. Net revenues and net earnings attributable to PMI for any interim period are not necessarily indicative of results that may be expected for the entire year.
Certain prior years' amounts have been reclassified to conform with the current year's presentation, as reflected in Note 8. Segment Reporting. The changes did not have an impact on PMI's consolidated financial position, results of operations or cash flows in any of the periods presented.
These statements should be read in conjunction with the audited consolidated financial statements and related notes, which appear in PMI’s Annual Report on Form 10-K for the year ended December 31, 2015.

Note 2. Asset Impairment and Exit Costs:
During the nine months and three months ended September 30, 2016 and 2015, PMI did not incur asset impairment and exit costs.

Movement in Exit Cost Liabilities
The movement in exit cost liabilities for the nine months ended September 30, 2016 was as follows:

(in millions)	
Liability balance, January 1, 2016	$54
Charges, net	—
Cash spent	(26)
Currency/other	—
Liability balance, September 30, 2016	$28

Cash payments related to exit costs at PMI were $26 million and $4 million for the nine months and three months ended September 30, 2016, respectively, and $220 million and $16 million for the nine months and three months ended September 30, 2015, respectively. Future cash payments for exit costs incurred to date are expected to be approximately $28 million, and will be substantially paid by the end of 2017.

Note 3. Stock Plans:

In May 2012, PMI’s shareholders approved the Philip Morris International Inc. 2012 Performance Incentive Plan (the “2012 Plan”). Under the 2012 Plan, PMI may grant to eligible employees restricted stock, restricted stock units and deferred stock units (collectively referred to as restricted share units), performance-based cash incentive awards and performance-based equity awards. Up to 30 million shares of PMI’s common stock may be issued under the 2012 Plan. At September 30, 2016, shares available for grant under the 2012 Plan were 21,180,030.

In 2008, PMI adopted the Philip Morris International Inc. 2008 Stock Compensation Plan for Non-Employee Directors (the “Non-Employee Directors Plan”). A non-employee director is defined as a member of the PMI Board of Directors who is not a full-time employee of PMI or of any corporation in which PMI owns, directly or indirectly, stock possessing at least 50% of the total combined voting power of all classes of stock entitled to vote in the election of directors in such corporation. Up to 1 million shares of PMI common stock may be awarded under the Non-Employee Directors Plan. At September 30, 2016, shares available for grant under the plan were 678,533.

Restricted share unit (RSU) awards

During the nine months ended September 30, 2016, PMI granted 1.2 million shares of RSU awards to eligible employees at a weighted-average grant date fair value of $89.03 per share. During the nine months ended September 30, 2015, PMI granted 1.5 million shares of RSU awards to eligible employees at a weighted average grant date fair value of $82.27 per share. PMI recorded compensation expense related to RSU awards of $97 million and $132 million during the nine months ended September 30, 2016 and 2015, respectively, and $28 million and $38 million during the three months ended September 30, 2016 and 2015, respectively. As of September 30, 2016, PMI had $136 million of total unrecognized compensation cost related to non-vested RSU awards. The cost is recognized over the original restriction period of the awards, which is typically three or more years after the date of the award, or upon death, disability or reaching the age of 58.

During the nine months ended September 30, 2016, 2.2 million shares of PMI RSU awards vested. The grant date fair value of all the vested shares was approximately $197 million. The total fair value of RSU awards that vested during the nine months ended September 30, 2016 was approximately $205 million.

Performance share unit (PSU) awards

During the nine months ended September 30, 2016, PMI granted PSU awards to certain executives. The PSU awards require the achievement of certain performance factors, which are predetermined at the time of grant, over a three-year performance cycle. PMI’s performance metrics consist of PMI’s Total Shareholder Return (TSR) relative to a predetermined peer group, PMI’s currency neutral compound annual adjusted operating companies income growth rate, excluding acquisitions, and PMI’s performance against specific measures of PMI’s innovation. The aggregate of the weighted performance factors for the three metrics determines the percentage of PSUs that will vest at the end of the three-year performance cycle. Each vested PSU entitles the participant to one share of common stock. An aggregate weighted PSU performance factor of 100 will result in the targeted number of PSUs being vested. The minimum percentage of PSUs that can vest is zero, with a maximum percentage of 200. At the end of the performance cycle, participants are entitled to an amount equivalent to the accumulated dividends paid on common stock during the performance cycle for the number of shares earned.

During the nine months ended September 30, 2016, PMI granted 0.4 million shares of PSU awards to eligible employees. The grant date fair value of the PSU market based awards subject to the TSR performance factor is $104.60 per share, which was determined by using the Monte Carlo simulation model. The grant date fair value of the PSU awards subject to the other performance factors is $89.02 per share, which was determined by using the average of the high and low market price of PMI’s stock at the date of grant. PMI recorded compensation expense related to PSU awards of $24 million during the nine months ended September 30, 2016 and $4 million during the three months ended September 30, 2016. As of September 30, 2016, PMI had $29 million of total unrecognized compensation cost related to non-vested PSU awards. The cost is recognized over the performance cycle of the awards, or upon death, disability or reaching the age of 58.

Note 4. Benefit Plans:

Pension coverage for employees of PMI's subsidiaries is provided, to the extent deemed appropriate, through separate plans, many of which are governed by local statutory requirements. In addition, PMI provides health care and other benefits to substantially all U.S. retired employees and certain non-U.S. retired employees. In general, health care benefits for non-U.S. retired employees are covered through local government plans.

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Philip Morris International Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Pension Plans
Components of Net Periodic Benefit Cost
Net periodic pension cost consisted of the following:

	U.S. Plans		Non-U.S. Plans	
	For the Nine Months Ended September 30,		For the Nine Months Ended September 30,	
(in millions)	2016	2015	2016	2015
Service cost	$3	$4	$151	$150
Interest cost	12	13	96	108
Expected return on plan assets	(10)	(11)	(247)	(244)
Amortization:				
Net loss	2	8	133	135
Prior service cost	4	—	3	3
Net periodic pension cost	$11	$14	$136	$152

	U.S. Plans		Non-U.S. Plans	
	For the Three Months Ended September 30,		For the Three Months Ended September 30,	
(in millions)	2016	2015	2016	2015
Service cost	$ 1	$ 1	$51	$49
Interest cost	4	4	32	36
Expected return on plan assets	(3)	(4)	(83)	(80)
Amortization:				
Net loss	—	3	45	45
Prior service cost	1	—	1	1
Net periodic pension cost	$ 3	$ 4	$46	$51

Employer Contributions
PMI makes, and plans to make, contributions, to the extent that they are tax deductible and to meet specific funding requirements of its funded U.S. and non-U.S. plans. Employer contributions of $80 million were made to the pension plans during the nine months ended September 30, 2016. Currently, PMI anticipates making additional contributions during the remainder of 2016 of approximately $98 million to its pension plans, based on current tax and benefit laws. However, this estimate is subject to change as a result of changes in tax and other benefit laws, as well as asset performance significantly above or below the assumed long-term rate of return on pension assets, or changes in interest and currency rates.

Note 5. Goodwill and Other Intangible Assets, net:

Goodwill and other intangible assets, net, by segment were as follows:

	Goodwill		Other Intangible Assets, net	
(in millions)	September 30, 2016	December 31, 2015	September 30, 2016	December 31, 2015
European Union	$1,329	$ 1,310	$ 501	$ 516
Eastern Europe, Middle East & Africa	387	374	201	201
Asia	3,729	3,581	1,116	1,087
Latin America & Canada	2,201	2,150	760	819
Total	$7,646	$ 7,415	$ 2,578	$ 2,623

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Philip Morris International Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Goodwill primarily reflects PMI's acquisitions in Canada, Colombia, Greece, Indonesia, Mexico, Pakistan and Serbia, as well as the business combination in the Philippines. The movements in goodwill from December 31, 2015, were as follows:

(in millions)	European Union	Eastern Europe, Middle East & Africa	Asia	Latin America & Canada	Total
Balances, December 31, 2015	$ 1,310	$ 374	$3,581	$ 2,150	$7,415
Changes due to:					
Currency	19	13	148	51	231
Balances, September 30, 2016	$ 1,329	$ 387	$3,729	$ 2,201	$7,646

Additional details of other intangible assets were as follows:

	September 30, 2016		December 31, 2015	
(in millions)	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Non-amortizable intangible assets	$1,515		$1,527	
Amortizable intangible assets	1,643	$ 580	1,609	$ 513
Total other intangible assets	$3,158	$ 580	$3,136	$ 513

Non-amortizable intangible assets substantially consist of trademarks from PMI's acquisitions in Indonesia in 2005 and Mexico in 2007. Amortizable intangible assets primarily consist of certain trademarks and distribution networks associated with business combinations. The gross carrying amount, the range of useful lives as well as the weighted-average remaining useful life of amortizable intangible assets at September 30, 2016, were as follows:

(dollars in millions)	Gross Carrying Amount	Initial Estimated Useful Lives	Weighted-Average Remaining Useful Life
Trademarks	$ 1,403	2 - 40 years	20 years
Distribution networks	152	5 - 30 years	10 years
Other (including farmer contracts and intellectual property rights)	88	4 - 17 years	10 years
	$ 1,643		

Pre-tax amortization expense for intangible assets during the nine months ended September 30, 2016 and 2015 was $56 million and $62 million, respectively, and $19 million and $19 million for the three months ended September 30, 2016 and 2015, respectively. Amortization expense for each of the next five years is estimated to be $74 million or less, assuming no additional transactions occur that require the amortization of intangible assets.

The increase in the gross carrying amount of other intangible assets from December 31, 2015, was due to currency movements.

During the second quarter of 2016, PMI changed the date of its annual goodwill impairment test from the first quarter to the second quarter. The change was made to more closely align the impairment testing date with PMI's long-range planning and forecasting process. PMI believes that the change in the annual impairment testing date did not delay, accelerate, or avoid an impairment charge. PMI has determined that this change in accounting principle is preferable under the circumstances and does not result in an adjustment to its financial statements when applied retrospectively.

PMI completed its review of goodwill for potential impairment using a discounted cash flow model, supported by the market valuation approach. No impairment charge was required as a result of this review.

During the second quarter of 2016, PMI completed its annual review of non-amortizable intangible assets for potential impairment, and no impairment charges were required as a result of this review.

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Philip Morris International Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Note 6. Financial Instruments:
Overview
PMI operates in markets outside of the United States of America, with manufacturing and sales facilities in various locations around the world. PMI utilizes certain financial instruments to manage foreign currency and interest rate exposure. Derivative financial instruments are used by PMI principally to reduce exposures to market risks resulting from fluctuations in foreign currency exchange and interest rates by creating offsetting exposures. PMI is not a party to leveraged derivatives and, by policy, does not use derivative financial instruments for speculative purposes. Financial instruments qualifying for hedge accounting must maintain a specified level of effectiveness between the hedging instrument and the item being hedged, both at inception and throughout the hedged period. PMI formally documents the nature and relationships between the hedging instruments and hedged items, as well as its risk-management objectives, strategies for undertaking the various hedge transactions and method of assessing hedge effectiveness. Additionally, for hedges of forecasted transactions, the significant characteristics and expected terms of the forecasted transaction must be specifically identified, and it must be probable that each forecasted transaction will occur. If it were deemed probable that the forecasted transaction would not occur, the gain or loss would be recognized in earnings. PMI reports its net transaction gains or losses in marketing, administration and research costs on the condensed consolidated statements of earnings.
PMI uses deliverable and non-deliverable forward foreign exchange contracts, foreign currency swaps and foreign currency options, collectively referred to as foreign exchange contracts ("foreign exchange contracts"), and interest rate contracts to mitigate its exposure to changes in exchange and interest rates from third-party and intercompany actual and forecasted transactions. The primary currencies to which PMI is exposed include the Australian dollar, Euro, Indonesian rupiah, Japanese yen, Mexican peso, Russian ruble, Swiss franc and Turkish lira. At September 30, 2016, PMI had contracts with aggregate notional amounts of $28.5 billion of which $4.1 billion related to cash flow hedges, $8.0 billion related to hedges of net investments in foreign operations and $16.4 billion related to other derivatives that primarily offset currency exposures on intercompany financing.
The fair value of PMI’s foreign exchange contracts included in the condensed consolidated balance sheets as of September 30, 2016 and December 31, 2015, were as follows:

	Asset Derivatives			Liability Derivatives		
		Fair Value			Fair Value	
(in millions)	Balance Sheet Classification	At September 30, 2016	At December 31, 2015	Balance Sheet Classification	At September 30, 2016	At December 31, 2015
Foreign exchange contracts designated as hedging instruments	Other current assets	$12	$ 301	Other accrued liabilities	$98	$ 26
	Other assets	165	181	Other liabilities	216	117
Foreign exchange contracts not designated as hedging instruments	Other current assets	30	7	Other accrued liabilities	39	29
	Other assets	62	85	Other liabilities	—	—
Total derivatives		$269	$ 574		$353	$ 172

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For the nine months and three months ended September 30, 2016 and 2015, PMI's cash flow and net investment hedging instruments impacted the condensed consolidated statements of earnings and comprehensive earnings as follows:

(pre-tax, millions)	For the Nine Months Ended September 30,				
	Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings/(Losses) on Derivatives		Statement of Earnings Classification of Gain/(Loss) Reclassified from Other Comprehensive Earnings/(Losses) into Earnings	Amount of Gain/(Loss) Reclassified from Other Comprehensive Earnings/(Losses) into Earnings	
	2016	2015		2016	2015
Derivatives in Cash Flow Hedging Relationship					
Foreign exchange contracts	$(215)	$33			
			Net revenues	$ (29)	$ 115
			Cost of sales	41	(3)
			Marketing, administration and research costs	2	5
			Interest expense, net	(39)	(27)
Derivatives in Net Investment Hedging Relationship					
Foreign exchange contracts	(209)	191			
Total	$(424)	$224		$ (25)	$ 90

(pre-tax, millions)	For the Three Months Ended September 30,				
	Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings/(Losses) on Derivatives		Statement of Earnings Classification of Gain/(Loss) Reclassified from Other Comprehensive Earnings/(Losses) into Earnings	Amount of Gain/(Loss) Reclassified from Other Comprehensive Earnings/(Losses) into Earnings	
	2016	2015		2016	2015
Derivatives in Cash Flow Hedging Relationship					
Foreign exchange contracts	$(12)	$(39)			
			Net revenues	$ (28)	$ 40
			Cost of sales	16	(3)
			Marketing, administration and research costs	3	(11)
			Interest expense, net	(10)	(10)
Derivatives in Net Investment Hedging Relationship					
Foreign exchange contracts	(150)	(18)			

Total	$(162)	$(57)	$ (19)	$ 16

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Cash Flow Hedges
PMI has entered into foreign exchange contracts to hedge the foreign currency exchange and interest rate risks related to certain forecasted transactions. The effective portion of gains and losses associated with qualifying cash flow hedge contracts is deferred as a component of accumulated other comprehensive losses until the underlying hedged transactions are reported in PMI's condensed consolidated statements of earnings. During the nine months and three months ended September 30, 2016 and 2015, ineffectiveness related to cash flow hedges was not material. As of September 30, 2016, PMI has hedged forecasted transactions for periods not exceeding the next twenty-one months with the exception of one foreign exchange contract that expires in May 2024. The impact of these hedges is primarily included in operating cash flows on PMI's condensed consolidated statements of cash flows.

Hedges of Net Investments in Foreign Operations
PMI designates certain foreign currency denominated debt and foreign exchange contracts as net investment hedges of its foreign operations. For the nine months ended September 30, 2016 and 2015, these hedges of net investments resulted in gains (losses), net of income taxes, of $(232) million and $584 million, respectively. For the three months ended September 30, 2016 and 2015, these hedges of net investments resulted in losses, net of income taxes, of $(153) million and $(58) million, respectively. These gains (losses) were reported as a component of accumulated other comprehensive losses within currency translation adjustments. For the nine months and three months ended September 30, 2016 and 2015, ineffectiveness related to net investment hedges was not material. Other investing cash flows on PMI's condensed consolidated statements of cash flows include the premiums paid for, and settlements of, net investment hedges.

Other Derivatives
PMI has entered into foreign exchange contracts to hedge the foreign currency exchange and interest rate risks related to intercompany loans between certain subsidiaries, and third-party loans. While effective as economic hedges, no hedge accounting is applied for these contracts; therefore, the unrealized gains (losses) relating to these contracts are reported in PMI's condensed consolidated statements of earnings. For the nine months ended September 30, 2016 and 2015, the gains (losses) from contracts for which PMI did not apply hedge accounting were $101 million and $(467) million, respectively. For the three months ended September 30, 2016 and 2015, the gains from contracts for which PMI did not apply hedge accounting were $32 million and $268 million, respectively. The gains (losses) from these contracts substantially offset the losses and gains generated by the underlying intercompany and third-party loans being hedged.

For the nine months and three months ended September 30, 2016 and 2015, the net impact of these contracts on the condensed consolidated statements of earnings was not material.

Qualifying Hedging Activities Reported in Accumulated Other Comprehensive Losses
Derivative gains or losses reported in accumulated other comprehensive losses are a result of qualifying hedging activity. Transfers of these gains or losses to earnings are offset by the corresponding gains or losses on the underlying hedged item. Hedging activity affected accumulated other comprehensive losses, net of income taxes, as follows:

(in millions)	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2016	2015	2016	2015
Gain/(loss) at beginning of period	$59	$123	$(111)	$123
Derivative (gains)/losses transferred to earnings	19	(79)	16	(13)

Change in fair value	(184)	30	(11)	(36)
Gain/(loss) as of September 30,	$(106)	$74	$(106)	$74

At September 30, 2016, PMI expects $84 million of derivative losses that are included in accumulated other comprehensive losses to be reclassified to the condensed consolidated statement of earnings within the next twelve months. These losses are expected to be substantially offset by the statement of earnings impact of the respective hedged transactions.

Contingent Features

PMI’s derivative instruments do not contain contingent features.

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Credit Exposure and Credit Risk
PMI is exposed to credit loss in the event of non-performance by counterparties. While PMI does not anticipate non-performance, its risk is limited to the fair value of the financial instruments less any cash collateral received or pledged. PMI actively monitors its exposure to credit risk through the use of credit approvals and credit limits, and by selecting and continuously monitoring a diverse group of major international banks and financial institutions as counterparties.
Fair Value
See Note 12. Fair Value Measurements and Note 14. Balance Sheet Offsetting for additional discussion of derivative financial instruments.

Note 7. Earnings Per Share:
Basic and diluted earnings per share ("EPS") were calculated using the following:

(in millions)	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2016	2015	2016	2015
Net earnings attributable to PMI	$5,256	$5,624	$1,938	$1,942
Less distributed and undistributed earnings attributable to share-based payment awards	15	20	5	7
Net earnings for basic and diluted EPS	$5,241	$5,604	$1,933	$1,935
Weighted-average shares for basic and diluted EPS	1,551	1,549	1,551	1,549

Unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents are participating securities and therefore are included in PMI's earnings per share calculation pursuant to the two-class method.
For the 2016 and 2015 computations, there were no antidilutive stock awards.

Note 8. Segment Reporting:

PMI's subsidiaries and affiliates are engaged in the manufacture and sale of cigarettes, other tobacco products and other nicotine-containing products in markets outside of the United States of America. Reportable segments for PMI are organized and managed by geographic region. PMI's reportable segments are the European Union; Eastern Europe, Middle East & Africa; Asia; and Latin America & Canada. PMI records net revenues and operating companies income to its segments based upon the geographic area in which the customer resides.

PMI's management evaluates segment performance and allocates resources based on operating companies income, which PMI defines as operating income, excluding general corporate expenses and amortization of intangibles, plus equity (income)/loss in unconsolidated subsidiaries, net. Interest expense, net, and provision for income taxes are centrally managed and, accordingly, such items are not presented by segment since they are excluded from the measure of segment profitability reviewed by management.

In the fourth quarter of 2015, to further align with the Member State composition of the European Union, PMI transferred the management of its operations in Bulgaria, Croatia, Romania and Slovenia from its Eastern Europe, Middle East & Africa segment to its European Union segment, resulting in the reclassification of prior year amounts between the two segments.

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Segment data were as follows:

(in millions)	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2016	2015	2016	2015
Net revenues:				
European Union	$20,664	$19,916	$7,387	$7,018
Eastern Europe, Middle East & Africa	13,650	13,908	5,122	5,107
Asia	15,014	14,683	5,113	4,880
Latin America & Canada	6,436	7,030	2,313	2,417
Net revenues	$55,764	$55,537	$19,935	$19,422
Earnings before income taxes:				
Operating companies income:				
European Union	$3,096	$2,977	$1,120	$1,045
Eastern Europe, Middle East & Africa	2,389	2,721	962	1,002
Asia	2,288	2,421	761	690
Latin America & Canada	677	849	224	294
Amortization of intangibles	(56)	(62)	(19)	(19)
General corporate expenses	(119)	(115)	(36)	(33)
Less:				
Equity (income)/loss in unconsolidated subsidiaries, net	(72)	(69)	(35)	(20)
Operating income	8,203	8,722	2,977	2,959
Interest expense, net	(690)	(781)	(220)	(247)
Earnings before income taxes	$7,513	$7,941	$2,757	$2,712

Note 9. Contingencies:

Tobacco-Related Litigation

Legal proceedings covering a wide range of matters are pending or threatened against us, and/or our subsidiaries, and/or our indemnitees in various jurisdictions. Our indemnitees include distributors, licensees, and others that have been named as parties in certain cases and that we have agreed to defend, as well as to pay costs and some or all of judgments, if any, that may be entered against them. Pursuant to the terms of the Distribution Agreement between Altria Group, Inc. ("Altria") and PMI, PMI will indemnify Altria and Philip Morris USA Inc. ("PM USA"), a U.S. tobacco subsidiary of Altria, for tobacco product claims based in substantial part on products manufactured by PMI or contract manufactured for PMI by PM USA, and PM USA will indemnify PMI for tobacco product claims based in substantial part on products manufactured by PM USA, excluding tobacco products contract manufactured for PMI.

It is possible that there could be adverse developments in pending cases against us and our subsidiaries. An unfavorable outcome or settlement of pending tobacco-related litigation could encourage the commencement of additional litigation.

Damages claimed in some of the tobacco-related litigation are significant and, in certain cases in Brazil, Canada and Nigeria, range into the billions of U.S. dollars. The variability in pleadings in multiple jurisdictions, together with the actual experience of management in litigating claims, demonstrate that the monetary relief that may be specified in a lawsuit bears little relevance to the ultimate outcome. Much of the tobacco-related litigation is in its early stages, and litigation is subject to uncertainty. However, as discussed below, we have to date been largely successful in defending tobacco-related litigation.

We and our subsidiaries record provisions in the consolidated financial statements for pending litigation when we determine that an unfavorable outcome is probable and the amount of the loss can be reasonably estimated. At the present time, while it is reasonably possible that an unfavorable outcome in a case may occur, after assessing the information available to it (i) management has not concluded that it is probable that a loss has been incurred in any of the pending tobacco-related cases; (ii) management is unable to estimate the possible loss or range of loss for any of the pending tobacco-related cases; and (iii) accordingly, no estimated loss has been accrued in the consolidated financial statements for unfavorable outcomes in these cases, if any. Legal defense costs are expensed as incurred.

It is possible that our consolidated results of operations, cash flows or financial position could be materially affected in a particular fiscal quarter or fiscal year by an unfavorable outcome or settlement of certain pending litigation. Nevertheless, although litigation is subject to uncertainty, we and each of our subsidiaries named as a defendant believe, and each has been so advised by counsel handling the respective cases, that we have valid defenses to the litigation pending against us, as well as valid bases for appeal of adverse verdicts. All such cases are, and will continue to be, vigorously defended. However, we and our subsidiaries may enter into settlement discussions in particular cases if we believe it is in our best interests to do so.

To date, no tobacco-related case has been finally resolved in favor of a plaintiff against us, our subsidiaries or indemnitees.

The table below lists the number of tobacco-related cases pending against us and/or our subsidiaries or indemnitees as of October 21, 2016, October 27, 2015 and October 30, 2014:

Type of Case	Number of Cases Pending as of October 21, 2016	Number of Cases Pending as of October 27, 2015	Number of Cases Pending as of October 30, 2014
Individual Smoking and Health Cases	67	69	64
Smoking and Health Class Actions	11	11	11
Health Care Cost Recovery Actions	16	16	15
Lights Class Actions	—	—	1
Individual Lights Cases	3	3	2
Public Civil Actions	2	2	2

Since 1995, when the first tobacco-related litigation was filed against a PMI entity, 450 Smoking and Health, Lights, Health Care Cost Recovery, and Public Civil Actions in which we and/or one of our subsidiaries and/or indemnitees were a defendant have been terminated in our favor. Thirteen cases have had decisions in favor of plaintiffs. Nine of these cases have subsequently reached final resolution in our favor and four remain on appeal.

The table below lists the verdict and significant post-trial developments in the four pending cases where a verdict was returned in favor of the plaintiff:

Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
February 2004	Brazil/The Smoker Health Defense Association	Class Action	The Civil Court of São Paulo found defendants liable without hearing evidence. In April 2004, the court awarded “moral damages” of R$1,000 (approximately $315) per smoker per full year of smoking plus interest at the rate of 1% per month, as of the date of the ruling. The court did not assess actual damages, which were to be assessed in a	Defendants appealed to the São Paulo Court of Appeals, which annulled the ruling in November 2008, finding that the trial court had inappropriately ruled without hearing evidence and returned the case to the trial court for further proceedings. In May 2011, the trial court dismissed

	second phase of the case. The size of the class was not defined in the ruling.	the claim. Plaintiff appealed the decision. In February 2015, the appellate court unanimously dismissed plaintiff's appeal. In September 2015, plaintiff appealed to the Superior Court of Justice. In addition, the defendants filed a constitutional appeal to the Federal Supreme Tribunal on the basis that plaintiff did not have standing to bring the lawsuit. This appeal is still pending.

