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

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2016
OR

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number 001-33708
Philip Morris International Inc.

(Exact name of registrant as specified in its charter)

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

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

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

Former name, former address and former fiscal year, if changed since last report
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

company” in Rule 12b-2 of the Exchange Act.

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

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

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

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

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PART I – FINANCIAL INFORMATION
Item 1. Financial Statements.
Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(in millions of dollars)
(Unaudited)

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

See notes to condensed consolidated financial statements.
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Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Balance Sheets (Continued)
(in millions of dollars, except share data)
(Unaudited)

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

See notes to condensed consolidated financial statements.

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

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

See notes to condensed consolidated financial statements.

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

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

See notes to condensed consolidated financial statements.

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

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

See notes to condensed consolidated financial statements

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

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

See notes to condensed consolidated financial statements

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

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

See notes to condensed consolidated financial statements.

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

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

See notes to condensed consolidated financial statements.

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

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

See notes to condensed consolidated financial statements.

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

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

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

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

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

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

Note 3. Stock Plans:

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

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

Restricted share unit (RSU) awards

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

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

Performance share unit (PSU) awards

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

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

Note 4. Benefit Plans:

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

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

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

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

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

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

Note 5. Goodwill and Other Intangible Assets, net:

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

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

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

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

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

Additional details of other intangible assets were as follows:

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

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

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

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

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

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

PMI completed its review of goodwill for potential impairment using a discounted cash flow model, supported by the market valuation approach. No impairment charge was required as a result of this review.
During the second quarter of 2016, PMI completed its annual review of non-amortizable intangible assets for potential impairment, and no impairment charges were required as a result of this review.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Contingent Features

PMI’s derivative instruments do not contain contingent features.

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

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

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

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

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

Note 8. Segment Reporting:

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

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

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

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Philip Morris International Inc. and Subsidiaries
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Segment data were as follows:

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

Note 9. Contingencies:

Tobacco-Related Litigation

Legal proceedings covering a wide range of matters are pending or threatened against us, and/or our subsidiaries, and/or our indemnitees in various jurisdictions. Our indemnitees include distributors, licensees, and others that have been named as parties in certain cases and that we have agreed to defend, as well as to pay costs and some or all of judgments, if any, that may be entered against them. Pursuant to the terms of the Distribution Agreement between Altria Group, Inc. ("Altria") and PMI, PMI will indemnify Altria and Philip Morris USA Inc. ("PM USA"), a U.S. tobacco subsidiary of Altria, for tobacco product claims based in substantial part on products manufactured by PMI or contract manufactured for PMI by PM USA, and PM USA will indemnify PMI for tobacco product claims based in substantial part on products manufactured by PM USA, excluding tobacco products contract manufactured for PMI.
It is possible that there could be adverse developments in pending cases against us and our subsidiaries. An unfavorable outcome or settlement of pending tobacco-related litigation could encourage the commencement of additional litigation.
Damages claimed in some of the tobacco-related litigation are significant and, in certain cases in Brazil, Canada and Nigeria, range into the billions of U.S. dollars. The variability in pleadings in multiple jurisdictions, together with the actual experience of management in litigating claims, demonstrate that the monetary relief that may be specified in a lawsuit bears little relevance to the ultimate outcome. Much of the tobacco-related litigation is in its early stages, and litigation is subject to uncertainty. However, as discussed below, we have to date been largely successful in defending tobacco-related litigation.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

In the second health care cost recovery case in Nigeria, The Attorney General of Kano State v. British American Tobacco (Nigeria) Limited, et al., High Court of Kano State, Kano, Nigeria, filed May 9, 2007, we and other members of the industry are defendants. Plaintiff seeks reimbursement for the cost of treating alleged smoking-related diseases for the past 20 years, payment of anticipated costs of treating alleged smoking-related diseases for the next 20 years, various forms of injunctive relief, plus punitive damages. We are in the process of making challenges to service and the court's jurisdiction. Currently, the case is stayed in the trial court pending the appeals of certain co-defendants relating to service objections.

In the third health care cost recovery case in Nigeria, The Attorney General of Gombe State v. British American Tobacco (Nigeria) Limited, et al., High Court of Gombe State, Gombe, Nigeria, filed October 17, 2008, we and other members of the industry are defendants. Plaintiff seeks reimbursement for the cost of treating alleged smoking-related diseases for the past 20 years, payment of anticipated costs of treating alleged smoking-related diseases for the next 20 years, various forms of injunctive relief, plus punitive damages. In February 2011, the court ruled that the plaintiff had not complied with the procedural steps necessary to serve us. As a result of this ruling, plaintiff must re-serve its claim. We have not yet been re-served.

