Philip Morris International Inc.
Form 10-Q
October 31, 2014
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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, 2014
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 29, 2014, there were 1,553,715,140 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" refers 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, 2014	December 31, 2013
ASSETS		
Cash and cash equivalents	$2,043	$2,154
Receivables (less allowances of $49 in 2014 and $53 in 2013)	3,785	3,853
Inventories:		
Leaf tobacco	3,316	3,709
Other raw materials	1,749	1,596
Finished product	2,914	4,541
	7,979	9,846
Deferred income taxes	381	502
Other current assets	573	497
Total current assets	14,761	16,852
Property, plant and equipment, at cost	13,361	13,957
Less: accumulated depreciation	7,088	7,202
	6,273	6,755
Goodwill (Note 5)	8,707	8,893
Other intangible assets, net (Note 5)	3,134	3,193
Investments in unconsolidated subsidiaries (Note 16)	1,371	1,536
Other assets	1,155	939
TOTAL ASSETS	$35,401	$38,168

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, 2014	December 31, 2013
LIABILITIES		
Short-term borrowings (Note 12)	$2,091	$2,400
Current portion of long-term debt (Note 12)	1,357	1,255
Accounts payable	1,255	1,274
Accrued liabilities:		
Marketing and selling	587	503
Taxes, except income taxes	4,961	6,492
Employment costs	1,251	949
Dividends payable	1,568	1,507
Other	1,175	1,382
Income taxes	744	1,192
Deferred income taxes	128	112
Total current liabilities	15,117	17,066
Long-term debt (Note 12)	25,395	24,023
Deferred income taxes	1,709	1,477
Employment costs	1,250	1,313
Other liabilities	607	563
Total liabilities	44,078	44,442
Contingencies (Note 10)		
STOCKHOLDERS' (DEFICIT) EQUITY		
Common stock, no par value (2,109,316,331 shares issued in 2014 and 2013)	—	—
Additional paid-in capital	692	723
Earnings reinvested in the business	29,192	27,843
Accumulated other comprehensive losses	(5,022)	(4,190)
	24,862	24,376
Less: cost of repurchased stock (553,357,455 and 520,313,919 shares in 2014 and 2013, respectively)	34,974	32,142
Total PMI stockholders' deficit	(10,112)	(7,766)
Noncontrolling interests	1,435	1,492
Total stockholders' deficit	(8,677)	(6,274)
TOTAL LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY	$35,401	$38,168

See notes to condensed consolidated financial statements.

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

	For the Nine Months Ended September 30,	
	2014	2013
Net revenues	$60,165	$59,639
Cost of sales	7,804	7,808
Excise taxes on products	37,595	36,211
Gross profit	14,766	15,620
Marketing, administration and research costs	5,026	5,214
Asset impairment and exit costs (Note 2)	503	8
Amortization of intangibles	67	71
Operating income	9,170	10,327
Interest expense, net	789	721
Earnings before income taxes	8,381	9,606
Provision for income taxes	2,446	2,777
Equity (income)/loss in unconsolidated subsidiaries, net	(74)	15
Net earnings	6,009	6,814
Net earnings attributable to noncontrolling interests	128	225
Net earnings attributable to PMI	$5,881	$6,589
Per share data (Note 8):		
Basic earnings per share	$3.73	$4.02
Diluted earnings per share	$3.73	$4.02
Dividends declared	$2.88	$2.64

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,	
	2014	2013
Net revenues	$21,335	$20,629
Cost of sales	2,734	2,618
Excise taxes on products	13,479	12,702
Gross profit	5,122	5,309
Marketing, administration and research costs	1,763	1,687
Asset impairment and exit costs (Note 2)	(9)	—
Amortization of intangibles	23	23
Operating income	3,345	3,599
Interest expense, net	267	239
Earnings before income taxes	3,078	3,360
Provision for income taxes	918	952
Equity (income)/loss in unconsolidated subsidiaries, net	(38)	6
Net earnings	2,198	2,402
Net earnings attributable to noncontrolling interests	43	62
Net earnings attributable to PMI	$2,155	$2,340
Per share data (Note 8):		
Basic earnings per share	$1.38	$1.44
Diluted earnings per share	$1.38	$1.44
Dividends declared	$1.00	$0.94

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,	
	2014	2013
Net earnings	$6,009	$6,814
Other comprehensive earnings (losses), net of income taxes:		
Change in currency translation adjustment:		
Unrealized losses, net of income taxes of ($346) in 2014 and $119 in 2013	(944)	(1,383)
Change in net loss and prior service cost:		
Net losses and prior service costs, net of income taxes of $4 in 2014 and $- in 2013	(41)	—
Amortization of net losses, prior service costs and net transition costs, net of income taxes of ($37) in 2014 and ($41) in 2013	119	178
Change in fair value of derivatives accounted for as hedges:		
Gains transferred to earnings, net of income taxes of $4 in 2014 and $23 in 2013	(10)	(158)
Gains recognized, net of income taxes of ($1) in 2014 and ($23) in 2013	21	158
Total other comprehensive losses	(855)	(1,205)
Total comprehensive earnings	5,154	5,609
Less comprehensive earnings attributable to:		
Noncontrolling interests	105	183
Redeemable noncontrolling interest (Note 7)	—	52
Comprehensive earnings attributable to PMI	$5,049	$5,374

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,	
	2014	2013
Net earnings	$2,198	$2,402
Other comprehensive earnings (losses), net of income taxes:		
Change in currency translation adjustment:		
Unrealized losses, net of income taxes of ($287) in 2014 and $95 in 2013	(830)	(661)
Change in net loss and prior service cost:		
Net losses and prior service costs, net of income taxes of $1 in 2014 and $- in 2013	—	—
Amortization of net losses, prior service costs and net transition costs, net of income taxes of ($11) in 2014 and ($14) in 2013	38	60
Change in fair value of derivatives accounted for as hedges:		
Losses (gains) transferred to earnings, net of income taxes of $2 in 2014 and $9 in 2013	3	(63)
Gains recognized, net of income taxes of ($6) in 2014 and $- in 2013	56	2
Total other comprehensive losses	(733)	(662)
Total comprehensive earnings	1,465	1,740
Less comprehensive earnings attributable to:		
Noncontrolling interests	18	95
Redeemable noncontrolling interest (Note 7)	—	9
Comprehensive earnings attributable to PMI	$1,447	$1,636

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, 2014 and 2013
(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, 2013	$—	$ 1,334	$ 25,076	$ (3,604)	$ (26,282)	$ 322	$ (3,154)
Net earnings			6,589			150 [a]	6,739 [a]
Other comprehensive earnings (losses), net of income taxes				(1,165)		(17) [a]	(1,182) [a]
Issuance of stock awards and exercise of stock options		17			135		152
Dividends declared ($2.64 per share)			(4,306)				(4,306)
Payments to noncontrolling interests						(176)	(176)
Purchase of subsidiary shares from noncontrolling interests		(672)		(51)		(41)	(764)
Common stock repurchased					(4,500)		(4,500)
Balances, September 30, 2013	$—	$ 679	$ 27,359	$ (4,820)	$ (30,647)	$ 238	$ (7,191)
Balances, January 1, 2014	$—	$ 723	$ 27,843	$ (4,190)	$ (32,142)	$ 1,492	$ (6,274)
Net earnings			5,881			128	6,009
Other comprehensive earnings (losses), net of income taxes				(832)		(23)	(855)
Issuance of stock awards and exercise of stock options		(31)			168		137
Dividends declared ($2.88 per share)			(4,532)				(4,532)
Payments to noncontrolling interests						(168)	(168)
Common stock repurchased					(3,000)		(3,000)
Other						6	6
Balances, September 30, 2014	$—	$ 692	$ 29,192	$ (5,022)	$ (34,974)	$ 1,435	$ (8,677)

(a) For the nine months ended September 30, 2013, net earnings attributable to noncontrolling interests exclude $75 million of earnings related to the redeemable noncontrolling interest, which was originally reported outside of the equity section in the condensed consolidated balance sheet at September 30, 2013. Other comprehensive earnings, net of income taxes, also exclude $23 million of net currency translation adjustment losses related to the redeemable noncontrolling interest at September 30, 2013. In December 2013, the redeemable noncontrolling interest balance of $1,275 million was reclassified to noncontrolling interests due to the termination of an exit rights agreement. See Note 7. Redeemable Noncontrolling Interests for further details.