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Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
May 27, 2015	Canada/Cecilia Létourneau	Class Action	On May 27, 2015, the Superior Court of the District of Montreal, Province of Quebec ruled in favor of the Létourneau class on liability and awarded a total of CAD 131 million (approximately $100 million) in punitive damages, allocating CAD 46 million (approximately $35 million) to our subsidiary. The trial court ordered defendants to pay the full punitive damage award into a trust within 60 days. The court did not order the payment of compensatory damages.	In June 2015, our subsidiary commenced the appellate process with the Court of Appeal of Quebec. Our subsidiary also filed a motion to cancel the trial court's order for payment into a trust notwithstanding appeal. In July 2015, the Court of Appeal granted the motion to cancel and overturned the trial court's ruling that our subsidiary make the payment into a trust. In August 2015, plaintiffs filed a motion for security with the Court of Appeal covering both the Létourneau case and the Blais case described below. In October 2015, the Court of Appeal granted the motion and ordered our subsidiary to furnish security totaling CAD 226 million (approximately $172 million) to cover both the Létourneau and Blais cases. A hearing for the merits appeal is scheduled for November 2016. (See below for further detail.)

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Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
May 27, 2015	Canada/Conseil Québécois Sur Le Tabac Et La Santé and Jean-Yves Blais	Class Action	On May 27, 2015, the Superior Court of the District of Montreal, Province of Quebec ruled in favor of the Blais class on liability and found the class members' compensatory damages totaled approximately CAD 15.5 billion (approximately $11.8 billion), including pre-judgment interest. The trial court awarded compensatory damages on a joint and several liability basis, allocating 20% to our subsidiary (approximately CAD 3.1 billion including pre-judgment interest (approximately $2.4 billion)). The trial court awarded CAD 90,000 (approximately $68,000) in punitive damages, allocating CAD 30,000 (approximately $23,000) to our subsidiary. The trial court ordered defendants to pay CAD 1 billion (approximately $759 million) of the compensatory damage award, CAD 200 million (approximately $152 million) of which is our subsidiary's portion, into a trust within 60 days.	In June 2015, our subsidiary commenced the appellate process with the Court of Appeal of Quebec. Our subsidiary also filed a motion to cancel the trial court's order for payment into a trust notwithstanding appeal. In July 2015, the Court of Appeal granted the motion to cancel and overturned the trial court's ruling that our subsidiary make the payment into a trust. In August 2015, plaintiffs filed a motion for security with the Court of Appeal. In October 2015, the Court of Appeal granted the motion and ordered our subsidiary to furnish security totaling, together with the Létourneau case, CAD 226 million (approximately $172 million). A hearing for the merits appeal is scheduled for November 2016. (See below for further detail.)

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Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
August 5, 2016	Argentina/Hugo Lespada	Individual Action	On August 5, 2016, the Civil Court No. 14 - Mar del Plata, issued a verdict in favor of plaintiff, an individual smoker, and awarded him ARS 110,000 (approximately $7,250), plus interest, in compensatory and moral damages. The Court found that our subsidiary failed to warn plaintiff of the risk of becoming addicted to cigarettes.	On August 23, 2016, our subsidiary filed its notice of appeal.

Pending claims related to tobacco products generally fall within the following categories:
Smoking and Health Litigation: These cases primarily allege personal injury and are brought by individual plaintiffs or on behalf of a class or purported class of individual plaintiffs. Plaintiffs' allegations of liability in these cases are based on various theories of recovery, including negligence, gross negligence, strict liability, fraud, misrepresentation, design defect, failure to warn, breach of express and implied warranties, violations of deceptive trade practice laws and consumer protection statutes. Plaintiffs in these cases seek various forms of relief, including compensatory and other damages, and injunctive and equitable relief. Defenses raised in these cases include licit activity, failure to state a claim, lack of defect, lack of proximate cause, assumption of the risk, contributory negligence, and statute of limitations.
As of October 21, 2016, there were a number of smoking and health cases pending against us, our subsidiaries or indemnitees, as follows:

- 67 cases brought by individual plaintiffs in Argentina (34), Brazil (17), Canada (2), Chile (8), Costa Rica (2), Italy (2), the Philippines (1) and Scotland (1), compared with 69 such cases on October 27, 2015, and 64 cases on October 30, 2014; and
- 11 cases brought on behalf of classes of individual plaintiffs in Brazil (2) and Canada (9), compared with 11 such cases on October 27, 2015 and 11 such cases on October 30, 2014.

In the first class action pending in Brazil, The Smoker Health Defense Association (ADESF) v. Souza Cruz, S.A. and Philip Morris Marketing, S.A., Nineteenth Lower Civil Court of the Central Courts of the Judiciary District of São Paulo, Brazil, filed July 25, 1995, our subsidiary and another member of the industry are defendants. The plaintiff, a consumer organization, is seeking damages for all addicted smokers and former smokers, and injunctive relief. In 2004, the trial court found defendants liable without hearing evidence and awarded “moral damages” of R$1,000 (approximately $315) per smoker per full year of smoking plus interest at the rate of 1% per month, as of the date of the ruling. The court did not award actual damages, which were to be assessed in the second phase of the case. The size of the class was not estimated. Defendants appealed to the São Paulo Court of Appeals, which annulled the ruling in November 2008, finding that the trial court had inappropriately ruled without hearing evidence and returned the case to the trial court for further proceedings. In May 2011, the trial court dismissed the claim. Plaintiff appealed the decision. In February 2015, the appellate court unanimously dismissed plaintiff's appeal. In September 2015, plaintiff appealed to the Superior Court of Justice. In addition, the defendants filed a constitutional appeal to the Federal Supreme Tribunal on the basis that plaintiff did not have standing to bring the lawsuit. This appeal is still pending.

In the second class action pending in Brazil, Public Prosecutor of São Paulo v. Philip Morris Brasil Industria e Comercio Ltda., Civil Court of the City of São Paulo, Brazil, filed August 6, 2007, our subsidiary is a defendant. The plaintiff, the Public Prosecutor of the State of São Paulo, is seeking (i) damages on behalf of all smokers nationwide, former smokers, and their relatives; (ii) damages on behalf of people exposed to environmental tobacco smoke nationwide, and their relatives; and (iii) reimbursement of the health care costs allegedly incurred for the treatment of tobacco-related diseases by all Brazilian States and Municipalities, and the Federal District. In an interim ruling issued in December 2007, the trial court limited the scope of this claim to the State of São Paulo only. In December 2008, the Seventh Civil Court of São Paulo issued a decision declaring that it lacked jurisdiction because the case involved issues similar to the ADESF case discussed above and should be transferred to the Nineteenth Lower Civil Court in São Paulo where the ADESF case is pending. The court further stated that these cases should be consolidated for the purposes of judgment. In April 2010, the São Paulo Court of Appeals reversed the Seventh Civil Court's decision that consolidated the cases, finding that they are based on different legal claims and are progressing at different stages of proceedings. This case was returned to the Seventh Civil Court of São Paulo, and our subsidiary filed its closing arguments in December 2010. In March 2012, the trial court dismissed the case on the merits. In January 2014, the São Paulo Court of Appeals rejected plaintiff's appeal and affirmed the trial court decision. In July 2014, plaintiff appealed to the Superior Court of Justice.

In the first class action pending in Canada, Cecilia Létourneau v. Imperial Tobacco Ltd., Rothmans, Benson & Hedges Inc. and JTI Macdonald Corp., Quebec Superior Court, Canada, filed in September 1998, our subsidiary and other Canadian manufacturers (Imperial Tobacco Canada Ltd. and JTI-MacDonald Corp.) are defendants. The plaintiff, an individual smoker, sought compensatory and punitive damages for each member of the class who is deemed addicted to smoking. The class was certified in 2005. Trial began in March 2012 and concluded in December 2014. The trial court issued its judgment on May 27, 2015. The trial court found our subsidiary and two other Canadian manufacturers liable and awarded a total of CAD 131 million (approximately $100 million) in punitive damages, allocating CAD 46 million (approximately $35 million) to our subsidiary. The trial court found that defendants violated the Civil Code of Quebec, the Quebec Charter of Human Rights and Freedoms, and the Quebec Consumer

Protection Act by failing to warn adequately of the dangers of smoking. The trial court also found that defendants conspired to prevent consumers from learning the dangers of smoking. The trial court further held that these civil faults were a cause of the class members' addiction. The trial court rejected other grounds of fault advanced by the class, holding that: (i) the evidence was insufficient to show that defendants marketed to youth, (ii) defendants' advertising did not convey false information about the characteristics of cigarettes, and (iii) defendants did not commit a fault by using the descriptors light or mild for cigarettes with a lower tar delivery. The trial court estimated the size of the addiction class at 918,000 members but declined to award compensatory damages to the addiction class because the evidence did not establish the claims with sufficient accuracy. The trial court ordered defendants to pay the full punitive damage award into a trust within 60 days and found that a claims process to allocate the awarded damages to individual class members would be too expensive and difficult to administer. The trial court ordered a briefing on the proposed process for the distribution of sums remaining from the punitive damage award after payment of attorneys' fees and legal costs. In June 2015, our subsidiary commenced the appellate process by filing its inscription of appeal of the trial court's judgment with the Court of Appeal of Quebec. Our subsidiary also filed a motion to cancel the trial court's order for payment into a trust within 60 days notwithstanding appeal. In July 2015, the Court of Appeal granted the motion to cancel and overturned the trial court's ruling that our subsidiary make the payment into a trust within 60 days. In August 2015, plaintiffs filed a motion with the Court of Appeal seeking security in both the Létourneau case and the Blais case described below. In October 2015, the Court of Appeal granted the motion and ordered our subsidiary to furnish security totaling CAD 226 million (approximately $172 million), in the form of cash into a court trust or letters of credit, in six equal consecutive quarterly installments of approximately CAD 37.6 million (approximately $28.6 million) beginning in December 2015 through March 2017. See the Blais description for further detail concerning the security order. The Court of Appeal has scheduled a hearing for the merits appeal for November 2016. Our subsidiary and PMI believe that the findings of liability and damages were incorrect and should ultimately be set aside on any one of many grounds, including the following: (i) holding that defendants violated Quebec law by failing to warn class members of the risks of smoking even after the court found that class members knew, or should have known, of the risks, (ii) finding that plaintiffs were not required to prove that defendants' alleged misconduct caused injury to each class member in direct contravention of binding precedent, (iii) creating a factual presumption, without any evidence from class members or otherwise, that defendants' alleged misconduct caused all smoking by all class members, (iv) holding that the addiction class members' claims for punitive damages were not time-barred even though the case was filed more than three years after a prominent addiction warning appeared on all packages, and (v) awarding punitive damages to punish defendants without proper consideration as to whether punitive damages were necessary to deter future misconduct.

In the second class action pending in Canada, Conseil Québécois Sur Le Tabac Et La Santé and Jean-Yves Blais v. Imperial Tobacco Ltd., Rothmans, Benson & Hedges Inc. and JTI Macdonald Corp., Quebec Superior Court, Canada, filed in November 1998, our subsidiary and other Canadian manufacturers (Imperial Tobacco Canada Ltd. and JTI-MacDonald Corp.) are defendants. The plaintiffs, an anti-smoking organization and an individual smoker, sought compensatory and punitive damages for each member of the class who allegedly suffers from certain smoking-related diseases. The class was certified in 2005. Trial began in March 2012 and concluded in December 2014. The trial court issued its judgment on May 27, 2015. The trial court found our subsidiary and two other Canadian manufacturers liable and found that the class members' compensatory damages totaled approximately CAD 15.5 billion, including pre-judgment interest (approximately $11.8 billion). The trial court awarded compensatory damages on a joint and several liability basis, allocating 20% to our subsidiary (approximately CAD 3.1 billion, including pre-judgment interest (approximately $2.4 billion)). In addition, the trial court awarded CAD 90,000 (approximately $68,000) in punitive damages, allocating CAD 30,000 (approximately $23,000) to our subsidiary and found that defendants violated the Civil Code of Quebec, the Quebec Charter of Human Rights and Freedoms, and the Quebec Consumer Protection Act by failing to warn adequately of the dangers of smoking. The trial court also found that defendants conspired to prevent consumers from learning the dangers of smoking. The trial court further held that these civil faults were a cause of the class members' diseases. The trial court rejected other grounds of fault advanced by the class, holding that: (i) the evidence was insufficient to show that defendants marketed to youth, (ii) defendants' advertising did not convey false information about the characteristics of cigarettes, and (iii) defendants did not commit a fault by using the descriptors light or mild for cigarettes with a lower tar delivery. The trial court estimated the disease class at 99,957 members. The trial court ordered defendants to pay CAD 1 billion (approximately $759 million) of the compensatory damage award into a trust within 60 days, CAD 200 million (approximately $152 million) of which is our subsidiary's portion and ordered briefing on a proposed claims process for the distribution of damages to individual class members and for payment of attorneys' fees and legal costs. In June 2015, our subsidiary commenced the appellate process by filing its inscription of appeal of the trial court's judgment with the Court of Appeal of Quebec. Our subsidiary also filed a motion to cancel the trial court's order for payment into a trust within 60 days notwithstanding appeal. In July 2015, the Court of Appeal granted the motion to cancel and overturned the trial court's ruling that our subsidiary make an initial payment within 60 days. In August 2015, plaintiffs filed a motion with the Court of Appeal seeking an order that defendants place irrevocable letters of credit totaling CAD 5 billion (approximately $3.8 billion) into trust, to secure the judgments in both the Létourneau and Blais cases. Plaintiffs subsequently withdrew their motion for security against JTI-MacDonald Corp. and proceeded only against our subsidiary and Imperial Tobacco

Canada Ltd. In October 2015, the Court of Appeal granted the motion and ordered our subsidiary to furnish security totaling CAD 226 million (approximately $172 million) to cover both the Létourneau and Blais cases. Such security may take the form of cash into a court trust or letters of credit, in six equal consecutive quarterly installments of approximately CAD 37.6 million (approximately $28.6 million) beginning in December 2015 through March 2017. The Court of Appeal ordered Imperial Tobacco Canada Ltd. to furnish security totaling CAD 758 million (approximately $576 million) in seven equal consecutive quarterly installments of approximately CAD 108 million (approximately $82 million) beginning in December 2015 through June 2017. In September 2016, our subsidiary made its fourth quarterly installment of security for approximately CAD 37.6 million (approximately $28.6 million) into a court trust. This payment is included in other assets on the condensed consolidated balance sheets and in cash used in operating activities in the condensed consolidated statements of cash flows. The Court of Appeal ordered that the security is payable upon a final judgment of the Court of Appeal affirming the trial court's judgment or upon further order of the Court of Appeal. The Court of Appeal has scheduled a hearing for the merits appeal for November 2016. Our subsidiary and PMI believe that the findings of liability and damages were incorrect and should ultimately be set aside on any one of many grounds, including the following: (i) holding that defendants violated Quebec law by failing to warn class members of the risks of smoking even after the court found that class members knew, or should have known, of the risks, (ii) finding that plaintiffs were not required to prove that defendants' alleged misconduct caused injury to each class member in direct contravention of binding precedent, (iii) creating a factual presumption, without any evidence from class members or otherwise, that defendants' alleged misconduct caused all smoking by all class members, (iv) relying on epidemiological evidence that did not meet recognized scientific standards, and (v) awarding punitive damages to punish defendants without proper consideration as to whether punitive damages were necessary to deter future misconduct.

In the third class action pending in Canada, Kunta v. Canadian Tobacco Manufacturers' Council, et al., The Queen's Bench, Winnipeg, Canada, filed June 12, 2009, we, our subsidiaries, and our indemnitees (PM USA and Altria), and other members of the industry are defendants. The plaintiff, an individual smoker, alleges her own addiction to tobacco products and chronic obstructive pulmonary disease ("COPD"), severe asthma, and mild reversible lung disease resulting from the use of tobacco products. She is seeking compensatory and punitive damages on behalf of a proposed class comprised of all smokers, their estates, dependents and family members, as well as restitution of profits, and reimbursement of government health care costs allegedly caused by tobacco products. In September 2009, plaintiff's counsel informed defendants that he did not anticipate taking any action in this case while he pursues the class action filed in Saskatchewan (see description of Adams, below).

In the fourth class action pending in Canada, Adams v. Canadian Tobacco Manufacturers' Council, et al., The Queen's Bench, Saskatchewan, Canada, filed July 10, 2009, we, our subsidiaries, and our indemnitees (PM USA and Altria), and other members of the industry are defendants. The plaintiff, an individual smoker, alleges her own addiction to tobacco products and COPD resulting from the use of tobacco products. She is seeking compensatory and punitive damages on behalf of a proposed class comprised of all smokers who have smoked a minimum of 25,000 cigarettes and have allegedly suffered, or suffer, from COPD, emphysema, heart disease, or cancer, as well as restitution of profits. Preliminary motions are pending.

In the fifth class action pending in Canada, Semple v. Canadian Tobacco Manufacturers' Council, et al., The Supreme Court (trial court), Nova Scotia, Canada, filed June 18, 2009, we, our subsidiaries, and our indemnitees (PM USA and Altria), and other members of the industry are defendants. The plaintiff, an individual smoker, alleges his own addiction to tobacco products and COPD resulting from the use of tobacco products. He is seeking compensatory and punitive damages on behalf of a proposed class comprised of all smokers, their estates, dependents and family members, as well as restitution of profits, and reimbursement of government health care costs allegedly caused by tobacco products. No activity in this case is anticipated while plaintiff's counsel pursues the class action filed in Saskatchewan (see description of Adams, above).

In the sixth class action pending in Canada, Dorion v. Canadian Tobacco Manufacturers' Council, et al., The Queen's Bench, Alberta, Canada, filed June 15, 2009, we, our subsidiaries, and our indemnitees (PM USA and Altria), and other members of the industry are defendants. The plaintiff, an individual smoker, alleges her own addiction to tobacco products and chronic bronchitis and severe sinus infections resulting from the use of tobacco products. She is seeking compensatory and punitive damages on behalf of a proposed class comprised of all smokers, their estates, dependents and family members, restitution of profits, and reimbursement of government health care costs allegedly caused by tobacco products. To date, we, our subsidiaries, and our indemnitees have not been properly served with the complaint. No activity in this case is anticipated while plaintiff's counsel pursues the class action filed in Saskatchewan (see description of Adams, above).

In the seventh class action pending in Canada, McDermid v. Imperial Tobacco Canada Limited, et al., Supreme Court, British Columbia, Canada, filed June 25, 2010, we, our subsidiaries, and our indemnitees (PM USA and Altria), and other members of the industry are defendants. The plaintiff, an individual smoker, alleges his own addiction to tobacco products and heart disease resulting from the use of tobacco products. He is seeking compensatory and punitive damages on behalf of a proposed class comprised of all smokers who were alive on June 12, 2007, and who suffered from heart disease allegedly caused by smoking, their estates, dependents and family members, plus disgorgement of revenues earned by the defendants from January 1, 1954, to the date the claim was filed.

In the eighth class action pending in Canada, Bourassa v. Imperial Tobacco Canada Limited, et al., Supreme Court, British Columbia, Canada, filed June 25, 2010, we, our subsidiaries, and our indemnitees (PM USA and Altria), and other members of the industry are defendants. The plaintiff, the heir to a deceased smoker, alleges that the decedent was addicted to tobacco products and suffered from emphysema resulting from the use of tobacco products. She is seeking compensatory and punitive damages on behalf of a proposed class comprised of all smokers who were alive on June 12, 2007, and who suffered from chronic respiratory diseases allegedly caused by smoking, their estates, dependents and family members, plus disgorgement of revenues earned by the defendants from January 1, 1954, to the date the claim was filed. In December 2014, the plaintiff filed an amended statement of claim.

In the ninth class action pending in Canada, Suzanne Jacklin v. Canadian Tobacco Manufacturers' Council, et al., Ontario Superior Court of Justice, filed June 20, 2012, we, our subsidiaries, and our indemnitees (PM USA and Altria), and other members of the industry are defendants. The plaintiff, an individual smoker, alleges her own addiction to tobacco products and COPD resulting from the use of tobacco products. She is seeking compensatory and punitive damages on behalf of a proposed class comprised of all smokers who have smoked a minimum of 25,000 cigarettes and have allegedly suffered, or suffer, from COPD, heart disease, or cancer, as well as restitution of profits. Plaintiff's counsel has indicated that he does not intend to take any action in this case in the near future.

Health Care Cost Recovery Litigation: These cases, brought by governmental and non-governmental plaintiffs, seek reimbursement of health care cost expenditures allegedly caused by tobacco products. Plaintiffs' allegations of liability in these cases are based on various theories of recovery including unjust enrichment, negligence, negligent design, strict liability, breach of express and implied warranties, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, defective product, failure to warn, sale of cigarettes to minors, and claims under statutes governing competition and deceptive trade practices. Plaintiffs in these cases seek various forms of relief including compensatory and other damages, and injunctive and equitable relief. Defenses raised in these cases include lack of proximate cause, remoteness of injury, failure to state a claim, adequate remedy at law, “unclean hands” (namely, that plaintiffs cannot obtain equitable relief because they participated in, and benefited from, the sale of cigarettes), and statute of limitations.

As of October 21, 2016, there were 16 health care cost recovery cases pending against us, our subsidiaries or indemnitees in Canada (10), Korea (1) and Nigeria (5), compared with 16 such cases on October 27, 2015 and 15 such cases on October 30, 2014.

In the first health care cost recovery case pending in Canada, Her Majesty the Queen in Right of British Columbia v. Imperial Tobacco Limited, et al., Supreme Court, British Columbia, Vancouver Registry, Canada, filed January 24, 2001, we, our subsidiaries, our indemnitee (PM USA), and other members of the industry are defendants. The plaintiff, the government of the province of British Columbia, brought a claim based upon legislation enacted by the province authorizing the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, resulting from a “tobacco related wrong.” The Supreme Court of Canada has held that the statute is constitutional. We and certain other non-Canadian defendants challenged the jurisdiction of the court. The court rejected the jurisdictional challenge. Pre-trial discovery is ongoing.

In the second health care cost recovery case filed in Canada, Her Majesty the Queen in Right of New Brunswick v. Rothmans Inc., et al., Court of Queen's Bench of New Brunswick, Trial Court, New Brunswick, Fredericton, Canada, filed March 13, 2008, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of New Brunswick based on legislation enacted in the province. This legislation is similar to the law introduced in British Columbia that authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a "tobacco related wrong." Pre-trial discovery is ongoing. In September 2016, the trial court entered a consent order establishing a discovery timetable that contemplates the province of New Brunswick applying by September 2017 for a trial date.

In the third health care cost recovery case filed in Canada, Her Majesty the Queen in Right of Ontario v. Rothmans Inc., et al., Ontario Superior Court of Justice, Toronto, Canada, filed September 29, 2009, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Ontario based on legislation enacted in the province. This legislation is similar to the laws introduced in British Columbia and New Brunswick that authorize the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a "tobacco related wrong." Pre-trial discovery is ongoing.

In the fourth health care cost recovery case filed in Canada, Attorney General of Newfoundland and Labrador v. Rothmans Inc., et al., Supreme Court of Newfoundland and Labrador, St. Johns, Canada, filed February 8, 2011, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Newfoundland and Labrador based on legislation enacted in the province that is similar to the laws introduced in British Columbia, New Brunswick and Ontario. The legislation authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a "tobacco related wrong." Pre-trial discovery is ongoing.

In the fifth health care cost recovery case filed in Canada, Attorney General of Quebec v. Imperial Tobacco Limited, et al., Superior Court of Quebec, Canada, filed June 8, 2012, we, our subsidiary, our indemnitee (PM USA), and other members of the industry are defendants. The claim was filed by the government of the province of Quebec based on legislation enacted in the province that is similar to the laws enacted in several other Canadian provinces. The legislation authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a "tobacco related wrong." Pre-trial discovery is ongoing.

In the sixth health care cost recovery case filed in Canada, Her Majesty in Right of Alberta v. Altria Group, Inc., et al., Supreme Court of Queen's Bench Alberta, Canada, filed June 8, 2012, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Alberta based on legislation enacted in the province that is similar to the laws enacted in several other Canadian provinces. The legislation authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a "tobacco related wrong." Pre-trial discovery is ongoing.

In the seventh health care cost recovery case filed in Canada, Her Majesty the Queen in Right of the Province of Manitoba v. Rothmans, Benson & Hedges, Inc., et al., The Queen's Bench, Winnipeg Judicial Centre, Canada, filed May 31, 2012, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Manitoba based on legislation enacted in the province that is similar to the laws enacted in several other Canadian provinces. The legislation authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a "tobacco related wrong." Defendants filed their defenses in September 2014. Discovery is scheduled to begin in 2017.

In the eighth health care cost recovery case filed in Canada, The Government of Saskatchewan v. Rothmans, Benson & Hedges Inc., et al., Queen's Bench, Judicial Centre of Saskatchewan, Canada, filed June 8, 2012, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Saskatchewan based on legislation enacted in the province that is similar to the laws enacted in several other Canadian provinces. The legislation authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a "tobacco related wrong." Defendants filed their defenses in February 2015. Discovery is scheduled to begin in 2017.

In the ninth health care cost recovery case filed in Canada, Her Majesty the Queen in Right of the Province of Prince Edward Island v. Rothmans, Benson & Hedges Inc., et al., Supreme Court of Prince Edward Island (General Section), Canada, filed September 10, 2012, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Prince Edward Island based on legislation enacted in the province that is similar to the laws enacted in several other Canadian provinces. The legislation authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a "tobacco related wrong." Defendants filed their defenses in February 2015. Discovery is scheduled to begin in 2017.

In the tenth health care cost recovery case filed in Canada, Her Majesty the Queen in Right of the Province of Nova Scotia v. Rothmans, Benson & Hedges Inc., et al., Supreme Court of Nova Scotia, Canada, filed January 2, 2015, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Nova Scotia based on legislation enacted in the province that is similar to the laws enacted in several other Canadian provinces. The legislation authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a "tobacco related wrong." Defendants filed their defenses in July 2015. Discovery is scheduled to begin in 2017.

