Philip Morris International Inc.
Form 10-K
February 14, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 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)

917-663-2000
(Registrant’s telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, no par value	New York Stock Exchange
1.625% Notes due 2017	New York Stock Exchange
1.250% Notes due 2017	New York Stock Exchange
1.125% Notes due 2017	New York Stock Exchange
1.250% Notes due 2017	New York Stock Exchange
5.650% Notes due 2018	New York Stock Exchange
1.875% Notes due 2019	New York Stock Exchange
1.375% Notes due 2019	New York Stock Exchange
2.125% Notes due 2019	New York Stock Exchange
1.750% Notes due 2020	New York Stock Exchange
4.500% Notes due 2020	New York Stock Exchange
1.875% Notes due 2021	New York Stock Exchange
1.875% Notes due 2021	New York Stock Exchange
4.125% Notes due 2021	New York Stock Exchange
2.900% Notes due 2021	New York Stock Exchange
2.500% Notes due 2022	New York Stock Exchange
2.625% Notes due 2023	New York Stock Exchange
2.125% Notes due 2023	New York Stock Exchange
3.600% Notes due 2023	New York Stock Exchange
2.875% Notes due 2024	New York Stock Exchange
3.250% Notes due 2024	New York Stock Exchange
2.750% Notes due 2025	New York Stock Exchange

Title of each class	Name of each exchange on which registered
3.375% Notes due 2025	New York Stock Exchange
2.750% Notes due 2026	New York Stock Exchange
2.875% Notes due 2026	New York Stock Exchange
2.875% Notes due 2029	New York Stock Exchange
3.125% Notes due 2033	New York Stock Exchange
2.000% Notes due 2036	New York Stock Exchange
6.375% Notes due 2038	New York Stock Exchange
4.375% Notes due 2041	New York Stock Exchange
4.500% Notes due 2042	New York Stock Exchange
3.875% Notes due 2042	New York Stock Exchange
4.125% Notes due 2043	New York Stock Exchange
4.875% Notes due 2043	New York Stock Exchange
4.250% Notes due 2044	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No ¨
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No þ
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 website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨
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 Act). Yes ¨ No þ

As of June 30, 2016, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was approximately $158 billion based on the closing sale price of the common stock as reported on the New York Stock Exchange.

Class	Outstanding at January 31, 2017
Common Stock, no par value	1,551,385,884 shares

DOCUMENTS INCORPORATED BY REFERENCE

Document	Parts Into Which Incorporated

Portions of the registrant’s definitive proxy statement for use in connection with its annual meeting of shareholders to be held on May 3, 2017, to be filed with the Securities and Exchange Commission (“SEC”) on or about March 23, 2017.	Part III

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In this report, “PMI,” “we,” “us” and “our” refers to Philip Morris International Inc. and its subsidiaries.

PART I

Item 1. Business.

(a) General Development of Business

General

Philip Morris International Inc. is a Virginia holding company incorporated in 1987. Our 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. 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.

Our portfolio of international and local brands is led by Marlboro, the world's best-selling international cigarette, which accounted for approximately 35% of our total 2016 shipment volume. Marlboro is complemented in the premium-price category by Parliament and Virginia S. Our leading mid-price brands are L&M, Lark, Merit, Muratti and Philip Morris. Other leading international brands include Bond Street, Chesterfield, Next and Red & White.

We also own a number of important local cigarette brands, such as Dji Sam Soe, Sampoerna and U Mild in Indonesia; Champion, Fortune and Jackpot in the Philippines; Apollo-Soyuz and Optima in Russia; Morven Gold in Pakistan; Boston in Colombia; Belmont, Canadian Classics and Number 7 in Canada; f6 in Germany; Delicados in Mexico; Assos in Greece, and Petra in the Czech Republic and Slovakia. While there are a number of markets where local brands remain important, international brands are expanding their share in numerous markets. With international brands contributing approximately 77% of our shipment volume in 2016, we are well positioned to continue to benefit from this trend.

In addition to the manufacture and sale of cigarettes and other tobacco products, we are engaged in the development and commercialization of Reduced-Risk Products ("RRPs"). RRPs is the term we use to refer to products that present, are likely to present, or have the potential to present less risk of harm to smokers who switch to these products versus continued smoking. We have a range of RRPs in various stages of development, scientific assessment and commercialization. Because our RRPs do not burn tobacco, they produce far lower quantities of harmful and potentially harmful compounds than found in cigarette smoke. Further details on our RRPs are described in the Research and Development section below and Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of this Annual Report on Form 10-K ("Item 7"), Business Environment — Reduced-Risk Products.

Separation from Altria Group, Inc.

We were a wholly owned subsidiary of Altria Group, Inc. ("Altria") until the distribution of all of our shares owned by Altria (the "Spin-off") was made on March 28, 2008 (the "Distribution Date").

Acquisitions and Other Business Arrangements

Details about our acquisitions and other business arrangements are described in Item 8. Financial Statements and Supplementary Data of this Annual Report on Form 10-K ("Item 8") in Note 6. Acquisitions and Other Business Arrangements to our consolidated financial statements.

Source of Funds — Dividends

We are 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.

(b) Financial Information About Segments

We divide our markets into four geographic regions, which constitute our segments for financial reporting purposes:

- The European Union ("EU") Region is headquartered in Lausanne, Switzerland, and covers all the EU countries and also comprises Switzerland, Norway and Iceland, which are linked to the EU through trade agreements;
- The Eastern Europe, Middle East & Africa ("EEMA") Region is also headquartered in Lausanne and includes Eastern Europe, certain Balkan countries, Turkey, the Middle East and Africa and our international duty free business;
- The Asia Region is headquartered in Hong Kong and covers all other Asian markets as well as Australia, New Zealand and the Pacific Islands; and
- The Latin America & Canada Region is headquartered in New York and covers the South American continent, Central America, Mexico, the Caribbean and Canada.

Net revenues and operating companies income* (together with a reconciliation to operating income) attributable to each segment for each of the last three years are set forth in Note 12. Segment Reporting to the consolidated financial statements in Item 8. See Item 7 of this Annual Report on Form 10-K for a discussion of our operating results by business segment.

The relative percentages of operating companies income attributable to each reportable segment were as follows:

	2016	2015	2014
European Union	35.8 %	32.6 %	31.6 %
Eastern Europe, Middle East & Africa	27.1	31.2	33.5
Asia	28.7	26.3	26.4
Latin America & Canada	8.4	9.9	8.5
	100.0%	100.0%	100.0%

* Our management evaluates segment performance and allocates 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. The accounting policies of the segments are the same as those described in Note 2. Summary of Significant Accounting Policies to the consolidated financial statements in Item 8.

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 local governments, and, in those circumstances, we include excise taxes in our net revenues and 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.

(c) Narrative Description of Business

Our subsidiaries and affiliates and their licensees are engaged in the manufacture, market and sale of cigarettes, other tobacco products and other nicotine-containing products in markets outside the United States of America.

Our total cigarette shipments decreased by 4.1% in 2016 to 812.9 billion units. We estimate that international cigarette market shipments were approximately 5.3 trillion units in 2016, a 3.0% decrease over 2015. We estimate that our reported share of the international cigarette market (which is defined as worldwide cigarette volume, excluding the United States of America) was approximately 15.3% in 2016, 15.5% in 2015 and 15.4% in 2014. Excluding the People's Republic of China ("PRC"), we estimate that our reported share of the international cigarette market was approximately 27.9%, 28.5%, and 28.3% in 2016, 2015 and 2014, respectively.

Shipments of our principal cigarette brand, Marlboro, decreased by 1.4% in 2016 and represented approximately 9.6% of the international cigarette market, excluding the PRC, in 2016, 9.6% in 2015 and 9.4% in 2014.

We have a cigarette market share of at least 15% and, in a number of instances, substantially more than 15%, in approximately 100 markets, including Algeria, Argentina, Australia, Austria, Belgium, Canada, the Czech Republic, France, Germany, Hong Kong, Indonesia, Israel, Italy, Japan, Korea, Kuwait, Mexico, the Netherlands, Norway, the Philippines, Poland, Portugal, Russia, Saudi Arabia, Spain, Switzerland, Thailand, Turkey and United Arab Emirates.

The term IQOS Consumables refers to the consumable used in our IQOS device. Total shipment volume of IQOS Consumables reached 7.4 billion units, up from 396 million units during the year ended December 31, 2015.

Our other tobacco products ("OTP") primarily include tobacco for roll-your-own and make-your-own cigarettes, pipe tobacco, cigars and cigarillos, and do not include Reduced-Risk Products. Total shipment volume of OTP, in cigarette equivalent units, decreased by 4.5% to 32.6 billion units.

References to total international cigarette market, defined as worldwide cigarette volume excluding the United States, total cigarette market, total market and market shares in this Form 10-K are our tax-paid estimates based on the latest available data from a number of internal and external sources.

Consumer Focused Marketing & Sales

In 2016, we continued to deploy our new strategic framework that combines our marketing and sales expertise with our in-depth knowledge of various sales territories. This framework allows us not only to engage more effectively with our adult smokers but also to enhance the success of our direct and indirect trade partners. The main benefits are:

- Improved effectiveness of direct adult smoker engagement activities;
- More effective communication with our retailers about our brands;
- Increased speed, efficiency and widespread availability of our products; and
- Distribution and Sales Strategies and Trade Engagement Programs tailored to the individual characteristics of each market.

The four main types of distribution that we use globally, often simultaneously in a given market, are:

- Direct Sales and Distribution, where we have set up our own distribution selling directly to the retailers;
- Distribution through Independent Distributors who also are distributing other fast-moving consumer goods and are responsible for distribution in a single market;
- Exclusive Zonified Distribution, where the distributors are dedicated to us in tobacco products distribution and assigned to exclusive territories within a market, enabling them to get an appropriate return on their investment; and
- Distribution through national or regional wholesalers that then supply the retail trade.

In many markets we also directly supply key accounts, including gas stations, retail chains and supermarkets.

Our distribution and sales systems are supported by sales forces that total approximately 19,800 employees worldwide. Our sales forces are well trained and recognized by trade surveys for their professionalism.

Our products are marketed and promoted through various media and channels, including, where permitted by law, point of sale communications, brand events, access-restricted websites and printed and direct communication to verified adult smokers. Our direct communication with verified adult smokers utilizes mail, e-mail and other electronic communication tools. Promotional activities include, where permitted by law, competitions, invitations to events, interactive programs, consumer premiums and price promotions. To support advertising and promotional activities in the markets, we have a dedicated consumer engagement group that develops innovative engagement tools for adult smokers based on the latest technologies and adult smoker trends. In addition, we developed digital and non-digital engagement programs for retailers.

Our IQOS distribution strategy is tailored to the individual characteristic of each market. We have adopted a scalable strategy for the IQOS commercialization focused on retail experience, guided consumer trials and customer care. We are also developing several ways to connect with adult smokers through digital communication tools such as mobile apps in several markets.

Competition

We are subject to highly competitive conditions in all aspects of our business. We compete primarily on the basis of product quality, brand recognition, brand loyalty, taste, innovation, packaging, service, marketing, advertising and retail price. Our 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, Egypt, the PRC, 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. We predominantly sell American blend cigarette brands, such as Marlboro, L&M, Parliament and Chesterfield, which are the most popular across many of our markets. We seek to compete in all profitable retail price categories, although our brand portfolio is weighted towards the premium-price category.

Procurement and Raw Materials

We purchase tobacco leaf of various types, grades and styles throughout the world, mostly through independent tobacco suppliers. We also contract directly with farmers in several countries, including Argentina, Brazil, Colombia, Ecuador, Italy, Kazakhstan, Pakistan, the Philippines and Poland. Direct sourcing from farmers represents approximately 17% of PMI’s global leaf requirements. The largest supplies of tobacco leaf are sourced from Brazil, Indonesia (mostly for domestic use in kretek products), China, Malawi, India, the United States, Mozambique, Argentina, Philippines and Tanzania.