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,	
	2014	2013
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES		
Net earnings	$6,009	$6,814
Adjustments to reconcile net earnings to operating cash flows:		
Depreciation and amortization	660	659
Deferred income tax provision	52	73
Asset impairment and exit costs, net of cash paid	240	(9)
Cash effects of changes, net of the effects from acquired companies:		
Receivables, net	(176)	(206)
Inventories	1,326	546
Accounts payable	127	26
Income taxes	(438)	(606)
Accrued liabilities and other current assets	(1,408)	183
Pension plan contributions	(98)	(82)
Other	91	417
Net cash provided by operating activities	6,385	7,815
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES		
Capital expenditures	(804)	(821)
Purchase of businesses, net of acquired cash	(110)	—
Investments in unconsolidated subsidiaries	(22)	(656)
Other	163	6
Net cash used in investing activities	(773)	(1,471)

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, 2014	2013
CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES		
Short-term borrowing activity by original maturity:		
Net issuances - maturities of 90 days or less	$233	$215
Issuances - maturities longer than 90 days	977	1,610
Repayments - maturities longer than 90 days	(1,435)	(516)
Long-term debt proceeds	3,632	5,205
Long-term debt repaid	(1,240)	(2,738)
Repurchases of common stock	(3,050)	(4,516)
Issuance of common stock	1	—
Dividends paid	(4,471)	(4,202)
Purchase of subsidiary shares from noncontrolling interests	—	(703)
Other	(209)	(258)
Net cash used in financing activities	(5,562)	(5,903)
Effect of exchange rate changes on cash and cash equivalents	(161)	(42)
Cash and cash equivalents:		
(Decrease) Increase	(111)	399
Balance at beginning of period	2,154	2,983
Balance at end of period	$2,043	$3,382

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 to the current year's presentation, due to the separate disclosure of investments in unconsolidated subsidiaries. For further details, see Note 16. Investments in Unconsolidated Subsidiaries.
These statements should be read in conjunction with the audited consolidated financial statements and related notes, which appear in PMI’s Annual Report to Shareholders and which are incorporated by reference into PMI’s Annual Report on Form 10-K for the year ended December 31, 2013.

Note 2. Asset Impairment and Exit Costs:
Pre-tax asset impairment and exit costs consisted of the following:

(in millions)	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2014	2013	2014	2013
Separation programs:				
European Union	$343	$—	$(16)	$—
Asia	24	—	—	—
Latin America & Canada	3	—	3	—
Total separation programs	370	—	(13)	—
Contract termination charges:				
Asia	—	8	—	—
Total contract termination charges	—	8	—	—
Asset impairment charges:				
European Union	129	—	—	—
Latin America & Canada	4	—	4	—
Total asset impairment charges	133	—	4	—
Asset impairment and exit costs	$503	$8	$(9)	$—

Movement in Exit Cost Liabilities
The movement in exit cost liabilities for the nine months ended September 30, 2014 was as follows:

(in millions)	
Liability balance, January 1, 2014	$308
Charges, net	370
Cash spent	(263)
Currency/other	(48)
Liability balance, September 30, 2014	$367

Cash payments related to exit costs at PMI were $263 million and $33 million for the nine months and three months ended September 30, 2014, respectively, and $17 million and $5 million for the nine months and three months ended September 30, 2013, respectively. Future cash payments for exit costs incurred to date are expected to be approximately $367 million, and will be substantially paid by the third quarter of 2015.

The pre-tax asset impairment and exit costs shown above are primarily a result of the following:

The Netherlands

On April 4, 2014, PMI announced the initiation by its affiliate, Philip Morris Holland B.V. ("PMH"), of consultations with employee representatives on a proposal to discontinue cigarette production at its factory located in Bergen op Zoom, the Netherlands. PMH reached an agreement with the trade unions and their members on a social plan, and ceased cigarette production on September 1, 2014. For the nine months ended September 30, 2014, total pre-tax asset impairment and exit costs of $472 million were recorded and for the three months ended September 30, 2014 a reversal of $16 million was recorded for this program due to a change in estimate in the European Union segment.

Other
Separation Program Charges
PMI recorded other pre-tax separation program charges of $27 million and $3 million for the nine months and three months ended September 30, 2014 related to severance costs for factory closures in Australia and Canada.

Contract Termination Charges
During the nine months ended September 30, 2013, PMI recorded exit costs of $8 million related to the termination of distribution agreements.

Asset Impairment Charges
PMI recorded other pre-tax asset impairment charges of $4 million for the nine months and three months ended September 30, 2014 related to a factory closure in Canada.

Note 3. Stock Plans:
In May 2012, PMI's stockholders approved the Philip Morris International Inc. 2012 Performance Incentive Plan (the "2012 Plan"). The 2012 Plan replaced the 2008 Performance Incentive Plan (the "2008 Plan") and, as a result, there will be no additional grants under the 2008 Plan. Under the 2012 Plan, PMI may grant to eligible employees restricted stock, restricted stock units and deferred stock 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, 2014, shares available for grant under the 2012 Plan were 24,799,010.

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, 2014, shares available for grant under the plan were 715,904.
During the nine months ended September 30, 2014, PMI granted 2.4 million shares of deferred stock awards to eligible employees at a weighted-average grant date fair value of $77.74 per share. During the nine months ended September 30, 2013, PMI granted 2.8 million shares of deferred stock awards to eligible employees at a weighted-average grant date fair value of $88.43 per share. PMI recorded compensation expense related to stock awards of $161 million and $172 million during the nine months ended September 30, 2014 and 2013, respectively and $48 million during the three months ended September 30, 2014 and 2013, respectively. As of September 30, 2014, PMI had $236 million of total unrecognized compensation cost related to non-vested deferred stock 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, subject to earlier vesting on death or disability or normal retirement, or separation from employment by mutual agreement after reaching age 58.

During the nine months ended September 30, 2014, 3.5 million shares of PMI restricted stock and deferred stock awards vested. The grant date fair value of all the vested shares was approximately $212 million. The total fair value of restricted stock and deferred stock awards that vested during the nine months ended September 30, 2014 was approximately $277 million.

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.

Pension Plans

Components of Net Periodic Benefit Cost

Net periodic pension cost consisted of the following:

	U.S. Plans For the Nine Months Ended September 30,		Non-U.S. Plans For the Nine Months Ended September 30,	
(in millions)	2014	2013	2014	2013
Service cost	$4	$5	$155	$190
Interest cost	12	12	155	126
Expected return on plan assets	(12)	(11)	(265)	(257)
Amortization:				
Net loss	5	8	87	151
Prior service cost	—	1	5	7
Net transition obligation	—	—	—	1
Net periodic pension cost	$9	$15	$137	$218

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

	U.S. Plans For the Three Months Ended September 30,		Non-U.S. Plans For the Three Months Ended September 30,	
(in millions)	2014	2013	2014	2013
Service cost	$1	$1	$51	$63
Interest cost	4	4	52	42
Expected return on plan assets	(4)	(3)	(88)	(84)
Amortization:				
Net loss	2	2	30	49
Prior service cost	—	—	1	2
Net periodic pension cost	$3	$4	$46	$72

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 $98 million were made to the pension plans during the nine months ended September 30, 2014. Currently, PMI anticipates making additional contributions during the remainder of 2014 of approximately $70 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 rates.