In the first health care cost recovery case in Nigeria, The Attorney General of Lagos State v. British American Tobacco (Nigeria) Limited, et al., High Court of Lagos State, Lagos, Nigeria, filed March 13, 2008, we and other members of the industry are defendants. Plaintiff seeks reimbursement for the cost of treating alleged smoking-related diseases for the past 20 years, payment of anticipated costs of treating alleged smoking-related diseases for the next 20 years, various forms of injunctive relief, plus punitive damages. We are in the process of making challenges to service and the court's jurisdiction. Currently, the case is stayed in the trial court pending the appeals of certain co-defendants relating to service objections.

In the second health care cost recovery case in Nigeria, The Attorney General of Kano State v. British American Tobacco (Nigeria) Limited, et al., High Court of Kano State, Kano, Nigeria, filed May 9, 2007, we and other members of the industry are defendants. Plaintiff seeks reimbursement for the cost of treating alleged smoking-related diseases for the past 20 years, payment of anticipated costs of treating alleged smoking-related diseases for the next 20 years, various forms of injunctive relief, plus punitive damages. We are in the process of making challenges to service and the court's jurisdiction. Currently, the case is stayed in the trial court pending the appeals of certain co-defendants relating to service objections.
In the third health care cost recovery case in Nigeria, The Attorney General of Gombe State v. British American Tobacco (Nigeria) Limited, et al., High Court of Gombe State, Gombe, Nigeria, filed October 17, 2008, we and other members of the industry are defendants. Plaintiff seeks reimbursement for the cost of treating alleged smoking-related diseases for the past 20 years, payment of anticipated costs of treating alleged smoking-related diseases for the next 20 years, various forms of injunctive relief, plus punitive damages. In February 2011, the court ruled that the plaintiff had not complied with the procedural steps necessary to serve us. As a result of this ruling, plaintiff must re-serve its claim. We have not yet been re-served.
In the fourth health care cost recovery case in Nigeria, The Attorney General of Oyo State, et al., v. British American Tobacco (Nigeria) Limited, et al., High Court of Oyo State, Ibadan, Nigeria, filed May 25, 2007, we and other members of the industry are defendants. Plaintiffs seek reimbursement for the cost of treating alleged smoking-related diseases for the past 20 years, payment of anticipated costs of treating alleged smoking-related diseases for the next 20 years, various forms of injunctive relief, plus punitive damages. We challenged service as improper. In June 2010, the court ruled that plaintiffs did not have leave to serve the writ of summons on the defendants and that they must re-serve the writ. We have not yet been re-served.
In the fifth health care cost recovery case in Nigeria, The Attorney General of Ogun State v. British American Tobacco (Nigeria) Limited, et al., High Court of Ogun State, Abeokuta, Nigeria, filed February 26, 2008, we and other members of the industry are defendants. Plaintiff seeks reimbursement for the cost of treating alleged smoking-related diseases for the past 20 years, payment of anticipated costs of treating alleged smoking-related diseases for the next 20 years, various forms of injunctive relief, plus punitive damages. In May 2010, the trial court rejected our service objections. We have appealed.
In the health care cost recovery case in Korea, the National Health Insurance Service v. KT&G, et. al., filed April 14, 2014, our subsidiary and other Korean manufacturers are defendants. Plaintiff alleges that defendants concealed the health hazards of smoking, marketed to youth, added ingredients to make their products more harmful and addictive, and misled consumers into believing that Lights cigarettes are safer than regular cigarettes. The National Health Insurance Service seeks to recover approximately $53.7 million allegedly incurred in treating 3,484 patients with small cell lung cancer, squamous cell lung cancer, and squamous cell laryngeal cancer from 2003 to 2012. The case is now in the evidentiary phase.

Lights Cases: These cases, brought by individual plaintiffs, allege that the use of the term “lights” constitutes fraudulent and misleading conduct. Plaintiffs' allegations of liability in these cases are based on various theories of recovery including misrepresentation, deception, and breach of consumer protection laws. Plaintiffs seek various forms of relief including restitution, injunctive relief, and compensatory and other damages. Defenses raised include lack of causation, lack of reliance, assumption of the risk, and statute of limitations.

As of October 21, 2016, there were 3 lights cases brought by individual plaintiffs pending against our subsidiaries or indemnitees in Chile (2) and Italy (1), compared with 3 such cases on October 27, 2015, and 2 such cases on October 30, 2014.

Public Civil Actions: Claims have been filed either by an individual, or a public or private entity, seeking to protect collective or individual rights, such as the right to health, the right to information or the right to safety. Plaintiffs' allegations of liability in these cases are based on various theories of recovery including product defect, concealment, and misrepresentation. Plaintiffs in these cases seek various forms of relief including injunctive relief such as banning cigarettes, descriptors, smoking in certain places and advertising, as well as implementing communication campaigns and reimbursement of medical expenses incurred by public or private institutions.

As of October 21, 2016, there were 2 public civil actions pending against our subsidiaries in Argentina (1) and Venezuela (1), compared with 2 such cases on October 27, 2015, and 2 such cases on October 30, 2014.

In the public civil action in Argentina, Asociación Argentina de Derecho de Danos v. Massalin Particulares S.A., et al., Civil Court of Buenos Aires, Argentina, filed February 26, 2007, our subsidiary and another member of the industry are defendants. The plaintiff, a consumer association, seeks the establishment of a relief fund for reimbursement of medical costs associated with diseases allegedly caused by smoking. Our subsidiary filed its answer in September 2007. In March 2010, the case file was transferred to the Federal Court on Administrative Matters after the Civil Court granted the plaintiff's request to add the national government as a co-plaintiff in the case. The case is currently in the evidentiary stage.

In the public civil action in Venezuela, Federation of Consumers and Users Associations ("FEVACU"), et al. v. National Assembly of Venezuela and the Venezuelan Ministry of Health, Constitutional Chamber of the Venezuelan Supreme Court, filed April 29, 2008, we were not named as a defendant, but the plaintiffs published a notice pursuant to court order, notifying all interested parties to appear in the case. In January 2009, our subsidiary appeared in the case in response to this notice. The plaintiffs purport to represent the right to health of the citizens of Venezuela and claim that the government failed to protect adequately its citizens' right to health. The claim asks the court to order the government to enact stricter regulations on the manufacture and sale of tobacco products. In addition, the plaintiffs ask the court to order companies involved in the tobacco industry to allocate a percentage of their "sales or benefits" to establish a fund to pay for the health care costs of treating smoking-related diseases. In October 2008, the court ruled that plaintiffs have standing to file the claim and that the claim meets the threshold admissibility requirements. In December 2012, the court admitted our subsidiary and BAT's subsidiary as interested third parties. In February 2013, our subsidiary answered the complaint.

Other Litigation

The Department of Special Investigations of the government of Thailand has been conducting an investigation into alleged underpayment by our subsidiary, Philip Morris (Thailand) Limited ("PM Thailand"), of customs duties and excise taxes relating to imports from the Philippines covering the period 2003-2007. On January 18, 2016, the Public Prosecutor filed charges against our subsidiary and seven former and current employees in the Bangkok Criminal Court alleging that PM Thailand and the individual defendants jointly and with the intention to defraud the Thai government, under declared import prices of cigarettes to avoid full payment of taxes and duties in connection with 272 import entries of cigarettes from the Philippines during the period of July 2003 to June 2006. The government is seeking a fine of approximately THB 80.8 billion (approximately $2.31 billion). The case is in the pre-trial evidentiary phase. PM Thailand contends that its declared import prices are in compliance with the Customs Valuation Agreement of the World Trade Organization and Thai law and that the allegations of the Public Prosecutor are inconsistent with several decisions already taken by Thai Customs and other Thai governmental agencies.

We are also involved in additional litigation arising in the ordinary course of our business. While the outcomes of these proceedings are uncertain, management does not expect that the ultimate outcomes of other litigation, including any reasonably possible losses in excess of current accruals, will have a material adverse effect on our consolidated results of operations, cash flows or financial position.

Note 10. Income Taxes:
Income tax provisions for jurisdictions outside the United States of America, as well as state and local income tax provisions, were determined on a separate company basis and the related assets and liabilities were recorded in PMI's condensed consolidated balance sheets.

PMI's effective tax rates for the nine months and three months ended September 30, 2016 were 28.1% and 27.7%, respectively. PMI's effective tax rates for the nine months and three months ended September 30, 2015 were 28.7% and 27.6%, respectively. PMI estimates that its full-year 2016 effective tax rate will be approximately 28%. The effective tax rate for the nine months ended September 30, 2015, was unfavorably impacted by changes to repatriation assertions on certain foreign subsidiary historical earnings ($58 million), partially offset by the recognition of a tax benefit of $13 million following the conclusion of the IRS examination of Altria's consolidated tax returns for the years 2007 and 2008. Prior to March 28, 2008, PMI was a wholly owned subsidiary of Altria. Excluding the effect of these items, the change in the effective tax rate for the nine months ended September 30, 2016, as compared to the nine months ended September 30, 2015, was primarily due to earnings mix by taxing jurisdiction and repatriation cost differences.

The effective tax rates are based on PMI’s full-year earnings mix projections by taxing jurisdiction and cash repatriation plans. Changes in earnings mix by taxing jurisdiction or in cash repatriation plans could have an impact on the effective tax rates, which PMI monitors each quarter. Significant judgment is required in determining income tax provisions and in evaluating tax positions.

PMI is regularly examined by tax authorities around the world and is currently under examination in a number of jurisdictions. The U.S. federal statute of limitations remains open for the years 2013 and onward. Foreign and U.S. state jurisdictions have statutes of limitations generally ranging from three to five years.

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It is reasonably possible that within the next twelve months certain tax examinations will close, which could result in a change in unrecognized tax benefits, along with related interest and penalties. An estimate of any possible change cannot be made at this time.

Note 11. Indebtedness:
Short-term Borrowings:
At September 30, 2016 and December 31, 2015, PMI's short-term borrowings, consisting of bank loans to certain PMI subsidiaries, had a carrying value of $710 million and $825 million, respectively. The fair value of PMI's short-term borrowings, based on current market interest rates, approximates carrying value.

Long-term Debt:
At September 30, 2016 and December 31, 2015, PMI's long-term debt consisted of the following:

(in millions)	September 30, 2016	December 31, 2015
U.S. dollar notes, 1.125% to 6.375% (average interest rate 3.662%), due through 2044	$ 19,865	$ 18,091
Foreign currency obligations:		
Euro notes, 1.750% to 3.125% (average interest rate 2.400%), due through 2036	7,342	7,423
Swiss franc notes, 0.750% to 2.000% (average interest rate 1.216%), due through 2024	1,724	1,690
Other (average interest rate 3.154%), due through 2024	446	451
	29,377	27,655
Less current portion of long-term debt	2,417	2,405
	$ 26,960	$ 25,250

Other foreign currency debt above includes mortgage debt in Switzerland, capital lease obligations and a bank loan in the Philippines.
PMI's debt issuances in the first nine months of 2016 were as follows:
(in millions)

Type	Face Value	Interest Rate	Issuance	Maturity
U.S. dollar notes [a]	$500	1.375%	February 2016	February 2019
U.S. dollar notes [a]	$750	1.875%	February 2016	February 2021
U.S. dollar notes [a]	$750	2.750%	February 2016	February 2026
U.S. dollar notes [b]	$500	2.125%	May 2016	May 2023
U.S. dollar notes [b]	$500	4.250%	May 2016 [d]	November 2044
EURO notes [c]	€500 (approximately $578)	2.000%	May 2016	May 2036

[a] Interest on these notes is payable semi-annually in arrears beginning in August 2016.
[b] Interest on these notes is payable semi-annually in arrears beginning in November 2016.
[c] Interest on these notes is payable annually in arrears beginning in May 2017.
[d] These notes are a further issuance of the 4.25% notes issued by PMI in November 2014.
The net proceeds from the sale of the securities listed in the table above has been and will be used for general corporate purposes.

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Credit Facilities:

On January 27, 2016, PMI entered into an agreement to amend and extend its existing $2.0 billion 364-day revolving credit facility from February 9, 2016 to February 7, 2017. On January 27, 2016, PMI also entered into an agreement to extend the term of its existing $2.5 billion multi-year revolving credit facility from February 28, 2020 to February 28, 2021.
At September 30, 2016, PMI's total committed credit facilities were as follows:

(in billions)

Type	Committed Credit Facilities
364-day revolving credit, expiring February 7, 2017	$ 2.0
Multi-year revolving credit, expiring February 28, 2021	2.5
Multi-year revolving credit, expiring October 1, 2020 [1]	3.5
Total facilities	$ 8.0

[1] On August 30, 2016, PMI entered into an agreement, effective October 1, 2016, to extend the term of its multi-year revolving credit facility, for an additional year covering the period October 1, 2020 to October 1, 2021 in the amount of $3.35 billion.

At September 30, 2016, there were no borrowings under these committed credit facilities, and the entire committed amounts were available for borrowing.

Note 12. Fair Value Measurements:
The authoritative guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The guidance also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of input that may be used to measure fair value, which are as follows:
Level 1 - Quoted prices in active markets for identical assets or liabilities;
Level 2 - Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and
Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

PMI's policy is to reflect transfers between hierarchy levels at the end of the reporting period.
Derivative Financial Instruments
PMI assesses the fair value of its foreign exchange contracts and interest rate contracts using standard valuation models that use, as their basis, readily observable market inputs. The fair value of PMI’s foreign exchange forward contracts is determined by using the prevailing foreign exchange spot rates and interest rate differentials, and the respective maturity dates of the instruments. The fair value of PMI’s currency options is determined by using a Black-Scholes methodology based on foreign exchange spot rates and interest rate differentials, currency volatilities

and maturity dates. PMI’s derivative financial instruments have been classified within Level 2 in the table shown below. See Note 6. Financial Instruments for an additional discussion of derivative financial instruments.

Debt
The fair value of PMI’s outstanding debt, which is utilized solely for disclosure purposes, is determined using quotes and market interest rates currently available to PMI for issuances of debt with similar terms and remaining maturities. The aggregate carrying value of PMI’s debt, excluding short-term borrowings and $14 million of capital lease obligations, was $29,363 million at September 30, 2016. The fair value of PMI’s outstanding debt, excluding the aforementioned short-term borrowings and capital lease obligations, has been classified within Level 1 and Level 2 in the table shown below.

The aggregate fair values of PMI’s derivative financial instruments and debt as of September 30, 2016, were as follows:

(in millions)	Fair Value at September 30, 2016	Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Foreign exchange contracts	$ 269	$ —	$ 269	$ —
Total assets	$ 269	$ —	$ 269	$ —
Liabilities:				
Debt	$ 32,595	$ 32,128	$ 467	$ —
Foreign exchange contracts	353	—	353	—
Total liabilities	$ 32,948	$ 32,128	$ 820	$ —

Note 13. Accumulated Other Comprehensive Losses:
PMI’s accumulated other comprehensive losses, net of taxes, consisted of the following:

(in millions)	At September 30, 2016	At December 31, 2015	At September 30, 2015
Currency translation adjustments	$ (5,605)	$ (6,129)	$ (6,147)
Pension and other benefits	(3,178)	(3,332)	(2,854)
Derivatives accounted for as hedges	(106)	59	74
Total accumulated other comprehensive losses	$ (8,889)	$ (9,402)	$ (8,927)

Reclassifications from Other Comprehensive Earnings

The movements in accumulated other comprehensive losses and the related tax impact, for each of the components above, that are due to current period activity and reclassifications to the income statement are shown on the condensed consolidated statements of comprehensive earnings for the nine months and three months ended September 30, 2016 and 2015. For additional information, see Note 4. Benefit Plans and Note 6. Financial Instruments for disclosures related to PMI's pension and other benefits, and derivative financial instruments, respectively.

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Philip Morris International Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Note 14. Balance Sheet Offsetting:

Derivative Financial Instruments

PMI uses foreign exchange contracts and interest rate contracts to mitigate its exposure to changes in exchange and interest rates from third-party and intercompany actual and forecasted transactions. Substantially all of PMI's derivative financial instruments are subject to master netting arrangements, whereby the right to offset occurs in the event of default by a participating party. While these contracts contain the enforceable right to offset through close-out netting rights, PMI elects to present them on a gross basis in the condensed consolidated balance sheets. Collateral associated with these arrangements is in the form of cash and is unrestricted. See Note 6. Financial Instruments for disclosures related to PMI's derivative financial instruments.

The effects of these derivative financial instrument assets and liabilities on PMI's condensed consolidated balance sheets were as follows:

(in millions)	Gross Amounts Recognized	Gross Amount Offset in the Condensed Consolidated Balance Sheet	Net Amounts Presented in the Condensed Consolidated Balance Sheet	Gross Amounts Not Offset in the Condensed Consolidated Balance Sheet		Net Amount
				Financial Instruments	Cash Collateral Received/Pledged	
At September 30, 2016						
Assets						
Foreign exchange contracts	$ 269	$ —	$ 269	$ (144)	$ (107)	$ 18
Liabilities						
Foreign exchange contracts	$ 353	$ —	$ 353	$ (144)	$ (191)	$ 18
At December 31, 2015						
Assets						
Foreign exchange contracts	$ 574	$ —	$ 574	$ (131)	$ (432)	$ 11
Liabilities						
Foreign exchange contracts	$ 172	$ —	$ 172	$ (131)	$ (30)	$ 11

Note 15. Investments in Unconsolidated Subsidiaries:

At September 30, 2016 and December 31, 2015, PMI had total investments in unconsolidated subsidiaries of $986 million and $890 million, respectively, which were accounted for under the equity method of accounting. Equity method investments are initially recorded at cost. Under the equity method of accounting, the investment is adjusted for PMI's proportionate share of earnings or losses and movements in currency translation adjustments. The carrying value of our equity method investments at September 30, 2016 and December 31, 2015 exceeded our share of the unconsolidated subsidiaries' book value by $851 million and $806 million, respectively. The difference between the investment carrying value and the amount of underlying equity in net assets, excluding $791 million and $744 million attributable to goodwill as of September 30, 2016 and December 31, 2015, respectively, is being amortized on a straight-line basis over the underlying assets' estimated useful lives of 3 to 20 years. At September 30, 2016 and December 31, 2015, PMI received year-to-date dividends from unconsolidated subsidiaries of $102 million and $127 million, respectively.

PMI holds a 49% equity interest in United Arab Emirates-based Emirati Investors-TA (FZC) (“EITA”), formerly Arab Investors-TA (FZC). As a result of this transaction, PMI holds an approximate 25% economic interest in Société des Tabacs Algéro-Emiratie (“STAEM”), an Algerian joint venture that is 51% owned by EITA and 49% by the Algerian state-owned enterprise Société Nationale des Tabacs et Allumettes SpA. STAEM manufactures and distributes under license some of PMI’s brands. The initial investment in EITA was recorded at cost and is included in investments in unconsolidated subsidiaries on the condensed consolidated balance sheets.

PMI acquired in 2013 from Megapolis Investment BV a 20% equity interest in Megapolis Distribution BV, the holding company of CJSC TK Megapolis ("Megapolis"), PMI's distributor in Russia, for a purchase price of $760 million. An additional payment of up to $100 million, which is contingent on Megapolis's operational performance over the four fiscal years following the closing of the transaction, will also be made by PMI if the performance criteria are satisfied. PMI has also agreed to provide Megapolis Investment BV with a $100 million interest-bearing loan. PMI and Megapolis Investment BV have agreed to set off any future contingent payments owed by PMI against the future repayments due under the loan agreement. Any loan repayments in excess of the contingent consideration earned by the performance of Megapolis are due to be repaid, in cash, to PMI on March 31, 2017. At December 31, 2013, PMI had recorded a $100 million asset related to the loan receivable and a discounted liability of $86 million related to the contingent consideration. The initial investment in Megapolis was recorded at cost and is included in investments in unconsolidated subsidiaries on the condensed consolidated balance sheets. As of September 30, 2016, Megapolis satisfied certain performance criteria which resulted in contingent consideration of $74 million. As required under the terms of the agreement, the amount of the contingent consideration was offset against the future repayments due under the loan agreement.

PMI’s earnings activity from unconsolidated subsidiaries was as follows:

(in millions)	For the Nine Months Ended September 30, 2016	2015	For the Three Months Ended September 30, 2016	2015
Net revenues	$2,856	$3,269	$1,090	$1,051

PMI’s balance sheet activity related to unconsolidated subsidiaries was as follows:

(in millions)	At September 30, 2016	At December 31, 2015
Receivables	$ 366	$ 64
Notes receivable	$ 28	$ 100
Other liabilities	$ 26	$ 100

The activity primarily related to agreements with PMI’s unconsolidated subsidiaries within the Eastern Europe, Middle East & Africa segment. These agreements, which are in the ordinary course of business, are primarily for distribution, contract manufacturing and licenses. PMI eliminated its respective share of all significant intercompany transactions with the equity method investees.

Note 16. Acquisitions and Other Business Arrangements:

As announced in June 2015, PMI’s subsidiary PT HM Sampoerna Tbk. (“Sampoerna”), of which PMI held a 98.18% interest, was required to comply with the January 30, 2014, Indonesian Stock Exchange (“IDX”) regulation requiring all listed public companies to have at least a 7.5% public shareholding by January 30, 2016. In order to comply with this requirement, Sampoerna conducted a rights issue (the “Rights Issue”). The exercise price for the rights was set at Rp. 77,000 per share, a 1.349% premium to the closing price on the IDX as of September 30, 2015. In connection with the Rights Issue, PT Philip Morris Indonesia (“PMID”), a fully consolidated subsidiary of PMI, sold 264,209,711 of the rights to third-party investors. Delivery of the rights sold took place on October 26, 2015. The total net proceeds from the Rights Issue were $1.5 billion at prevailing exchange rates on the closing date. The sale of the rights resulted in an increase to PMI's additional paid-in capital of $1.1 billion during the fourth quarter of 2015.

In June 2014, PMI acquired 100% of Nicocigs Limited, a leading U.K.-based e-vapor company, for the final purchase price of $103 million, net of cash acquired, with additional contingent payments of up to $77 million, primarily relating to performance targets over a three-year period. As of September 30, 2016, PMI does not anticipate that the performance targets will be met.

In September 2013, Grupo Carso, S.A.B. de C.V. ("Grupo Carso") sold to PMI its remaining 20% interest in PMI's Mexican tobacco business for $703 million. As a result, PMI now owns 100% of its Mexican tobacco business. A former director of PMI, whose term expired at the Annual Meeting of Shareholders in May 2015, had an affiliation with Grupo Carso. The final purchase price was subject to an adjustment based on the actual performance of the Mexican tobacco business over the three-year period ending two fiscal years after the closing of the purchase. In May 2015, PMI received a payment of $113 million from Grupo Carso as the final purchase price adjustment. This resulted in a total net purchase price of $590 million. In addition, PMI agreed to pay a dividend of approximately $38 million to Grupo Carso related to the earnings of the Mexican tobacco business for the nine months ended September 30, 2013. In March 2014, the dividend was declared and paid. The purchase of the remaining 20% interest resulted in a net decrease to PMI's additional paid-in capital of $559 million.

The effects of these acquisitions were not material to PMI's condensed consolidated financial position, results of operations or operating cash flows in any of the periods presented.

Note 17. Sale of Accounts Receivable:

To mitigate risk and enhance cash and liquidity management PMI sells trade receivables to unaffiliated financial institutions. These arrangements allow PMI to sell, on an ongoing basis, certain trade receivables without recourse. The trade receivables sold are generally short-term in nature and are removed from the condensed consolidated balance sheets. PMI sells trade receivables under two types of arrangements, servicing and non-servicing. For servicing arrangements, PMI continues to service the sold trade receivables on an administrative basis and does not act on behalf of the unaffiliated financial institutions. When applicable, a servicing liability is recorded for the estimated fair value of the servicing. The amounts associated with the servicing liability were not material as of September 30, 2016 and September 30, 2015. Under the non-servicing arrangements, PMI does not provide any administrative support or servicing after the trade receivables have been sold to the unaffiliated financial institutions.

Cumulative trade receivables sold, including excise taxes, for the nine months ended September 30, 2016 and 2015, were $7.0 billion and $1.1 billion, respectively. PMI’s operating cash flows were positively impacted by the amount of the trade receivables sold and derecognized from the condensed consolidated balance sheets, which remained outstanding with the unaffiliated financial institutions. The trade receivables sold that remained outstanding under these arrangements as of September 30, 2016 and September 30, 2015, were $0.7 billion, and $0.2 billion, respectively. The net proceeds received are included in cash provided by operating activities in the condensed consolidated statements of cash flows. The difference between the carrying amount of the trade receivables sold and the sum of the cash received is recorded as a loss on sale of trade receivables within marketing, administration and research costs in the condensed consolidated statements of earnings. For the nine months and three months ended September 30, 2016 and 2015, the loss on sale of trade receivables was not material.

Note 18. New Accounting Standards:

On February 25, 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update ASU 2016-02, “Leases” (“ASU 2016-02”). ASU 2016-02 requires organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Additionally, ASU 2016-02 modifies current guidance for lessors' accounting. ASU 2016-02 is effective for interim and annual reporting periods beginning on or after January 1, 2019, with early adoption permitted. PMI is currently assessing the impact that the adoption of ASU 2016-02 will have on its financial position or results of operations.

On January 5, 2016, the FASB issued Accounting Standard Update ASU 2016-01, “Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities” (“ASU 2016-01”). ASU 2016-01 will require equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. Additionally, ASU 2016-01 also changes certain disclosure requirements and other aspects of current U.S. GAAP. ASU 2016-01 is effective for interim and annual reporting periods beginning on or after January 1, 2018. PMI is currently assessing the impact that the adoption of ASU 2016-01 will have on its financial position or results of operations.