In the fourth health care cost recovery case in Nigeria, The Attorney General of Oyo State, et al., v. British American Tobacco (Nigeria) Limited, et al., High Court of Oyo State, Ibadan, Nigeria, filed May 25, 2007, we and other members of the industry are defendants. Plaintiffs seek reimbursement for the cost of treating alleged smoking-related diseases for the past 20 years, payment of anticipated costs of treating alleged smoking-related diseases for the next 20 years, various forms of injunctive relief, plus punitive damages. We challenged service as improper. In June 2010, the court ruled that plaintiffs did not have leave to serve the writ of summons on the defendants and that they must re-serve the writ. We have not yet been re-served.

In the fifth health care cost recovery case in Nigeria, The Attorney General of Ogun State v. British American Tobacco (Nigeria) Limited, et al., High Court of Ogun State, Abeokuta, Nigeria, filed February 26, 2008, we and other members of the industry are defendants. Plaintiff seeks reimbursement for the cost of treating alleged smoking-related diseases for the past 20 years, payment of anticipated costs of treating alleged smoking-related diseases for the next 20 years, various forms of injunctive relief, plus punitive damages. In May 2010, the trial court rejected our service objections. We have appealed.

In the health care cost recovery case in Korea, the National Health Insurance Service v. KT&G, et. al., filed April 14, 2014, our subsidiary and other Korean manufacturers are defendants. Plaintiff alleges that defendants concealed the health hazards of smoking, marketed to youth, added ingredients to make their products more harmful and addictive, and misled consumers into believing that Lights cigarettes are safer than regular cigarettes. The National Health Insurance Service seeks to recover approximately $53.7 million allegedly incurred in treating 3,484 patients with small cell lung cancer, squamous cell lung cancer, and squamous cell laryngeal cancer from 2003 to 2012. The case is now in the evidentiary phase.

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

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

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

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

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

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

Other Litigation

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Credit Facilities:

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

(in billions)

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

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

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

Note 12. Fair Value Measurements:
The authoritative guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The guidance also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of input that may be used to measure fair value, which are as follows:

Level 1 - Quoted prices in active markets for identical assets or liabilities;

Level 2 - Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

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

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

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

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

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

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

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

Reclassifications from Other Comprehensive Earnings

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

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Note 14. Balance Sheet Offsetting:

Derivative Financial Instruments

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

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

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

Note 15. Investments in Unconsolidated Subsidiaries:

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

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

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

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

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

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

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

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

Note 16. Acquisitions and Other Business Arrangements:

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

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

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

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

Note 17. Sale of Accounts Receivable:

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

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

Note 18. New Accounting Standards:

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

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

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

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

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

1. retrospectively to each prior period presented; or

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

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

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

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

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

Our products are sold in more than 180 markets, and in many of these markets they hold the number one or number two market share position. We have a wide range of premium, mid-price and low-price brands. Our portfolio comprises both international and local brands. We are engaged in the development and commercialization of Reduced-Risk Products ("RRPs"). RRPs is the term we use to refer to products with the potential to reduce individual risk and population harm in comparison to smoking cigarettes.

We use the term net revenues to refer to our operating revenues from the sale of our products, net of sales and promotion incentives. Our net revenues and operating income are affected by various factors, including the volume of products we sell, the price of our products, changes in currency exchange rates and the mix of products we sell. Mix is a term used to refer to the proportionate value of premium-price brands to mid-price or low-price brands in any given market (product mix). Mix can also refer to the proportion of shipment volume in more profitable markets versus shipment volume in less profitable markets (geographic mix). We often collect excise taxes from our customers and then remit them to governments, and, in those circumstances, we include the excise taxes in our net revenues and in excise taxes on products. Our cost of sales consists principally of tobacco leaf, non-tobacco raw materials, labor and manufacturing costs.

Our marketing, administration and research costs include the costs of marketing and selling our products, other costs generally not related to the manufacture of our products (including general corporate expenses), and costs incurred to develop new products. The most significant components of our marketing, administration and research costs are marketing and sales expenses and general and administrative expenses.

Philip Morris International Inc. is a legal entity separate and distinct from our direct and indirect subsidiaries. Accordingly, our right, and thus the right of our creditors and stockholders, to participate in any distribution of the assets or earnings of any subsidiary is subject to the prior rights of creditors of such subsidiary, except to the extent that claims of our company itself as a creditor may be recognized. As a holding company, our principal sources of funds, including funds to make payment on our debt securities, are from the receipt of dividends and repayment of debt from our subsidiaries. Our principal wholly owned and majority-owned subsidiaries currently are not limited by long-term debt or other agreements in their ability to pay cash dividends or to make other distributions with respect to their common stock.

Certain prior years' amounts have been reclassified to conform with the current year's presentation. In the fourth quarter of 2015, to further align with the Member State composition of the European Union, PMI transferred the management of its operations in Bulgaria, Croatia, Romania and Slovenia from its EEMA segment to its European Union segment, resulting in the reclassification of prior year amounts between the two segments. The changes did not have an impact on our consolidated financial position, results of operations or cash flows in any of the periods presented.

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Executive Summary

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

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

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

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

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

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

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

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

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

partially offset by

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

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

| | Diluted EPS | % Growth |
|---|---|---|
| For the three months ended September 30, 2015 | $ | |