Note 5. Goodwill and Other Intangible Assets, net:
Goodwill and other intangible assets, net, by segment was as follows:

	Goodwill		Other Intangible Assets, net	
(in millions)	September 30, 2014	December 31, 2013	September 30, 2014	December 31, 2013
European Union	$1,472	$1,472	$622	$604
Eastern Europe, Middle East & Africa	544	617	219	228
Asia	3,957	3,960	1,230	1,251
Latin America & Canada	2,734	2,844	1,063	1,110
Total	$8,707	$8,893	$3,134	$3,193

Goodwill is due primarily to 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, 2013, were as follows:

(in millions)	European Union	Eastern Europe, Middle East & Africa	Asia	Latin America & Canada	Total
Balances, December 31, 2013	$1,472	$617	$3,960	$2,844	$8,893
Changes due to:					
Acquisitions	114	—	—	2	116
Currency	(114)	(73)	(3)	(112)	(302)
Balances, September 30, 2014	$1,472	$544	$3,957	$2,734	$8,707

The increase in goodwill from acquisitions was due primarily to the preliminary purchase price allocation for PMI's June 2014 purchase of Nicocigs Limited, a U.K.-based e-vapor company. For further details, see Note 17. Acquisitions and Other Business Arrangements.

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

Additional details of other intangible assets were as follows:

	September 30, 2014		December 31, 2013	
(in millions)	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Non-amortizable intangible assets	$1,780		$1,798	
Amortizable intangible assets	1,945	$591	1,940	$545
Total other intangible assets	$3,725	$591	$3,738	$545

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, distribution networks and non-compete agreements 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, 2014, were as follows:

(dollars in millions)	Gross Carrying Amount	Initial Estimated Useful Lives	Weighted-Average Remaining Useful Life
Trademarks	$1,553	2 - 40 years	24 years
Distribution networks	174	5 - 30 years	13 years
Non-compete agreements	126	3 - 10 years	1 year
Other (including farmer contracts and intellectual property rights)	92	10 - 17 years	12 years
	$1,945		

Pre-tax amortization expense for intangible assets during the nine months ended September 30, 2014 and 2013 was $67 million and $71 million, respectively, and $23 million for each of the three months ended September 30, 2014 and 2013. Amortization expense for each of the next five years is estimated to be $86 million or less, assuming no additional transactions occur that require the amortization of intangible assets.
The decrease in the gross carrying amount of other intangible assets from December 31, 2013, was due primarily to currency movements, partially offset by the preliminary purchase price allocation for PMI's June 2014 purchase of Nicocigs Limited, as well as the purchase of additional patent rights related to an aerosol delivery technology acquired in 2011.
During the first quarter of 2014, PMI completed its annual review of goodwill and non-amortizable intangible assets for potential impairment, and no impairment charges were required as a result of this review.

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 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.

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PMI uses deliverable and non-deliverable forward foreign exchange contracts, foreign currency swaps and foreign currency options, collectively referred to as foreign exchange 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, 2014, PMI had contracts with aggregate notional amounts of $20.7 billion of which $2.9 billion related to cash flow hedges, $2.5 billion related to hedges of net investments in foreign operations and $15.3 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 sheet as of September 30, 2014 and December 31, 2013, were as follows:

	Asset Derivatives			Liability Derivatives		
		Fair Value			Fair Value	
(in millions)	Balance Sheet Classification	At September 30, 2014	At December 31, 2013	Balance Sheet Classification	At September 30, 2014	At December 31, 2013
Foreign exchange contracts designated as hedging instruments	Other current assets	$151	$111	Other accrued liabilities	$15	$44
	Other assets	66	—	Other liabilities	20	46
Foreign exchange contracts not designated as hedging instruments	Other current assets	36	42	Other accrued liabilities	91	12
	Other assets	2	—	Other liabilities	—	14
Total derivatives		$255	$153		$126	$116

Hedging activities, which represent movement in derivatives as well as the respective underlying transactions, had the following effect on PMI's condensed consolidated statements of earnings and other comprehensive earnings for the nine months and three months ended September 30, 2014 and 2013:

(in millions)	For the Nine Months Ended September 30, 2014				
Gain (Loss)	Cash Flow Hedges	Net Investment Hedges	Other Derivatives	Income Taxes	Total
Statement of Earnings:					
Net revenues	$59		$—		$59
Cost of sales	—		—		—
Marketing, administration and research costs	(18)		—		(18)
Operating income	41		—		41
Interest expense, net	(27)		(2)		(29)
Earnings before income taxes	14		(2)		12
Provision for income taxes	(4)		1		(3)
Net earnings attributable to PMI	$10		$(1)		$9
Other Comprehensive Earnings/(Losses):					
Gains transferred to earnings	$(14)			$4	$(10)
Recognized gains	22			(1)	21
Net impact on equity	$8			$3	$11
Currency translation adjustments		$159		$(52)	$107

(in millions)	For the Nine Months Ended September 30, 2013				
Gain (Loss)	Cash Flow Hedges	Net Investment Hedges	Other Derivatives	Income Taxes	Total
Statement of Earnings:					
Net revenues	$213		$—		$213
Cost of sales	6		—		6
Marketing, administration and research costs	—		—		—
Operating income	219		—		219
Interest expense, net	(38)		—		(38)
Earnings before income taxes	181		—		181
Provision for income taxes	(23)		2		(21)
Net earnings attributable to PMI	$158		$2		$160
Other Comprehensive Earnings/(Losses):					
Gains transferred to earnings	$(181)			$23	$(158)
Recognized gains	181			(23)	158
Net impact on equity	$—			$—	$—
Currency translation adjustments		$(28)		$9	$(19)

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(in millions)	For the Three Months Ended September 30, 2014				
Gain (Loss)	Cash Flow Hedges	Net Investment Hedges	Other Derivatives	Income Taxes	Total
Statement of Earnings:					
Net revenues	$27		$—		$27
Cost of sales	—		—		—
Marketing, administration and research costs	(17)		—		(17)
Operating income	10		—		10
Interest expense, net	(11)		(3)		(14)
Earnings before income taxes	(1)		(3)		(4)
Provision for income taxes	(2)		1		(1)
Net earnings attributable to PMI	$(3)		$(2)		$(5)
Other Comprehensive Earnings/(Losses):					
Losses transferred to earnings	$1			$2	$3
Recognized gains	62			(6)	56
Net impact on equity	$63			$(4)	$59
Currency translation adjustments		$123		$(45)	$78

(in millions)	For the Three Months Ended September 30, 2013				
Gain (Loss)	Cash Flow Hedges	Net Investment Hedges	Other Derivatives	Income Taxes	Total
Statement of Earnings:					
Net revenues	$88		$—		$88
Cost of sales	—		—		—
Marketing, administration and research costs	—		—		—
Operating income	88		—		88
Interest expense, net	(16)		(2)		(18)
Earnings before income taxes	72		(2)		70
Provision for income taxes	(9)		1		(8)
Net earnings attributable to PMI	$63		$(1)		$62
Other Comprehensive Earnings/(Losses):					
Gains transferred to earnings	$(72)			$9	$(63)
Recognized gains	2			—	2
Net impact on equity	$(70)			$9	$(61)
Currency translation adjustments		$(44)		$10	$(34)

Each type of hedging activity is described in greater detail below.