On November 20, 2015, the FASB issued Accounting Standard Update ASU 2015-17, “Balance Sheet Classification of Deferred Taxes” (“ASU 2015-17”). ASU 2015-17 requires that all deferred tax assets and liabilities, along with any related valuation allowance, be classified as noncurrent on the balance sheet. ASU 2015-17 is effective for interim and annual reporting periods beginning on or after January 1, 2017 with early adoption permitted. Entities can apply the final standard either prospectively, for all deferred tax assets and liabilities, or retrospectively with disclosures providing qualitative information about the effects of the accounting change on prior periods. PMI plans to adopt ASU 2015-17 prospectively on October 1, 2016. The adoption of ASU 2015-17 will not have a material impact on PMI’s consolidated results of operations, financial position or cash flows.

On May 28, 2014, the FASB issued Accounting Standards Update ASU 2014-09, “Revenue from Contracts with Customers” (“ASU 2014-09”). ASU 2014-09 contains principles that an entity will need to apply to determine the measurement of revenue and timing of when it is recognized. The underlying principle is that an entity will recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Entities can apply the final standard using one of the following two methods:

1. retrospectively to each prior period presented; or

2. retrospectively, with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial application, with additional disclosures in reporting periods that include the date of initial application.

ASU 2014-09 is effective for interim and annual reporting periods beginning on or after January 1, 2017. In July 2015, the FASB approved a proposal which allows for a deferral of the implementation until January 1, 2018, and permits early application, but not before the original effective date of January 1, 2017. PMI plans to adopt ASU 2014-09 on January 1, 2018 and is currently assessing the impact that the new standard will have on its financial position or results of operations.

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Item 2.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Description of Our Company
We are a holding company whose subsidiaries and affiliates, and their licensees, are engaged in the manufacture and sale of cigarettes, other tobacco products and other nicotine-containing products in markets outside the United States of America. We manage our business in four segments:

- European Union;
- Eastern Europe, Middle East & Africa ("EEMA");
- Asia; and
- Latin America & Canada.

Our products are sold in more than 180 markets, and in many of these markets they hold the number one or number two market share position. We have a wide range of premium, mid-price and low-price brands. Our portfolio comprises both international and local brands. We are engaged in the development and commercialization of Reduced-Risk Products ("RRPs"). RRPs is the term we use to refer to products with the potential to reduce individual risk and population harm in comparison to smoking cigarettes.
We use the term net revenues to refer to our operating revenues from the sale of our products, net of sales and promotion incentives. Our net revenues and operating income are affected by various factors, including the volume of products we sell, the price of our products, changes in currency exchange rates and the mix of products we sell. Mix is a term used to refer to the proportionate value of premium-price brands to mid-price or low-price brands in any given market (product mix). Mix can also refer to the proportion of shipment volume in more profitable markets versus shipment volume in less profitable markets (geographic mix). We often collect excise taxes from our customers and then remit them to governments, and, in those circumstances, we include the excise taxes in our net revenues and in excise taxes on products. Our cost of sales consists principally of tobacco leaf, non-tobacco raw materials, labor and manufacturing costs.
Our marketing, administration and research costs include the costs of marketing and selling our products, other costs generally not related to the manufacture of our products (including general corporate expenses), and costs incurred to develop new products. The most significant components of our marketing, administration and research costs are marketing and sales expenses and general and administrative expenses.
Philip Morris International Inc. is a legal entity separate and distinct from our direct and indirect subsidiaries. Accordingly, our right, and thus the right of our creditors and stockholders, to participate in any distribution of the assets or earnings of any subsidiary is subject to the prior rights of creditors of such subsidiary, except to the extent that claims of our company itself as a creditor may be recognized. As a holding company, our principal sources of funds, including funds to make payment on our debt securities, are from the receipt of dividends and repayment of debt from our subsidiaries. Our principal wholly owned and majority-owned subsidiaries currently are not limited by long-term debt or other agreements in their ability to pay cash dividends or to make other distributions with respect to their common stock.
Certain prior years' amounts have been reclassified to conform with the current year's presentation. In the fourth quarter of 2015, to further align with the Member State composition of the European Union, PMI transferred the management of its operations in Bulgaria, Croatia, Romania and Slovenia from its EEMA segment to its European Union segment, resulting in the reclassification of prior year amounts between the two segments. The changes did not have an impact on our consolidated financial position, results of operations or cash flows in any of the periods presented.

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Executive Summary

The following executive summary provides significant highlights from the "Discussion and Analysis" that follows.

Consolidated Operating Results for the Nine Months Ended September 30, 2016 – The changes in our reported diluted earnings per share (“diluted EPS”) for the nine months ended September 30, 2016, from the comparable 2015 amounts, were as follows:

	Diluted EPS	% Growth
For the nine months ended September 30, 2015	$ 3.62	
2015 Asset impairment and exit costs	—	
2015 Tax items	(0.01)	
Subtotal of 2015 items	(0.01)	
2016 Asset impairment and exit costs	—	
2016 Tax items	—	
Subtotal of 2016 items	—	
Currency	(0.32)	
Interest	0.04	
Change in tax rate	0.04	
Impact of shares outstanding and share-based payments	(0.01)	
Operations	0.02	
For the nine months ended September 30, 2016	$ 3.38	(6.6)%

Currency – The unfavorable currency impact during the reporting period results from the strengthening of the U.S. dollar, especially against the Argentine peso, Australian dollar, Canadian dollar, Egyptian pound, Indonesian rupiah, Kazakh tenge, Korean won, Mexican peso, Russian ruble and Turkish lira, partially offset by the Brazilian real, Euro, Japanese yen and Swiss franc. This unfavorable currency movement has impacted our profitability across our primary revenue markets and local currency cost bases.

Interest – The favorable impact of interest was due primarily to lower effective interest rates on debt.

Income Taxes – Our effective income tax rate for the nine months ended September 30, 2016 decreased by 0.6 percentage points to 28.1%. The 2015 tax items that increased our diluted EPS by $0.01 per share in 2015 per the table above represents the recognition of a tax benefit of $13 million following the conclusion of the IRS examination of Altria Group Inc.'s ("Altria") consolidated tax returns for the years 2007 and 2008. Prior to March 28, 2008, PMI was a wholly owned subsidiary of Altria. The change in the tax rate increased our diluted EPS by $0.04 per share in 2016. The change in the tax rate for the nine months ended September 30, 2015, was unfavorably impacted by changes to repatriation assertions on certain foreign subsidiary historical earnings ($58 million). Excluding the effect of the 2015 repatriation assertion changes, the change in the tax rate for the nine months ended September 30, 2016, as compared to the nine months ended September 30, 2015, was primarily due to earnings mix by taxing jurisdiction and repatriation cost differences. We estimate that our full-year 2016 effective tax rate will be approximately 28%.

Operations – The increase in diluted EPS of $0.02 from our operations in the table above was due primarily to the following segments:

- EEMA: Higher pricing, partially offset by unfavorable volume/mix;
- European Union: Higher pricing, partially offset by unfavorable volume/mix and higher marketing, administration and research costs; and
-

Latin America & Canada: Higher pricing, partially offset by unfavorable volume/mix, higher marketing, administration and research costs and higher manufacturing costs;

partially offset by

- Asia: Unfavorable volume/mix and higher marketing, administration and research costs, partially offset by higher pricing.

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Consolidated Operating Results for the Three Months Ended September 30, 2016 – The changes in our reported diluted EPS for the three months ended September 30, 2016, from the comparable 2015 amounts, were as follows:

	Diluted EPS	% Growth
For the three months ended September 30, 2015	$ 1.25	
2015 Asset impairment and exit costs	—	
2015 Tax items	(0.01)	
Subtotal of 2015 items	(0.01)	
2016 Asset impairment and exit costs	—	
2016 Tax items	—	
Subtotal of 2016 items	—	
Currency	(0.04)	
Interest	0.01	
Change in tax rate	0.01	
Impact of shares outstanding and share-based payments	—	
Operations	0.03	
For the three months ended September 30, 2016	$ 1.25	—%

Currency – The unfavorable currency impact during the reporting period results from the strengthening of the U.S. dollar, especially against the Egyptian pound, Kazakh tenge, Mexican peso, Russian ruble and Turkish lira, partially offset by the Argentine peso, Brazilian real, Euro and Japanese yen. This unfavorable currency movement has impacted our profitability across our primary revenue markets and local currency cost bases.

Interest – The favorable impact of interest was due primarily to lower effective interest rates on debt.

Income Taxes – Our effective income tax rate for the three months ended September 30, 2016 increased by 0.1 percentage point to 27.7%. The 2015 tax items that increased our diluted EPS by $0.01 per share in 2015 per the table above represents the recognition of a tax benefit of $13 million following the conclusion of the IRS examination of Altria's consolidated tax returns for the years 2007 and 2008. The change in the tax rate that increased our diluted EPS by $0.01 per share in the table above was primarily due to earnings mix by taxing jurisdiction and repatriation cost differences.

Operations – The increase in diluted EPS of $0.03 from our operations in the table above was due primarily to the following segments:

- EEMA: Higher pricing and lower marketing, administration and research costs, partially offset by unfavorable volume/mix and higher manufacturing cost;
- European Union: Higher pricing, partially offset by higher marketing, administration and research costs and unfavorable volume/mix; and
- Asia: Higher pricing, partially offset by unfavorable volume/mix and higher marketing, administration and research costs;

partially offset by

- Latin America & Canada: Unfavorable volume/mix, higher marketing, administration and research costs, and higher manufacturing costs, partially offset by higher pricing.

For further details, see the “Consolidated Operating Results” and “Operating Results by Business Segment” sections of the following “Discussion and Analysis.”

2016 Forecasted Results - On October 18, 2016, we reaffirmed our 2016 full-year reported diluted EPS forecast to be in a range of $4.53 to $4.58 versus $4.42 in 2015, as previously communicated on September 29, 2016. Excluding an unfavorable currency impact, at prevailing exchange rates, of approximately $0.35 per share for the full-year 2016, the diluted earnings per share range represents a projected increase of approximately 10.5% to 11.5% versus adjusted diluted earnings per share of $4.42 in 2015. This forecast does not include any share repurchases in 2016.

We calculated 2015 adjusted diluted EPS as reported diluted EPS of $4.42, plus the $0.03 per share charge related to asset impairment and exit costs, less the $0.03 per share benefit related to discrete tax items.

Adjusted diluted EPS is not a measure under accounting principles generally accepted in the United States of America ("U.S. GAAP"). We define adjusted diluted EPS as reported diluted EPS adjusted for asset impairment and exit costs, discrete tax items and unusual items. We believe it is appropriate to disclose this measure as it represents core earnings, improves comparability and helps investors analyze business performance and trends. Adjusted diluted EPS should be considered neither in isolation nor as a substitute for reported diluted EPS prepared in accordance with U.S. GAAP.

This 2016 guidance excludes the impact of any future acquisitions, unanticipated asset impairment and exit cost charges, future changes in currency exchange rates and any unusual events. The factors described in the "Cautionary Factors That May Affect Future Results" section of the following "Discussion and Analysis" represent continuing risks to this forecast.

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Discussion and Analysis

Consolidated Operating Results

See pages 77-81 for a discussion of our "Cautionary Factors That May Affect Future Results." Our cigarette volume, net revenues, excise taxes on products and operating companies income by segment were as follows:

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
(in millions)	2016	2015	2016	2015
Cigarette volume:				
European Union	148,393	147,379	52,001	51,771
Eastern Europe, Middle East & Africa	203,630	210,140	72,172	76,318
Asia	196,214	213,167	61,693	67,786
Latin America & Canada	64,144	66,815	21,185	23,036
Total cigarette volume	612,381	637,501	207,051	218,911
Net revenues:				
European Union	$20,664	$19,916	$7,387	$7,018
Eastern Europe, Middle East & Africa	13,650	13,908	5,122	5,107
Asia	15,014	14,683	5,113	4,880
Latin America & Canada	6,436	7,030	2,313	2,417
Net revenues	$55,764	$55,537	$19,935	$19,422
Excise taxes on products:				
European Union	$14,446	$13,782	$5,187	$4,895
Eastern Europe, Middle East & Africa	8,448	8,261	3,186	3,091
Asia	8,777	8,399	2,977	2,896
Latin America & Canada	4,379	4,693	1,603	1,613
Excise taxes on products	$36,050	$35,135	$12,953	$12,495
Operating income:				
Operating companies income:				
European Union	$3,096	$2,977	$1,120	$1,045
Eastern Europe, Middle East & Africa	2,389	2,721	962	1,002
Asia	2,288	2,421	761	690
Latin America & Canada	677	849	224	294
Amortization of intangibles	(56)	(62)	(19)	(19)
General corporate expenses	(119)	(115)	(36)	(33)
Less:				
Equity (income)/loss in unconsolidated subsidiaries, net	(72)	(69)	(35)	(20)
Operating income	$8,203	$8,722	$2,977	$2,959

As discussed in Note 8. Segment Reporting to our condensed consolidated financial statements, we evaluate segment performance and allocate resources based on operating companies income, which we define as operating income, excluding general corporate expenses and amortization of intangibles, plus equity (income)/loss in unconsolidated subsidiaries, net. We believe it is appropriate to disclose this measure to help investors analyze the business performance and trends of our various business segments.

References to total international cigarette market, defined as worldwide cigarette volume excluding the United States, total cigarette market, total market and market shares throughout this "Discussion and Analysis" reflect our best estimates of tax-paid volumes based on a number of internal and external sources.

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Consolidated Operating Results for the Nine Months Ended September 30, 2016

The following discussion compares our consolidated operating results for the nine months ended September 30, 2016, with the nine months ended September 30, 2015.

Our cigarette shipment volume decreased by 3.9% due to:

- EEMA, principally Algeria and Russia, partly offset by Turkey and Ukraine;
- Asia, principally Indonesia, Japan, Pakistan, the Philippines and Thailand, partly offset by Korea; and
- Latin America & Canada, predominantly Argentina, Brazil and Ecuador, partly offset by Mexico;

partially offset by:

- European Union, driven by the Czech Republic, France, Poland, Spain and the United Kingdom, partly offset by Greece and Italy.

Our cigarette shipment volume by brand is shown in the table below:

PMI Cigarette Shipment Volume by Brand (Million Units)

	Nine Months Year-to-Date		
	2016	2015	Change
Marlboro	211,426	213,754	(1.1)%
L&M	73,592	73,402	0.3 %
Parliament	34,247	33,372	2.6 %
Bond Street	32,792	33,003	(0.6)%
Chesterfield	34,203	31,015	10.3 %
Philip Morris	26,845	25,983	3.3 %
Lark	21,031	22,034	(4.6)%
Others	178,245	204,938	(13.0)%
Total PMI	612,381	637,501	(3.9)%

Cigarette shipment volume of Marlboro decreased, notably in Argentina, Japan, North Africa and Vietnam, partly offset by Korea, Mexico, the Philippines and Spain.

Cigarette shipment volume of L&M increased, notably in Kazakhstan, North Africa, Poland, Portugal and Ukraine, partly offset by Russia, Thailand and Turkey.

Cigarette shipment volume of Parliament increased, mainly driven by Korea and Turkey, partly offset by Russia. Cigarette shipment volume of Bond Street decreased, mainly due to the European Union and Russia, partly offset by Ukraine. Cigarette shipment volume of Chesterfield increased, mainly driven by: Argentina, the Czech Republic, reflecting the morphing of Red & White; Italy, Turkey and the United Kingdom, partly offset by Portugal, Russia and Ukraine. Cigarette shipment volume of Philip Morris increased, driven mainly by Canada and France; and Italy, benefiting from the morphing of Diana; partly offset by Argentina. Cigarette shipment volume of Lark decreased, principally due to Japan, partly offset by Turkey. Cigarette shipment volume of "Others" decreased, mainly due to local and largely low-margin brands in Indonesia, Pakistan, the Philippines and Russia.

Our cigarette market share increased in a number of markets, including Belgium, Canada, the Czech Republic, France, Kuwait, Mexico, the Netherlands, Poland, Saudi Arabia, Spain, Switzerland, Turkey and the United Kingdom.

Our other tobacco products ("OTP") primarily include tobacco for roll-your-own and make-your-own cigarettes, pipe tobacco, cigars and cigarillos. Total shipment volume of OTP, in cigarette equivalent units, decreased by 3.9%.

Total shipment volume for cigarettes and OTP, in cigarette equivalent units, decreased by 3.9%.

Total shipment volume of HeatSticks reached 3.7 billion units, up from 334 million units during the nine months ended September 30, 2015.

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Our net revenues and excise taxes on products were as follows:

(in millions)	For the Nine Months Ended September 30, 2016	2015	Variance	%
Net revenues	$55,764	$55,537	$227	0.4 %
Excise taxes on products	36,050	35,135	915	2.6 %
Net revenues, excluding excise taxes on products	$19,714	$20,402	$(688)	(3.4)%

Net revenues, which include excise taxes billed to customers, increased by $227 million. Excluding excise taxes, net revenues decreased by $688 million due to:

- unfavorable currency ($1.2 billion) and
- unfavorable volume/mix ($554 million), partly offset by
- price increases ($1.1 billion).

The unfavorable currency was due primarily to the Argentine peso, Australian dollar, Brazilian real, Canadian dollar, Egyptian pound, Euro, Indonesian rupiah, Kazakh tenge, Mexican peso, Philippine peso, Russian ruble and Turkish lira, partially offset by the Japanese yen.

Net revenues include $1,362 million in 2016 and $1,374 million in 2015 related to sales of OTP. These net revenue amounts include excise taxes billed to customers. Excluding excises taxes, net revenues for OTP were $484 million in 2016 and $506 million in 2015.

Excise taxes on products increased by $915 million due to:

- higher excise taxes resulting from changes in retail prices and tax rates ($3.7 billion) and
- higher excise taxes resulting from volume/mix ($406 million), partly offset by
- favorable currency ($3.2 billion).

Governments have consistently increased excise taxes in most of the markets in which we operate. As discussed in “Business Environment,” we expect excise taxes to continue to increase.

Our cost of sales; marketing, administration and research costs; and operating income were as follows:

(in millions)	For the Nine Months Ended September 30, 2016	2015	Variance	%
Cost of sales	$6,892	$6,990	$(98)	(1.4)%
Marketing, administration and research costs	4,563	4,628	(65)	(1.4)%
Operating income	8,203	8,722	(519)	(6.0)%

Cost of sales decreased $98 million due to:

- favorable currency ($261 million), partly offset by
- higher cost of sales resulting from volume/mix ($151 million) and
- higher manufacturing costs ($12 million).

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Marketing, administration and research costs decreased by $65 million due to:

- favorable currency ($266 million), partly offset by
- higher expenses ($201 million, primarily higher marketing and selling expenses).

Operating income decreased by $519 million due primarily to:

- unfavorable volume/mix ($705 million),
- unfavorable currency ($660 million) and
- higher marketing, administration and research costs ($201 million), partly offset by
- price increases ($1.1 billion).

Interest expense, net, of $690 million decreased by $91 million (11.7%), due primarily to lower effective interest rates on debt.

Our effective tax rate decreased by 0.6 percentage points to 28.1%. We estimate that our full-year 2016 effective tax rate will be approximately 28%. The effective tax rate for the nine months ended September 30, 2015, was unfavorably impacted by changes to repatriation assertions on certain foreign subsidiary historical earnings ($58 million), partially offset by the recognition of a tax benefit of $13 million following the conclusion of the IRS examination of Altria's consolidated tax returns for the years 2007 and 2008. Prior to March 28, 2008, PMI was a wholly owned subsidiary of Altria. The effective tax rate is based on our full-year earnings mix by taxing jurisdiction and cash repatriation plans. Changes in earnings mix by taxing jurisdiction or in our cash repatriation plans could have an impact on the effective tax rate, which we monitor each quarter. Significant judgment is required in determining income tax provisions and in evaluating tax positions.

We are regularly examined by tax authorities around the world, and we are currently under examination in a number of jurisdictions. It is reasonably possible that within the next twelve months certain tax examinations will close, which could result in a change in unrecognized tax benefits along with related interest and penalties. An estimate of any possible change cannot be made at this time.

Net earnings attributable to PMI of $5.3 billion decreased by $368 million (6.5%). This decrease was due primarily to lower operating income as discussed above, partially offset by a lower effective tax rate and lower interest expense, net. Diluted and basic EPS of $3.38 decreased by 6.6%. Excluding an unfavorable currency impact of $0.32, diluted EPS increased by 2.2%.

Consolidated Operating Results for the Three Months Ended September 30, 2016

The following discussion compares our consolidated operating results for the three months ended September 30, 2016, with the three months ended September 30, 2015.

Our cigarette shipment volume decreased by 5.4% due to:

- EEMA, principally North Africa and Russia, partly offset by Ukraine;
- Asia, principally Indonesia, Pakistan, the Philippines and Thailand; and
- Latin America & Canada, predominantly Argentina, Brazil and Ecuador.

partially offset by:

- European Union, notably France and the United Kingdom, partly offset by Greece and Italy.

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Our cigarette shipment volume by brand is shown in the table below:

PMI Cigarette Shipment Volume by Brand (Million Units)

	Third-Quarter		
	2016	2015	Change
Marlboro	73,338	74,185	(1.1)%
L&M	25,349	26,179	(3.2)%
Parliament	12,200	12,289	(0.7)%
Bond Street	11,709	12,045	(2.8)%
Chesterfield	12,425	10,864	14.4 %
Philip Morris	8,726	9,390	(7.1)%
Lark	6,994	7,320	(4.5)%
Others	56,310	66,639	(15.5)%
Total PMI	207,051	218,911	(5.4)%

Cigarette shipment volume of Marlboro decreased, notably in Algeria, Argentina and Vietnam, partly offset by France, Germany, Mexico, the Philippines and Spain.

Cigarette shipment volume of L&M decreased, mainly due to Egypt, Russia, Thailand and Turkey, partly offset by Algeria, Kazakhstan and Ukraine.

Cigarette shipment volume of Parliament decreased, due mainly to Japan and Russia, partly offset by Korea and Ukraine. Cigarette shipment volume of Bond Street decreased, mainly due to Russia, partly offset by Ukraine. Cigarette shipment volume of Chesterfield increased, mainly driven by Argentina, the morphing of Red & White in the Czech Republic, Turkey and the United Kingdom, partly offset by Russia. Cigarette shipment volume of Philip Morris decreased, mainly due to Argentina, partly offset by France. Cigarette shipment volume of Lark decreased, principally due to Turkey. Cigarette shipment volume of "Others" decreased, mainly due to local and largely low-margin brands in Indonesia, Pakistan, the Philippines and Russia.

Our cigarette market share increased in a number of markets, including Belgium, the Czech Republic, France, Germany, Kuwait, Poland, Saudi Arabia, Spain, Switzerland, Turkey, Ukraine and the United Kingdom.

Total shipment volume of OTP, in cigarette equivalent units, decreased by 4.5%.

Total shipment volume for cigarettes and OTP, in cigarette equivalent units, decreased by 5.4%.

Total shipment volume of HeatSticks reached 2.1 billion units, up from 278 million units during the three months ended September 30, 2015.

Our net revenues and excise taxes on products were as follows:

	For the Three Months Ended September 30,			
(in millions)	2016	2015	Variance	%
Net revenues	$19,935	$19,422	$513	2.6%
Excise taxes on products	12,953	12,495	458	3.7%
Net revenues, excluding excise taxes on products	$6,982	$6,927	$55	0.8%

Net revenues, which include excise taxes billed to customers, increased by $513 million. Excluding excise taxes, net revenues increased by $55 million due to:

- price increases ($440 million), partly offset by
- unfavorable currency ($196 million) and
- unfavorable volume/mix ($189 million).

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The unfavorable currency was due primarily to the Argentine peso, Egyptian pound, Kazakh tenge, Mexican peso, Russian ruble and Turkish lira, partially offset by the Euro, Indonesian rupiah and Japanese yen.

Net revenues include $470 million in 2016 and $478 million in 2015 related to sales of OTP. These net revenue amounts include excise taxes billed to customers. Excluding excise taxes, net revenues for OTP were $165 million in 2016 and $174 million in 2015.

Excise taxes on products increased by $458 million due to:

- higher excise taxes resulting from changes in retail prices and tax rates ($1.5 billion), partly offset by
- favorable currency ($837 million) and
- lower excise taxes resulting from volume/mix ($211 million).

Our cost of sales; marketing, administration and research costs; and operating income were as follows:

	For the Three Months Ended September 30,			
(in millions)	2016	2015	Variance	%
Cost of sales	$2,432	$2,383	$49	2.1 %
Marketing, administration and research costs	1,554	1,566	(12)	(0.8)%
Operating income	2,977	2,959	18	0.6 %

Cost of sales increased by $49 million due to:

- higher manufacturing costs ($71 million) and
- higher cost of sales resulting from volume/mix ($20 million), partly offset by
- favorable currency ($42 million).

Marketing, administration and research costs decreased by $12 million due to:

- favorable currency ($64 million), partly offset by
- higher expenses ($52 million, primarily higher marketing and selling expenses).

Operating income increased by $18 million due primarily to:

- price increases ($440 million), partly offset by
- unfavorable volume/mix ($209 million),
- unfavorable currency ($89 million),
- higher manufacturing costs ($71 million) and
- higher marketing, administration and research costs ($52 million).

Our effective tax rate increased by 0.1 percentage point to 27.7%. The effective tax rate is based on our full-year earnings mix by taxing jurisdiction and cash repatriation plans. Changes in earnings mix by taxing jurisdiction or in our cash repatriation plans could have an impact on the effective tax rate, which we monitor each quarter. Significant judgment is required in determining income tax provisions and in evaluating tax positions.

Interest expense, net, of $220 million decreased by $27 million (10.9%), due primarily to lower effective interest rates on debt.

Net earnings attributable to PMI of $1.9 billion decreased by $4 million (0.2%). Diluted and basic EPS of $1.25 was flat. Excluding an unfavorable currency impact of $0.04, diluted EPS increased by 3.2%.