We believe that there is an adequate supply of tobacco leaf in the world markets to satisfy our current and anticipated production requirements.

In addition to tobacco leaf, we purchase a wide variety of direct materials from a total of approximately 450 suppliers. Our top ten suppliers of direct materials combined represent approximately 50% of our total direct materials purchases. The three most significant direct materials that we purchase are printed paper board used in packaging, acetate tow used in filter making and fine paper used in cigarette manufacturing. In addition, the adequate supply and procurement of cloves are of particular importance to our Indonesian business.

Business Environment

Information called for by this Item is hereby incorporated by reference to the paragraphs in Item 7, Business Environment.

Other Matters

Customers

None of our business segments is dependent upon a single customer or a few customers, the loss of which would have a material adverse effect on our consolidated results of operations.

Employees

At December 31, 2016, we employed approximately 79,500 people worldwide, including employees under temporary contracts and hourly paid part-time staff. Our businesses are subject to a number of laws and regulations relating to our relationship with our employees. Generally, these laws and regulations are specific to the location of each business. In addition, in accordance with European Union requirements, we have established a European Works

Council composed of management and elected members of our workforce. We believe that our relations with our employees and their representative organizations are excellent.

Executive Officers of the Registrant

The disclosure regarding executive officers is set forth under the heading “Executive Officers as of February 14, 2017” in Item 10. Directors, Executive Officers and Corporate Governance of this Annual Report on Form 10-K ("Item 10").

Research and Development

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 providing a better choice for those who would otherwise continue to smoke. We recognize that no single product will appeal to all adult smokers. Therefore, we are developing a portfolio of products intended to appeal to a variety of distinct tastes. Four RRP platforms are in various stages of development and commercialization readiness. We describe each of them in more detail in Item 7, Business Environment—Reduced-Risk Products.

The research and development expense for the years ended December 31, 2016, 2015 and 2014, is set forth in Item 8, Note 14. Additional Information to the consolidated financial statements.

Intellectual Property

Our trademarks are valuable assets, and their protection and reputation are essential to us. We own the trademark rights to all of our principal brands, including Marlboro, or have the right to use them in all countries where we use them.

In addition, we have more than 5,900 granted patents worldwide and approximately 6,400 pending patent applications. Our patent portfolio, as a whole, is material to our business. However, no one patent, or group of related patents, is material to us. We also have registered industrial designs and proprietary secrets, technology, know-how, processes and other intellectual property rights that are not registered.

Effective January 1, 2008, PMI entered into an Intellectual Property Agreement with Philip Morris USA Inc. ("PM USA"). The Intellectual Property Agreement governs the ownership of intellectual property between PMI and PM USA. Ownership of the jointly funded intellectual property has been allocated as follows:

- PMI owns all rights to the jointly funded intellectual property outside the United States, its territories and possessions; and
- PM USA owns all rights to the jointly funded intellectual property in the United States, its territories and possessions.

Ownership of intellectual property related to patent applications and resulting patents based solely on the jointly funded intellectual property, regardless of when filed or issued, will be exclusive to PM USA in the United States, its territories and possessions and exclusive to PMI everywhere else.

The Intellectual Property Agreement contains provisions concerning intellectual property that is independently developed by us or PM USA following the Distribution Date. For ten years following the Distribution Date, independently developed intellectual property may be subject to rights under certain circumstances that would allow either us or PM USA a priority position to obtain the rights to the new intellectual property from the other party, with the price and other commercial terms to be negotiated.

In the event of a dispute between us and PM USA under the Intellectual Property Agreement, we have agreed with PM USA to submit the dispute first to negotiation between our and PM USA's senior executives and then to binding arbitration.

Seasonality

Our business segments are not significantly affected by seasonality, although in certain markets cigarette consumption trends rise during the summer months due to longer daylight time and tourism.

Environmental Regulation

We are subject to international, national and local environmental laws and regulations in the countries in which we do business. We have specific programs across our business units designed to meet applicable environmental compliance requirements and reduce our carbon footprint and wastage as well as water and energy consumption. We report externally about our climate change mitigation strategy, together with associated targets and results in reducing our carbon footprint, through CDP (formerly, the Carbon Disclosure Project), the leading international non-governmental organization assessing the work of thousands of companies worldwide in the area of climate change. We have developed and implemented a consistent environmental and occupational health, safety and security management system ("EHSS"), which involves policies, standard practices and procedures at all our manufacturing centers. We also conduct regular safety assessments at our offices, warehouses and car fleet organizations. Furthermore, we have engaged an external certification body to validate the effectiveness of our EHSS management system at our manufacturing centers around the world, in accordance with internationally recognized standards for safety and environmental management. The environmental performance data we report externally is also verified by a qualified third party. Our subsidiaries expect to continue to make investments in order to drive improved performance and maintain compliance with environmental laws and regulations. We assess and report the compliance status of all our legal entities on a regular basis. Based on the management and controls we have in place and our review of climate change risks (both physical and regulatory), environmental expenditures have not had, and are not expected to have, a material adverse effect on our consolidated results of operations, capital expenditures, financial position, earnings or competitive position.

(d) Financial Information About Geographic Areas

The amounts of net revenues and long-lived assets attributable to each of our geographic segments for each of the last three fiscal years are set forth in Item 8, Note 12. Segment Reporting to the consolidated financial statements.

(e) Available Information

We are required to file with the SEC annual, quarterly and current reports, proxy statements and other information required by the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Investors may read and copy any document that we file, including this Annual Report on Form 10-K, at the SEC’s Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Investors may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet website at http://www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC, from which investors can electronically access our SEC filings.

We make available free of charge on, or through, our website at www.pmi.com our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Investors can access our filings with the SEC by visiting www.pmi.com.

The information on our website is not, and shall not be deemed to be, a part of this report or incorporated into any other filings we make with the SEC.

Item 1A. Risk Factors.

The following risk factors should be read carefully in connection with evaluating our business and the forward-looking statements contained in this Annual Report on Form 10-K. Any of the following risks could materially adversely affect our business, our operating results, our financial condition and the actual outcome of matters as to which forward-looking statements are made in this Annual Report on Form 10-K.

Forward-Looking and Cautionary Statements

We may from time to time make written or oral forward-looking statements, including statements contained in this Annual Report on Form 10-K and other 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 Item 7, Business Environment. 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. 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 Item 7, Business Environment.

- 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 World Health Organization's Framework Convention on Tobacco Control ("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 promote increasingly restrictive regulatory measures on the marketing and sale 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.

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. See Item 3. Legal Proceedings and Item 8, Financial Statements and Supplementary Data, Note 19. Contingencies 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 PRC, 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.

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;
- ensure adequate production capacity to meet demand for our products; and
- be able to protect or enhance margins through price increases.

In periods of economic uncertainty, 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 Item 3, Legal Proceedings-Other Litigation and Item 7, 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 the commercialization of these products or health-related claims.

Our key strategic priorities are: to develop and commercialize products that present less risk of harm to adult smokers who switch to those products versus continued smoking; and to convince current adult smokers who would otherwise continue to smoke to switch to those RRPs. For our efforts to be successful, we must: develop RRPs that such adult smokers find acceptable alternatives to smoking; conduct rigorous scientific studies to substantiate that they reduce exposure to harmful and potentially harmful constituents in smoke and, ultimately, that these products present, are likely to present, or have the potential to present less risk of harm to adult smokers who switch to them versus continued smoking; and effectively advocate for the development of science-based regulatory frameworks for the development and commercialization of RRPs, including communication of scientifically substantiated information to enable adult consumers to make better health choices. We might not succeed in our 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 sale and/or marketing of RRPs with health-related claims. Such restrictions could limit the success of our RRPs.

- 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 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 under current U.S. tax law. Furthermore, our effective tax rate could be increased due to changes in the earnings mix or applicable tax laws. In addition, 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.

- 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 place us at a competitive disadvantage, result in a 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.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

At December 31, 2016, we operated and owned 48 manufacturing facilities and maintained contract manufacturing relationships with 22 third-party manufacturers across 21 markets. In addition, we work with 38 third-party operators in Indonesia who manufacture our hand-rolled cigarettes.

PMI-Owned Manufacturing Facilities

	EU [(1)]	EEMA	Asia	Latin America & Canada	TOTAL
Fully integrated	9	8	9	8	34
Make-pack	—	—	1	2	3
Other	4	1	3	3	11
Total	13	9	13	13	48

(1) Includes facilities that produced IQOS Consumables in 2016.

In 2016, 27 of our facilities each manufactured over 10 billion cigarettes, of which eight facilities each produced over 30 billion units. Our largest factories are in St. Petersburg and Krasnodar (Russia), Sukorejo and Karawang (Indonesia), Izmir (Turkey), Marikina and Batangas (Philippines), Krakow (Poland), Berlin (Germany), Kharkiv (Ukraine), and Klaipeda (Lithuania). Our smallest factories are mostly in Latin America and Asia, where due to tariff and other constraints we have established small manufacturing units in individual markets. We will continue to optimize our manufacturing base, taking into consideration the evolution of trade blocks.

The plants and properties owned or leased and operated by our subsidiaries are maintained in good condition and are believed to be suitable and adequate for our present needs.

We are integrating IQOS Consumables production into our existing manufacturing facilities in Europe and progressing with our plans to build manufacturing capacity for our other RRP platforms. For further details on our IQOS Consumables capacity, see Item 7, Business Environment-Reduced-Risk Products.

Item 3. Legal Proceedings.

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 February 10, 2017, December 31, 2015 and December 31, 2014:

Type of Case	Number of Cases Pending as of February 10, 2017	Number of Cases Pending as of December 31, 2015	Number of Cases Pending as of December 31, 2014
Individual Smoking and Health Cases	63	68	63
Smoking and Health Class Actions	11	11	11
Health Care Cost Recovery Actions	16	16	15
Lights Class Actions	—	—	—
Individual Lights Cases	2	3	2
Public Civil Actions	2	3	2

Since 1995, when the first tobacco-related litigation was filed against a PMI entity, 456 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 $321) 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 second phase of the case. The size of the class was not defined in the ruling.	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.

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	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 $173 million) to cover both the

damages.	Létourneau and Blais cases. The hearing for the merits appeal took place in 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 $68,800) in punitive damages, allocating CAD 30,000 (approximately $22,900) to our subsidiary. The trial court ordered defendants to pay CAD 1 billion (approximately $764 million) of the compensatory damage award, CAD 200 million (approximately $153 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 $173 million). The hearing for the merits appeal took place in November 2016. (See below for further detail.)

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 $7,100), 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 February 10, 2017, there were a number of smoking and health cases pending against us, our subsidiaries or indemnitees, as follows:

- 63 cases brought by individual plaintiffs in Argentina (35), Brazil (16), Canada (2), Chile (5), Costa Rica (2), Italy (1), the Philippines (1) and Scotland (1), compared with 68 such cases on December 31, 2015, and 63 cases on December 31, 2014; and
- 11 cases brought on behalf of classes of individual plaintiffs in Brazil (2) and Canada (9), compared with 11 such cases on December 31, 2015 and December 31, 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 $321) 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. 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. Both appeals are 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

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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 $173 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 $28.7 million) beginning in December 2015 through March 2017. See the Blais description for further detail concerning the security order. The Court of Appeal heard oral arguments on the merits appeal in 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 $68,800) in punitive damages, allocating CAD 30,000 (approximately $22,900) 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 $764 million) of the compensatory damage award into a trust within 60 days, CAD 200 million (approximately $153 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 $173 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 $28.7 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 $579 million) in seven equal consecutive quarterly installments of approximately CAD 108 million (approximately $83 million) beginning in December 2015 through June 2017. In December 2016, our subsidiary made its fifth quarterly installment of security for approximately CAD 37.6 million (approximately $28.7 million) into a court trust. This payment is included in other assets on the consolidated balance sheets and in cash used in operating activities in the 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 heard oral arguments on the merits appeal in 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, 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 February 10, 2017, 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 December 31, 2015 and 15 such cases on December 31, 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. Pre-trial discovery is ongoing.