Cash Flow Hedges

PMI has entered into foreign exchange contracts to hedge foreign currency exchange risk 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, 2014 and 2013, ineffectiveness related to cash flow hedges was not material. As of September 30, 2014, substantially all of PMI's hedged forecasted transactions are for periods not exceeding the next fifteen 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.

For the nine months and three months ended September 30, 2014 and 2013, foreign exchange contracts that were designated as cash flow hedging instruments impacted the condensed consolidated statements of earnings and comprehensive earnings as follows:

(pre-tax, in millions)	For the Nine Months Ended September 30,				
Derivatives in Cash Flow Hedging Relationship	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		Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings/(Losses) on Derivatives	
		2014	2013	2014	2013
Foreign exchange contracts				$ 22	$ 181
	Net revenues	$59	$213		
	Cost of sales	—	6		
	Marketing, administration and research costs	(18)	—		
	Interest expense, net	(27)	(38)		
Total		$14	$181	$ 22	$ 181

(pre-tax, in millions)	For the Three Months Ended September 30,				
Derivatives in Cash Flow Hedging Relationship	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		Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings/(Losses) on Derivatives	
		2014	2013	2014	2013
Foreign exchange contracts				$ 62	$ 2
	Net revenues	$27	$88		
	Marketing, administration and research costs	(17)	—		
	Interest expense, net	(11)	(16)		
Total		$(1)	$72	$ 62	$ 2

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, 2014 and 2013, these hedges of net investments resulted in gains (losses), net of income taxes of $624 million and $(163) million, respectively. For the three months ended September 30, 2014 and 2013, these hedges of net investments resulted in gains (losses), net of income taxes, of $531 million and $(199) 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, 2014 and 2013, 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.

For the nine months and three months ended September 30, 2014 and 2013, foreign exchange contracts that were designated as net investment hedging instruments impacted the condensed consolidated statements of earnings and comprehensive earnings as follows:

(pre-tax, in millions)	For the Nine Months Ended September 30,				
Derivatives in Net Investment Hedging Relationship	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		Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings/(Losses) on Derivatives	
		2014	2013	2014	2013
Foreign exchange contracts	Interest expense, net	$—	$—	$159	$(28)

(pre-tax, in millions)	For the Three Months Ended September 30,				
Derivatives in Net Investment Hedging Relationship	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		Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings/(Losses) on Derivatives	
		2014	2013	2014	2013
Foreign exchange contracts	Interest expense, net	$—	$—	$123	$(44)

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, 2014 and 2013, the gains (losses) from contracts for which PMI did not apply hedge accounting were $(113) million and $67 million, respectively. For the three months ended September 30, 2014 and 2013, the gains/(losses) from contracts for which PMI did not apply hedge accounting were $(207) million and $87 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.

As a result, for the nine months and three months ended September 30, 2014 and 2013, these items impacted the condensed consolidated statements of earnings as follows:

(pre-tax, in millions)	For the Three Months Ended September 30,				
Derivatives not Designated as Hedging Instruments	Statement of Earnings Classification of Gain/(Loss)	Amount of Gain/(Loss) Recognized in Earnings			
		For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
		2014	2013	2014	2013

Foreign exchange contracts					
	Interest expense, net	$(2)	$—	$(3)	$(2)

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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,	
	2014	2013	2014	2013
Gain at beginning of period	$63	$92	$15	$153
Derivative (gains)/losses transferred to earnings	(10)	(158)	3	(63)
Change in fair value	21	158	56	2
Gain as of September 30,	$74	$92	$74	$92

At September 30, 2014, PMI expects $50 million of derivative gains that are included in accumulated other comprehensive losses to be reclassified to the condensed consolidated statement of earnings within the next twelve months. These gains 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.
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 13. Fair Value Measurements and Note 15. Balance Sheet Offsetting for additional discussion of derivative financial instruments.

Note 7. Redeemable Noncontrolling Interest:
Philippines Business Combination:
On February 25, 2010, PMI's affiliate, Philip Morris Philippines Manufacturing Inc. (“PMPMI”), and Fortune Tobacco Corporation (“FTC”) combined their respective business activities by transferring selected assets and liabilities of PMPMI and FTC to a new company called PMFTC Inc. (“PMFTC”). PMPMI and FTC hold equal economic interests in PMFTC, while PMI manages the day-to-day operations of PMFTC and has a majority of its Board of Directors. Consequently, PMI accounted for the contributed assets and liabilities of FTC as a business combination.
The fair value of the assets and liabilities contributed by FTC in this non-cash transaction was determined to be $1.17 billion. At the time of the business combination, FTC was given the right to sell its interest in PMFTC to PMI, except in certain circumstances, during the period from February 25, 2015, through February 24, 2018, at an agreed-upon value of $1.17 billion, which was recorded on PMI’s condensed consolidated balance sheet as a redeemable noncontrolling interest at the date of the business combination. On December 10, 2013, FTC terminated the agreement related to this exit right. As a result, the amount included in the consolidated balance sheet as redeemable noncontrolling interest at that date was reclassified to noncontrolling interests within stockholders' deficit on the December 31, 2013 consolidated balance sheet.

The redeemable noncontrolling interest balance at September 30, 2013 was $1,283 million. The movement in redeemable noncontrolling interest for the nine months ended September 30, 2013 was as follows:

(in millions)	
Redeemable noncontrolling interest at December 31, 2012	$1,301
Share of net earnings	75
Dividend payments	(70)
Currency translation losses	(23)
Redeemable noncontrolling interest at September 30, 2013	$1,283

Note 8. 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,	
	2014	2013	2014	2013
Net earnings attributable to PMI	$5,881	$6,589	$2,155	$2,340
Less distributed and undistributed earnings attributable to share-based payment awards	27	35	9	12
Net earnings for basic and diluted EPS	$5,854	$6,554	$2,146	$2,328
Weighted-average shares for basic and diluted EPS	1,571	1,630	1,560	1,614

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 2014 and 2013 computations, there were no antidilutive stock options.

Note 9. Segment Reporting:

PMI's subsidiaries and affiliates are engaged in the manufacture and sale of cigarettes and other tobacco 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 European Union; Eastern Europe, Middle East & Africa; Asia; and Latin America & Canada.

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.

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Segment data were as follows:

(in millions)	For the Nine Months Ended September 30, 2014	2013	For the Three Months Ended September 30, 2014	2013
Net revenues:				
European Union	$22,225	$21,255	$7,777	$7,487
Eastern Europe, Middle East & Africa	16,347	15,346	6,111	5,546
Asia	14,515	15,776	4,943	5,144
Latin America & Canada	7,078	7,262	2,504	2,452
Net revenues	$60,165	$59,639	$21,335	$20,629
Earnings before income taxes:				
Operating companies income:				
European Union	$2,875	$3,227	$1,186	$1,207
Eastern Europe, Middle East & Africa	3,218	2,968	1,204	1,088
Asia	2,614	3,567	799	1,097
Latin America & Canada	734	776	267	267
Amortization of intangibles	(67)	(71)	(23)	(23)
General corporate expenses	(130)	(155)	(50)	(43)
Less:				
Equity (income)/loss in unconsolidated subsidiaries, net	(74)	15	(38)	6
Operating income	9,170	10,327	3,345	3,599
Interest expense, net	(789)	(721)	(267)	(239)
Earnings before income taxes	$8,381	$9,606	$3,078	$3,360

Items affecting the comparability of results from operations are asset impairment and exit costs. See Note 2. Asset Impairment and Exit Costs for a breakdown of these costs by segment.