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Operating Results by Business Segment

Business Environment

Taxes, Legislation, Regulation and Other Matters Regarding the Manufacture, Marketing, Sale and Use of Tobacco Products

The tobacco industry and our business face a number of challenges that may adversely affect our business, volume, results of operations, cash flows and financial position. These challenges, which are discussed below and in "Cautionary Factors That May Affect Future Results," include:

- fiscal challenges, such as excise tax increases and discriminatory tax structures;
- actual and proposed extreme regulatory requirements, including regulation of the packaging, marketing and sale of tobacco products, as well as the products themselves, that may reduce our competitiveness, eliminate our ability to communicate with adult smokers, ban certain of our products, limit our ability to differentiate our products from those of our competitors, and interfere with our intellectual property rights;
- illicit trade in cigarettes and other tobacco products, including counterfeit, contraband and so-called "illicit whites";
- intense competition, including from non-tax paid volume by certain local manufacturers;
- pending and threatened litigation as discussed in Note 9. Contingencies; and
- governmental investigations.

FCTC: The World Health Organization's ("WHO") Framework Convention on Tobacco Control ("FCTC"), an international public health treaty with the objective of reducing tobacco use, drives much of the regulation that shapes the business environment in which we operate. The treaty, to which 179 countries and the European Union are Parties, requires Parties to have in place various tobacco control measures and recommends others.

We support many of the regulatory policies required by the FCTC, including measures that strictly prohibit the sale of tobacco products to minors, limit public smoking, require health warnings on tobacco packaging, and regulate product content to prevent increased adverse health effects of smoking. We advocate measures that establish science-based regulatory frameworks for Reduced-Risk Products. We also support the use of tax and price policies to achieve public health objectives, as long as such policies are not discriminatory or excessive, and do not result in increased illicit trade.

The FCTC governing body, the Conference of the Parties ("CoP"), has adopted non-binding guidelines and policy recommendations related to certain articles of the FCTC. We disagree with some of them because they limit our ability to differentiate our products, disrupt competition, are not based on sound evidence of a public health benefit, and are likely to lead to adverse consequences, such as increased illicit trade.

It is not possible to predict whether or to what extent measures recommended in the FCTC guidelines will be implemented.

Excise, Sales and Other Taxes: Excessive and disruptive tax increases and discriminatory tax structures are expected to continue to have an adverse impact on our profitability, due to lower consumption and consumer down-trading from premium to non-premium, discount, other low-price or low-taxed tobacco products, such as fine cut tobacco and illicit products. In addition, in certain jurisdictions, our products are subject to tax structures that discriminate against premium-price products and manufactured cigarettes. We believe that such tax policies undermine public health by encouraging consumers to turn to the illicit trade for cheaper tobacco products and ultimately undercut government revenue objectives, disrupt the competitive environment, and encourage criminal activity. Other jurisdictions have imposed, or are seeking to impose, levies or other taxes specifically on tobacco companies, such as taxes on revenues and/or profits. We oppose such extreme and discriminatory tax measures.

EU Tobacco Products Directive: In April 2014, the EU adopted the text of a significantly revised EU Tobacco Products Directive that, among other things, provides for:

- health warnings covering 65% of the front and back panels of cigarette packs and roll-your-own packaging with specific health warning dimensions that have the effect of prohibiting certain pack formats. Member States would also have the option to further standardize tobacco packaging, including, under certain conditions, by introducing plain packaging;

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- a ban on packs of fewer than 20 cigarettes;
- a ban on characterizing flavors in some tobacco products, with a transition period for menthol expiring in May 2020;
- security features and tracking and tracing measures, which we support, but also tracking at pack level down to retail as from May 2019, which we believe will most likely not provide any incremental benefit in the fight against illicit trade, but have the potential to increase operational expenses if excessive implementing regulation is enacted; and
- a framework for the regulation of novel tobacco products and e-cigarettes (except for those found to be medicines or medical devices), including requirements for health warnings and information leaflets, prohibiting product packaging text related to reduced risk, and introducing notification requirements in advance of commercialization.

To date, 22 Member States have adopted laws transposing the Directive, while the remaining Member States are concluding the national transpositions.

Plain Packaging: Plain packaging legislation bans the use of branding, logos and colors on packaging on all or some specified tobacco products other than the brand name and variant, which may be printed only in specified locations and in a uniform font. Similarly, the brand name and variant may be printed on individual cigarettes only in specified locations and in a uniform font or not at all.

To date, Australia, France, the U.K., Ireland, Hungary, and New Zealand have adopted plain packaging legislation. In Australia, plain packaging has been implemented since December 2012. In France, full compliance at retail is required as of January 2017, and in the U.K., full compliance is required as of May 2017. In Hungary, full compliance is required as of May 2019 for products that were in the market prior to April 30, 2016, and new product launches must comply with the plain packaging requirements immediately. In Ireland, implementation is subject to a Ministerial Commencement Order, which has yet to be issued. In New Zealand, no implementation date has yet been set.

Several countries have initiated World Trade Organization ("WTO") dispute settlement proceedings against Australia related to Australia's plain packaging legislation. In May 2015, three of our subsidiaries filed papers in the English High Court seeking judicial review of the U.K.’s plain packaging legislation. In May 2016, the Court issued a judgment rejecting our claims as well as those from other tobacco companies. We are not appealing the decision, but the judgment has been appealed by other claimants. The Conseil d’Etat in France is currently considering whether the decree that implements France’s plain packaging legislation is valid under French law. A decision is expected by the end of 2016. It is not possible to predict the outcome of these proceedings.

In other countries, such as Norway, proposals to enact plain packaging are in various stages of the legislative process. Additionally, several countries, including Canada and Singapore, are considering plain packaging, but no legislative proposals have been published. It is not possible to predict whether any of these countries will implement plain packaging.

Restrictions and Bans on the Use of Ingredients: Currently, the WHO and others in the public health community recommend restrictions or total bans on the use of some or all ingredients in tobacco products, including menthol. Broad restrictions and ingredient bans would require us to reformulate our American Blend tobacco products and could reduce our ability to differentiate these products in the market in the long term. Menthol bans would eliminate the entire category of mentholated tobacco products. Some regulators have considered and rejected such proposals, while others have proposed and, in a few cases, adopted restrictions or bans. In particular, as mentioned above, the European Union has banned characterizing flavors in some tobacco products, subject to an exemption until May 2020 for menthol. Other countries may follow the EU’s approach. For instance, Turkey has banned menthol as of May 2020. More sweeping ingredient bans have been adopted by Canada and Brazil.

While the Canadian ingredient ban exempts menthol at the national level, the majority of Canadian provinces have adopted or are in the process of adopting menthol bans.

The Brazil ingredients ban, which, as originally drafted, would prohibit the use of virtually all ingredients with flavoring or aromatic properties, is not in force due to a legal challenge by a tobacco industry union, of which our Brazilian subsidiary is a member. It is not possible to predict the outcome of this legal proceeding.

Many countries have enacted or proposed legislation or regulations that require cigarette manufacturers to disclose to governments and to the public the ingredients used in the manufacture of tobacco products and, in certain cases, to provide toxicological information about those ingredients. We have made, and will continue to make, full disclosures where adequate assurances of trade secret protection are provided.

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Bans on Display of Tobacco Products at Retail: In a few of our markets, including Norway, Russia, and Canada, governments have banned or propose to ban the display of tobacco products at the point of retail sale. Other countries have rejected display ban proposals.

Health Warning Requirements: In most countries, governments require large and often graphic health warnings covering at least 30% of the front and back of cigarette packs (the size mandated by the FCTC). A growing number of countries require warnings covering 50% of the front and back of the pack, and a small number of countries require larger warnings, such as Australia (75% front and 90% back), Mexico (30% front and 100% back), Uruguay (80% front and back), Thailand (85% front and back), India (85% front and back), and Canada (75% front and back).

In Thailand, litigation challenging excessively large health warnings is pending. It is not possible to predict the outcome of this proceeding.

Other Packaging Restrictions: Some governments have passed, or are seeking to pass, restrictions on packaging and labeling, including standardizing the shape, format and layout of packaging, as well as imposing broad restrictions on how the space left for branding and product descriptions can be used. Examples include prohibitions on: (1) the use of colors that are alleged to suggest that one brand is less harmful than others and (2) specific descriptive phrases deemed to be misleading, including, for example, “premium,” “full flavor,” “international,” “gold,” “silver,” and “menthol.”

Bans and Restrictions on Advertising, Marketing, Promotions and Sponsorships: For many years, the FCTC has called for, and countries have imposed, partial or total bans on tobacco advertising, marketing, promotions and sponsorships, including bans and restrictions on advertising on radio and television, in print and on the Internet. The FCTC also requires disclosure of expenditures on advertising, promotion and sponsorship where such activities are not prohibited. The FCTC guidelines recommend that governments prohibit all forms of communication with adult smokers, with which we disagree.

Restrictions on Product Design: Some members of the public health community are calling for the further standardization of tobacco products by requiring, for example, that cigarettes have a certain minimum diameter, which amounts to a ban on slim cigarettes, or requiring the use of standardized filter and cigarette paper designs.

Reduced cigarette ignition propensity (“RCIP”) standards recommended by the FCTC guidelines have been adopted in several of our markets (e.g., Australia, Canada, South Africa, South Korea, and the EU), and are being considered in several others. While the available evidence (namely, from two provinces in Canada, the State of New York and Sweden) so far suggests that the implementation of RCIP standards did not result in the predicted reduction of smoking-related fires, RCIP standards do increase production costs.

Restrictions on Public Smoking: The pace and scope of public smoking restrictions have increased significantly in most of our markets. Many countries around the world have adopted, or are likely to adopt, regulations that restrict or ban smoking in public and/or work places, restaurants, bars and nightclubs. Some public health groups have called for, and some countries, regional governments and municipalities have adopted or proposed, bans on smoking in outdoor places, as well as bans on smoking in cars (typically, when minors are present) and private homes. The FCTC requires Parties to adopt restrictions on public smoking, and the guidelines call for broad bans in all indoor public places but limit their recommendations on private-place smoking, such as in cars and homes, to increased education on the risk of exposure to environmental tobacco smoke.

While we believe outright bans are appropriate in many public places, such as schools, playgrounds, youth facilities, and many indoor public places, governments can and should seek a balance between the desire to protect non-smokers from environmental tobacco smoke and allowing adults who choose to smoke to do so.

Restrictions on the Sale of Novel Tobacco Products: Some countries have passed, or are seeking to pass, regulations that ban the sale of e-cigarettes or "emerging" tobacco products, including novel tobacco or nicotine products, such as heated tobacco (where no combustion takes place and no smoke is produced), dissolvable tobacco products or nicotine, and nicotine delivery systems (e.g., e-vapor products). These regulations might foreclose adult smoker access to products that have the potential to reduce individual risk and population harm compared to cigarette smoking, and therefore, we oppose such blanket bans. By contrast, we support regulation that sets strict standards and encourages innovation to benefit adult smokers and public health.

Other Regulatory Issues: Some regulators are considering, or in some cases have adopted, regulatory measures designed to reduce the supply of tobacco products. These include regulations intended to reduce the number of retailers selling tobacco by, for example, reducing the overall number of tobacco retail licenses available or banning the sale of tobacco within arbitrary distances of certain public facilities.

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Some public health groups have also called for the exclusion of tobacco from certain basic provisions of trade and investment agreements. The Trans-Pacific Partnership Agreement ("TPP") includes a provision that denies investors access to the Investor State Dispute Settlement Mechanism to challenge "tobacco control measures," as defined in the TPP. None of the 12 parties to this agreement has yet ratified it. If this carve-out enters into force, we believe it would constitute unfair discrimination against a legal industry, be at odds with fundamental principles of international investment protection, and constitute a dangerous precedent for many other sectors.

In a limited number of markets, most notably Japan, we are dependent on governmental approvals that may limit our pricing flexibility.

Illicit Trade: The illicit tobacco trade creates a cheap and unregulated supply of tobacco products, undermines efforts to reduce smoking, especially among youth, damages legitimate businesses, stimulates organized crime, increases corruption and reduces government tax revenue. Illicit trade may account for as much as 10% of global cigarette consumption; this includes counterfeit, contraband and the growing problem of "illicit whites," which are cigarettes legally produced in one jurisdiction for the sole purpose of being exported and illegally sold in another jurisdiction where they have no legitimate market. We estimate that illicit trade in the European Union accounted for more than 10% of total cigarette consumption in 2015.

A number of jurisdictions are considering actions to prevent illicit trade. In November 2012, the FCTC adopted the Protocol to Eliminate Illicit Trade in Tobacco Products (the "Protocol"), which includes supply chain control measures, such as licensing of manufacturers and distributors, enforcement in free trade zones, controls on duty free and Internet sales and the implementation of tracking and tracing technologies. To date, 54 countries have signed the Protocol and 22 countries and the European Union have ratified it. The Protocol will come into force once the fortieth country ratifies it, after which countries must implement its measures via national legislation. We expect, and welcome, that other countries will ratify the Protocol.

Additionally, we and our subsidiaries have entered into cooperation agreements with governments and authorities to support their anti-illicit trade efforts. For example, in 2004, we entered into a cooperation agreement with the EU and its member states that provided for cooperation with European law enforcement agencies on anti-contraband and on anti-counterfeit efforts. Under the terms of this agreement we made financial contributions of approximately $75 million per year (recorded as an expense in cost of sales when product is shipped) to support these efforts. The EU Commission decided not to renew the agreement, which expired in July 2016.

In 2009, our Colombian subsidiaries entered into an Investment and Cooperation Agreement with the national and regional governments of Colombia to promote investment in, and cooperation on, anti-contraband and anti-counterfeit efforts. The agreement provides $200 million in funding over a 20-year period to address issues such as combating the illegal cigarette trade and increasing the quality and quantity of locally grown tobacco.

In May 2016, PMI launched PMI IMPACT, a new global initiative that supports third party projects dedicated to fighting illegal trade and related crimes such as corruption, organized criminal networks and money laundering. The centerpiece of PMI IMPACT is a council of external independent experts with impeccable credentials in the fields of law, anti-corruption and law enforcement. The experts are responsible for evaluating and approving funding proposals for PMI IMPACT grants. PMI has pledged $100 million to fund projects within PMI IMPACT during the next three years.

Reduced-Risk Products: We use the term RRP to refer to products with the potential to reduce individual risk and population harm in comparison to smoking cigarettes. Our aim is to become the leader of the RRP product category, with the objective of having RRPs ultimately replace combustible products to the benefit of adult smokers, society, and our company. To date, almost one million adult smokers have converted to our iQOS product described below. Our RRPs are in various stages of development and commercialization, and we are conducting extensive and rigorous scientific studies to determine whether we can support claims for such products of reduced exposure to harmful and potentially harmful constituents in smoke and, ultimately, claims of reduced disease risk when compared to smoking cigarettes. Before making any such claims, we will rigorously evaluate the full set of data from the relevant scientific studies to determine whether they substantiate reduced exposure or risk. Any such claims may also be subject to government review and authorization, as is the case in certain markets today. We draw upon a team of world-class scientists and engineers from a broad spectrum of scientific disciplines, and our efforts are guided by the following three key objectives:

- to develop RRPs that provide adult smokers the taste, sensory experience, nicotine delivery profile and ritual characteristics that are similar to those currently provided by cigarettes;

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- to substantiate the reduction of risk for the individual adult smoker and the reduction of harm to the population as a whole, based on robust scientific evidence derived from well-established assessment processes; and
- to advocate for the development of science-based regulatory frameworks for the development and commercialization of RRPs, including the communication to adult smokers of scientifically substantiated reduced exposure or reduced risk claims.

Our product development is based on the elimination of combustion via tobacco heating and other innovative systems for aerosol generation, which we believe is the most promising path to reduce individual risk and population harm compared to continued cigarette smoking.

Our approach to individual risk assessment is to use cessation as the benchmark, because the short-term and long-term effects of smoking cessation on risk reduction are well known.

Four RRP platforms are in various stages of development and commercialization readiness:

- Platform 1 uses a precisely controlled heating device that we are commercializing under the iQOS brand name, into which a specially designed tobacco product under the Marlboro, Parliament, Heets and HeatSticks brand names is inserted and heated to generate an aerosol. Six short-term clinical studies have been completed. The study results show a substantial reduction in relevant biomarkers of exposure to harmful or potentially harmful constituents (“HPHCs”) in adult consumers who switched to iQOS compared to adult consumers who continued to smoke cigarettes over a five-day period. The final reports of the three-month clinical reduced-exposure studies conducted in Japan and the U.S. have been issued. In these studies, we observed reduction in all 15 biomarkers of exposure to corresponding HPHCs measured in those who switched to iQOS compared to those who continued to smoke cigarettes. Furthermore, the reductions measured in those who switched to iQOS approached those that were observed in study participants who quit smoking for the duration of the study. We also initiated a 6+6 month exposure response study in December 2014, and expect the results regarding the first six-month term in the first half of 2017.
- Platform 2 uses a pressed carbon heat source to generate an aerosol by heating tobacco. Clinical testing of Platform 2 that started in the second quarter of 2015, including a pharmacokinetic study and a five-day reduced-exposure study, have now been completed. The report for the pharmacokinetic study has been finalized. In this study, we observed that the nicotine pharmacokinetic profile and the subjective user satisfaction are comparable to smoking cigarettes, indicating that this platform could be an acceptable substitute for adult smokers who want to continue to use tobacco products but seek an alternative to cigarettes. We expect that the reduced-exposure study report will be issued later in the year. Finally, the clinical phase of a three-month reduced-exposure study has also been completed; we expect the results to be reported in 2017.
- Platform 3 is based on technology we acquired from Professor Jed Rose of Duke University and his co-inventors in 2011. This product creates an aerosol of nicotine salt formed by the chemical reaction of nicotine with a weak organic acid and replicates the feel and ritual of smoking. We are exploring two routes for this platform, one with electronics and one without. We have begun pre-clinical and clinical testing of this platform, including a pharmacokinetic study in New Zealand for the electronic version. This study assessed this product's nicotine pharmacokinetic profile in comparison to a nicotine inhalator. Our study showed that nicotine absorption with this product reached peak levels six times faster than with the inhalator, suggesting easier absorption and a significantly higher potential for acceptance by smokers. We are also conducting a pharmacodynamics study in the U.S. and expect to commence a safety and efficacy study in early 2017.

Platform 4 covers e-vapor products, which are battery-powered devices that produce an aerosol by vaporizing a liquid nicotine solution. Our e-vapor products comprise devices using current generation technology, and we are well advanced in the development and commercialization plans for the next generation of e-vapor technologies ("MESH") to address certain challenges presented by the e-vapor products currently on the market. Our MESH products are designed to ensure the consistency and quality of the generated aerosol. We have commenced non-clinical studies, and our clinical assessment, that we expect to initiate in the near future, includes a pharmacokinetic study and a reduced-exposure study.

We are also developing other potential product platforms.

We are proceeding with the commercialization of RRPs. In 2014, we introduced the iQOS system in pilot city launches in Nagoya, Japan, and in Milan, Italy. Thereafter, we launched iQOS in Switzerland, started pilot city launches in Moscow, Bucharest, Kiev, and Lisbon and continued the gradual expansion in Italy, where we launched in several cities, including Rome, Modena, Turin and Bologna, and in Sicily. We achieved national coverage in Japan as of April 2016. By the end of June 2016, iQOS was present in ten markets, following its commercialization in select cities in Denmark and Germany, and in the Principality of Monaco. We plan to introduce iQOS in key cities in 20 markets by the end of 2016 and in an additional ten to fifteen markets during 2017. To date, the product has not been marketed with claims of reduced risk.

We started broad commercial production of Platform 1 tobacco sticks (HeatSticks) in the first quarter of 2016. To date, we have experienced short-term supply shortages resulting from the stronger than anticipated demand in Japan and anticipate capacity limitations to continue through the first quarter of 2017. Therefore, additional investments are planned. Total corporate capital expenditures are expected to be $1.2 billion and $1.5 billion, respectively, in 2016 and 2017, reflecting the planned RRP capacity increase. Subsequent capital expenditure levels will depend on consumer demand dynamics. We expect that the 2016 and 2017 year-end installed HeatSticks capacity will be approximately 15 billion units and 50 billion units, respectively. This installed capacity is expected to allow us to produce approximately 32 billion units in 2017, up from 7 billion in 2016. As of 2018, we estimate that we can increase installed annual capacity, as needed, by approximately four billion units per month, with a lead time of 12 months. We expect RRPs to approach break-even operating companies income in 2017 and to start contributing positively to our operating companies income in 2018.

In the United States of America, an established regulatory framework for assessing “Modified Risk Tobacco Products” exists under the jurisdiction of the Food and Drug Administration (“FDA”). We expect that future FDA actions are likely to influence the regulatory approach of other interested governments. Our assessment approach and the studies conducted to date reflect the rigorous evidentiary package contemplated in the FDA’s Draft Guidance for Modified Risk Tobacco Product Applications (2012). We have shared our approach and studies with the FDA’s Center for Tobacco Products. We plan to submit a Modified Risk Tobacco Product Application for Platform 1 by the end of 2016 and a Premarket Tobacco Application during the first quarter of 2017.

In the EU, a majority of Member States have already transposed the EU Tobacco Products Directive, including the provisions on novel tobacco products and e-cigarettes. With regard to novel tobacco products, most of the EU Member States require a notification submitted 6 months before the intended placing on the market of a novel tobacco product, while Austria, Belgium, Germany, Poland, Greece, Portugal and Luxembourg require pre-market authorizations for the introduction of such products into the market. We are also engaging with regulators in several EU Member States, where we filed a comprehensive dossier summarizing our scientific assessment of Platform 1 and results to date in accordance with the requirements of applicable law.

As we work to develop evidence to substantiate the risk reduction potential of our products, we review our ability to make claims of reduced exposure or risk based on applicable laws and regulations and, as we are already doing, engage with regulators and share the evidence with them. We are also engaging with the scientific community, sharing our assessment approach and the results we have generated. There can be no assurance that we will succeed in our efforts or that regulators will permit the marketing of our RRPs with substantiated claims of reduced exposure or risk as compared with smoking cigarettes.

In December 2013, we established a strategic framework with Altria Group, Inc. (“Altria”) under which Altria will make available its e-vapor products exclusively to us for commercialization outside the United States of America, and we will make available two of our RRPs exclusively to Altria for commercialization in the United States of America. In March 2015, we launched Solaris, a Platform 4 e-vapor product licensed from Altria, in Spain. In December 2015, we introduced Solaris in Israel.

In July 2015, we extended the strategic framework with Altria to include a Joint Research, Development and Technology Sharing Agreement. The additional agreement provides the framework under which PMI and Altria will collaborate to develop the next generation of e-vapor products for commercialization in the United States of America by Altria and in markets outside the United States of America by PMI. The collaboration between PMI and Altria in this endeavor is enabled by exclusive technology cross licenses and technical information sharing. The agreements also provide for cooperation on the scientific assessment of, and for the sharing of improvements to, the existing generation of licensed products.

In June 2014, we acquired 100% of Nicocigs Limited, a leading U.K.-based e-vapor company whose principal brand is Nicolites. This acquisition provided PMI with immediate access to, and a significant presence in, the U.K. e-vapor market.

Other Legislation, Regulation or Governmental Action: It is not possible to predict what, if any, additional legislation, regulation or other governmental action will be enacted or implemented relating to the manufacturing, advertising, sale or use of tobacco products, or the tobacco industry generally. It is possible, however, that legislation, regulation or other governmental action could be enacted or implemented that might materially affect our business, volume, results of operations, cash flows and financial position.

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Governmental Investigations

From time to time, we are subject to governmental investigations on a range of matters.

The Department of Special Investigations ("DSI") of the government of Thailand has been conducting an investigation into alleged underpayment by Philip Morris (Thailand) Limited ("PM Thailand") of customs duties and excise taxes of approximately $1.8 billion, relating to imports from Indonesia covering the period 2000-2003. In September 2016, the DSI commenced formal investigations and alleged that PM Thailand, jointly with others, including Philip Morris International Inc., underpaid customs duties and excise taxes of approximately $250 million. PM Thailand disagrees with the DSI's allegations and believes that its declared import prices are in compliance with the Customs Valuation Agreement of the WTO and Thai law. If at the end of its formal investigations, the DSI recommends prosecution, the DSI will refer the matter to the Public Prosecutor, who will decide whether to file formal charges against PM Thailand and/or the other alleged co-offenders.

Additionally, in November 2010, a WTO panel issued its decision in a dispute relating to facts that arose from August 2006 between the Philippines and Thailand concerning a series of Thai customs and tax measures affecting cigarettes imported by PM Thailand into Thailand from the Philippines (see Note 9. Contingencies for additional information). The WTO panel decision, which was upheld by the WTO Appellate Body, concluded that Thailand had no basis to find that PM Thailand's declared customs values and taxes paid were too low, as alleged by the DSI in 2009. The decision also created obligations for Thailand to revise its laws, regulations, or practices affecting the customs valuation and tax treatment of future cigarette imports. Thailand agreed in September 2011 to fully comply with the decision by October 2012. The Philippines contends that to date Thailand has not fully complied and commenced formal proceedings at the WTO to address the outstanding issues. The Philippines has repeatedly expressed concerns with ongoing investigations by Thailand of PM Thailand, including those that led to the criminal charges described in Note 9. Contingencies, noting that these investigations appear to be based on grounds not supported by WTO customs valuation rules and inconsistent with several decisions already taken by Thai Customs and other Thai governmental agencies.

The South Korean Board of Audit and Inspection ("BAI") has been conducting an audit of certain Korean government agencies and the tobacco industry into whether inventory movements ahead of the January 1, 2015 increase of cigarette-related taxes by tobacco companies, including Philip Morris Korea Inc. ("PM Korea"), our South Korean affiliate, were in compliance with South Korean tax laws. In September 2016, the BAI alleged that PM Korea underpaid approximately $152 million in taxes in connection with its inventory movements. The BAI recommended the tax authorities to collect the alleged underpaid taxes together with a penalty of approximately $61 million. The tax authorities are currently considering this recommendation. If, in addition to the assessment of the foregoing amounts, at the end of the tax audit, the tax authorities recommend prosecution, they will refer the matter to the Public Prosecutor, who will further investigate and decide whether or not to file criminal charges against PM Korea and/or other alleged co-offenders. If the Public Prosecutor decides to prosecute, it may seek up to three times the underpaid tax for company criminal penalties and up to five times the underpaid tax for individual criminal penalties. PM Korea believes that it has paid cigarette-related taxes in compliance with the South Korean tax laws.