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 February 10, 2017, there were 2 lights cases brought by individual plaintiffs pending against our subsidiaries or indemnitees in Chile (1) and Italy (1), compared with 3 such cases on December 31, 2015, and 2 such cases on

December 31, 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 February 10, 2017, there were 2 public civil actions pending against our subsidiaries in Argentina (1) and Venezuela (1), compared with 3 such cases on December 31, 2015, and 2 such cases on December 31, 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 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 ("DSI") conducted 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, underdeclared 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 $2.29 billion). The case is in the pre-trial evidentiary phase. Trials are scheduled to begin during the last quarter of 2017. PM Thailand believes 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.

The DSI also conducted an investigation into alleged underpayment by PM Thailand of customs duties and excise taxes relating to imports from Indonesia covering the period 2000-2003. On January 26, 2017, the Public Prosecutor filed charges against PM Thailand and its Thai ex-employee in the Bangkok Criminal Court alleging that PM Thailand and its Thai ex-employee jointly and with the intention to defraud the Thai government underdeclared import prices of cigarettes to avoid full payment of taxes and duties in connection with 780 import entries during the period from January 2002 to July 2003. The government is seeking a fine of approximately THB 19.8 billion (approximately $562 million). The first hearing, which will focus on preliminary procedural matters, is scheduled for April 2017. PM Thailand disagrees with the allegations and believes that its declared import prices are in compliance with the Customs Valuation Agreement of the WTO and Thai law.

The South Korean Board of Audit and Inspection (“BAI”) conducted 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 November 2016, the tax authorities completed their audit and assessed allegedly underpaid taxes and penalties. In order to avoid nonpayment financial costs, PM Korea paid the total amount that the tax authorities demanded, namely, approximately KRW 100 billion (approximately $85 million) in December 2016 and approximately KRW 118 billion (approximately $100 million) in January 2017. The total demanded amount is included in other assets, and the January 2017 payment is included in accrued liabilities, in the consolidated balance sheets for the year ended 2016. The December 2016 payment is reflected in cash used in operating activities in the consolidated statements of cash flows for the year ended 2016. In the beginning of 2017, PM Korea received demand notices from other government authorities for other amounts of approximately KRW 54 billion (approximately $46 million) in the aggregate. PM Korea will appeal the assessments. The tax authorities have also referred the matter to the Public Prosecutor, who will further investigate and decide whether 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. In addition, the South Korean Ministry of Strategy and Finance ("MOSF") filed a criminal complaint with the Public Prosecutor against PM Korea and its managing director. In its criminal complaint, the MOSF alleged that PM Korea exceeded the monthly product withdrawal limits that the MOSF had set in its notice. The Public Prosecutor will investigate the MOSF's criminal complaint and decide whether to prosecute. PM Korea disagrees with the MOSF's allegations.

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.

Item 4. Mine Safety Disclosures.

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

The principal stock exchange on which our common stock (no par value) is listed is the New York Stock Exchange. At January 31, 2017, there were approximately 61,000 holders of record of our common stock.

Our common stock is also listed on the NYSE Euronext in Paris and the SIX Swiss Exchange.

Performance Graph

The graph below compares the cumulative total shareholder return on PMI's common stock with the cumulative total return for the same period of PMI's Peer Groups (Old and New) and the S&P 500 Index. The graph assumes the investment of $100 as of December 31, 2011, in PMI common stock (at prices quoted on the New York Stock Exchange) and each of the indices as of the market close and reinvestment of dividends on a quarterly basis.

Date	PMI	PMI Peer Group-Old [1,3]	PMI Peer Group-New [2,3]	S&P 500 Index
December 31, 2011	$100.00	$100.00	$100.00	$100.00
December 31, 2012	$110.60	$112.30	$113.90	$116.00
December 31, 2013	$120.00	$143.30	$140.00	$153.60
December 31, 2014	$117.50	$149.00	$151.90	$174.60
December 31, 2015	$133.30	$156.20	$164.70	$177.00
December 31, 2016	$144.70	$153.60	$168.00	$198.20

(1) The PMI Peer Group-Old (formerly, the PMI Compensation Survey Group) consists of the following companies with substantial global sales that are direct competitors; or have similar market capitalization; or are primarily focused on consumer products (excluding high technology and financial services); and are companies for which comparative executive compensation data are readily available: Bayer AG, British American Tobacco p.l.c., The Coca-Cola Company, Diageo plc, GlaxoSmithKline, Heineken N.V., Imperial Brands PLC (formerly, Imperial Tobacco Group PLC), Johnson & Johnson, McDonald's Corp., Mondelēz International, Inc., Nestlé S.A., Novartis AG, PepsiCo, Inc., Pfizer Inc., Roche Holding AG, Unilever NV and PLC and Vodafone Group Plc.
(2) In 2016, PMI determined that it should use a single customized peer group both to benchmark its compensation programs and to compare its Total Shareholder Return when calculating its Performance Share Unit performance factor. The new Peer Group was established based on a review of four characteristics: global presence; a focus on consumer products; and net revenues and a market capitalization of a similar size to those of PMI. The review also considered the primary international tobacco companies. As a result of this review, Altria Group, Inc., Anheuser-Busch InBev SA/NV, Colgate-Palmolive Co., Japan Tobacco Inc., Kimberly-Clark Corporation, The Kraft-Heinz Company, The Procter & Gamble Company and Reynolds American Inc. were added to the new Peer Group and Bayer AG, GlaxoSmithKline, Novartis AG, Pfizer Inc. and Vodafone Group Plc. were removed.

(3) On October 1, 2012, Mondelēz International, Inc., formerly Kraft Foods Inc., announced that it had completed the spin-off of its North American grocery business, Kraft Foods Group, Inc. Mondelēz International, Inc. was retained in the PMI Peer Group-Old (formerly, PMI Compensation Survey Group) and in the PMI Peer Group-New indices because of its global footprint. The PMI Peer Group-Old and in the PMI Peer Group-New indices total cumulative return calculation weight Mondelēz International, Inc.'s total shareholder return at 65% of historical Kraft Foods Inc.'s market capitalization on December 31, 2011, based on Mondelēz International, Inc.'s initial market capitalization relative to the combined market capitalization of Mondelēz International, Inc. and Kraft Foods Group, Inc. in October 2012. Although included in the PMI Peer Group-New, Kraft Heinz Company is not included in the total cumulative return calculation, having become publicly traded only in October 2012.

Note: Figures are rounded to the nearest $0.10.

Issuer Purchases of Equity Securities During the Quarter Ended December 31, 2016

Our share repurchase activity for each of the three months in the quarter ended December 31, 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
October 1, 2016 – October 31, 2016 (1)	—	$ —	—	$ —
November 1, 2016 – November 30, 2016 (1)	—	$ —	—	$ —
December 1, 2016 – December 31, 2016 (1)	—	$ —	—	$ —
Pursuant to Publicly Announced Plans or Programs	—	$ —		
October 1, 2016 – October 31, 2016 (3)	424	$ 97.91		
November 1, 2016 – November 30, 2016 (3)	1,144	$ 96.18		
December 1, 2016 – December 31, 2016 (3)	20,088	$ 91.70		
For the Quarter Ended December 31, 2016	21,656	$ 92.06		

(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.

The other information called for by this Item is included in Item 8, Note 23. Quarterly Financial Data (Unaudited) to the consolidated financial statements.

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Item 6. Selected Financial Data

(in millions of dollars, except per share data)

	2016	2015	2014	2013	2012
Summary of Operations:					
Net revenues	$ 74,953	$ 73,908	$ 80,106	$ 80,029	$ 77,393
Cost of sales	9,391	9,365	10,436	10,410	10,373
Excise taxes on products	48,268	47,114	50,339	48,812	46,016
Gross profit	17,294	17,429	19,331	20,807	21,004
Operating income	10,815	10,623	11,702	13,515	13,863
Interest expense, net	891	1,008	1,052	973	859
Earnings before income taxes	9,924	9,615	10,650	12,542	13,004
Pre-tax profit margin	13.2 %	13.0 %	13.3 %	15.7 %	16.8 %
Provision for income taxes	2,768	2,688	3,097	3,670	3,833
Net earnings	7,250	7,032	7,658	8,850	9,154
Net earnings attributable to noncontrolling interests	283	159	165	274	354
Net earnings attributable to PMI	6,967	6,873	7,493	8,576	8,800
Basic earnings per share	4.48	4.42	4.76	5.26	5.17
Diluted earnings per share	4.48	4.42	4.76	5.26	5.17
Dividends declared per share	4.12	4.04	3.88	3.58	3.24
Capital expenditures	1,172	960	1,153	1,200	1,056
Depreciation and amortization	743	754	889	882	898
Property, plant and equipment, net	6,064	5,721	6,071	6,755	6,645
Inventories	9,017	8,473	8,592	9,846	8,949
Total assets	36,851	33,956	35,187	38,168	37,670
Long-term debt	25,851	25,250	26,929	24,023	17,639
Total debt	29,067	28,480	29,455	27,678	22,839
Stockholders' deficit	(10,900)	(11,476)	(11,203)	(6,274)	(3,154)
Common dividends declared as a % of Diluted EPS	92.0 %	91.4 %	81.5 %	68.1 %	62.7 %
Market price per common share — high/low	104.20-84.46	90.27-75.27	91.63-75.28	96.73-82.86	94.13-72.85
Closing price of common share at year end	91.49	87.91	81.45	87.13	83.64
Price/earnings ratio at year end — Diluted	20	20	17	17	16
Number of common shares outstanding at year end (millions)	1,551	1,549	1,547	1,589	1,654
Number of employees	79,500	80,200	82,500	91,100	87,100

This Selected Financial Data should be read in conjunction with Item 7 and Item 8.

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with the other sections of this Annual Report on Form 10-K, including the consolidated financial statements and related notes contained in Item 8, and the discussion of risks and cautionary factors that may affect future results in Item 1A. Risk Factors.

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. In addition to the manufacture and sale of cigarettes and other tobacco products, we are engaged in the development and commercialization of Reduced-Risk Products ("RRPs"). RRPs is the term we use to refer to products that present, are likely to present, or have the potential to present less risk of harm to smokers who switch to these products versus continued smoking. We have a range of RRPs in various stages of development, scientific assessment and commercialization. Because our RRPs do not burn tobacco, they produce far lower quantities of harmful and potentially harmful compounds than found in cigarette smoke.

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.

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Executive Summary

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

- Consolidated Operating Results – The changes in our reported diluted earnings per share ("diluted EPS") for the year ended December 31, 2016, from the comparable 2015 amounts, were as follows:

	Diluted EPS	% Growth
For the year ended December 31, 2015	$4.42	
2015 Asset impairment and exit costs	0.03	
2015 Tax items	(0.03)	
Subtotal of 2015 items	—	
2016 Asset impairment and exit costs	—	
2016 Tax items	—	
Subtotal of 2016 items	—	
Currency	(0.46)	
Interest	0.05	
Change in tax rate	0.03	
Operations	0.44	
For the year ended December 31, 2016	$4.48	1.4 %

See the discussion of events affecting the comparability of statement of earnings amounts in the Consolidated Operating Results section of the following Discussion and Analysis.

- Asset Impairment and Exit Costs – During 2015, we recorded pre-tax asset impairment and exit costs of $68 million ($52 million after tax or $0.03 per share) related to severance costs for the organizational restructuring in the European Union segment. During 2016, we did not have an EPS impact related to asset impairment and exit costs.