Note 10. 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, Israel 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, if any. 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, we have paid one judgment in a tobacco-related case. That judgment, including costs, was approximately €1,400 (approximately $1,800), and that payment was made in order to appeal an Italian small claims case, which was subsequently reversed on appeal. 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 30, 2014, October 30, 2013 and November 1, 2012:

Type of Case	Number of Cases Pending as of October 30, 2014	Number of Cases Pending as of October 30, 2013	Number of Cases Pending as of November 1, 2012
Individual Smoking and Health Cases	64	61	75
Smoking and Health Class Actions	11	11	10
Health Care Cost Recovery Actions	15	15	15
Lights Class Actions	1	1	2
Individual Lights Cases	2	2	7
Public Civil Actions	2	3	4

Since 1995, when the first tobacco-related litigation was filed against a PMI entity, 427 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. Ten cases have had decisions in favor of plaintiffs. Eight of these cases have subsequently reached final resolution in our favor and two remain on appeal.

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The table below lists the verdicts and post-trial developments in the following cases where verdicts were returned in favor of plaintiffs:

Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
September 2009	Brazil/Bernhardt	Individual Smoking and Health	The Civil Court of Rio de Janeiro found for plaintiff and ordered Philip Morris Brasil to pay R$13,000 (approximately $5,400) in "moral damages."	Philip Morris Brasil filed its appeal against the decision on the merits with the Court of Appeals in November 2009. In February 2010, without addressing the merits, the Court of Appeals annulled the trial court's decision and remanded the case to the trial court to issue a new ruling, which was required to address certain compensatory damage claims made by the plaintiff that the trial court did not address in its original ruling. In July 2010, the trial court reinstated its original decision, while specifically rejecting the compensatory damages claim. Philip Morris Brasil appealed this decision. In March 2011, the Court of Appeals affirmed the trial court's decision and denied Philip Morris Brasil's appeal. The Court of Appeals increased the amount of damages awarded to the plaintiff to R$100,000 (approximately $41,400). Philip Morris Brasil has appealed this decision to the Superior Court of Justice.

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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. The court did not assess actual damages, which were to be assessed in a second phase of the case. The size of the class was not defined in the ruling.	In April 2004, the court clarified its ruling, awarding “moral damages” of R$1,000 (approximately $410) 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 has appealed. In addition, the defendants filed a constitutional appeal to the Federal Supreme Tribunal on the basis that the plaintiff did not have standing to bring the lawsuit. This appeal is still pending.

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 30, 2014, there were a number of smoking and health cases pending against us, our subsidiaries or indemnitees, as follows:

•

64 cases brought by individual plaintiffs in Argentina (23), Brazil (23), Canada (2), Chile (8), Costa Rica (2), Greece (1), Italy (3), the Philippines (1) and Scotland (1), compared with 61 such cases on October 30, 2013, and 75 cases on November 1, 2012; and

- 11 cases brought on behalf of classes of individual plaintiffs in Brazil (2) and Canada (9), compared with 11 such cases on October 30, 2013 and 10 such cases on November 1, 2012.

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 smokers and former smokers and injunctive relief. The verdict and post-trial developments in this case are described in the above table.

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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 Letourneau 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 are defendants. The plaintiff, an individual smoker, is seeking compensatory and punitive damages for each member of the class who is deemed addicted to smoking. The class was certified in 2005. In February 2011, the trial court ruled that the federal government would remain as a third party in the case. In November 2012, the Court of Appeals dismissed defendants' third-party claims against the federal government. Trial began on March 12, 2012. Closing arguments began in September 2014 and are scheduled to conclude in December 2014, with a judgment to follow at an indeterminate point after the conclusion of the trial proceedings.

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 are defendants. The plaintiffs, an anti-smoking organization and an individual smoker, are seeking compensatory and punitive damages for each member of the class who allegedly suffers from certain smoking-related diseases. The class was certified in 2005. In February 2011, the trial court ruled that the federal government would remain as a third party in the case. In November 2012, the Court of Appeals dismissed defendants' third-party claims against the federal government. Trial began on March 12, 2012. Closing arguments began in September 2014 and are scheduled to conclude in December 2014, with a judgment to follow at an indeterminate point after the conclusion of the trial proceedings.

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. Defendants have filed jurisdictional challenges on the grounds that this action should not proceed during the pendency of the Saskatchewan class action (see description of Adams, above).

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. Defendants have filed jurisdictional challenges on the grounds that this action should not proceed during the pendency of the Saskatchewan class action (see description of Adams, above).

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 30, 2014, there were 15 health care cost recovery cases pending against us, our subsidiaries or indemnitees in Canada (9), Korea (1) and Nigeria (5), compared with 15 such cases on October 30, 2013 and 15 such cases on November 1, 2012.

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 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." Preliminary motions are pending.

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." Preliminary motions are pending.

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." Preliminary motions are pending.

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." In September 2014, defendants filed their statements of defense.

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.” Preliminary motions are pending.

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.” Preliminary motions are pending.

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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. We currently have no employees, operations or assets in Nigeria.
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 court has scheduled a preliminary hearing for early November 2014.

Lights Cases: These cases, brought by individual plaintiffs, or on behalf of a class of 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 30, 2014, the following lights cases were pending against our subsidiaries or indemnitees:

- 1 case brought on behalf of individual plaintiffs in Israel, compared with 1 such case on October 30, 2013 and 2 such cases on November 1, 2012; and
- 2 cases brought by individual plaintiffs in Chile (1) and Italy (1), compared with 2 such cases on October 30, 2013, and 7 such cases on November 1, 2012.

In the class action pending in Israel, El-Roy, et al. v. Philip Morris Incorporated, et al., District Court of Tel-Aviv/Jaffa, Israel, filed January 18, 2004, our subsidiary and our indemnitees (PM USA and our former importer) are defendants. The plaintiffs filed a purported class action claiming that the class members were misled by the descriptor “lights” into believing that lights cigarettes are safer than full flavor cigarettes. The claim seeks recovery of the purchase price of lights cigarettes and compensation for distress for each class member. In November 2012, the court denied class certification and dismissed the individual claims. Plaintiffs appealed to the Supreme Court. An oral hearing has been scheduled for the middle of November 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 30, 2014, there were 2 public civil actions pending against our subsidiaries in Argentina (1) and Venezuela (1), compared with 3 such cases on October 30, 2013, and 4 such cases on November 1, 2012.

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

We are also involved in other 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 11. Income Taxes:

Income tax provisions for jurisdictions outside the United States, 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.

The American Taxpayer Relief Act of 2012 (the “Act”) was enacted on January 2, 2013. Included in the Act were extensions through 2013 of several expired or expiring temporary business tax provisions, commonly referred to as "extenders." The tax impact of new legislation is recognized in the reporting period in which it is enacted. Therefore, PMI recognized the impact of the Act, which was $17 million of expense, in the condensed consolidated financial statements in the first quarter of 2013.

PMI's effective tax rates for the nine months and three months ended September 30, 2014 were 29.2% and 29.8%, respectively. PMI's effective tax rates for the nine months and three months ended September 30, 2013 were 28.9% and 28.3%, respectively. The effective tax rate for the nine months ended September 30, 2013 was unfavorably impacted by the additional expense associated with the Act ($17 million). Excluding the special 2013 tax item, the change in the effective tax rate for the nine months ended September 30, 2014, as compared to the nine months ended September 30, 2013, was primarily due to earnings mix by taxing jurisdiction and repatriation cost differences.