Acquisitions and Other Business Arrangements

In July 2015, we dissolved our exclusive joint venture agreement with Swedish Match AB ("SWMA") to commercialize Swedish snus and other smoke-free tobacco products worldwide, outside of Scandinavia and the United States. The dissolution, mutually agreed with SWMA, means that both companies will now focus on independent strategies for the commercialization of these products, and the trademarks and intellectual property licensed to the joint venture by the companies will revert to their original owners. The dissolution of this agreement was not material to our consolidated financial position, results of operations or cash flows in any of the periods presented.

On January 30, 2014, the Indonesian Stock Exchange (“IDX”) adopted a regulation requiring all listed public companies to have at least a 7.5% public shareholding by January 30, 2016. In order to comply with this requirement, our subsidiary PT HM Sampoerna Tbk. (“Sampoerna”), of which we held a 98.18% interest, conducted a rights issue. The exercise price for the rights was set at Rp. 77,000 per share, a 1.349% premium to the closing price on the IDX as of September 30, 2015. In connection with the rights issue, PT Philip Morris Indonesia (“PMID”), a fully consolidated subsidiary of PMI, sold 264,209,711 of the rights to third-party investors. Delivery of the rights sold took place on October 26, 2015. The total net proceeds from the rights issue were $1.5 billion at prevailing exchange rates on the closing date. The sale of the rights resulted in an increase to our additional paid-in capital of $1.1 billion.

In September 2013, Grupo Carso, S.A.B. de C.V. ("Grupo Carso") sold to us its remaining 20% interest in our Mexican tobacco business for $703 million. As a result, we now own 100% of the Mexican tobacco business. A former director of PMI, whose term expired at the Annual Meeting of Shareholders in May 2015, had an affiliation with Grupo Carso. The final purchase price was

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subject to an adjustment based on the actual performance of the Mexican tobacco business over the three-year period ending two fiscal years after the closing of the purchase. In May 2015, we received a payment of $113 million from Grupo Carso as the final purchase price adjustment. This resulted in a total net purchase price of $590 million. In addition, we agreed to pay a dividend of approximately $38 million to Grupo Carso related to the earnings of the Mexican tobacco business for the nine months ended September 30, 2013. In March 2014, the dividend was declared and paid. The purchase of the remaining 20% interest resulted in a net decrease to our additional paid-in capital of $559 million.

Asset Impairment and Exit Costs

In November 2015, we commenced the implementation of a restructuring program within our European Union segment. The program is expected to be completed by the end of 2017. In total, we expect to incur a total pre-tax charge of approximately $93 million for the program. During 2015, we recorded pre-tax exit costs of $68 million related to employee separation costs. In addition, as part of the total program, up to $25 million of pre-tax implementation costs, primarily related to costs for the project team and notice period payments, will be reflected in cost of sales and marketing, administration and research costs in our condensed consolidated statement of earnings.

Trade Policy

We are subject to various trade restrictions imposed by the United States of America and countries in which we do business (“Trade Sanctions”), including the trade and economic sanctions administered by the U.S. Department of the Treasury's Office of Foreign Assets Control and the U.S. Department of State. It is our policy to comply fully with these Trade Sanctions.

Tobacco products are agricultural products under U.S. law and are not technological or strategic in nature. From time to time we make sales in countries subject to Trade Sanctions, either where they do not apply to our business or pursuant to either exemptions or licenses granted under the applicable Trade Sanctions.

A subsidiary sells products to distributors that in turn sell those products to duty free customers that supply U.N. peacekeeping forces around the world, including those in the Republic of the Sudan. We do not believe that these exempt sales of our products for ultimate resale in the Republic of the Sudan, which are de minimis in volume and value, present a material risk to our shareholders, our reputation or the value of our shares. We have no employees, operations or assets in the Republic of the Sudan.

In October 2016, we received guidance from the relevant U.S. regulatory agencies that under current U.S. regulations we would generally be authorized to export tobacco products to Cuba. At this time, we do not export or sell products to Cuba, but are exploring opportunities to do so.

To our knowledge, none of our commercial arrangements results in the governments of any country identified by the U.S. government as a state sponsor of terrorism, nor entities controlled by those governments, receiving cash or acting as intermediaries in violation of U.S. laws.

We do not sell products in Iran, North Korea and Syria.

Certain states within the U.S. have enacted legislation permitting state pension funds to divest or abstain from future investment in stocks of companies that do business with certain countries that are sanctioned by the U.S. We do not believe such legislation has had a material effect on the price of our shares.

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Operating Results – Nine Months and Three Months Ended September 30, 2016

The following discussion compares operating results within each of our reportable segments for the nine months and three months ended September 30, 2016, with the nine months and three months ended September 30, 2015.

European Union:

European Union	For the Nine Months Ended September 30,			
(in millions)	2016	2015	Variance	%
Net revenues	$20,664	$19,916	$748	3.8%
Excise taxes on products	14,446	13,782	664	4.8%
Net revenues, excluding excise taxes on products	6,218	6,134	84	1.4%
Operating companies income	3,096	2,977	119	4.0%

For the nine months ended September 30, 2016, net revenues, which include excise taxes billed to customers, increased by $748 million. Excluding excise taxes, net revenues increased by $84 million due to:

- price increases ($272 million), partly offset by
- unfavorable currency ($122 million) and
- unfavorable volume/mix ($66 million).

The net revenues of the European Union segment include $1,064 million in 2016 and $1,094 million in 2015 related to sales of OTP. Excluding excise taxes, OTP net revenues for the European Union segment were $371 million in 2016 and $382 million in 2015.

Operating companies income increased by $119 million during the nine months ended September 30, 2016. This increase was due primarily to:

- price increases ($272 million) and
- lower manufacturing costs ($10 million), partly offset by
- unfavorable volume/mix ($84 million) and
- higher marketing, administration and research costs ($84 million).

European Union	For the Three Months Ended September 30,			
(in millions)	2016	2015	Variance	%
Net revenues	$7,387	$7,018	$369	5.3%
Excise taxes on products	5,187	4,895	292	6.0%
Net revenues, excluding excise taxes on products	2,200	2,123	77	3.6%
Operating companies income	1,120	1,045	75	7.2%

For the three months ended September 30, 2016, net revenues increased by $369 million. Excluding excise taxes, net revenues increased by $77 million due primarily to:

- price increases ($93 million), partly offset by
- unfavorable volume/mix ($10 million).

The net revenues of the European Union segment include $359 million in 2016 and $378 million in 2015 related to sales of OTP. Excluding excise taxes, OTP net revenues for the European Union segment were $123 million in 2016 and $130 million in 2015.

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Operating companies income increased by $75 million during the three months ended September 30, 2016. This increase was due primarily to:

- price increases ($93 million) and
- favorable currency ($29 million), partially offset by
- higher marketing, administration and research costs ($31 million, primarily related to the commercialization of our RRPs) and
- unfavorable volume/mix ($19 million).

European Union - Industry Volume

In the third quarter, the estimated total cigarette market decreased by 1.4% to 137.9 billion units, mainly reflecting the lower contribution of two favorable factors in 2015, namely the estimated positive impact of immigration and a recovery from illicit trade, partly offset by improved macroeconomics and a lower prevalence of e-vapor products.

In the third quarter, the estimated total OTP market decreased by 2.6% to 39.8 billion cigarette equivalent units, reflecting a lower total fine cut market, down by 2.7% to 36.9 billion cigarette equivalent units.

For the nine months year-to-date, the estimated total cigarette market decreased by 0.2% to 382.4 billion units, reflecting improved macroeconomics, a lower prevalence of illicit trade and e-vapor products and, in certain geographies, the estimated positive impact of immigration, which was mainly concentrated in the first half of 2016.

For the nine months year-to-date, the estimated total OTP market decreased by 0.8% to 114.9 billion cigarette equivalent units, reflecting a lower total fine cut market, down by 0.8% to 106.8 billion cigarette equivalent units.

European Union - PMI Shipment Volume and Market Share

Cigarette shipment volume and market share performance by brand are shown in the tables below:

European Union Cigarette Shipment Volume by Brand (Million Units)

	Third-Quarter			Nine Months Year-to-Date		
	2016	2015	Change	2016	2015	Change
Marlboro	25,943	25,463	1.9 %	73,582	72,370	1.7 %
L&M	9,454	9,570	(1.2)%	26,628	26,457	0.6 %
Chesterfield	8,055	7,432	8.4 %	23,111	21,090	9.6 %
Philip Morris	4,330	4,101	5.6 %	12,621	10,215	23.6 %
Others	4,219	5,205	(18.9)%	12,451	17,247	(27.8)%
Total EU	52,001	51,771	0.4 %	148,393	147,379	0.7 %

European Union Cigarette Market Shares by Brand

	Third-Quarter			Nine Months Year-to-Date		
	2016	2015	Change p.p.	2016	2015	Change p.p.
Marlboro	19.0 %	18.7 %	0.3	19.0 %	18.8 %	0.2
L&M	6.8 %	6.8 %	—	6.9 %	6.8 %	0.1

Chesterfield	5.9	%	5.5	%	0.4		6.0	%	5.5	%	0.5
Philip Morris	3.2	%	3.1	%	0.1		3.3	%	3.1	%	0.2
Others	3.3	%	3.7	%	(0.4	)	3.2	%	4.0	%	(0.8)
Total EU	38.2	%	37.8	%	0.4		38.4	%	38.2	%	0.2

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In the third quarter, our cigarette shipment volume increased by 0.4% to 52.0 billion units, mainly driven by France and the United Kingdom, partly offset by Greece and Italy. Excluding the net impact of distributor inventory movements, notably in Italy, our cigarette shipment volume decreased by 0.5%. Our cigarette shipment volume of Marlboro increased by 1.9%, mainly driven by France, Germany, Spain and the United Kingdom, partly offset by Greece. Our total cigarette market share increased by 0.4 points to 38.2%, with gains, notably in France, Germany, Poland and the United Kingdom, partly offset by declines, mainly in Italy and Portugal. Cigarette shipment volume of "Others" decreased, mainly due to the morphing of various trademarks in the Baltic States, the Czech Republic and Italy into international brands.

In the third quarter, our shipments of OTP decreased by 7.2% to 5.7 billion cigarette equivalent units. Our total OTP market share decreased by 0.5 points to 14.6%.

For the nine months year-to-date, our cigarette shipment volume increased by 0.7% to 148.4 billion units, mainly driven by the Czech Republic, France, Poland, Spain and the United Kingdom, partly offset by Greece and Italy. Excluding the net impact of distributor inventory movements, notably in Spain, our cigarette shipment volume increased by 0.3%. Our cigarette shipment volume of Marlboro increased by 1.7%, mainly driven by France, Germany and Spain, partly offset by Greece and Italy. Our total cigarette market share increased by 0.2 points to 38.4%, with gains, notably in France, Poland, Spain and the United Kingdom, partly offset by declines, mainly in Italy and Portugal. Cigarette shipment volume of "Others" decreased, mainly due to the same factors as for the quarter.

For the nine months year-to-date, our shipments of OTP decreased by 3.7% to 17.1 billion cigarette equivalent units. Our total OTP market share decreased by 0.4 points to 14.8%.

European Union - Key Market Commentaries

In France, estimated industry size, our cigarette shipment volume and market share performance are shown in the table below.

France Key Market Data

	Third-Quarter			Nine Months Year-to-Date		
	2016	2015	Change % / p.p.	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	12.1	11.8	2.3 %	34.5	34.2	0.8 %
PMI Shipments (million units)	5,034	4,746	6.1 %	14,869	14,450	2.9 %
PMI Cigarette Market Share						
Marlboro	26.3 %	25.8 %	0.5	26.2 %	25.7 %	0.5
Philip Morris	10.1 %	9.2 %	0.9	10.1 %	9.5 %	0.6
Chesterfield	3.1 %	3.3 %	(0.2)	3.1 %	3.3 %	(0.2)
Others	2.7 %	2.9 %	(0.2)	2.8 %	2.9 %	(0.1)
Total	42.2 %	41.2 %	1.0	42.2 %	41.4 %	0.8

In the third quarter, the estimated total cigarette market increased by 2.3%. Excluding the net impact of estimated trade inventory movements, the total market increased by 1.3%, partly reflecting a lower prevalence of illicit trade and e-vapor products. The increase in our cigarette shipment volume mainly reflected the higher total cigarette market and market share growth, driven by Marlboro, as well as the launch of Philip Morris 25s and 100s in January 2016. The estimated total industry fine cut category of 3.9 billion cigarette equivalent units increased by 1.5%. Our market share of the category increased by 0.7 points to 25.3%.

For the nine months year-to-date, the estimated total cigarette market increased by 0.8%, partly reflecting a lower prevalence of illicit trade and e-vapor products. The increase in our cigarette shipment volume mainly reflected market share growth, driven by the same dynamics as those in the quarter. The estimated total industry fine cut category of 11.3 billion cigarette equivalent units increased by 3.7%. Our market share of the category increased by 0.4 points to 25.3%.

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In Germany, estimated industry size, our cigarette shipment volume and market share performance are shown in the table below.

Germany Key Market Data						
	Third-Quarter			Nine Months Year-to-Date		
	2016	2015	Change % / p.p.	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	21.7	21.8	(0.5)%	59.7	59.9	(0.3)%
PMI Shipments (million units)	7,690	7,633	0.7 %	22,065	22,134	(0.3)%
PMI Cigarette Market Share						
Marlboro	21.5 %	20.8 %	0.7	22.3 %	21.9 %	0.4
L&M	11.1 %	11.2 %	(0.1)	11.6 %	12.0 %	(0.4)
Chesterfield	1.5 %	1.6 %	(0.1)	1.6 %	1.7 %	(0.1)
Others	1.3 %	1.4 %	(0.1)	1.5 %	1.4 %	0.1
Total	35.4 %	35.0 %	0.4	37.0 %	37.0 %	—

In the third quarter, the moderate decline of the estimated total cigarette market of 0.5% principally reflected a lower prevalence of illicit trade and a decrease in the rate of out-switching to other tobacco products. The increase in our cigarette shipment volume was driven by higher market share, principally Marlboro, benefiting from marketing support. The estimated total industry fine cut category of 10.7 billion cigarette equivalent units decreased by 0.5%. Our market share of the category decreased by 1.5 points to 10.7%.

For the nine months year-to-date, the moderate decline of the estimated total cigarette market of 0.3% principally reflected a lower prevalence of illicit trade and the estimated favorable impact of immigration. The decrease in our cigarette shipment volume reflected the lower total market. The estimated total industry fine cut category of 30.6 billion cigarette equivalent units increased by 0.6%. Our market share of the category decreased by 1.1 points to 11.6%.

In Italy, estimated industry size, our cigarette shipment volume and market share performance are shown in the table below.

Italy Key Market Data						
	Third-Quarter			Nine Months Year-to-Date		
	2016	2015	Change % / p.p.	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	19.7	20.1	(2.2)%	55.5	55.5	— %
PMI Shipments (million units)	9,939	10,148	(2.1)%	29,861	30,362	(1.6)%
PMI Cigarette Market Share						
Marlboro	24.4 %	24.8 %	(0.4)	24.3 %	24.7 %	(0.4)
Chesterfield	11.6 %	11.2 %	0.4	11.6 %	10.8 %	0.8
Philip Morris	8.3 %	9.0 %	(0.7)	8.6 %	9.3 %	(0.7)
Others	8.0 %	8.7 %	(0.7)	8.2 %	9.1 %	(0.9)
Total	52.3 %	53.7 %	(1.4)	52.7 %	53.9 %	(1.2)

In the third quarter, the estimated total cigarette market decreased by 2.2%, primarily reflecting the impact of price increases in the second quarter of 2016. Our cigarette shipments decreased by 2.1%, or by 5.2% excluding the net impact of distributor inventory movements. The decline mainly reflected the lower total market, and lower cigarette market share, notably due to Marlboro as a result of its price increase in the second quarter of 2016, and low-price Philip Morris, impacted by the growth of the super-low price segment, partly offset by super-low price Chesterfield. The estimated total industry fine cut category of 1.7 billion cigarette equivalent units increased by 3.1%. Our market share of the category decreased by 2.3 points to 38.7%.

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For the nine months year-to-date, the estimated total cigarette market was flat, primarily reflecting a lower prevalence of illicit trade and the favorable estimated impact of immigration. The decline of our cigarette shipments, down by 2.1% excluding the net impact of distributor inventory movements, and market share reflected the same dynamics as those in the quarter. The estimated total industry fine cut category of 4.9 billion cigarette equivalent units increased by 3.6%. Our market share of the category decreased by 2.3 points to 39.0%.

In Poland, estimated industry size, our cigarette shipment volume and market share performance are shown in the table below.

Poland Key Market Data

	Third-Quarter			Nine Months Year-to-Date		
	2016	2015	Change % / p.p.	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	11.5	11.6	(0.2)%	32.3	31.9	1.3 %
PMI Shipments (million units)	4,864	4,734	2.7 %	13,515	12,757	5.9 %
PMI Cigarette Market Share						
Marlboro	11.3 %	11.4 %	(0.1)	11.3 %	11.2 %	0.1
L&M	18.2 %	18.0 %	0.2	18.3 %	17.8 %	0.5
Chesterfield	9.4 %	8.6 %	0.8	9.1 %	8.4 %	0.7
Others	3.2 %	2.9 %	0.3	3.1 %	2.6 %	0.5
Total	42.1 %	40.9 %	1.2	41.8 %	40.0 %	1.8

In the third quarter, the estimated total cigarette market decreased by 0.2%. Excluding the net impact of estimated trade inventory movements, the total market increased by 1.0%, mainly driven by a lower prevalence of e-vapor products. The increase in our cigarette shipment volume primarily reflected higher market share, principally driven by Chesterfield, benefiting from its 100s and super-slims variants, and RGD in "Others," up by 0.4 points to 2.8%. The estimated total industry fine cut category of 1.1 billion cigarette equivalent units increased by 6.2%. Our market share of the category decreased by 1.3 points to 29.2%.

For the nine months year-to-date, the estimated total cigarette market increased by 1.3%. Excluding the net impact of estimated trade inventory movements, the total market increased by 2.1%, mainly driven by a lower prevalence of e-vapor products and non-duty paid products. The increase in our cigarette shipment volume resulted from the higher total market and higher market share, driven principally by L&M, reflecting the positive impact of brand support, Chesterfield, benefiting from its 100s and super-slims variants, and RGD in "Others," up by 0.6 points to 2.7%. The estimated total industry fine cut category of 3.3 billion cigarette equivalent units increased by 4.7%. Our market share of the category decreased by 5.0 points to 27.1%, mainly due to increased price competition at the bottom of the market.

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In Spain, estimated industry size, our cigarette shipment volume and market share performance are shown in the table below.

Spain Key Market Data

	Third-Quarter			Nine Months Year-to-Date		
	2016	2015	Change % / p.p.	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	13.0	13.1	(0.6)%	35.3	35.4	(0.3)%
PMI Shipments (million units)	4,272	4,173	2.4 %	12,637	11,861	6.5 %
PMI Cigarette Market Share						
Marlboro	18.6 %	17.7 %	0.9	18.1 %	16.9 %	1.2
Chesterfield	8.4 %	8.8 %	(0.4)	8.6 %	9.1 %	(0.5)
L&M	5.3 %	5.7 %	(0.4)	5.4 %	5.8 %	(0.4)
Others	2.1 %	1.8 %	0.3	2.0 %	1.5 %	0.5
Total	34.4 %	34.0 %	0.4	34.1 %	33.3 %	0.8

In the third quarter, the moderate decline of the estimated total cigarette market of 0.6% mainly reflected an improving economy, and the favorable estimated impact of in-switching from other tobacco products. Excluding the net impact of distributor inventory movements, our cigarette shipment volume increased by 0.9%, driven by higher market share reflecting the strong performance of Marlboro, benefiting from its round price point in the vending channel and the new Architecture 2.0. The estimated total industry fine cut category of 2.4 billion cigarette equivalent units decreased by 3.4%. Our market share of the fine cut category decreased by 1.4 points to 11.5%.

For the nine months year-to-date, the estimated total cigarette market decreased by 0.3%. Excluding the net impact of distributor inventory movements, our cigarette shipment volume increased by 2.1%, driven by the same dynamics as those for the quarter. The estimated total industry fine cut category of 7.0 billion cigarette equivalent units decreased by 2.6%. Our market share of the fine cut category decreased by 1.5 points to 12.1%.

Eastern Europe, Middle East & Africa:

Eastern Europe, Middle East & Africa	For the Nine Months Ended September 30,			
(in millions)	2016	2015	Variance	%
Net revenues	$13,650	$13,908	$(258)	(1.9)%
Excise taxes on products	8,448	8,261	187	2.3 %
Net revenues, excluding excise taxes on products	5,202	5,647	(445)	(7.9)%
Operating companies income	2,389	2,721	(332)	(12.2)%

For the nine months ended September 30, 2016, net revenues, which include excise taxes billed to customers, decreased by $258 million. Excluding excise taxes, net revenues decreased by $445 million due to:

- unfavorable currency ($515 million) and
- unfavorable volume/mix ($332 million), partly offset by
- price increases ($402 million).

Operating companies income decreased by $332 million during the nine months ended September 30, 2016. This decrease was due primarily to:

- unfavorable currency ($449 million) and
- unfavorable volume/mix ($317 million), partially offset by

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- price increases ($402 million),
- higher equity income in unconsolidated subsidiaries ($13 million) and
- lower manufacturing costs ($11 million).

Eastern Europe, Middle East & Africa	For the Three Months Ended September 30,			
(in millions)	2016	2015	Variance	%
Net revenues	$5,122	$5,107	$15	0.3 %
Excise taxes on products	3,186	3,091	95	3.1 %
Net revenues, excluding excise taxes on products	1,936	2,016	(80)	(4.0)%
Operating companies income	962	1,002	(40)	(4.0)%

For the three months ended September 30, 2016, net revenues increased by $15 million. Excluding excise taxes, net revenues decreased by $80 million due to:

- unfavorable currency ($141 million) and
- unfavorable volume/mix ($119 million), partly offset by
- price increases ($180 million).

Operating companies income decreased by $40 million during the three months ended September 30, 2016. This decrease was due to:

- unfavorable currency ($127 million),
- unfavorable volume/mix ($105 million) and
- higher manufacturing costs ($36 million), partly offset by
- price increases ($180 million),
- lower marketing, administration and research costs ($31 million) and
- higher equity income in unconsolidated subsidiaries ($17 million).

Eastern Europe, Middle East & Africa - PMI Cigarette Shipment Volume

In the third quarter, our cigarette shipment volume decreased by 5.4% to 72.2 billion units, mainly due to North Africa and Russia, partly offset by Ukraine. Our cigarette shipment volume of Marlboro decreased by 6.5% to 20.1 billion units, principally due to Algeria. Our cigarette shipment volume of Parliament increased by 0.3% to 9.3 billion units, primarily driven by Saudi Arabia and Ukraine, partly offset by Russia. Our cigarette shipment volume of L&M decreased by 1.3% to 13.5 billion units, mainly due to Egypt, Russia and Turkey, partly offset by Algeria, Kazakhstan and Ukraine.

For the nine months year-to-date, our cigarette shipment volume decreased by 3.1% to 203.6 billion units, mainly due to North Africa and Russia, partially offset by Turkey and Ukraine. Our cigarette shipment volume of Marlboro decreased by 8.8% to 55.0 billion units, principally due to North Africa, partly offset by Saudi Arabia and Turkey. Our cigarette shipment volume of Parliament increased by 1.6% to 25.5 billion units, driven by Saudi Arabia, Turkey and Ukraine, partly offset by Russia. Our cigarette shipment volume of L&M increased by 3.3% to 39.5 billion units, driven notably by Kazakhstan, North Africa and Ukraine, partly offset by Russia, Saudi Arabia and Turkey.

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Eastern Europe, Middle East & Africa - Key Market Commentaries

In North Africa (defined as Algeria, Egypt, Libya, Morocco and Tunisia), estimated industry size, our cigarette shipment volume and market share performance are shown in the table below.

North Africa Key Market Data

	Third-Quarter			Nine Months Year-to-Date		
	2016	2015	Change % / p.p.	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	36.5	33.1	10.4 %	105.0	101.0	3.9 %
PMI Shipments (million units)	8,480	9,928	(14.6)%	25,893	27,936	(7.3)%
PMI Cigarette Market Share						
Marlboro	10.3 %	14.1 %	(3.8)	8.2 %	14.2 %	(6.0)
L&M	11.7 %	13.6 %	(1.9)	12.6 %	11.5 %	1.1
Others	2.6 %	2.9 %	(0.3)	2.9 %	2.2 %	0.7
Total	24.6 %	30.6 %	(6.0)	23.7 %	27.9 %	(4.2)

In the third quarter, the estimated total cigarette market increased by 10.4%, principally driven by Egypt, mainly reflecting the favorable impact of estimated net inventory movements by our principal competitor, partly offset by Algeria, mainly due to challenging macro-economic conditions and geopolitical instability. Excluding the impact of the inventory movements in Egypt, the estimated total cigarette market increased by 5.5%. The decrease in our cigarette shipment volume reflected lower market share, mainly due to: Marlboro in Algeria, principally reflecting the impact of excise tax-driven price increases, as well as lower-than-anticipated acceptance of the 2.0 Architecture for Marlboro Round Taste; and L&M in Egypt.

For the nine months year-to-date, the estimated total cigarette market increased by 3.9%, principally driven by Egypt, partly offset by Algeria. The decrease in our cigarette shipment volume, down by 12.2% excluding the net impact of distributor inventory movements, reflected lower market share, mainly due to Marlboro in Algeria; partly offset by L&M in Algeria and Merit in Egypt.