- Income Taxes – Our effective income tax rate for 2016 decreased by 0.1 percentage point to 27.9%. The 2015 tax items that increased our diluted EPS by $0.03 per share in 2015 in the table above represents a reduction in unrecognized tax benefits of $41 million following the conclusion of the IRS examinations of Altria Group, Inc.'s ("Altria") consolidated tax returns for the years 2007 and 2008 and PMI's consolidated tax returns for the years 2009 through 2011. Prior to March 28, 2008, PMI was a wholly owned subsidiary of Altria. The change in tax rate that increased our diluted EPS by $0.03 per share in 2016 in the table above was primarily due to earnings mix by taxing jurisdiction and repatriation cost differences.

- Currency – The unfavorable currency impact during 2016 results from the strengthening of the U.S. dollar, especially against the Egyptian pound, Indonesian rupiah, Kazakh tenge, Mexican peso, Russian ruble and Turkish lira, partially offset by the 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 and higher interest income.

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Operations – The increase in diluted EPS of $0.44 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;
- European Union: Higher pricing, lower manufacturing costs and lower marketing, administration and research costs, partially offset by unfavorable volume/mix;
- Asia: Higher pricing and lower marketing, administration and research costs, partially offset by unfavorable volume/mix; and
- Latin America & Canada: Higher pricing, partially offset by unfavorable volume/mix, higher manufacturing costs and higher

marketing, administration and research costs.

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

• 2017 Forecasted Results – On February 2, 2017, we announced our forecast for 2017 full-year reported diluted EPS to be in a range of $4.70 to $4.85, at prevailing exchange rates at that time, versus $4.48 in 2016. Excluding an unfavorable currency impact at then-prevailing exchange rates of approximately $0.18 per share for the full-year 2017, the reported diluted earnings per share range represents an increase of approximately 9% to 12% versus adjusted diluted earnings per share of $4.48 in 2016. This forecast reflects net revenue growth, excluding excise taxes, in excess of our current annual growth target range of 4%-6%, excluding currency and acquisitions. This forecast does not include any share repurchases in 2017.

Our 2016 reported and adjusted diluted EPS was $4.48. During 2016, we did not have an EPS impact related to asset impairment and exit costs, and 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 2017 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 Item 1A. Risk Factors represent continuing risks to this forecast.

Discussion and Analysis

Critical Accounting Estimates

Item 8, Note 2. Summary of Significant Accounting Policies to our consolidated financial statements includes a summary of the significant accounting policies and methods used in the preparation of our consolidated financial statements. In most instances, we must use a particular accounting policy or method because it is the only one that is permitted under U.S. GAAP.

The preparation of financial statements requires that we use estimates and assumptions that affect the reported amounts of our assets, liabilities, net revenues and expenses, as well as our disclosure of contingencies. If actual amounts differ from previous estimates, we include the revisions in our consolidated results of operations in the period during which we know the actual amounts. Historically, aggregate differences, if any, between our estimates and actual amounts in any year have not had a significant impact on our consolidated financial statements.

The selection and disclosure of our critical accounting estimates have been discussed with our Audit Committee. The following is a discussion of the more significant assumptions, estimates, accounting policies and methods used in the preparation of our consolidated financial statements:

• Revenue Recognition - We recognize revenue when persuasive evidence of an arrangement exists, delivery of product has occurred, the sales price is fixed or determinable and collectability is reasonably assured. For our company, this means that revenue is recognized when title and risk of loss is transferred to our customers. Title transfers to our customers upon shipment or upon receipt at the customer's location as determined by the sales terms for each transaction. The company estimates the cost of sales returns based on historical experience, and these estimates are immaterial.

• Goodwill and Non-Amortizable Intangible Assets Valuation - We test goodwill and non-amortizable intangible assets for impairment annually or more frequently if events occur that would warrant such review. During the second quarter of 2016, we changed the date of our 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 our long-range planning and forecasting process. We have determined that this change in accounting principle is preferable under the circumstances and believe that the change in the annual impairment testing date did not delay, accelerate, or avoid an impairment charge. While the company has the option to perform a qualitative assessment for both goodwill and non-amortizable intangible assets to determine if it is more likely than not that an impairment exists, the company elects to perform the quantitative assessment for our annual impairment analysis. The impairment analysis involves comparing the fair value of each reporting unit or non-amortizable intangible asset to the carrying value. If the carrying value exceeds the fair value, goodwill or a non-amortizable intangible asset is considered impaired. To determine the fair value of goodwill, we primarily use a discounted cash flow model, supported by the market approach using earnings multiples of comparable global and local companies within the tobacco industry. At December 31, 2016, the carrying value of our goodwill was $7.3 billion, which is related to ten reporting units, each of which consists of a group of markets with similar economic characteristics. The estimated fair value of each of our ten reporting units exceeded the carrying value as of December 31, 2016. To determine the fair value of non-amortizable intangible assets, we primarily use a discounted cash flow model applying the relief-from-royalty method. We concluded that the fair value of our non-amortizable intangible assets exceeded the carrying value. These discounted cash flow models include management assumptions relevant for forecasting operating cash flows, which are subject to changes in business conditions, such as volumes and prices, costs to produce, discount rates and estimated capital needs. Management considers historical experience and all available information at the time the fair values are estimated, and we believe these assumptions are consistent with the assumptions a hypothetical marketplace participant would use. Since the March 28, 2008, spin-off from Altria, we have not recorded a charge to earnings for an impairment of goodwill or non-amortizable intangible assets.

• Marketing and Advertising Costs - We incur certain costs to support our products through programs that include advertising, marketing, consumer engagement and trade promotions. The costs of our advertising and marketing programs are expensed in accordance with U.S. GAAP. Recognition of the cost related to our consumer engagement and trade promotion programs contain uncertainties due to the judgment required in estimating the potential performance and compliance for each program. For volume-based incentives provided to customers, management continually assesses and estimates, by customer, the likelihood of the customer's achieving the specified targets, and records the reduction of revenue as the sales are made. For other trade promotions, management relies on estimated utilization rates that have been developed from historical experience. Changes in the assumptions used in estimating the cost of any individual marketing program would not result in a material change in our financial position, results of operations or operating cash flows. We have not made any material changes in the accounting methodology used to estimate our marketing programs during the past three years.

• Employee Benefit Plans - As discussed in Item 8, Note 13. Benefit Plans to our consolidated financial statements, we provide a range of benefits to our employees and retired employees, including pensions, postretirement health care and postemployment benefits (primarily severance). We record annual amounts relating to these plans based on calculations specified by U.S. GAAP. These calculations include various actuarial assumptions, such as discount rates, assumed rates of return on plan assets, compensation increases, mortality, turnover rates and health care cost trend rates. We review actuarial assumptions on an annual basis and make modifications to the assumptions based on current rates and trends when it is deemed appropriate to do so. As permitted by U.S. GAAP, any effect of the modifications is generally amortized over future periods. We believe that the assumptions utilized in calculating our obligations under these plans are reasonable based upon our historical experience and advice from our actuaries.

Weighted-average discount rate assumptions for pensions and postretirement plans are as follows:

	2016	2015
U.S. pension plans	4.07%	4.30%
Non-U.S. pension plans	1.39%	1.68%
Postretirement plans	3.68%	4.45%

We anticipate that assumption changes will decrease 2017 pre-tax U.S. and non-U.S. pension and postretirement expense to approximately $199 million as compared with approximately $215 million in 2016, excluding amounts related to early retirement programs. The anticipated decrease is primarily due to lower interest cost, partially offset by lower expected return on assets.

Weighted-average expected rate of return and discount rate assumptions have a significant effect on the amount of expense reported for the employee benefit plans. A fifty-basis-point decrease in our discount rate would increase our

2017 pension and postretirement expense by approximately $43 million, and a fifty-basis-point increase in our discount rate would decrease our 2017 pension and postretirement expense by approximately $40 million. Similarly, a fifty-basis-point decrease (increase) in the expected return on plan assets would increase (decrease) our 2017 pension expense by approximately $33 million. See Item 8, Note 13. Benefit Plans to our consolidated financial statements for a sensitivity discussion of the assumed health care cost trend rates.

Beginning January 1, 2017, we changed the method used to calculate the service and interest cost components for the net periodic pension benefit costs. Specifically, service costs will be determined based on duration-specific spot rates applied to service cost cash flows and interest costs will be determined by applying duration specific spot rates to the year-by-year projected benefit. The change will not have a material impact to our consolidated results of operations, financial position or cash flows and will be accounted for prospectively as a change in accounting estimate.

• Income Taxes - Income tax provisions for jurisdictions outside the United States, as well as state and local income tax provisions, are determined on a separate company basis, and the related assets and liabilities are recorded in our consolidated balance sheets.

The extent of our operations involves dealing with uncertainties and judgments in the application of complex tax regulations in a multitude of jurisdictions. The final taxes paid are dependent upon many factors, including negotiations with taxing authorities in various jurisdictions and resolution of disputes arising from federal, state, and international tax audits. In accordance with the authoritative guidance for income taxes, we evaluate potential tax exposures and record tax liabilities for anticipated tax audit issues based on our estimate of whether, and the extent to which, additional taxes will be due. We adjust these reserves in light of changing facts and circumstances; however, due to the complexity of some of these uncertainties, the ultimate resolution may result in a payment that is materially different from our current estimate of the tax liabilities. If our estimate of tax liabilities proves to be less than the ultimate assessment, an additional charge to expense would result. If payment of these amounts ultimately proves to be less than the recorded amounts, the reversal of the liabilities would result in tax benefits being recognized in the period when we determine the liabilities are no longer necessary.

The effective tax rates used for interim reporting are based on our full-year geographic earnings mix projections and cash repatriation plans. Changes in currency exchange rates, earnings mix by taxing jurisdiction or in cash repatriation plans could have an impact on the effective tax rates, which we monitor each quarter. Significant judgment is required in determining income tax provisions and in evaluating tax positions.

For further details, see Item 8, Note 11. Income Taxes to our consolidated financial statements.

• Hedging - As discussed below in “Market Risk,” we use derivative financial instruments principally to reduce exposures to market risks resulting from fluctuations in foreign currency exchange and interest rates by creating offsetting exposures. For derivatives to which we have elected to apply hedge accounting, gains and losses on these derivatives are initially deferred in accumulated other comprehensive losses on the consolidated balance sheet and recognized in the consolidated statement of earnings in the periods when the related hedged transactions are also recognized in operating results. If we had elected not to use the hedge accounting provisions, gains (losses) deferred in stockholders’ (deficit) equity would have been recorded in our net earnings for these derivatives.

• Contingencies - As discussed in Item 8, Note 19. Contingencies to our consolidated financial statements, 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. 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. 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. 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.

Consolidated Operating Results

Our cigarette volume, net revenues, excise taxes on products and operating companies income by segment were as follows:

(in millions)	2016	2015	2014
Cigarette Volume			
European Union	193,586	194,589	194,746
Eastern Europe, Middle East & Africa	271,393	279,411	278,374
Asia	260,029	281,350	288,128
Latin America & Canada	87,938	91,920	94,706
Total cigarette volume	812,946	847,270	855,954

(in millions)	2016	2015	2014
Net Revenues			
European Union	$27,129	$26,563	$30,517
Eastern Europe, Middle East & Africa	18,286	18,328	20,469
Asia	20,531	19,469	19,255
Latin America & Canada	9,007	9,548	9,865
Net revenues	$74,953	$73,908	$80,106

(in millions)	2016	2015	2014
Excise Taxes on Products			
European Union	$18,967	$18,495	$21,370
Eastern Europe, Middle East & Africa	11,286	10,964	11,855
Asia	11,850	11,266	10,527
Latin America & Canada	6,165	6,389	6,587
Excise taxes on products	$48,268	$47,114	$50,339

(in millions)	2016	2015	2014
Operating Income			
Operating companies income:			
European Union	$3,994	$3,576	$3,815
Eastern Europe, Middle East & Africa	3,016	3,425	4,033
Asia	3,196	2,886	3,187
Latin America & Canada	938	1,085	1,030
Amortization of intangibles	(74)	(82)	(93)
General corporate expenses	(161)	(162)	(165)
Less:			
Equity (income)/loss in unconsolidated subsidiaries, net	(94)	(105)	(105)
Operating income	$10,815	$10,623	$11,702

As discussed in Item 8, Note 12. Segment Reporting to our 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 are our tax-paid estimates based on the latest available data from a number of internal and external sources.