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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 2007 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 12. Indebtedness:

Short-term Borrowings:

At September 30, 2014 and December 31, 2013, PMI’s short-term borrowings, consisting of commercial paper and bank loans to certain PMI subsidiaries, had a carrying value of $2,091 million and $2,400 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, 2014 and December 31, 2013, PMI’s long-term debt consisted of the following:

(in millions)	September 30, 2014	December 31, 2013
U.S. dollar notes, 0.277% to 6.375% (average interest rate 3.877%), due through 2043	$15,265	$16,500
Foreign currency obligations:		
Euro notes, 1.750% to 5.875% (average interest rate 3.104%), due through 2033	9,556	7,303
Swiss franc notes, 0.750% to 2.000% (average interest rate 1.217%), due through 2024	1,757	1,289
Other (average interest rate 3.716%), due through 2024	174	186
	26,752	25,278
Less current portion of long-term debt	1,357	1,255
	$25,395	$24,023

Other foreign currency debt above includes mortgage debt in Switzerland and capital lease obligations at September 30, 2014 and December 31, 2013.

PMI's debt issuances in the first nine months of 2014 were as follows:
(in millions)

Type		Face Value [d]	Interest Rate		Issuance	Maturity
EURO notes	[a]	€750 (approximately $1,029)	1.875	%	March 2014	March 2021
EURO notes	[a]	€1,000 (approximately $1,372)	2.875	%	March 2014	March 2026
EURO notes	[b]	€500 (approximately $697)	2.875	%	May 2014	May 2029
Swiss franc notes	[c]	CHF275 (approximately $311)	0.750	%	May 2014	December 2019
Swiss franc notes	[b]	CHF250 (approximately $283)	1.625	%	May 2014	May 2024

[a] Interest on these notes is payable annually in arrears beginning in March 2015.
[b] Interest on these notes is payable annually in arrears beginning in May 2015.
[c] Interest on these notes is payable annually in arrears beginning in December 2014.
[d] U.S. dollar equivalents for foreign currency notes were calculated based on exchange rates on the date of issuance.
The net proceeds from the sale of the securities listed in the table above will be used for general corporate purposes.
Credit Facilities:

On January 31, 2014, PMI extended the term of its $2.0 billion 364-day revolving credit facility until February 10, 2015. On February 28, 2014, PMI replaced its $2.5 billion multi-year revolving credit facility, expiring March 31, 2015, with a new $2.5 billion multi-year credit facility, expiring on February 28, 2019.
At September 30, 2014, PMI's total committed credit facilities were as follows:

(in billions)

Type	Committed Credit Facilities
364-day revolving credit, expiring February 10, 2015	$2.0
Multi-year revolving credit, expiring February 28, 2019	2.5
Multi-year revolving credit, expiring October 25, 2016	3.5
Total facilities	$8.0

At September 30, 2014, there were no borrowings under these committed credit facilities, and the entire committed amounts were available for borrowing.

Note 13. 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;

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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 – Foreign Exchange Contracts

PMI assesses the fair value of its derivative financial instruments, which consist of deliverable and non-deliverable foreign exchange forward contracts, foreign currency swaps and foreign currency options, using internally developed models that use, as their basis, readily observable market inputs. The fair value of PMI’s foreign exchange forward contracts is determined by using the prevailing foreign exchange spot rates and interest rate differentials, and the respective maturity dates of the instruments. The fair value of PMI’s currency options is determined by using a Black-Scholes methodology based on foreign exchange spot rates and interest rate differentials, currency volatilities and maturity dates. PMI’s derivative financial instruments have been classified within Level 2 in the table shown below. See Note 6. Financial Instruments for an additional discussion of derivative financial instruments.

Debt

The fair value of PMI’s outstanding debt, which is utilized solely for disclosure purposes, is determined using quotes and market interest rates currently available to PMI for issuances of debt with similar terms and remaining maturities. The aggregate carrying value of PMI’s debt, excluding short-term borrowings and $16 million of capital lease obligations, was $26,736 million at September 30, 2014. 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.

Contingent Consideration

The fair value of PMI's contingent consideration relating to acquisitions is determined utilizing a discounted cash flow approach using various probability weighted scenarios. The significant unobservable inputs used in calculating the fair value of the contingent consideration includes financial performance scenarios, the probability of achieving those scenarios, and the discount rate. PMI's contingent consideration has been classified within Level 3 in the table shown below. For additional information, see Note 17. Acquisitions and Other Business Arrangements.

The aggregate fair values of PMI’s derivative financial instruments, debt and contingent consideration as of September 30, 2014, were as follows:

(in millions)	Fair Value at September 30, 2014	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	$255	$—	$255	$—
Total assets	$255	$—	$255	$—
Liabilities:				
Debt	$28,645	$28,464	$181	$—
Foreign exchange contracts	126	—	126	—
Contingent consideration	23	—	—	23

Total liabilities	$28,794	$28,464	$307	$23

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Note 14. Accumulated Other Comprehensive Losses:
PMI’s accumulated other comprehensive losses, net of taxes, consisted of the following:

(in millions)	At September 30, 2014	At December 31, 2013	At September 30, 2013
Currency translation adjustments	$(3,128)	$(2,207)	$(1,724)
Pension and other benefits	(1,968)	(2,046)	(3,188)
Derivatives accounted for as hedges	74	63	92
Total accumulated other comprehensive losses	$(5,022)	$(4,190)	$(4,820)

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, 2014 and 2013. 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.

Note 15. Balance Sheet Offsetting:

Foreign Exchange Contracts

PMI uses deliverable and non-deliverable forward foreign exchange contracts, foreign currency swaps and foreign currency options, collectively referred to as foreign exchange 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 foreign exchange contracts 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 foreign exchange contract 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: Financial Instruments	Cash Collateral Received/Pledged	Net Amount
At September 30, 2014						
Assets						
Foreign exchange contracts	$255	$—	$255	$(63)	$ (136)	$56
Liabilities						

Foreign exchange contracts	$126	$—	$126	$(63)	$(31)	$32
At December 31, 2013						
Assets						
Foreign exchange contracts	$153	$—	$153	$(52)	$(79)	$22
Liabilities						
Foreign exchange contracts	$116	$—	$116	$(52)	$(47)	$17

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(Unaudited)

Note 16. Investments in Unconsolidated Subsidiaries:

At September 30, 2014 and December 31, 2013, PMI had total investments in unconsolidated subsidiaries of $1,371 million and $1,536 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 the acquisition date exceeded our share of the unconsolidated subsidiaries' book value by $1,417 million, including $1,264 million attributable to goodwill. The difference between the investment carrying value and the amount of underlying equity in net assets, excluding the $1,264 million attributable to goodwill, is being amortized on a straight-line basis over the underlying assets' estimated useful lives of 3 to 20 years. At September 30, 2014 and December 31, 2013, PMI received year-to-date dividends from unconsolidated subsidiaries of $73 million and $1 million, respectively.

On September 30, 2013, PMI acquired a 49% equity interest in United Arab Emirates-based Arab Investors-TA (FZC) ("AITA") for approximately $625 million. 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 AITA 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 AITA was recorded at cost and is included in investments in unconsolidated subsidiaries on the condensed consolidated balance sheets.

On December 12, 2013, PMI acquired 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.

At September 30, 2014 and December 31, 2013, PMI's investments in other unconsolidated subsidiaries were $38 million and $42 million, respectively, with ownership percentages ranging from 40% to 50%.

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

(in millions)	For the Nine Months Ended September 30, 2014	For the Three Months Ended September 30, 2014
Net revenues	$4,184	$1,578

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

(in millions)	At September 30, 2014	At December 31, 2013
Receivables	$525	$470
Notes receivable	$107	$100
Other liabilities	$92	$86

The activity primarily related to agreements with PMI’s unconsolidated subsidiaries within the Eastern Europe, Middle East & Africa Region. 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 17. Acquisitions and Other Business Arrangements:

In June 2014, PMI acquired 100% of Nicocigs Limited, a leading U.K.-based e-vapor company, for $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. For additional information regarding this contingent consideration, see Note 13. Fair Value Measurements. The purchase price allocation is expected to be completed by the end of 2014. The effect of this acquisition was not material to PMI's consolidated financial position, results of operations or cash flows in any of the periods presented.