In Russia, estimated industry size, our cigarette shipment volume and August quarter-to-date and year-to-date market share performance, as measured by Nielsen, are shown in the table below.

Russia Key Market Data

	Third-Quarter			Nine Months Year-to-Date		
	2016	2015	Change % / p.p.	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	76.4	81.1	(5.7)%	208.9	219.9	(5.0)%
PMI Shipments (million units)	20,762	23,742	(12.6)%	59,108	65,826	(10.2)%
PMI Cigarette Market Share						
Marlboro	1.3 %	1.4 %	(0.1)	1.4 %	1.4 %	—
Parliament	3.8 %	3.8 %	—	3.9 %	3.8 %	0.1
Bond Street	8.2 %	8.7 %	(0.5)	8.1 %	8.3 %	(0.2)
Others	13.6 %	15.1 %	(1.5)	13.8 %	14.7 %	(0.9)
Total	26.9 %	29.0 %	(2.1)	27.2 %	28.2 %	(1.0)

In the third quarter, the estimated total cigarette market decreased by 5.7%, mainly due to the impact of excise tax-driven price increases. The decrease in our cigarette shipment volume mainly reflected the lower total market, and lower cigarette market share due to Bond Street, a decline in "Others" of mid-price L&M and Chesterfield and super-low Optima, reflecting the timing of retail price increases compared to competition.

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For the nine months year-to-date, the estimated total cigarette market decreased by 5.0%, reflecting the same dynamic as for the quarter. The decrease in our cigarette shipment volume mainly reflected the lower total market, and lower cigarette market share due to the same factors as those for the quarter, partly offset by super-low Next/Dubliss in "Others."

In Turkey, estimated industry size, our cigarette shipment volume and August quarter-to-date and year-to-date market share performance, as measured by Nielsen, are shown in the table below.

Turkey Key Market Data

	Third-Quarter			Nine Months Year-to-Date		
	2016	2015	Change % / p.p.	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	29.3	29.3	0.1 %	79.4	75.0	6.0 %
PMI Shipments (million units)	14,041	14,150	(0.8)%	37,550	35,433	6.0 %
PMI Cigarette Market Share						
Marlboro	10.4 %	9.8 %	0.6	10.2 %	9.3 %	0.9
Parliament	11.7 %	11.9 %	(0.2)	11.6 %	11.7 %	(0.1)
Lark	7.3 %	7.7 %	(0.4)	7.5 %	7.5 %	—
Others	15.1 %	14.7 %	0.4	14.9 %	15.0 %	(0.1)
Total	44.5 %	44.1 %	0.4	44.2 %	43.5 %	0.7

In the third quarter, the estimated total cigarette market was essentially flat, mainly reflecting a lower prevalence of illicit trade. The increase in our market share was led by Marlboro, primarily reflecting the growth of its slimmer Touch variant, and Chesterfield, partly offset by L&M in "Others."

For the nine months year-to-date, the estimated total cigarette market increased by 6.0%, primarily reflecting a lower prevalence of illicit trade. The increase in our cigarette shipment volume was mainly driven by the higher total market and higher market share, reflecting the same dynamics as for the quarter.

In Ukraine, estimated industry size, our cigarette shipment volume and August quarter-to-date and year-to-date market share performance, as measured by Nielsen, are shown in the table below.

Ukraine Key Market Data

	Third-Quarter			Nine Months Year-to-Date		
	2016	2015	Change % / p.p.	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	18.9	18.8	0.8 %	55.6	52.4	6.1 %
PMI Shipments (million units)	5,624	4,704	19.6 %	17,222	14,382	19.7 %
PMI Cigarette Market Share						
Marlboro	3.2 %	3.5 %	(0.3)	3.2 %	4.1 %	(0.9)
Parliament	3.1 %	2.8 %	0.3	2.9 %	2.9 %	—
Bond Street	10.3 %	8.4 %	1.9	10.4 %	8.1 %	2.3
Others	13.5 %	14.7 %	(1.2)	14.0 %	15.7 %	(1.7)
Total	30.1 %	29.4 %	0.7	30.5 %	30.8 %	(0.3)

In the third quarter, the estimated total cigarette market increased by 0.8%. Excluding the net impact of estimated trade inventory movements in 2015, the total market decreased by 1.6%, principally driven by the impact of price increases in 2016. The increase in our cigarette shipment volume mainly reflected the increase in our market share, driven by low price Bond Street and L&M in

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"Others," partly offset by Marlboro, reflecting the impact of widened price gaps, and mid-price Chesterfield and super-low President in "Others," mainly resulting from competitive price pressure in the low price segment.

For the nine months year-to-date, the estimated total cigarette market increased by 6.1%, mainly driven by a lower prevalence of illicit trade. The increase in our cigarette shipment volume reflected the higher total cigarette market. The decrease in our market share was primarily due to Marlboro, reflecting the impact of widened price gaps, and mid-price Chesterfield and super-low President in "Others," mainly resulting from competitive price pressure in the low price segment, partly offset by Bond Street and L&M.

Asia:

Asia (in millions)	For the Nine Months Ended September 30, 2016	 2015	 Variance	 %
Net revenues	$15,014	$14,683	$331	2.3 %
Excise taxes on products	8,777	8,399	378	4.5 %
Net revenues, excluding excise taxes on products	6,237	6,284	(47)	(0.7)%
Operating companies income	2,288	2,421	(133)	(5.5)%

For the nine months ended September 30, 2016, net revenues, which include excise taxes billed to customers, increased by $331 million. Excluding excise taxes, net revenues decreased by $47 million due to:

- unfavorable currency ($126 million) and
- unfavorable volume/mix ($78 million), partly offset by
- price increases ($157 million).

Operating companies income decreased by $133 million during the nine months ended September 30, 2016. This decrease was due primarily to:

- unfavorable volume/mix ($238 million),
- higher marketing, administration and research costs ($54 million) and
- unfavorable currency ($11 million), partly offset by
- price increases ($157 million) and
- lower manufacturing costs ($14 million).

Asia (in millions)	For the Three Months Ended September 30, 2016	 2015	 Variance	 %
Net revenues	$5,113	$4,880	$233	4.8 %
Excise taxes on products	2,977	2,896	81	2.8 %
Net revenues, excluding excise taxes on products	2,136	1,984	152	7.7 %
Operating companies income	761	690	71	10.3%

For the three months ended September 30, 2016, net revenues increased by $233 million. Excluding excise taxes, net revenues increased by $152 million due primarily to:

- price increases ($95 million) and
- favorable currency ($59 million).

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Operating companies income increased by $71 million during the three months ended September 30, 2016. This increase was due primarily to:

- price increases ($95 million) and
- favorable currency ($57 million), partly offset by
- unfavorable volume/mix ($35 million),
- higher marketing, administration and research costs ($27 million, primarily related to commercialization of our RRPs), and
- higher manufacturing costs ($17 million).

Asia - PMI Cigarette Shipment Volume

In the third quarter, our cigarette shipment volume decreased by 9.0% to 61.7 billion units, mainly due to: Indonesia, reflecting the reversal of estimated trade inventory movements in the second quarter of 2016 related to the timing of Ramadan; Pakistan, reflecting a lower total estimated cigarette market resulting from excise tax-driven price increases and the growth of illicit trade; the Philippines, reflecting a lower total estimated cigarette market resulting from excise-tax driven price increases; and Thailand, primarily reflecting the impact of excise tax-driven price increases in the first quarter of 2016, as well as lower market share. Cigarette shipment volume of Marlboro increased by 3.4% to 19.0 billion units, predominantly driven by the Philippines, partly offset by Indonesia and Vietnam. Cigarette shipment volume of Parliament decreased by 1.3% to 2.5 billion units, due mainly to Japan, partly offset by Korea. Cigarette shipment volume of Lark decreased by 1.0% to 4.3 billion units, due to Japan.

For the nine months year-to-date, our cigarette shipment volume decreased by 8.0% to 196.2 billion units, mainly due to: Indonesia, reflecting a lower total estimated cigarette market, resulting from the impact of excise-tax driven price increases, and lower market share, reflecting the soft performance of our machine-made kretek portfolio due to competitors' discounted product offerings; Japan, mainly reflecting the continued underlying cigarette consumption decline and the growth of the Reduced-Risk Products category; Pakistan, the Philippines and Thailand, reflecting the same dynamics as for the quarter; partly offset by Korea, reflecting a normalization of the total estimated cigarette market following the disruptive excise tax increase in January 2015. Cigarette shipment volume of Marlboro increased by 3.8% to 57.3 billion units, mainly driven by Korea and the Philippines, partly offset by Japan and Vietnam. Cigarette shipment volume of Parliament increased by 9.3% to 7.5 billion units, driven by Korea. Cigarette shipment volume of Lark decreased by 7.7% to 13.4 billion units, principally due to Japan.

Asia - Key Market Commentaries

In Indonesia, estimated industry size, our cigarette shipment volume, market share and segmentation performance are shown in the tables below.

Indonesia Key Market Data

	Third-Quarter			Nine Months Year-to-Date		
	2016	2015	Change % / p.p.	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	72.3	75.5	(4.3)%	229.7	232.5	(1.2)%
PMI Shipments (million units)	25,084	26,552	(5.5)%	78,792	81,895	(3.8)%
PMI Cigarette Market Share						
Sampoerna A	14.4 %	14.9 %	(0.5)	14.4 %	15.0 %	(0.6)
Dji Sam Soe	6.6 %	7.2 %	(0.6)	6.6 %	7.1 %	(0.5)
U Mild	4.3 %	4.7 %	(0.4)	4.3 %	4.9 %	(0.6)

Others	9.4	%	8.3	%	1.1		9.0	%	8.2	%	0.8	
Total	34.7	%	35.1	%	(0.4	)	34.3	%	35.2	%	(0.9	)

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Indonesia Segmentation Data

	Third-Quarter 2016	Third-Quarter 2015	Change p.p.	Nine Months Year-to-Date 2016	Nine Months Year-to-Date 2015	Change p.p.
Segment % of Total Market						
Hand-Rolled Kretek (SKT)	17.2 %	18.4 %	(1.2)	17.8 %	18.8 %	(1.0)
Machine-Made Kretek (SKM)	76.7 %	75.2 %	1.5	76.0 %	74.9 %	1.1
Whites (SPM)	6.1 %	6.4 %	(0.3)	6.2 %	6.3 %	(0.1)
Total	100.0%	100.0%	—	100.0%	100.0%	—
PMI % Share of Segment						
Hand-Rolled Kretek (SKT)	38.6 %	40.3 %	(1.7)	38.9 %	38.7 %	0.2
Machine-Made Kretek (SKM)	30.2 %	30.0 %	0.2	29.4 %	30.5 %	(1.1)
Whites (SPM)	79.7 %	80.7 %	(1.0)	80.7 %	80.9 %	(0.2)

In the third quarter, the estimated total cigarette market decreased by 4.3%, reflecting the reversal of estimated trade inventory movements in the second quarter of 2016 related to the timing of Ramadan. Excluding the impact of these inventory movements, the estimated total cigarette market increased by 1.9%. The decrease in our cigarette shipments was mainly due to a lower total market, and lower market share mainly reflecting the soft performance of our SKT portfolio, in line with industry trends.

For the nine months year-to-date, the estimated total cigarette market decreased by 1.2%, mainly reflecting a soft economic environment and the impact of excise tax-driven price increases. The decrease in our cigarette shipments was mainly due to a lower total market, and lower market share, mainly reflecting the soft performance of: our SKM portfolio, due to competitors' discounted product offerings; and our SKT portfolio, in line with industry trends.

In Japan, estimated industry size, our cigarette shipment volume and market share performance are shown in the table below.

Japan Key Market Data

	Third-Quarter 2016	Third-Quarter 2015	Change % / p.p.	Nine Months Year-to-Date 2016	Nine Months Year-to-Date 2015	Change % / p.p.
Total Cigarette Market (billion units)	44.5	47.2	(5.8)%	130.8	135.8	(3.7)%
PMI Shipments (million units)	10,691	10,796	(1.0)%	33,284	36,194	(8.0)%
PMI Cigarette Market Share						
Marlboro	11.1 %	11.3 %	(0.2)	11.0 %	11.4 %	(0.4)
Parliament	2.4 %	2.3 %	0.1	2.4 %	2.3 %	0.1
Lark	10.0 %	10.0 %	—	9.9 %	10.0 %	(0.1)
Others	1.7 %	1.7 %	—	1.7 %	1.7 %	—
Total	25.2 %	25.3 %	(0.1)	25.0 %	25.4 %	(0.4)

In the third quarter, the estimated total cigarette market decreased by 5.8%, mainly reflecting the continued underlying cigarette consumption decline, the growth of Reduced-Risk Products, and the impact of the April price increases of certain brands of our key competitor. Excluding the net impact of distributor inventory movements, our cigarette shipment volume decreased by 6.8%, mainly reflecting the lower cigarette market. The decline of our cigarette market share partly reflected the cannibalization by Marlboro Heatsticks.

In the third quarter, the estimated national market share of Marlboro HeatSticks was 3.5%, bringing our total combined national market share to 27.9%, up by 2.5 points. We calculate national market share for HeatSticks in Japan as the total sales volume for HeatSticks as a percentage of the total estimated sales volume for cigarettes and HeatSticks.

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For the nine months year-to-date, the estimated total cigarette market decreased by 3.7%, reflecting the same dynamics as for the quarter. Excluding the net impact of distributor inventory movements, our cigarette shipment volume decreased by 5.1%. The decline was mainly due to a lower total cigarette market and lower cigarette market share, reflecting the impact of competitors' retail pricing, competitors' differentiated menthol taste product offerings and cannibalization by Marlboro Heatsticks.

For the nine months year-to-date, the estimated national market share of Marlboro HeatSticks was 2.2%, bringing our total combined national market share to 26.7%, up by 1.2 points.

In Korea, estimated industry size, our cigarette shipment volume and market share performance are shown in the table below.

Korea Key Market Data

	Third-Quarter			Nine Months Year-to-Date		
	2016	2015	Change % / p.p.	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	19.8	19.8	0.2 %	55.6	49.4	12.6 %
PMI Shipments (million units)	4,109	4,163	(1.3)%	11,553	10,352	11.6 %
PMI Cigarette Market Share						
Marlboro	9.7 %	9.6 %	0.1	9.5 %	9.6 %	(0.1)
Parliament	7.5 %	7.0 %	0.5	7.6 %	7.1 %	0.5
Virginia S.	3.1 %	3.7 %	(0.6)	3.2 %	3.8 %	(0.6)
Others	0.5 %	0.7 %	(0.2)	0.5 %	0.6 %	(0.1)
Total	20.8 %	21.0 %	(0.2)	20.8 %	21.1 %	(0.3)

In the third quarter, the estimated total cigarette market increased by 0.2%. Excluding the net impact of estimated trade inventory movements, the total market increased by 1.2%, reflecting the normalization of the market following the disruptive excise tax increase of 120% in January 2015. The decline in our cigarette shipment volume was due to lower market share, reflecting the impact of new brand launches by our principal competitor. The decline in market share of Virginia S. reflected the continued morphing of Virginia Super Slims into Parliament Super Slims that began in January 2016.

For the nine months year-to-date, the growth of the estimated total cigarette market reflected the normalization of the market following the disruptive excise tax increase of 120% in January 2015. The growth in our cigarette shipment volume reflected the higher estimated total market, partly offset by a decline of market share, reflecting the same dynamic as for the quarter.

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In the Philippines, estimated industry size, our cigarette shipment volume and market share performance are shown in the table below.

Philippines Key Market Data	Third-Quarter			Nine Months Year-to-Date		
	2016	2015	Change % / p.p.	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	20.2	23.3	(13.2)%	60.1	68.2	(11.8)%
PMI Shipments (million units)	14,277	17,192	(17.0)%	43,558	49,821	(12.6)%
PMI Cigarette Market Share						
Marlboro	28.5%	18.8%	9.7	27.9%	18.7%	9.2
Fortune	23.4%	30.9%	(7.5)	24.3%	29.5%	(5.2)
Jackpot	7.5%	12.2%	(4.7)	8.3%	13.0%	(4.7)
Others	11.3%	12.0%	(0.7)	11.9%	11.9%	—
Total	70.7%	73.9%	(3.2)	72.4%	73.1%	(0.7)

In the third quarter, the estimated total cigarette market decreased by 13.2%, mainly due to the impact of price increases, notably in the fourth quarter of 2015 ahead of the January 2016 excise tax increase. The decline in our cigarette shipment volume reflected the impact of these price increases, particularly on our low and super-low price brands, Fortune and Jackpot, partly offset by an increase in market share of Marlboro, benefiting from its narrowed price gap with lower-priced brands as a result of the excise tax increase.

For the nine months year-to-date, the estimated total cigarette market decreased by 11.8%, reflecting the same factors as those described for the quarter. The decline in our cigarette shipment volume and market share reflected the same dynamics as for the quarter.

Latin America & Canada:

Latin America & Canada	For the Nine Months Ended September 30,			
(in millions)	2016	2015	Variance	%
Net revenues	$6,436	$7,030	$(594)	(8.4)%
Excise taxes on products	4,379	4,693	(314)	(6.7)%
Net revenues, excluding excise taxes on products	2,057	2,337	(280)	(12.0)%
Operating companies income	677	849	(172)	(20.3)%

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For the nine months ended September 30, 2016, net revenues, which include excise taxes billed to customers, decreased by $594 million. Excluding excise taxes, net revenues decreased by $280 million due to:

- unfavorable currency ($427 million) and
- unfavorable volume/mix ($78 million), partly offset by
- price increases ($225 million).

Operating companies income decreased by $172 million during the nine months ended September 30, 2016. This decrease was due to:

- unfavorable currency ($220 million),
- unfavorable volume/mix ($66 million),
- higher marketing, administration and research costs ($64 million) and
- higher manufacturing costs ($47 million), partly offset by
- price increases ($225 million).

Latin America & Canada	For the Three Months Ended September 30,			
(in millions)	2016	2015	Variance	%
Net revenues	$2,313	$2,417	$(104)	(4.3)%
Excise taxes on products	1,603	1,613	(10)	(0.6)%
Net revenues, excluding excise taxes on products	710	804	(94)	(11.7)%
Operating companies income	224	294	(70)	(23.8)%

For the three months ended September 30, 2016, net revenues decreased by $104 million. Excluding excise taxes, net revenues decreased by $94 million due to:

- unfavorable currency ($108 million) and
- unfavorable volume/mix ($58 million), partly offset by
- price increases ($72 million).

Operating companies income decreased by $70 million during the three months ended September 30, 2016 due to:

- unfavorable currency ($53 million),
- unfavorable volume/mix ($50 million),
- higher marketing, administration and research costs ($20 million) and
- higher manufacturing costs ($19 million), partly offset by
- price increases ($72 million).

Latin America & Canada - PMI Cigarette Shipment Volume and Market Share

In the third quarter, our cigarette shipment volume decreased by 8.0% to 21.2 billion units, predominantly due to Argentina, Brazil and Ecuador, all reflecting the impact of tax-driven price increases in 2016. While cigarette shipment volume of Marlboro decreased by 6.2% to 8.3 billion units, its market share increased by 0.1 point to an estimated 15.4%, primarily driven by Brazil, up by 0.1 point to 9.8% and Colombia, up by 0.2 points to 9.3%, partly offset by Argentina, down by 1.7 points to 22.1%, and Mexico, down by 0.4 points to 48.5%. Cigarette shipment volume of Philip Morris decreased by 19.4% to 3.8 billion units, mainly due to Argentina, partly offset by Canada.

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For the nine months year-to-date, our cigarette shipment volume decreased by 4.0% to 64.1 billion units, mainly due to Argentina, Brazil and Ecuador, reflecting the same dynamics as for the quarter, partly offset by Mexico, reflecting a higher total market. While cigarette shipment volume of Marlboro decreased by 1.2% to 25.6 billion units, its market share increased by 0.6 points to an estimated 15.5%, primarily driven by Brazil, up by 0.4 points to 10.0%, Colombia, up by 0.2 points to 9.2%, and Mexico, up by 1.0 point to 48.3%, partly offset by Argentina, down by 1.2 points to 23.0%. Cigarette shipment volume of Philip Morris decreased by 11.1% to 12.6 billion units, mainly due to Argentina, partly offset by Canada.

Latin America & Canada - Key Market Commentaries

In Argentina, estimated industry size, our cigarette shipment volume and market share performance are shown in the table below.

Argentina Key Market Data

	Third-Quarter			Nine Months Year-to-Date		
	2016	2015	Change % / p.p.	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	8.5	9.9	(14.1)%	26.7	29.8	(10.5)%
PMI Shipments (million units)	6,418	7,648	(16.1)%	20,389	23,234	(12.2)%
PMI Cigarette Market Share						
Marlboro	22.1 %	23.8 %	(1.7)	23.0 %	24.2 %	(1.2)
Parliament	1.9 %	2.1 %	(0.2)	1.9 %	2.1 %	(0.2)
Philip Morris	39.9 %	44.5 %	(4.6)	43.2 %	44.6 %	(1.4)
Others	11.6 %	6.8 %	4.8	8.4 %	7.1 %	1.3
Total	75.5 %	77.2 %	(1.7)	76.5 %	78.0 %	(1.5)

In the third quarter, the estimated total cigarette market decreased by 14.1%, mainly due to a soft economic environment and the impact of the May 2016 excise tax increase that drove a more than 50% increase in average industry retail prices. The decrease in our cigarette shipment volume was principally due to the lower total market. Our lower cigarette market share primarily reflected growth in competitors' super-low priced products benefiting from down-trading, partly offset by low-price Chesterfield in "Others." The capsule segment was up by 0.4 points to 16.9% of the total market; our share of the segment decreased by 1.4 points to 72.5%.

For the nine months year-to-date, the decline of the estimated total cigarette market, our cigarette shipment volume and market share reflected the same dynamics as for the quarter. The capsule segment was up by 1.5 points to 17.6% of the total market; our share of the segment increased by 0.3 points to 73.4%.

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In Canada, estimated industry size, our cigarette shipment volume and market share performance are shown in the table below.

Canada Key Market Data

	Third-Quarter			Nine Months Year-to-Date		
	2016	2015	Change % / p.p.	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	6.9	7.0	(1.4)%	19.4	19.7	(1.5)%
PMI Shipments (million units)	2,675	2,725	(1.8)%	7,466	7,424	0.6 %
PMI Cigarette Market Share						
Belmont	3.9 %	3.6 %	0.3	3.7 %	3.3 %	0.4
Canadian Classics	10.2 %	10.8 %	(0.6)	10.2 %	10.5 %	(0.3)
Next	11.5 %	11.1 %	0.4	11.3 %	10.7 %	0.6
Others	13.4 %	13.7 %	(0.3)	13.1 %	13.2 %	(0.1)
Total	39.0 %	39.2 %	(0.2)	38.3 %	37.7 %	0.6

In the third quarter, the estimated total cigarette market decreased by 1.4%, or by 2.0% excluding the net impact of estimated competitors' trade inventory movements. The decrease in our cigarette shipment volume was mainly due to: the lower estimated total market; and lower cigarette market share, unfavorably impacted by the inventory movements, due to Canadian Classics, and Accord and Number 7 in "Others," partly offset by the strong performance of premium Belmont, low-price Next, and super-low price Philip Morris in "Others" that benefited from down-trading.

For the nine months year-to-date, the estimated total cigarette market decreased by 1.5%. Excluding the impact of estimated competitors' trade inventory movements, the total market increased by 0.5%, mainly driven by improved consumer spending. The increase in our cigarette shipment volume was principally due to higher market share, largely reflecting the strong performance of premium Belmont, low-price Next, and super-low price Philip Morris in "Others" that benefited from down-trading.

In Mexico, estimated industry size, our cigarette shipment volume and market share performance are shown in the table below.

Mexico Key Market Data

	Third-Quarter			Nine Months Year-to-Date		
	2016	2015	Change % / p.p.	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	8.8	8.5	3.4 %	26.2	24.6	6.2 %
PMI Shipments (million units)	6,055	5,980	1.3 %	18,013	16,866	6.8 %
PMI Cigarette Market Share						
Marlboro	48.5 %	48.9 %	(0.4)	48.3 %	47.3 %	1.0
Delicados	9.6 %	10.8 %	(1.2)	9.9 %	10.8 %	(0.9)
Benson & Hedges	4.8 %	4.6 %	0.2	4.7 %	4.6 %	0.1
Others	5.9 %	5.9 %	—	5.9 %	5.7 %	0.2
Total	68.8 %	70.2 %	(1.4)	68.8 %	68.4 %	0.4

In the third quarter, the estimated total cigarette market increased by 3.4%, or by 0.8% excluding the net impact of estimated trade inventory movements, primarily reflecting improved market conditions and a lower prevalence of illicit trade. The increase in our cigarette shipment volume reflected the higher total cigarette market. Our cigarette market share, unfavorably distorted by the impact of estimated trade inventory movements mentioned above, was down by 1.4 points, mainly due to low-price Delicados. Our share of the premium segment, representing 56.6% of the total market, was up by 0.4 points to 93.2%.

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For the nine months year-to-date, the estimated total cigarette market increased by 6.2%, or by 3.0% excluding the net impact of estimated trade inventory movements, reflecting the same factors as for the quarter. The increase in our cigarette shipment volume reflected the higher total market. Our cigarette market share, favorably distorted by the impact of estimated inventory movements, was up by 0.4 points, with growth of Marlboro and Benson & Hedges, reflecting the impact of new product launches, partly offset by low-price Delicados. Our share of the premium segment, representing 56.5% of the total market, increased by 1.1 points to 93.0%.

Financial Review

Net Cash Provided by Operating Activities

During the first nine months of 2016, net cash provided by operating activities of $5.9 billion decreased by $65 million compared with the first nine months of 2015. Excluding currency movements, net cash provided by operating activities was essentially flat as compared with the first nine months of 2015. Excluding these currency movements, net earnings growth and lower cash payments related to exit costs were offset by an increase in working capital requirements and 2016 installment payments of security into a court trust pertaining to the Létourneau and Blais cases (see Note 9. Contingencies for additional information).