The following events that occurred during 2016, 2015 and 2014 affected the comparability of our statement of earnings amounts:

• Asset Impairment and Exit Costs – For the year ended December 31, 2016, we did not incur asset impairment and exit costs. For the years ended December 31, 2015 and 2014, pre-tax asset impairment and exit costs by segment were as follows:

(in millions)	2015	2014
Separation programs:		
European Union	$ 68	$351
Eastern Europe, Middle East & Africa	—	2
Asia	—	35
Latin America & Canada	—	3
Total separation programs	68	391
Asset impairment charges:		
European Union	—	139
Latin America & Canada	—	5
Total asset impairment charges	—	144
Asset impairment and exit costs	$ 68	$535

For further details, see Item 8, Note 5. Asset Impairment and Exit Costs to our consolidated financial statements.

• Acquisitions and Other Business Arrangements – For further details, see Item 8, Note 6. Acquisitions and Other Business Arrangements to our consolidated financial statements.

2016 compared with 2015

The following discussion compares our consolidated operating results for the year ended December 31, 2016, with the year ended December 31, 2015.
Our cigarette shipment volume decreased by 4.1%, or by 4.7% excluding net estimated inventory movements, due to:

- European Union, principally Italy, Germany and Greece, partly offset by Poland and Spain;
- EEMA, mainly North Africa, primarily Algeria, and Russia, partly offset by Saudi Arabia and Ukraine;
- Asia, principally Indonesia, Pakistan, the Philippines and Thailand, partly offset by Korea; and
- Latin America & Canada, predominantly Argentina, partly offset by Mexico.

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

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

PMI Cigarette Shipment Volume by Brand (Million Units)

	Full-Year		
	2016	2015	Change
Marlboro	281,720	285,583	(1.4)%
L&M	96,770	97,884	(1.1)%
Parliament	45,671	44,879	1.8 %
Bond Street	44,567	43,608	2.2 %
Chesterfield	46,291	41,397	11.8 %
Philip Morris	35,914	35,815	0.3 %
Lark	27,571	28,828	(4.4)%
Others	234,442	269,276	(12.9)%
Total PMI	812,946	847,270	(4.1)%

Cigarette shipment volume of Marlboro decreased, driven by Algeria, Argentina, Egypt and Vietnam, as well as in-switching from that brand to IQOS Consumables, partly offset by Korea, Mexico, the Philippines, Saudi Arabia and Spain.

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

Our other tobacco products ("OTP") primarily include tobacco for roll-your-own and make-your-own cigarettes, pipe tobacco, cigars and cigarillos, and do not include Reduced-Risk Products. Total shipment volume of OTP, in cigarette equivalent units, decreased by 4.5% to 32.6 billion units.

Total shipment volume for cigarettes and OTP, in cigarette equivalent units, decreased by 4.1%.

Total shipment volume of IQOS Consumables reached 7.4 billion units, up from 396 million units in 2015.
Our net revenues and excise taxes on products were as follows:

	For the Years Ended December 31,			
(in millions)	2016	2015	Variance	%
Net revenues	$74,953	$73,908	$1,045	1.4 %
Excise taxes on products	48,268	47,114	1,154	2.4 %
Net revenues, excluding excise taxes on products	$26,685	$26,794	$(109)	(0.4)%

Net revenues, which include excise taxes billed to customers, increased by $1.0 billion. Excluding excise taxes, net revenues decreased by $109 million, due to:

- unfavorable currency ($1.3 billion) and
- unfavorable volume/mix ($450 million), partly offset by
- price increases ($1.6 billion).

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

Net revenues include $739 million in 2016 related to sale of RRPs, mainly driven by Japan. This amount includes excise taxes billed to customers. Excluding excise taxes, net revenues for RRPs were $733 million in 2016. In some jurisdictions, including Japan, we are not responsible for collecting excise taxes. Approximately 22% of our $733 million in 2016 RRP net revenues, excluding excise taxes, were from IQOS devices.

Net revenues related to RRPs represent the sale of heat-not-burn consumables, including IQOS Consumables, IQOS devices and related accessories, and other nicotine-containing products, primarily e-vapor products, net of sales and promotion incentives.

Net revenues include $1.8 billion in 2016 and 2015 related to sales of OTP. These net revenue amounts include excise taxes billed to customers. Excluding excises taxes, net revenues for OTP were $644 million in 2016 and $673 million in 2015.

Excise taxes on products increased by $1.2 billion, due to:

- higher excise taxes resulting from changes in retail prices and tax rates ($5.3 billion), partly offset by
- favorable currency ($3.9 billion) and
- lower excise taxes resulting from volume/mix ($236 million).

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 Years Ended December 31, 2016	2015	Variance	%
Cost of sales	$9,391	$9,365	$26	0.3 %
Marketing, administration and research costs	6,405	6,656	(251)	(3.8)%
Operating income	10,815	10,623	192	1.8 %

Cost of sales increased by $26 million, due to:

- higher cost of sales resulting from volume/mix ($242 million), partly offset by
- favorable currency ($216 million).

Marketing, administration and research costs decreased by $251 million, due to:

- lower expenses ($210 million, driven by a favorable comparison to 2015, notably related to cigarette brand building and business optimization initiatives, partly offset by increased support behind Reduced-Risk Products) and
- favorable currency ($41 million).

Operating income increased by $192 million, due primarily to:

- price increases ($1.6 billion) and
- lower marketing, administration and research costs ($210 million) and
- the non-recurrence of the 2015 pre-tax charges for asset impairment and exit costs ($68 million), partly offset by

- unfavorable currency ($1.0 billion) and
- unfavorable volume/mix ($692 million).

Interest expense, net, of $891 million decreased by $117 million, due primarily to lower effective interest rates on debt and higher interest income.

Our effective tax rate decreased by 0.1 percentage point to 27.9%. The 2015 effective tax rate was unfavorably impacted by changes to repatriation assertions on certain foreign subsidiary historical earnings ($58 million), partially offset by a reduction in unrecognized tax benefits of $41 million following the conclusion of the IRS examinations of Altria's consolidated tax returns for the years 2007 and 2008 and PMI's consolidated tax returns for the years 2009 through 2011. Prior to March 28, 2008, PMI was a wholly owned subsidiary of Altria. Changes in currency exchange rates, 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. Based upon tax regulations in existence at December 31, 2016, and our cash repatriation plans, we estimate that our 2017 effective tax rate will be approximately 28%.

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 12 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 charge cannot be made at this time.

Net earnings attributable to PMI of $7.0 billion increased by $94 million (1.4%). This increase was due primarily to higher operating income as discussed above, and lower interest expense, net. Diluted and basic EPS of $4.48 increased by 1.4%. Excluding an unfavorable currency impact of $0.46, diluted EPS increased by 11.8%.

2015 compared with 2014

The following discussion compares our consolidated operating results for the year ended December 31, 2015, with the year ended December 31, 2014.
Our cigarette shipment volume was down by 1.0%, excluding acquisitions, reflected declines in:

- Asia, mainly due to Korea, Pakistan and the Philippines; and
- Latin America & Canada, mainly due to Argentina, Brazil, Ecuador and Mexico;

partially offset by growth in:

- EEMA, notably Egypt, Saudi Arabia and Turkey, partially offset by Kazakhstan and Ukraine.

Total cigarette volume in the European Union was essentially flat, with declines in Greece, Italy and the United Kingdom largely offset by growth in France, Germany and Spain.

For the year ended December 31, 2015, estimated inventory movements were favorable, driven principally by a favorable comparison in Japan as a result of the 2014 correction of distributor inventory movements partly related to the VAT increase of April 2014. Excluding these estimated inventory movements, our total cigarette shipment volume decreased by 1.6%, excluding acquisitions.

Our cigarette market share increased in a number of key markets, including Argentina, Austria, Belgium, Egypt, France, Germany, Korea, the Netherlands, the Philippines, Poland, Russia, Saudi Arabia, Spain and Switzerland.

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

PMI Cigarette Shipment Volume by Brand (Million Units)

	Full-Year		
	2015	2014	Change
Marlboro	285,583	282,997	0.9 %
L&M	97,884	94,168	3.9 %
Parliament	44,879	47,199	(4.9)%
Bond Street	43,608	43,585	0.1 %
Chesterfield	41,397	42,144	(1.8)%
Philip Morris	35,815	31,948	12.1 %
Lark	28,828	28,473	1.2 %
Others	269,276	285,440	(5.7)%
Total PMI	847,270	855,954	(1.0)%

The increase in cigarette shipment volume of Marlboro reflected growth in: the European Union, notably France, Germany and Spain, partly offset by Italy and the United Kingdom; EEMA, notably Saudi Arabia and Turkey, partly offset by North Africa and Ukraine; and Asia, notably the Philippines and Vietnam, partly offset by Japan and Korea. Cigarette shipment volume of Marlboro decreased in Latin America & Canada, mainly due to Argentina, Brazil and Mexico, partly offset by Colombia.

The increase in cigarette shipment volume of L&M was predominantly driven by growth in EEMA, notably Egypt, Turkey and Ukraine, partly offset by Russia. The decrease in cigarette shipment volume of Parliament was primarily due to Kazakhstan, Korea, Russia and Ukraine, partly offset by Japan and Turkey. Cigarette shipment volume of Bond Street was essentially flat, with growth, notably driven by Australia, Russia and Serbia, largely offset by declines in the European Union, Kazakhstan and Ukraine. The decrease in cigarette shipment volume of Chesterfield was due to EEMA, mainly Russia, Turkey and Ukraine, partly offset by the European Union, mainly the Czech Republic, Italy and Poland, and by Latin America & Canada, mainly Mexico. The increase in cigarette shipment volume of Philip Morris primarily reflects the morphing of Diana in Italy. The increase in cigarette shipment volume of Lark was principally driven by Japan, partly offset by Korea.

Total shipment volume of OTP, in cigarette equivalent units, increased by 1.0% to 34.1 billion units.

Total shipment volume for cigarettes and OTP, in cigarette equivalent units, decreased by 1.0%, excluding acquisitions.

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

	For the Years Ended December 31,			
(in millions)	2015	2014	Variance	%
Net revenues	$73,908	$80,106	$(6,198)	(7.7)%
Excise taxes on products	47,114	50,339	(3,225)	(6.4)%
Net revenues, excluding excise taxes on products	$26,794	$29,767	$(2,973)	(10.0)%

Net revenues, which include excise taxes billed to customers, decreased by $6.2 billion. Excluding excise taxes, net revenues decreased by $3.0 billion due primarily to:

- unfavorable currency ($4.7 billion) and
- unfavorable volume/mix ($325 million), partly offset by
- price increases ($2.1 billion).

Currency movements decreased net revenues by $13.5 billion and net revenues, excluding excise taxes on products, by $4.7 billion. The $4.7 billion decrease was due primarily to the Argentine peso, Australian dollar, Canadian dollar, Euro, Indonesian rupiah, Japanese yen, Mexican peso, Russian ruble, Turkish lira and the Ukrainian hryvnia.

Net revenues include $1.8 billion in 2015 and $2.0 billion in 2014 related to sales of OTP. These net revenue amounts include excise taxes billed to customers. Excluding excises taxes, net revenues for OTP were $673 million in 2015 and $753 million in 2014.

Excise taxes on products decreased by $3.2 billion, due primarily to:

- favorable currency ($8.8 billion), partly offset by
- higher excise taxes resulting from changes in retail prices and tax rates ($5.4 billion) and
- higher excise taxes resulting from volume/mix ($142 million).