In May 2013, PMI announced that Grupo Carso, S.A.B. de C.V. ("Grupo Carso") would sell to PMI its remaining 20% interest in PMI's Mexican tobacco business. The sale was completed on September 30, 2013 for $703 million. As a result, PMI now owns 100% of its Mexican tobacco business. A director of PMI has an affiliation with Grupo Carso. The final purchase price is subject to a potential 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 addition, upon declaration, 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 decrease to PMI's additional paid-in capital of $672 million.

Note 18. New Accounting Standards:

On May 28, 2014, the Financial Accounting Standards Board 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 to 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. Early application is not permitted. PMI is currently assessing the impact that the adoption of ASU 2014-09 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, we 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 use the term net revenues to refer to our operating revenues from the sale of our products, net of sales and promotion incentives. Our net revenues and operating income are affected by various factors, including the volume of products we sell, the price of our products, changes in currency exchange rates and the mix of products we sell. Mix is a term used to refer to the proportionate value of premium-price brands to mid-price or low-price brands in any given market (product mix). Mix can also refer to the proportion of shipment volume in more profitable markets versus shipment volume in less profitable markets (geographic mix). We often collect excise taxes from our customers and then remit them to governments, and, in those circumstances, we include the excise taxes in our net revenues and in excise taxes on products. Our cost of sales consists principally of tobacco leaf, non-tobacco raw materials, labor and manufacturing costs.

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

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

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Executive Summary

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

Consolidated Operating Results for the Nine Months Ended September 30, 2014 – The changes in our reported diluted earnings per share ("diluted EPS") for the nine months ended September 30, 2014, from the comparable 2013 amounts, were as follows:

	Diluted EPS	% Growth
For the nine months ended September 30, 2013	$4.02	
2013 Asset impairment and exit costs	—	
2013 Tax items	0.01	
Subtotal of 2013 items	0.01	
2014 Asset impairment and exit costs	(0.26)	
2014 Tax items	—	
Subtotal of 2014 items	(0.26)	
Currency	(0.52)	
Interest	(0.03)	
Change in tax rate	0.01	
Impact of lower shares outstanding and share-based payments	0.15	
Operations	0.35	
For the nine months ended September 30, 2014	$3.73	(7.2)%

Asset Impairment and Exit Costs – During the nine months ended September 30, 2014, we recorded pre-tax asset impairment and exit costs of $503 million ($408 million after tax or $0.26 per share) related to the factory closures in the Netherlands, Australia and Canada. During the nine months ended September 30, 2013, we recorded pre-tax asset impairment and exit costs of $8 million (less than one cent impact on diluted EPS) related to the termination of distribution agreements in Asia.

On April 4, 2014, we announced the initiation by our affiliate, Philip Morris Holland B.V. ("PMH"), of consultations with employee representatives on a proposal to discontinue cigarette production at its factory located in Bergen op Zoom, the Netherlands. PMH reached an agreement with the trade unions and their members on a social plan, and ceased cigarette production on September 1, 2014. PMI expects to incur a total pre-tax charge of approximately $542 million for the total program. For the nine months ended September 30, 2014, we recorded pre-tax asset impairment and exist costs of $472 million, net of $16 million in reversals during the third quarter due to a change in estimate. For further details, see the "Asset Impairment and Exit Costs" section of the following "Discussion and Analysis."

Income Taxes – Our effective income tax rate for the nine months ended September 30, 2014 increased by 0.3 percentage points to 29.2%. The effective tax rate for the nine months ended September 30, 2014 was unfavorably impacted by the asset impairment and exit costs related to the factory closures. The effective tax rate for the nine months ended September 30, 2013 was unfavorably impacted by the additional expense associated with the enactment of the American Taxpayer Relief Act of 2012, which decreased our diluted EPS by $0.01 in 2013. Excluding the impact of these items, the change in tax rate that increased our diluted EPS by $0.01 per share in 2014 was primarily due to earnings mix by taxing jurisdiction and repatriation cost differences.

Currency – The unfavorable currency impact during the reporting period was due primarily to the Argentine peso, Australian dollar, Indonesian rupiah, Japanese yen, Kazakhstan tenge, Russian ruble, Swiss franc, Turkish lira and the Ukraine hryvnia.

Interest – The unfavorable impact of interest was due primarily to higher average debt levels, partially offset by lower average interest rates on debt.

Lower Shares Outstanding and Share-Based Payments – The favorable diluted EPS impact was due to the repurchase of our common stock pursuant to our share repurchase program.

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Operations – The increase in diluted EPS of $0.35 from our operations in the table above was due to the following segments:

- EEMA: Higher pricing and higher equity income in unconsolidated subsidiaries derived from our investments in North Africa and Russia, partially offset by unfavorable volume/mix and higher manufacturing costs;
- LA&C: Higher pricing, partially offset by unfavorable volume/mix, higher marketing, administration and research costs and higher manufacturing costs; and
- European Union: Higher pricing, mostly offset by unfavorable volume/mix, higher marketing, administration and research costs and higher manufacturing costs;

partially offset by:

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

Consolidated Operating Results for the Three Months Ended September 30, 2014 – The changes in our reported diluted EPS for the three months ended September 30, 2014, from the comparable 2013 amounts, were as follows:

	Diluted EPS	% Growth
For the three months ended September 30, 2013	$1.44	
2013 Asset impairment and exit costs	—	
2013 Tax items	—	
Subtotal of 2013 items	—	
2014 Asset impairment and exit costs	(0.01)	
2014 Tax items	—	
Subtotal of 2014 items	(0.01)	
Currency	(0.20)	
Interest	(0.01)	
Change in tax rate	(0.02)	
Impact of lower shares outstanding and share-based payments	0.05	
Operations	0.13	
For the three months ended September 30, 2014	$1.38	(4.2)%

Asset Impairment and Exit Costs – During the third quarter of 2014, we incurred an after tax asset impairment and exit costs charge of $0.01 per share related to factory closures in the Netherlands and Canada.

Income Taxes – Our effective income tax rate for the three months ended September 30, 2014 increased by 1.5 percentage points to 29.8%. This change in tax rate that decreased our diluted EPS by 0.02 per share in 2014 was primarily due to earnings mix by taxing jurisdiction and repatriation cost differences.

Currency – The unfavorable currency impact during the reporting period was due primarily to the Indonesian rupiah, Japanese yen, Russian ruble and the Ukraine hryvnia.

Interest – The unfavorable impact of interest was due primarily to higher average debt levels, partially offset by lower average interest rates on debt.

Lower Shares Outstanding and Share-Based Payments – The favorable diluted EPS impact was due to the repurchase of our common stock pursuant to our share repurchase program.

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Operations – The increase in diluted EPS of $0.13 from our operations in the table above was due primarily to the following segments:

- EEMA: Higher pricing and higher equity income in unconsolidated subsidiaries derived from our investments in North Africa and Russia, partially offset by higher manufacturing costs and higher marketing, administration and research costs; and
- LA&C: Higher pricing, partially offset by unfavorable volume/mix, higher manufacturing costs and higher marketing, administration and research costs;

partially offset by:

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

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

2014 Forecasted Results - On October 16, 2014, we revised our 2014 full-year reported diluted EPS forecast to be in a range of $4.76 to $4.81 versus $5.26 in 2013.
On an adjusted basis, diluted EPS are projected to increase in the range of approximately 6.5% to 7.5% versus adjusted diluted EPS of $5.40 in 2013. This adjustment reflects:

- an after-tax charge of $0.02 per share, recorded as asset impairment and exit costs of $0.01 per share in the first quarter of 2014 and an anticipated $0.01 per share in the fourth quarter of 2014, relating to the decision to discontinue cigarette production in Australia by the end of 2014;
- a total after-tax charge of $0.25 per share, recorded as asset impairment and exit costs in the second and third quarters of 2014, related to the decision to discontinue cigarette production in the Netherlands in 2014; and
- an unfavorable currency impact, at prevailing exchange rates, of approximately $0.72 per share for the full-year 2014 compared to unfavorable currency of approximately $0.61 per share in the prior guidance.