Excluding currency, the unfavorable movements in working capital were due primarily to the following:

- more cash used for accounts receivable, primarily due to the timing of sales and cash collections; and
- more cash used for income taxes, primarily due to the timing of payments; partially offset by
- more cash provided by lower other raw materials inventories.

Net Cash Used in Investing Activities

During the first nine months of 2016, net cash used in investing activities of $943 million increased by $555 million compared with the first nine months of 2015. This change was due principally to cash collateral movements, primarily from derivatives designated as net investment hedges, and higher capital expenditures.

Our capital expenditures were $734 million and $636 million during the nine months ended September 30, 2016 and 2015, respectively. The 2016 expenditures were primarily related to investments in RRPs, productivity-enhancing programs, and equipment for new products.

Net Cash Used in Financing Activities

During the first nine months of 2016, net cash used in financing activities of $3.6 billion decreased by $901 million compared with the first nine months of 2015. The change was due primarily to higher proceeds from long-term debt (primarily the $3.5 billion proceeds in the first nine months of 2016 from our debt issuances), partially offset by more cash used to repay long-term debt.

Dividends paid in the first nine months of 2016 and 2015 were $4.8 billion and $4.7 billion, respectively. The increase primarily reflects a higher dividend rate in 2016.

Debt and Liquidity

We define cash and cash equivalents as short-term, highly liquid investments, readily convertible to known amounts of cash that mature within a maximum of three months and have an insignificant risk of change in value due to interest rate or credit risk changes. As a policy, we do not hold any investments in structured or equity-linked products. Our cash and cash equivalents are predominantly held in short-term bank deposits with institutions that have investment-grade long-term credit rating.

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Credit Ratings – The cost and terms of our financing arrangements as well as our access to commercial paper markets may be affected by applicable credit ratings. On March 21, 2016, Standard & Poor's affirmed our long-term credit rating at "A" and short-term at "A-1," but revised our outlook to "Negative" from "Stable." On August 1, 2016, Fitch affirmed our long-term credit rating at "A" and short-term at "F1," as well as our "Negative" outlook. We do not expect the Standard & Poor's and Fitch negative outlooks to impact our borrowing costs. On August 10, 2016, Moody's affirmed our long-term credit rating at "A2" and short-term at "P-1," as well as our "Stable" outlook. At September 30, 2016, our credit ratings and outlook by major credit rating agencies were as follows:

	Short-term	Long-term	Outlook
Moody's	P-1	A2	Stable
Standard & Poor's	A-1	A	Negative
Fitch	F1	A	Negative

Credit Facilities – On January 27, 2016, we entered into an agreement to amend and extend our existing $2.0 billion 364-day revolving credit facility from February 9, 2016 to February 7, 2017. On January 27, 2016, we also entered into an agreement to extend the term of our existing $2.5 billion multi-year revolving credit facility from February 28, 2020 to February 28, 2021.

At September 30, 2016, our committed credit facilities and commercial paper outstanding were as follows:

(in billions)

Type	Committed Credit Facilities	Commercial Paper
364-day revolving credit, expiring February 7, 2017	$ 2.0	
Multi-year revolving credit, expiring February 28, 2021	2.5	
Multi-year revolving credit, expiring October 1, 2020 [1]	3.5	
Total facilities	$ 8.0	
Commercial paper outstanding		$ —

[1] On August 30, 2016, we entered into an agreement, effective October 1, 2016, to extend the term of our multi-year revolving credit facility, for an additional year covering the period October 1, 2020 to October 1, 2021 in the amount of $3.35 billion.

At September 30, 2016, there were no borrowings under the committed credit facilities, and the entire committed amounts were available for borrowing.

All banks participating in our committed credit facilities have an investment-grade long-term credit rating from the credit rating agencies. We continuously monitor the credit quality of our banking group, and at this time we are not aware of any potential non-performing credit provider.

Each of these facilities requires us to maintain a ratio of consolidated earnings before interest, taxes, depreciation and amortization ("consolidated EBITDA") to consolidated interest expense of not less than 3.5 to 1.0 on a rolling four-quarter basis. At September 30, 2016, our ratio calculated in accordance with the agreements was 10.0 to 1.0. These facilities do not include any credit rating triggers, material adverse change clauses or any provisions that could require us to post collateral. We expect to continue to meet our covenants. The terms "consolidated EBITDA" and "consolidated interest expense," both of which include certain adjustments, are defined in the facility agreements previously filed with the U.S. Securities and Exchange Commission.

In addition to the committed credit facilities discussed above, certain of our subsidiaries maintain short-term credit arrangements to meet their respective working capital needs. These credit arrangements, which amounted to approximately $2.6 billion at September 30, 2016 and $2.9 billion at December 31, 2015, are for the sole use of our subsidiaries. Borrowings under these arrangements amounted to $710 million at September 30, 2016, and $825 million at December 31, 2015.

Commercial Paper Program – We have commercial paper programs in place in the U.S. and in Europe. Our commercial paper programs in place in the U.S. and in Europe currently have an aggregate issuance capacity of $8.0 billion.

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At September 30, 2016 and December 31, 2015, we had no commercial paper outstanding.
We expect that the existence of the commercial paper program and the committed credit facilities, coupled with our operating cash flows, will enable us to meet our liquidity requirements.

Sale of Accounts Receivable – To mitigate credit risk and enhance cash and liquidity management we sell trade receivables to unaffiliated financial institutions. These arrangements allow us to sell, on an ongoing basis, certain trade receivables without recourse. The trade receivables sold are generally short-term in nature and are removed from the condensed consolidated balance sheets. We sell trade receivables under two types of arrangements, servicing and nonservicing.

PMI's operating cash flows were positively impacted by the amount of the trade receivables sold and derecognized from the condensed consolidated balance sheets, which remained outstanding with the unaffiliated financial institutions. The trade receivables sold that remained outstanding under these arrangements as of September 30, 2016, and September 30, 2015 were $0.7 billion and $0.2 billion, respectively. The net proceeds received are included in cash provided by operating activities in the condensed consolidated statements of cash flows.

For further details, see Note 17. Sale of Accounts Receivable to our condensed consolidated financial statements.

Debt – Our total debt was $30.1 billion at September 30, 2016 and $28.5 billion at December 31, 2015.

On February 21, 2014, we filed a shelf registration statement with the U.S. Securities and Exchange Commission, under which we may from time to time sell debt securities and/or warrants to purchase debt securities over a three-year period.
Our debt issuances in the first nine months of 2016 were as follows:
(in millions)

Type	Face Value	Interest Rate	Issuance	Maturity
U.S. dollar notes [a]	$500	1.375%	February 2016	February 2019
U.S. dollar notes [a]	$750	1.875%	February 2016	February 2021
U.S. dollar notes [a]	$750	2.750%	February 2016	February 2026
U.S. dollar notes [b]	$500	2.125%	May 2016	May 2023
U.S. dollar notes [b]	$500	4.250%	May 2016	[d] November 2044
EURO notes [c]	€500 (approximately $578)	2.000%	May 2016	May 2036

[a] Interest on these notes is payable semi-annually in arrears beginning in August 2016.
[b] Interest on these notes is payable semi-annually in arrears beginning in November 2016.
[c] Interest on these notes is payable annually in arrears beginning in May 2017.
[d] These notes are a further issuance of the 4.25% notes issued by PMI in November 2014.
The net proceeds from the sale of the securities listed in the table above has been and will be used for general corporate purposes.
Guarantees – At September 30, 2016, we were contingently liable for $0.7 billion of guarantees of our own performance, which were primarily related to excise taxes on the shipment of our products. There is no liability in the condensed consolidated financial statements associated with these guarantees. At September 30, 2016, our third-party guarantees were insignificant.

Equity and Dividends

In May 2012, our stockholders approved the Philip Morris International Inc. 2012 Performance Incentive Plan (the "2012 Plan"). Under the 2012 Plan, we may grant to eligible employees restricted stock, restricted stock units and deferred stock units (collectively referred to as restricted share units), performance-based cash incentive awards and performance-based equity awards. Up to 30 million shares of our common stock may be issued under the 2012 Plan. At September 30, 2016, shares available for grant under the 2012 Plan were 21,180,030.

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As discussed in Note 3. Stock Plans to our condensed consolidated financial statements, during the nine months ended September 30, 2016, we granted 1.2 million shares of restricted share units ("RSU") awards to eligible employees at a weighted-average grant date fair value of $89.03 per share. During the same period, we also granted 0.4 million shares of performance share units ("PSU") awards to certain executives.

On August 1, 2012, we began repurchasing shares under a three-year $18.0 billion share repurchase program that was authorized by our Board of Directors in June 2012. From August 1, 2012 through December 31, 2014, we repurchased 144.6 million shares of our common stock at a cost of $12.7 billion under this repurchase program. Our authorized three-year share repurchase program of $18 billion expired in August 2015. During 2015, we did not repurchase any shares under this program. On February 4, 2016, we announced that we do not plan any share repurchases in 2016. Dividends paid in the first nine months of 2016 were $4.8 billion. During the third quarter of 2016, our Board of Directors approved a 2.0% increase in the quarterly dividend to $1.04 per common share. As a result, the present annualized dividend rate is $4.16 per common share.

Market Risk

Counterparty Risk - We predominantly work with financial institutions with strong short- and long-term credit ratings as assigned by Standard & Poor’s and Moody’s. These banks are also part of a defined group of relationship banks. Non-investment grade institutions are only used in certain emerging markets to the extent required by local business needs. We have a conservative approach when it comes to choosing financial counterparties and financial instruments. As such we do not invest or hold investments in any structured or equity-linked products. The majority of our cash and cash equivalents is currently invested in bank deposits maturing within less than 30 days.

We continuously monitor and assess the credit worthiness of all our counterparties.

Derivative Financial Instruments - We operate in markets outside of the United States of America, with manufacturing and sales facilities in various locations throughout the world. Consequently, we use certain financial instruments to manage our foreign currency and interest rate exposure. We use derivative financial instruments principally to reduce our exposure to market risks resulting from fluctuations in foreign exchange rates by creating offsetting exposures. We are not a party to leveraged derivatives and, by policy, do not use derivative financial instruments for speculative purposes.

See Note 6. Financial Instruments, Note 12. Fair Value Measurements, and Note 14. Balance Sheet Offsetting to our condensed consolidated financial statements for further details on our derivative financial instruments and the related collateral arrangements.

Contingencies

See Note 9. Contingencies to our condensed consolidated financial statements for a discussion of contingencies.

Cautionary Factors That May Affect Future Results

Forward-Looking and Cautionary Statements

We may from time to time make written or oral forward-looking statements, including statements contained in filings with the SEC, in reports to stockholders 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.

We 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 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 our securities. In connection with the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995, we are identifying important factors that, individually or in the aggregate, could cause actual results and outcomes to differ materially from those contained in any forward-looking statements made by us; any such statement is qualified by reference to the following cautionary statements. We elaborate on these and other risks we face throughout this document, particularly in the "Business Environment" section. You should understand that it is not possible to predict or identify all risk factors. Consequently, you should not consider the following to be a complete discussion of all potential risks or uncertainties.

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We do not undertake to update any forward-looking statement that we may make from time to time, except in the normal course of our public disclosure obligations.

Risks Related to Our Business and Industry

Consumption of tax-paid cigarettes continues to decline in many of our markets.

This decline is due to multiple factors, including increased taxes and pricing, governmental actions, the diminishing social acceptance of smoking, continuing economic and geopolitical uncertainty, and the continuing prevalence of illicit products. These factors and their potential consequences are discussed more fully below and in the "Business Environment" section.

Cigarettes are subject to substantial taxes. Significant increases in cigarette-related taxes have been proposed or enacted and are likely to continue to be proposed or enacted in numerous jurisdictions. These tax increases may disproportionately affect our profitability and make us less competitive versus certain of our competitors.

Tax regimes, including excise taxes, sales taxes and import duties, can disproportionately affect the retail price of cigarettes versus other tobacco products, or disproportionately affect the relative retail price of our cigarette brands versus cigarette brands manufactured by certain of our competitors. Because our portfolio is weighted toward the premium-price cigarette category, tax regimes based on sales price can place us at a competitive disadvantage in certain markets. As a result, our volume and profitability may be adversely affected in these markets.

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 tobacco products and from the premium-price to the mid-price or low-price cigarette categories, where we may be under-represented, from local sales to legal cross-border purchases of lower price products, or to illicit products such as contraband, counterfeit and "illicit whites."

Our business faces significant governmental action aimed at increasing regulatory requirements with the goal of reducing or preventing the use of tobacco products.

Governmental actions, combined with the diminishing social acceptance of smoking and private actions to restrict smoking, have resulted in reduced industry volume in many of our markets, and we expect that such factors will continue to reduce consumption levels and will increase down-trading and the risk of counterfeiting, contraband, "illicit whites" and legal cross-border purchases. Significant regulatory developments will take place over the next few years in most of our markets, driven principally by the FCTC. The FCTC is the first international public health treaty on tobacco, and its objective is to establish a global agenda for tobacco regulation. The FCTC has led to increased efforts by tobacco control advocates and public health organizations to reduce the palatability and attractiveness of tobacco products to adult smokers. Regulatory initiatives that have been proposed, introduced or enacted include:

- restrictions on or licensing of outlets permitted to sell cigarettes;
- the levying of substantial and increasing tax and duty charges;
- restrictions or bans on advertising, marketing and sponsorship;
- the display of larger health warnings, graphic health warnings and other labeling requirements;
- restrictions on packaging design, including the use of colors, and plain packaging;
- restrictions on packaging and cigarette formats and dimensions;
- restrictions or bans on the display of tobacco product packaging at the point of sale and restrictions or bans on cigarette vending machines;
- requirements regarding testing, disclosure and performance standards for tar, nicotine, carbon monoxide and other smoke constituents;
- disclosure, restrictions, or bans of tobacco product ingredients;
- increased restrictions on smoking in public and work places and, in some instances, in private places and outdoors;
- restrictions on the sale of novel tobacco or nicotine-containing products;
- elimination of duty free sales and duty free allowances for travelers; and
- encouraging litigation against tobacco companies.

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Our operating income could be significantly affected by regulatory initiatives resulting in a significant decrease in demand for our brands, in particular requirements that lead to a commoditization of tobacco products, as well as any significant increase in the cost of complying with new regulatory requirements.

Litigation related to tobacco use and exposure to environmental tobacco smoke could substantially reduce our profitability and could severely impair our liquidity.

There is litigation related to tobacco products pending in certain jurisdictions. Damages claimed in some tobacco-related litigation are significant and, in certain cases in Brazil, Canada and Nigeria, range into the billions of U.S. dollars. We anticipate that new cases will continue to be filed. The FCTC encourages litigation against tobacco product manufacturers. It is possible that our consolidated results of operations, cash flows or financial position could be materially affected in a particular fiscal quarter or fiscal year by an unfavorable outcome or settlement of certain pending litigation. Please see Note 9. Contingencies to our condensed consolidated financial statements for a discussion of pending litigation.

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 on the basis of product quality, brand recognition, brand loyalty, taste, innovation, packaging, service, marketing, advertising and 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. Competitors include three large international tobacco companies and several regional and local tobacco companies and, in some instances, state-owned tobacco enterprises, principally in Algeria, the People's Republic of China, Egypt, Taiwan, Thailand and Vietnam. Industry consolidation and privatizations of state-owned enterprises have led to an overall increase in competitive pressures. Some competitors have different profit and volume objectives and some international competitors are susceptible to changes in different currency exchange rates.

Because we have operations in numerous countries, our results may be influenced by economic, regulatory and political developments, natural disasters or conflicts.

Some of the countries in which we operate face the threat of civil unrest and can be subject to regime changes. In others, nationalization, terrorism, conflict and the threat of war may have a significant impact on the business environment. Economic, political, regulatory or other developments or natural disasters could disrupt our supply chain, manufacturing capabilities or distribution capabilities. In addition, such developments could lead to loss of property or equipment that are critical to our business in certain markets and difficulty in staffing and managing our operations, which could reduce our volumes, revenues and net earnings.

There is an increasing number of conflicts, including in the Middle East and Ukraine. Political uncertainty, including potential effects from economic sanctions by the U.S. or other governments, could lead to significant disruptions to our business.

In certain markets, we are dependent on governmental approvals of various actions such as price changes, and failure to obtain such approvals could impair growth in our profitability.

In addition, despite our high ethical standards and rigorous control and compliance procedures aimed at preventing and detecting unlawful conduct, given the breadth and scope of our international operations, we may not be able to detect all potential improper or unlawful conduct by our employees and international partners.

We may be unable to anticipate changes in consumer preferences or to respond to consumer behavior influenced by 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;

- develop new products and markets and broaden brand portfolios;
- improve productivity; and
- be able to protect or enhance margins through price increases.

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In periods of economic uncertainty, consumers may tend to purchase lower-price brands, and the volume of our premium-price and mid-price brands and our profitability could suffer accordingly. Such down-trading trends may be reinforced by regulation that limits branding, communication and product differentiation.

We lose revenues as a result of counterfeiting, contraband, cross-border purchases and non-tax-paid volume produced by local manufacturers.

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, legal cross-border purchases and non-tax-paid volume produced by local manufacturers.

From time to time, we are subject to governmental investigations on a range of matters.

Investigations include allegations of contraband shipments of cigarettes, allegations of unlawful pricing activities within certain markets, allegations of underpayment of customs duties and/or excise taxes, allegations of false and misleading usage of descriptors and allegations of unlawful advertising. We cannot predict the outcome of those investigations or whether additional investigations may be commenced, and it is possible that our business could be materially affected by an unfavorable outcome of pending or future investigations. See “Management's Discussion and Analysis of Financial Condition and Results of Operations-Operating Results by Business Segment-Business Environment-Governmental Investigations” for a description of certain governmental investigations to which we are subject.

We may be unsuccessful in our attempts to introduce Reduced-Risk Products, and regulators may not permit reduced exposure or risk claims or the commercialization of these products.

We continue to seek ways to develop commercially viable new product technologies with the potential to reduce exposure to harmful constituents in smoke and individual risk and population harm, all in comparison to smoking cigarettes. Our goal is to develop and commercialize products whose potential to reduce exposure to harmful and potentially harmful constituents, individual risk and population harm can be substantiated by rigorous scientific studies and that provide adult smokers the taste, sensory experience, nicotine delivery profile and ritual characteristics that are similar to those currently provided by cigarettes. We may not succeed in these efforts. If we do not succeed, but others do, we may be at a competitive disadvantage. Furthermore, we cannot predict whether regulators will permit the marketing of tobacco products or other nicotine-containing products with claims of reduced exposure or risk as compared with smoking cigarettes. A prohibition on any such claims could significantly undermine the commercial viability of these products.

Our reported results could be adversely affected by unfavorable currency exchange rates, and currency devaluations could impair our competitiveness.

We conduct our business primarily in local currency and, for purposes of financial reporting, the local currency results are translated into U.S. dollars based on average exchange rates prevailing during a reporting period. During times of a strengthening U.S. dollar, our reported net revenues and operating income will be reduced because the local currency translates into fewer U.S. dollars. During periods of local economic crises, foreign currencies may be devalued significantly against the U.S. dollar, reducing our margins. Actions to recover margins may result in lower volume and a weaker competitive position.

The repatriation of our foreign earnings, changes in the earnings mix, and changes in U.S. tax laws may increase our effective tax rate. Our ability to receive payments from foreign subsidiaries or to repatriate royalties and dividends could be restricted by local country currency exchange controls.

Because we are a U.S. holding company, our most significant source of funds is distributions from our non-U.S. subsidiaries. Under current U.S. tax law, in general we do not pay U.S. taxes on our foreign earnings until they are repatriated to the U.S. as distributions from our non-U.S. subsidiaries. These distributions may result in a residual U.S. tax cost. It may be advantageous to us in certain circumstances to significantly increase the amount of such distributions, which could result in a material increase in our overall effective tax rate. Additionally, the Obama

Administration has indicated that it favors changes in U.S. tax law that would fundamentally change how our earnings are taxed in the U.S. If enacted and depending upon its precise terms, such legislation could increase our overall effective tax rate. Certain countries in which we operate have adopted or could institute currency exchange controls that limit or prohibit our local subsidiaries' ability to convert local currency into U.S. dollars or to make payments outside the country. This could subject us to the risks of local currency devaluation and business disruption.

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Our ability to grow profitability may be limited by our inability to introduce new products, enter new markets or improve our margins through higher pricing and improvements in our brand and geographic mix.
Our profit growth may suffer if we are unable to introduce new products or enter new markets successfully, to raise prices or to improve the proportion of our sales of higher margin products and in higher margin geographies.

We may be unable to expand our brand portfolio through successful acquisitions or the development of strategic business relationships.
One element of our growth strategy is to strengthen our brand portfolio and market positions through selective acquisitions and the development of strategic business relationships. Acquisition and strategic business development opportunities are limited and present risks of failing to achieve efficient and effective integration, strategic objectives and anticipated revenue improvements and cost savings. There is no assurance that we will be able to acquire attractive businesses on favorable terms, or that future acquisitions or strategic business developments will be accretive to earnings.
Government mandated prices, production control programs, shifts in crops driven by economic conditions and the impact of climate change may increase the cost or reduce the quality of the tobacco and other agricultural products used to manufacture our products.
As with other agricultural commodities, the price of tobacco leaf and cloves can be influenced by imbalances in supply and demand, and crop quality can be influenced by variations in weather patterns, including those caused by climate change. Tobacco production in certain countries is subject to a variety of controls, including government mandated prices and production control programs. Changes in the patterns of demand for agricultural products could cause farmers to plant less tobacco. Any significant change in tobacco leaf and clove prices, quality and quantity could affect our profitability and our business.
Our ability to implement our strategy of attracting and retaining the best global talent may be impaired by the decreasing social acceptance of cigarette smoking.
The tobacco industry competes for talent with consumer products and other companies that enjoy greater societal acceptance. As a result, we may be unable to attract and retain the best global talent.
The failure of our information systems to function as intended or their penetration by outside parties with the intent to corrupt them could result in business disruption, litigation and regulatory action, and loss of revenue, assets or personal or other sensitive data.
We use information systems to help manage business processes, collect and interpret business data and communicate internally and externally with employees, suppliers, customers and others. Some of these information systems are managed by third-party service providers. We have backup systems and business continuity plans in place, and we take care to protect our systems and data from unauthorized access. Nevertheless, failure of our systems to function as intended, or penetration of our systems by outside parties intent on extracting or corrupting information or otherwise disrupting business processes, could result in loss of revenue, assets or personal or other sensitive data, litigation and regulatory action, cause damage to our reputation and that of our brands and result in significant remediation and other costs to us.
We may be required to replace third-party contract manufacturers or service providers with our own resources.

In certain instances, we contract with third parties to manufacture some of our products or product parts or to provide other services. We may be unable to renew these agreements on satisfactory terms for numerous reasons, including government regulations. Accordingly, our costs may increase significantly if we must replace such third parties with our own resources.

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Item 4. Controls and Procedures.

PMI carried out an evaluation, with the participation of PMI’s management, including PMI’s Chief Executive Officer and Chief Financial Officer, of the effectiveness of PMI’s disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based upon that evaluation, PMI’s Chief Executive Officer and Chief Financial Officer concluded that PMI’s disclosure controls and procedures are effective. There have been no changes in PMI’s internal control over financial reporting during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, PMI’s internal control over financial reporting.

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Part II - OTHER INFORMATION

Item 1. Legal Proceedings.

See Note 9. Contingencies of the Notes to the Condensed Consolidated Financial Statements included in Part I – Item 1 of this report for a discussion of legal proceedings pending against Philip Morris International Inc. and its subsidiaries.

Item 1A. Risk Factors.

Information regarding Risk Factors appears in “MD&A – Cautionary Factors That May Affect Future Results,” in Part I – Item 2 of this Form 10-Q and in Part I – Item 1A. Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2015. There have been no material changes to the risk factors disclosed in our Annual Report on Form 10-K.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Our share repurchase activity for each of the three months in the quarter ended September 30, 2016 was as follows:

Period	Total Number of Shares Repurchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)	Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs
July 1, 2016 – July 31, 2016 (1)	—	$ —	—	$ —
August 1, 2016 – August 31, 2016 (1)	—	$ —	—	$ —
September 1, 2016 – September 30, 2016 (1)	—	$ —	—	$ —
Pursuant to Publicly Announced Plans or Programs	—	$ —		
July 1, 2016 – July 31, 2016 (3)	1,649	$ 100.42		
August 1, 2016 – August 31, 2016 (3)	1,585	$ 99.62		
September 1, 2016 – September 30, 2016 (3)	1,562	$ 99.27		
For the Quarter Ended September 30, 2016	4,796	$ 99.78		

(1) Our authorized three-year share repurchase program of $18 billion expired in August 2015. During this reporting period, we did not have an authorized share repurchase program.

(2) Aggregate number of shares repurchased under the above-mentioned share repurchase program as of the end of the period presented.

(3) Shares repurchased represent shares tendered to us by employees who vested in restricted share unit awards and used shares to pay all, or a portion of, the related taxes.

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Item 6. Exhibits.

10.1	Extension Agreement, effective as of October 1, 2016, to the Credit Agreement, dated as of October 1, 2015, among Philip Morris International Inc., the lenders named therein, Citibank Europe PLC, UK Branch (formerly, Citibank International Limited), as Facility Agent, and Citibank, N.A., as Swingline Agent (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed August 31, 2016).
12	Statement regarding computation of ratios of earnings to fixed charges.
31.1	Certification of the Registrant's Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Registrant's Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Registrant's Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of the Registrant's Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase.
101.DEF	XBRL Taxonomy Extension Definition Linkbase.
101.LAB	XBRL Taxonomy Extension Label Linkbase.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase.

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Signature

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PHILIP MORRIS INTERNATIONAL INC.

/s/ JACEK OLCZAK

Jacek Olczak
Chief Financial Officer

October 25, 2016