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

	For the Years Ended December 31,			
(in millions)	2015	2014	Variance	%
Cost of sales	$9,365	$10,436	$(1,071)	(10.3)%
Marketing, administration and research costs	6,656	7,001	(345)	(4.9)%
Operating income	10,623	11,702	(1,079)	(9.2)%

Cost of sales decreased by $1.1 billion, due primarily to:

- favorable currency ($1.4 billion), partly offset by
- higher manufacturing costs ($166 million) and
- higher cost of sales resulting from volume/mix ($148 million).

Marketing, administration and research costs decreased by $345 million, due primarily to:

- favorable currency ($979 million), partly offset by
- higher expenses ($628 million, primarily higher marketing and selling expenses).

Operating income decreased by $1.1 billion, due primarily to:

- unfavorable currency ($2.3 billion),
- higher marketing, administration and research costs ($628 million),
- unfavorable volume/mix ($473 million) and
- higher manufacturing costs ($166 million), partly offset by
- price increases ($2.1 billion) and
- lower pre-tax charges for asset impairment and exit costs ($467 million).

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Our effective tax rate decreased by 1.1 percentage points to 28.0%. The 2015 effective tax rate was unfavorably impacted by changes to repatriation assertions on certain foreign subsidiary historical earnings ($58 million), partially offset by a reduction in unrecognized tax benefits of $41 million following the conclusion of the IRS examinations of Altria's consolidated tax returns for the years 2007 and 2008 and PMI's consolidated tax returns for the years 2009 through 2011. The 2014 effective tax rate was unfavorably impacted by the asset impairment and exit costs related to the factory closures. The effective tax rate is based on our full-year earnings mix by taxing jurisdiction and cash repatriation plans.

Net earnings attributable to PMI of $6.9 billion decreased by $620 million (8.3%). This decrease was due primarily to lower operating income as discussed above, partially offset by a lower effective tax rate. Diluted and basic EPS of $4.42 decreased by 7.1%. Excluding an unfavorable currency impact of $1.20, diluted EPS increased by 18.1%.

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:

- regulatory restrictions on our portfolio of products, including restrictions on the packaging, marketing, and sale of tobacco or other nicotine-containing products that could reduce our competitiveness, eliminate our ability to communicate with adult smokers, or even ban certain of our products;
- fiscal challenges, such as excise tax increases and discriminatory tax structures;
- 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 Item 8, Note 19. Contingencies; and
- governmental investigations.

Regulatory Restrictions: The tobacco industry operates in a highly regulated environment. The well-known risks of smoking have led regulators to impose significant restrictions and high excise taxes on cigarettes.

We support a comprehensive regulatory framework for tobacco products based on the principle of harm reduction, including mandated health warnings, minimum age laws, restrictions on advertising, and public place smoking restrictions. We also support regulatory measures that help reduce illicit trade.

Much of the regulation that shapes the business environment in which we operate is driven by the World Health Organization's (“WHO”) Framework Convention on Tobacco Control (“FCTC”), which entered into force in 2005. The FCTC is the first international public health treaty and has as its main objective to establish a global agenda for tobacco regulation, with the purpose of reducing tobacco use. To date, 179 countries and the European Union are Parties to the FCTC. The treaty requires Parties to have in place various tobacco control measures and recommends others. The FCTC governing body, the Conference of the Parties (“CoP”), has also adopted non-binding guidelines and policy recommendations related to certain articles of the FCTC that go beyond the text of the treaty.

We have opposed certain measures and continue to engage in a dialogue with regulators with respect to those measures that we do not believe would protect public health and, if implemented, could disrupt competition, severely limit our ability to market and sell our products to adult smokers, or increase illicit trade. Certain measures are discussed in more detail below. It is not possible to predict whether or to what extent measures recommended in the

FCTC guidelines will be implemented.

Fiscal Challenges: Excessive and disruptive excise, sales and other 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 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 combustible products, mainly, cigarettes, 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.

EU Tobacco Products Directive: In April 2014, the EU adopted the text of a significantly revised EU Tobacco Products Directive (TPD), which entered into force in May 2016. To date, 23 Member States and Norway have adopted laws transposing the TPD, while the remaining ones are concluding the national transposition. The TPD sets forth a comprehensive set of regulatory requirements for tobacco products, including:

- health warnings covering 65% of the front and back panels of cigarette packs, with an option for Member States to further standardize tobacco packaging, including the introduction of plain packaging;
- 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 some of which could increase operational expenses depending on the scope of the implementing regulation; and
- a framework for the regulation of novel tobacco products and e-cigarettes, including requirements for health warnings and information leaflets, a prohibition on product packaging text related to reduced risk, and the introduction of notification requirements or authorization procedures in advance of commercialization.

Plain Packaging and Other Packaging Restrictions: Plain packaging legislation bans the use of branding, logos and colors on packaging other than the brand name and variant that may be printed only in specified locations and in a uniform font. To date, Australia, France, Hungary, Ireland, New Zealand, Norway and the U.K., have adopted plain packaging legislation. In Australia, plain packaging has been implemented since December 2012. In France, plain packaging has been fully implemented since January 2017, and in the U.K., full compliance is required as of May 2017. In Hungary, full compliance is required immediately for new product launches and no later than May 2019 for other products. No implementation date has yet been set in New Zealand, Norway, or Ireland.

Several countries have initiated World Trade Organization ("WTO") dispute settlement proceedings against Australia related to Australia's plain packaging legislation. The matter is still pending before the WTO panel. 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 chose not to appeal the decision. In December 2016, the Conseil d'Etat in France upheld the decree that implements France's plain packaging legislation.

Other countries are also considering adopting plain packaging legislation, including, but not limited to, Canada, Turkey and Singapore.

Some countries have adopted, or are considering adopting, packaging restrictions that could have an impact similar to plain packaging. Examples of such restrictions include standardizing the shape and size of packages, prohibiting certain colors or the use of certain descriptive phrases on packaging, and requiring very large graphic health warnings that leave little space for branding.

Restrictions and Bans on the Use of Ingredients: The WHO and others in the public health community have recommended 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. The European Union has banned flavored 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 currently exempts menthol at the national level, the majority of Canadian provinces have adopted or are in the process of adopting menthol bans. The Canadian federal government also recently published draft regulations that would prohibit menthol in cigarettes. The Brazil ingredients ban, which 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. Other lawsuits are also pending against the Brazil ingredients ban. It is not possible to predict the outcome of these legal proceedings.

Bans on Display of Tobacco Products at Retail: In a number of our markets, including, but not limited to, Australia, Canada, Norway, Russia, and Singapore, governments have banned the display of tobacco products at the point of sale. Other countries are also considering similar bans.

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 guidelines recommend that governments prohibit all forms of communication with adult smokers.

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 would amount to a ban on slim cigarettes, or requiring the use of standardized filter and cigarette paper designs. In addition, at its meeting in November 2016, the CoP adopted non-binding guidelines recommending that countries regulate product design features that increase the attractiveness of tobacco products, such as the diameter of cigarettes and the use of flavor capsules. Reduced cigarette ignition propensity ("RCIP") standards previously 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 others.

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.

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.

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 slightly less than 10% of total cigarette consumption in 2016.

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 24 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.

We and our subsidiaries have entered into cooperation agreements with governments and authorities to support their anti-illicit trade efforts. 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 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 a three-year period. We expect that the first round of grants will be awarded in the second quarter of 2017.

In November 2016, PMI signed a joint Declaration of Intent to Prevent the Maritime Transportation of Counterfeit Goods together with eight other global brand owners and five of the world's largest shipping companies. This commitment was a result of a dialogue with the International Chamber of Commerce's Business Action to Stop Counterfeiting and Piracy. The signatories aim to tackle the infiltration of shipping services by criminal networks that exploit vessels to transport counterfeit goods, including "illicit whites," across the oceans.

Reduced-Risk Products

Our Approach to RRPs: We recognize that smoking cigarettes causes serious diseases and that the best way to avoid the harms of smoking is never to start or to quit. Nevertheless, it is predicted that over the next decade the number of smokers will remain largely unchanged from the current estimate of 1.1 billion, despite the considerable efforts to discourage smoking.

Cigarettes burn tobacco, which produces smoke. As a result of the combustion process, the smoker inhales various toxic substances. In contrast, Reduced-Risk Products do not burn tobacco and produce significantly lower levels of harmful or potentially harmful compounds than found in smoke.

For smokers who would otherwise continue to smoke, we believe that RRPs offer a much better choice. Accordingly, our key strategic priorities are: to develop and commercialize products that present less risk of harm to adult smokers who switch to those products versus continued smoking; and to convince current adult smokers who would otherwise continue to smoke to switch to those Reduced-Risk Products.

We recognize that this transformation from cigarettes to RRPs will take time and that the speed of transformation will depend in part upon factors beyond our control, such as the willingness of governments, regulators and other policy groups to embrace RRPs as a desired solution to the smoking problem. We also recognize that the transformation must be funded from our existing cigarette business. For so long as a significant number continues to smoke, it is critical that the industry be led by responsible and ethical manufacturers. Therefore, during the transformation, we intend to remain the leading international cigarette manufacturer.

We have a range of RRPs in various stages of development, scientific assessment and commercialization. We conduct rigorous scientific assessment of our RRP platforms to establish that they reduce exposure to harmful and potentially harmful constituents in smoke and, ultimately, that these products present, are likely to present, or have the potential to present less risk of harm to adult smokers who switch to them versus continued smoking. We draw upon a team of expert scientists and engineers from a broad spectrum of scientific disciplines and our extensive learnings of consumer preferences to develop and assess our RRPs. Our efforts are guided by the following key objectives:

- to develop RRPs that adult smokers who would otherwise continue to smoke find to be satisfying alternatives to smoking;
- for those adult smokers, our goal is to offer RRPs with a scientifically substantiated risk reduction profile that approaches as closely as possible that associated with smoking cessation;
- to substantiate the reduction of risk for the individual adult smoker and the reduction of harm to the population as a whole, based on scientific evidence of the highest standard that is made available for scrutiny and review by external independent scientists and relevant regulatory bodies; and
- to advocate for the development of science-based regulatory frameworks for the development and commercialization of RRPs, including the communication of scientifically substantiated information to enable adult consumers to make better health choices.

Our RRP Platforms: 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 providing a better choice for those who would otherwise continue to smoke. We recognize that no single product will appeal to all adult smokers. Therefore, we are developing a portfolio of products intended to appeal to a variety of distinct tastes.

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 and proprietary consumable tobacco product ("IQOS Consumables") is inserted and heated to generate an aerosol. Eight clinical studies have been completed (including two with the duration of three months). The study results show a substantial reduction in relevant biomarkers of exposure to harmful or potentially harmful constituents ("HPHCs") in those adult smokers who switched to IQOS compared to those who continued to smoke cigarettes for the duration of the study. 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. While these reduced exposure clinical studies were primarily designed to focus on biomarkers of exposure, in our three-month studies, we also measured six clinical risk markers. These clinical risk markers are associated with disease mechanisms known to be affected by smoking and to reverse upon cessation. The results are generally consistent with the expected direction of change and indicate that switching completely to IQOS led to an overall improvement of clinical risk markers affected by smoking after only three months. 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 third quarter of 2017. We have developed a new version of IQOS to further improve the consumer experience and plan to introduce this new version in the second quarter of 2017.

Platform 2 uses a pressed carbon heat source, which when ignited, generates an aerosol by heating tobacco. A pharmacokinetic study and a five-day reduced-exposure study with Platform 2 have now been completed. In the pharmacokinetic 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. The results of the reduced exposure study show a substantial reduction in relevant biomarkers of exposure to HPHCs in those who switched to Platform 2 compared to those who continued to smoke cigarettes over a five-day period. 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 creates an aerosol of nicotine salt formed by the chemical reaction of nicotine with a weak organic acid. 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. The study assessed this product's nicotine pharmacokinetic profile in comparison to a nicotine inhalator. The study showed that nicotine absorption with this product reached peak levels six times faster than with the inhalator, in line with the pharmacokinetic profile of a cigarette, suggesting a significantly higher potential for acceptance by smokers. We have also completed the clinical phase of a pharmacodynamics study in the U.S. and expect final results for this study in the first half of 2017. We expect to commence a safety and efficacy study in the first half of 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 of our next generation of e-vapor technology, MESH, which addresses certain challenges presented by some 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 planned clinical assessment includes a pharmacokinetic study scheduled to start in 2017 and a reduced-exposure study that we expect to start in 2018.

We are also developing other potential product platforms.

Commercialization of RRPs: In 2014, we introduced the IQOS system in pilot city launches in Nagoya, Japan, and in Milan, Italy. Since then, we have expanded our commercialization activities to include all of Japan, as well as multiple cities in Italy. We also launched IQOS in various cities in Switzerland, Russia, Romania, Ukraine, Portugal, Germany, New Zealand, Canada and other markets. By the end of December 2016, IQOS was available for sale nationwide in Japan and in key cities in 20 markets, and approximately 1.4 million adult smokers had converted to it. We expect to expand IQOS nationally in many of these markets in 2017 as IQOS Consumables capacity increases. We are also targeting launches of IQOS in key cities in an additional ten to fifteen markets by the end of 2017 as capacity permits.

On the basis of our experience in Japan and Italy, we estimate that only a very small percentage of adult smokers who fully convert to IQOS switch back to cigarettes.

In the first quarter of 2016, we started broad commercial production of IQOS Consumables. To date, we have experienced supply shortages resulting from stronger-than-anticipated demand, primarily in Japan, and expect capacity limitations to ease as 2017 unfolds. Our 2016 year-end installed capacity was approximately 15 billion IQOS Consumables, and we expect that our 2017 year-end installed IQOS Consumables capacity will reach approximately 50 billion units. This installed capacity is expected to allow us to produce approximately 32 billion units in 2017, up from 7 billion in 2016. We estimate that as of 2018, we can increase installed annual capacity, as needed, by approximately four billion units per month, with a lead time of 12 months.

As a result of the supply shortages of IQOS Consumables, in June 2016, we began to limit the sale of our IQOS devices in Japan. While we currently have sufficient capacity with respect to IQOS devices, we plan to expand our supplier base. Our IQOS devices are subject to product warranties for a period of 12 months from the date of purchase or such other periods as required by law. Warranty claims for these devices have not had a material impact on our consolidated financial position, results of operations or cash flows in any of the periods presented, although they may become more significant as the number of units sold increases.

We currently market our e-vapor products in several markets, including the United Kingdom, Spain, and Israel. In November 2016, we began the city test of MESH, our Platform 4 product, in Birmingham, United Kingdom. We also expect to conduct city tests of our Platform 2 and Platform 3 products in 2017.

RRP Regulation and Taxation: RRPs contain nicotine and are not risk-free. We therefore support science-based regulation and taxation of RRPs. Regulation and taxation should differentiate between cigarettes and products that present, are likely to present, or have the potential to present less risk of harm to adult smokers who switch to these products versus continued smoking. Regulation should provide minimum standards for RRPs and specific rules for, among other things, ingredients, labelling and consumer communication, and should ensure that the public is informed about the health risks of all tobacco and nicotine-containing products. Regulation, as well as tobacco industry activities, should reflect the fact that youth should not consume nicotine in any form.

Some governments have banned or are seeking to ban or severely restrict emerging tobacco and nicotine-containing products such as our RRPs. These regulations might foreclose or unreasonably restrict consumer access even to products that might be shown to be a better health choice than continuing to smoke. We oppose such blanket bans and unreasonable restrictions of products that have the potential to present less risk of harm compared to continued smoking. By contrast, we support regulation that sets clear standards and propels innovation to benefit adult smokers.

In the United States, an established regulatory framework for assessing “Modified Risk Tobacco Products” and “New Tobacco Products” exists under the jurisdiction of the Food and Drug Administration (“FDA”). Future FDA actions may influence the regulatory approach of other interested governments. In December 2016, we submitted a Modified Risk Tobacco Product Application for Platform 1 to the FDA. We plan to submit a Premarket Tobacco Application in the first quarter of 2017 for Platform 1.

In the EU, a majority of Member States have transposed the EU Tobacco Products Directive, including the provisions on Novel Tobacco Products, such as IQOS Consumables, and e-cigarettes. Most of the EU Member States require a notification submitted six months before the intended placing on the market of a Novel Tobacco Product, while some require pre-market authorizations for the introduction of such products. To date, pursuant to these requirements, we have filed a comprehensive dossier summarizing our scientific assessment of Platform 1 in 14 Member States.

There can be no assurance that we will succeed in our efforts to replace cigarettes with RRPs or that regulation will allow us to commercialize RRPs in all markets or treat RRPs differently from combustible tobacco products such as cigarettes.

Our RRP Business Development Initiatives: 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, and we will make available two of our RRPs exclusively to Altria for commercialization in the United States. 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 by Altria and in markets outside the United States 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.

Governmental Investigations

From time to time, we are subject to governmental investigations on a range of matters. We describe certain matters pending in Thailand and South Korea in Item 3. Legal Proceedings-Other Litigation.

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 Item 3. Legal Proceedings-Other Litigation 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 Item 3. Legal Proceedings-Other Litigation, 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.

Acquisitions and Other Business Arrangements

We discuss our acquisitions and other business arrangements in Item 8, Note 6. Acquisitions and Other Business Arrangements to our consolidated financial statements.

Investments in Unconsolidated Subsidiaries

We discuss our investments in unconsolidated subsidiaries in Item 8, Note 4. Investments in Unconsolidated Subsidiaries to our consolidated financial statements.

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 have incurred 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, have been reflected in cost of sales and marketing, administration and research costs in our consolidated statement of earnings.
On April 4, 2014, we announced the initiation by our affiliate Philip Morris Holland B.V. ("PMH") of consultations with employee representatives on a proposal to discontinue cigarette production at its factory located in Bergen op Zoom, the Netherlands. PMH reached an agreement with the trade unions and their members on a social plan, and ceased cigarette production on September 1, 2014. In total, we have incurred a total pre-tax charge of approximately $549 million for the program. During 2014, we recorded pre-tax asset impairment and exit costs of $489 million. This amount included employee separation costs of $343 million, asset impairment costs of $139 million and other separation costs of $7 million. In addition, as part of the total program, approximately $60 million of pre-tax implementation costs, primarily related to notice period payments, have been reflected in cost of sales and marketing, administration and research costs in our consolidated statement of earnings, of which $50 million were recognized during 2014. Excluding asset impairment costs, substantially all of these charges have resulted in cash expenditures. The program was substantially completed as of December 31, 2015.
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 such sanctions do not apply to our business or pursuant to exemptions or licenses.

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, Sudan, North Korea, Cuba and Syria. We may from time to time explore opportunities to sell our products in one or more of these countries, as permitted by law.

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.

2016 compared with 2015

The following discussion compares operating results within each of our reportable segments for 2016 with 2015.

European Union:

European Union (in millions)	For the Years Ended December 31, 2016	2015	Variance	%
Net revenues	$27,129	$26,563	$566	2.1 %
Excise taxes on products	18,967	18,495	472	2.6 %
Net revenues, excluding excise taxes on products	8,162	8,068	94	1.2 %
Operating companies income	3,994	3,576	418	11.7%

Net revenues, which include excise taxes billed to customers, increased by $566 million. Excluding excise taxes, net revenues increased by $94 million, due to:

- price increases ($390 million), party offset by
- unfavorable volume/mix ($149 million) and
- unfavorable currency ($147 million).

The net revenues of the European Union segment include $1.4 billion in 2016 and $1.5 billion in 2015 related to sales of OTP. Excluding excise taxes, OTP net revenues for the European Union segment were $485 million in 2016 and $509 million in 2015.
Operating companies income increased by $418 million during 2016. This increase was due primarily to:

- price increases ($390 million),
- the non-recurrence of the 2015 pre-tax charges for asset impairment and exit costs ($68 million),
- lower manufacturing costs ($49 million),
- lower marketing, administration and research costs ($47 million) and
- favorable currency ($34 million), partly offset by
- unfavorable volume/mix ($168 million).

European Union - Industry Volume

The estimated total cigarette market decreased by 1.6% to 501.0 billion units. The moderate decline of the estimated total cigarette market reflected improved macroeconomics, a lower prevalence of illicit trade and, in certain geographies, the estimated positive impact of immigration, which was concentrated in the first half of 2016.

The estimated total OTP market decreased by 2.3% to 152.5 billion cigarette equivalent units, reflecting a lower total fine cut market, down by 2.4% to 141.7 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)

	Full-Year		
	2016	2015	Change
Marlboro	96,245	95,588	0.7 %
L&M	34,691	35,010	(0.9)%
Chesterfield	30,140	28,278	6.6 %
Philip Morris	16,290	14,205	14.7 %
Others	16,220	21,508	(24.6)%
Total EU	193,586	194,589	(0.5)%

European Union Cigarette Market
Shares by Brand

	Full-Year		
	2016	2015	Change p.p.
Marlboro	19.0 %	18.8 %	0.2
L&M	6.9 %	6.9 %	—
Chesterfield	5.9 %	5.6 %	0.3
Philip Morris	3.2 %	3.2 %	—
Others	3.3 %	3.8 %	(0.5)
Total EU	38.3 %	38.3 %	—

Our cigarette shipment volume decreased by 0.5% to 193.6 billion units, mainly due to Italy, Germany and Greece, partly offset by Poland and Spain. Cigarette shipment volume of Marlboro increased by 0.7%, mainly driven by Spain, partly offset by Greece. Our total cigarette market share was flat at 38.3%, with gains, notably in the Czech Republic, France, Poland and Spain, offset by declines, mainly in Greece and Italy. Cigarette shipment volume of "Others" decreased, mainly due the morphing of various trademarks in the Czech Republic and Italy into international brands.

Our shipments of OTP decreased by 5.3% to 22.2 billion cigarette equivalent units. Our total OTP market share decreased by 0.4 points to 14.6%.

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

	Full-Year		
	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	44.9	45.5	(1.2)%
PMI Shipments (million units)	19,243	18,943	1.6%
PMI Cigarette Market Share			
Marlboro	26.4%	25.9%	0.5
Philip Morris	10.2%	9.5%	0.7
Chesterfield	3.1%	3.3%	(0.2)
Others	2.7%	2.9%	(0.2)
Total	42.4%	41.6%	0.8

The estimated total cigarette market decreased moderately by 1.2%, 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 Marlboro, as well as the launch of certain Philip Morris variants in January 2016. The estimated total industry fine cut category of 14.7 billion cigarette equivalent units increased by 1.2%. Our market share of the category increased by 0.6 points to 25.6%.

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

Germany Key Market Data

	Full-Year		
	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	78.1	80.0	(2.4)%
PMI Shipments (million units)	28,950	29,778	(2.8)%
PMI Cigarette Market Share			
Marlboro	22.5%	22.1%	0.4
L&M	11.6%	11.9%	(0.3)
Chesterfield	1.6%	1.7%	(0.1)
Others	1.4%	1.5%	(0.1)
Total	37.1%	37.2%	(0.1)

The estimated total cigarette market decreased by 2.4%, primarily reflecting the impact of price increases. The decrease in our cigarette shipment volume primarily reflected the lower total market. The estimated total industry fine cut category of 40.6 billion cigarette equivalent units decreased by 0.8%. Our market share of the category decreased by 1.4 points to 11.3%.

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

Italy Key Market Data	Full-Year		
	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	72.1	73.8	(2.4)%
PMI Shipments (million units)	38,624	39,717	(2.8)%
PMI Cigarette Market Share			
Marlboro	24.2 %	24.6 %	(0.4)
Chesterfield	11.5 %	11.0 %	0.5
Philip Morris	8.5 %	9.2 %	(0.7)
Others	8.2 %	8.9 %	(0.7)
Total	52.4 %	53.7 %	(1.3)

The estimated total cigarette market decreased by 2.4%, primarily reflecting the impact of price increases. The decline of our cigarette shipments, down by 4.8% excluding the net impact of distributor inventory movements, 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 6.6 billion cigarette equivalent units increased by 3.5%. Our market share of the category decreased by 1.9 points to 39.2%.

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

Poland Key Market Data	Full-Year		
	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	41.3	41.1	0.5 %
PMI Shipments (million units)	17,485	16,763	4.3 %
PMI Cigarette Market Share			
Marlboro	11.6 %	11.4 %	0.2
L&M	18.5 %	18.1 %	0.4
Chesterfield	9.1 %	8.6 %	0.5
Others	3.1 %	2.7 %	0.4
Total	42.3 %	40.8 %	1.5

The estimated total cigarette market increased by 0.5%, primarily reflecting a lower prevalence of non-duty paid products. The increase in our cigarette shipment volume was mainly driven by higher cigarette market share, principally L&M, reflecting the positive impact of brand support, Chesterfield, benefiting from its 100s and super-slims variants, and RGD in "Others," up by 0.4 points to 2.6%. The estimated total industry fine cut category of 4.1 billion cigarette equivalent units increased by 3.3%. Our market share of the category decreased by 4.7 points to 26.7%, mainly due to increased price competition at the bottom of the market.

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

Spain Key Market Data

	Full-Year		
	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	46.7	46.7	(0.1)%
PMI Shipments (million units)	16,365	15,435	6.0 %
PMI Cigarette Market Share			
Marlboro	18.0 %	17.0 %	1.0
Chesterfield	8.6 %	9.1 %	(0.5)
L&M	5.4 %	5.8 %	(0.4)
Others	1.9 %	1.5 %	0.4
Total	33.9 %	33.4 %	0.5

The estimated total cigarette market decreased by 0.1%, reflecting an improved 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 1.6%, 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 9.3 billion cigarette equivalent units decreased by 2.7%. Our market share of the fine cut category decreased by 1.9 points to 11.6%.

Eastern Europe, Middle East & Africa:

Eastern Europe, Middle East & Africa	For the Years Ended December 31,			
(in millions)	2016	2015	Variance	%
Net revenues	$18,286	$18,328	$(42)	(0.2)%
Excise taxes on products	11,286	10,964	322	2.9 %
Net revenues, excluding excise taxes on products	7,000	7,364	(364)	(4.9)%
Operating companies income	3,016	3,425	(409)	(11.9)%

Net revenues, which include excise taxes billed to customers, decreased by $42 million. Excluding excise taxes, net revenues decreased by $364 million, due to:

- unfavorable currency ($600 million) and
- unfavorable volume/mix ($348 million), partly offset by
- price increases ($584 million).

Operating companies income decreased by $409 million during 2016. This decrease was due primarily to:

- unfavorable currency ($839 million) and
- unfavorable volume/mix ($333 million), partly offset by
- price increases ($584 million) and
- lower marketing, administration and research costs ($170 million).

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

Our cigarette shipment volume decreased by 2.9% to 271.4 billion units, mainly due to North Africa, primarily Algeria, and Russia, partially offset by Saudi Arabia and Ukraine. Cigarette shipment volume of Marlboro decreased by 8.5% to 73.8 billion units, principally due to Algeria and Egypt, partly offset by Saudi Arabia. Cigarette shipment volume of Parliament increased by 1.0% to 33.9 billion units, driven by Saudi Arabia, Turkey and Ukraine, partly offset by Russia. Cigarette shipment volume of L&M increased by 1.9% to 52.2 billion units, driven notably by Algeria, Kazakhstan and Ukraine, partly offset by Russia and Turkey.

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

	Full-Year					
	2016		2015		Change % / p.p.	
Total Cigarette Market (billion units)	139.0		138.5		0.4	%
PMI Shipments (million units)	34,035		38,111		(10.7	)%
PMI Cigarette Market Share						
Marlboro	8.5	%	13.7	%	(5.2	)
L&M	12.5	%	11.9	%	0.6	
Others	2.7	%	2.3	%	0.4	
Total	23.7	%	27.9	%	(4.2	)

The estimated total cigarette market increased by 0.4%, driven by Egypt, Morocco and Tunisia, partly offset by Algeria. The decrease in our cigarette shipment volume reflected lower market share, mainly due to Marlboro in Algeria, principally resulting from the impact of excise tax-driven price increases, as well as lower-than-anticipated acceptance of Architecture 2.0 for Marlboro Round Taste.

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

Russia Key Market Data

	Full-Year		
	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	280.7	294.1	(4.6)%
PMI Shipments (million units)	79,651	84,422	(5.7)%
PMI Cigarette Market Share			
Marlboro	1.4 %	1.4 %	—
Parliament	3.8 %	3.9 %	(0.1)
Bond Street	8.4 %	8.4 %	—
Others	13.6 %	14.7 %	(1.1)
Total	27.2 %	28.4 %	(1.2)

The estimated total cigarette market decreased by 4.6%, mainly due to the impact of excise tax-driven price increases. The decrease in our cigarette shipment volume, down by 8.3% excluding the impact of estimated distributor inventory movements, mainly reflected the lower total market, and lower cigarette market share primarily due to a decline in "Others" of mid-price L&M and Chesterfield and super-low Optima, resulting from the timing of retail price increases compared to competition.

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

Turkey Key Market Data

	Full-Year		
	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	105.5	103.2	2.2 %
PMI Shipments (million units)	49,624	49,014	1.2 %
PMI Cigarette Market Share			
Marlboro	10.2 %	9.5 %	0.7
Parliament	11.7 %	11.6 %	0.1
Lark	7.4 %	7.6 %	(0.2)
Others	15.0 %	15.1 %	(0.1)
Total	44.3 %	43.8 %	0.5

The estimated total cigarette market increased by 2.2%, primarily reflecting a lower prevalence of illicit trade. The increase in our cigarette shipment volume was mainly driven by the higher total market. Our higher market share, led by Marlboro, primarily reflecting the growth of its slimmer Touch variant, and Chesterfield, partly offset by L&M in "Others."

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

Ukraine Key Market Data

	Full-Year		
	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	72.7	70.6	2.9 %
PMI Shipments (million units)	22,014	19,195	14.7 %
PMI Cigarette Market Share			
Marlboro	3.2 %	3.8 %	(0.6)
Parliament	3.0 %	2.9 %	0.1
Bond Street	10.1 %	8.3 %	1.8
Others	13.6 %	15.0 %	(1.4)
Total	29.9 %	30.0 %	(0.1)

The estimated total cigarette market increased by 2.9%, 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 in "Others."

Asia:

Asia	For the Years Ended December 31,			
(in millions)	2016	2015	Variance	%
Net revenues	$20,531	$19,469	$1,062	5.5 %
Excise taxes on products	11,850	11,266	584	5.2 %
Net revenues, excluding excise taxes on products	8,681	8,203	478	5.8 %
Operating companies income	3,196	2,886	310	10.7 %

Net revenues, which include excise taxes billed to customers, increased by $1.1 billion. Excluding excise taxes, net revenues increased by $478 million, due primarily to:

- price increases ($335 million) and
- favorable volume/mix ($151 million).

Net revenues include $666 million in 2016 related to sale of RRPs, mainly driven by Japan. Excluding excise taxes, net revenues for RRPs were $666 million in 2016. In some jurisdictions, including Japan, we are not responsible for collecting excise taxes.

Operating companies income increased by $310 million during 2016. This increase was due primarily to:

- price increases ($335 million),
- favorable currency ($52 million) and
- lower marketing, administration and research costs ($28 million), partly offset by
- unfavorable volume/mix ($106 million).

Asia - PMI Cigarette Shipment Volume

Our cigarette shipment volume decreased by 7.6% to 260.0 billion units, mainly due to: Indonesia; Pakistan, reflecting a lower total estimated cigarette market resulting from excise tax-driven price increases and the growth of illicit trade; the Philippines; and Thailand, primarily reflecting the impact of excise tax-driven price increases in the first quarter of 2016, as well as lower market share; and in-switching from our cigarette brands to IQOS Consumables; 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 4.0% to 76.5 billion units, mainly driven by Korea and the Philippines, partly offset by Vietnam, as well as in-switching from that brand to IQOS Consumables. Cigarette shipment volume of Parliament increased by 7.5% to 10.1 billion units, driven by Korea. Cigarette shipment volume of Lark decreased by 3.8% to 17.6 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

	Full-Year					
	2016		2015		Change % / p.p.	
Total Cigarette Market (billion units)	315.6		320.0		(1.4	)%
PMI Shipments (million units)	105,524		109,840		(3.9	)%
PMI Cigarette Market Share						
Sampoerna A	14.0	%	14.6	%	(0.6	)
Dji Sam Soe	6.5	%	6.9	%	(0.4	)
U Mild	4.2	%	4.7	%	(0.5	)
Others	8.7	%	8.1	%	0.6	
Total	33.4	%	34.3	%	(0.9	)

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	Indonesia Segmentation Data Full-Year		
	2016	2015	Change p.p.
Segment % of Total Market			
Hand-Rolled Kretek (SKT)	18.2 %	19.1 %	(0.9)
Machine-Made Kretek (SKM)	75.8 %	74.7 %	1.1
Whites (SPM)	6.0 %	6.2 %	(0.2)
Total	100.0%	100.0%	—
PMI % Share of Segment			
Hand-Rolled Kretek (SKT)	37.3 %	37.7 %	(0.4)
Machine-Made Kretek (SKM)	28.9 %	29.7 %	(0.8)
Whites (SPM)	79.5 %	80.3 %	(0.8)

The estimated total cigarette market decreased by 1.4%, 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 lower market share, reflecting the soft performance of our SKM portfolio, due to competitors' discounted product offerings, and our SKT portfolio, broadly in line with industry trends, as well as a lower estimated total market.

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

	Japan Key Market Data Full-Year		
	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	173.8	182.3	(4.6)%
PMI Shipments (million units)	43,915	45,690	(3.9)%
PMI Cigarette Market Share			
Marlboro	10.9 %	11.3 %	(0.4)
Parliament	2.4 %	2.3 %	0.1
Lark	9.9 %	9.9 %	—
Others	1.7 %	1.8 %	(0.1)
Total	24.9 %	25.3 %	(0.4)

The estimated total cigarette market decreased by 4.6%, 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 6.5%. The decline was mainly due to a lower total cigarette market, as well as lower cigarette market share, reflecting the impact of competitors' retail pricing, competitors' differentiated menthol taste product offerings and in-switching from our cigarette brands to IQOS Consumables.

The estimated national market share of IQOS Consumables was 2.9%, bringing our total combined national market share to 27.1%, up by 1.7 points. We calculate national market share for IQOS Consumables in Japan as the total sales volume for IQOS Consumables as a percentage of the total estimated sales volume for cigarettes and IQOS Consumables.

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

Korea Key Market Data

	Full-Year		
	2016	2015	Change % / p.p.
Total Cigarette Market (billion units)	73.6	67.3	9.4 %
PMI Shipments (million units)	15,490	14,201	9.1 %
PMI Cigarette Market Share			
Marlboro	9.6 %	9.6 %	—
Parliament	8.5 %	8.4 %	0.1
Virginia S.	2.4 %	2.6 %	(0.2)
Others	0.5 %	0.6 %	(0.1)
Total	21.0 %	21.2 %	(0.2)

Excluding a favorable comparison with the prior year driven by estimated trade inventory movements, the estimated total cigarette market increased by 4.3%, reflecting the normalization of the market following the disruptive excise tax increase of 120% in January 2015. The growth in our cigarette shipment volume primarily reflected the higher estimated total market.

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

Philippines Key Market Data

Full-Year