This forecast includes a productivity and cost savings target of $300 million and a share repurchase target of $4.0 billion.
We calculated 2013 adjusted diluted EPS as reported diluted EPS of $5.26, plus the $0.02 per share charge related to discrete tax items, and the $0.12 per share charge related to asset impairment and exit costs.
Adjusted diluted EPS is not a measure under accounting principles generally accepted in the United States of America ("U.S. GAAP"). We define adjusted diluted EPS as reported diluted EPS adjusted for asset impairment and exit costs, discrete tax items and unusual items. We believe it is appropriate to disclose this measure as it represents core earnings, improves comparability and helps investors analyze business performance and trends. Adjusted diluted EPS should be considered neither in isolation nor as a substitute for reported diluted EPS prepared in accordance with U.S. GAAP.
This 2014 guidance excludes the impact of any future acquisitions, unanticipated asset impairment and exit cost charges, future changes in currency exchange rates and any unusual events. The factors described in the "Cautionary Factors That May Affect Future Results" section of the following "Discussion and Analysis" represent continuing risks to this forecast.

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Discussion and Analysis

Consolidated Operating Results

See pages 68-72 for a discussion of our "Cautionary Factors That May Affect Future Results." Our cigarette volume, net revenues, excise taxes on products and operating companies income by segment were as follows:

(in millions)	For the Nine Months Ended September 30, 2014	2013	For the Three Months Ended September 30, 2014	2013
Cigarette volume:				
European Union	140,827	140,659	49,209	48,969
Eastern Europe, Middle East & Africa	213,428	220,034	77,252	76,902
Asia	218,806	226,503	72,352	73,296
Latin America & Canada	68,001	69,774	23,487	23,957
Total cigarette volume	641,062	656,970	222,300	223,124
Net revenues:				
European Union	$22,225	$21,255	$7,777	$7,487
Eastern Europe, Middle East & Africa	16,347	15,346	6,111	5,546
Asia	14,515	15,776	4,943	5,144
Latin America & Canada	7,078	7,262	2,504	2,452
Net revenues	$60,165	$59,639	$21,335	$20,629
Excise taxes on products:				
European Union	$15,462	$14,798	$5,420	$5,206
Eastern Europe, Middle East & Africa	9,621	8,837	3,677	3,261
Asia	7,790	7,751	2,711	2,601
Latin America & Canada	4,722	4,825	1,671	1,634
Excise taxes on products	$37,595	$36,211	$13,479	$12,702
Operating income:				
Operating companies income:				
European Union	$2,875	$3,227	$1,186	$1,207
Eastern Europe, Middle East & Africa	3,218	2,968	1,204	1,088
Asia	2,614	3,567	799	1,097
Latin America & Canada	734	776	267	267
Amortization of intangibles	(67)	(71)	(23)	(23)
General corporate expenses	(130)	(155)	(50)	(43)
Less:				
Equity (income)/loss in unconsolidated subsidiaries, net	(74)	15	(38)	6
Operating income	$9,170	$10,327	$3,345	$3,599

As discussed in Note 9. Segment Reporting to our condensed consolidated financial statements, we evaluate segment performance and allocate resources based on operating companies income, which we define as operating income, excluding general corporate expenses and amortization of intangibles, plus equity (income)/loss in unconsolidated subsidiaries, net. We believe it is appropriate to disclose this measure to help investors analyze the business performance and trends of our various business segments.

References to total international cigarette market, total cigarette market, total market and market shares throughout this "Discussion and Analysis" reflect our best estimates based on a number of internal and external sources.

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Consolidated Operating Results for the Nine Months Ended September 30, 2014

The following discussion compares our consolidated operating results for the nine months ended September 30, 2014, with the nine months ended September 30, 2013.

Our cigarette shipment volume of 641.1 billion units decreased by 15.9 billion units (2.4%), due principally to:

- Asia, mainly reflecting a lower total market and share and unfavorable estimated inventory movements in Japan, lower market share in Pakistan, and lower market share in Indonesia, partially offset by a higher market share in the Philippines;
- EEMA, due mainly to a lower total market in Russia, and lower total market and share in Kazakhstan, Serbia and Ukraine, partially offset by a higher total market and share in Algeria, higher share in Russia and a higher total market in Turkey; and
- Latin America & Canada, principally due to a lower total market and share in Mexico, partially driven by estimated trade inventory movements, and the impact of tax-driven price increases in Canada;

partially offset by:

- the European Union, reflecting share growth in Germany, Italy and Spain, partially offset by lower total markets.

Our market share increased in a number of key markets, including Algeria, Argentina, Austria, Brazil, Canada, France, Germany, Greece, Hungary, Italy, the Netherlands, the Philippines, Poland, Russia, Saudi Arabia, Spain, Thailand and the United Kingdom.

Total cigarette shipments of Marlboro of 211.7 billion units decreased by 2.2%, due primarily to Asia, notably Japan; the European Union, notably France, Germany, Italy and Poland; and Latin America & Canada, notably Mexico; partially offset by EEMA, notably Algeria and Saudi Arabia.

Total cigarette shipments of L&M of 69.1 billion units were down by 3.2%, due notably to Egypt, Poland, Saudi Arabia, Spain and Turkey, partially offset by Germany. Total cigarette shipments of Bond Street of 32.4 billion units decreased by 3.2%, due predominantly to Hungary, Kazakhstan, Serbia and Ukraine partially offset by Australia and Russia. Total cigarette shipments of Parliament of 35.2 billion units were up by 6.3%, driven mainly by Japan and Turkey, partially offset by Kazakhstan and Ukraine. Total cigarette shipments of Philip Morris of 23.8 billion units decreased by 8.7%, due primarily to the morphing to Lark in Japan, partially offset by Argentina. Total cigarette shipments of Chesterfield of 32.1 billion units were up by 24.9%, due primarily to Italy, Poland and Turkey, partially offset by Russia and Ukraine. Total cigarette shipments of Lark of 22.7 billion units increased by 3.4%, due primarily to the above-mentioned morphing from Philip Morris in Japan, partially offset by Turkey.

Our other tobacco products ("OTP") primarily include tobacco for roll-your-own and make-your-own cigarettes, pipe tobacco, cigars and cigarillos. Total shipment volume of OTP, in cigarette equivalent units, increased by 3.5% to 24.8 billion cigarette equivalent units, mainly due to growth in the fine cut category, principally in Belgium, Czech Republic, Hungary, Italy and Poland, partially offset by declines in France, Germany and Spain.

Total shipment volume for cigarettes and OTP, in cigarette equivalent units, was down by 2.2%.

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

	For the Nine Months Ended September 30,			
(in millions)	2014	2013	Variance	%
Net revenues	$60,165	$59,639	$526	0.9%
Excise taxes on products	37,595	36,211	1,384	3.8%
Net revenues, excluding excise taxes on products	$22,570	$23,428	$(858)	(3.7)%

Currency movements decreased net revenues by $3.5 billion and net revenues, excluding excise taxes on products by $1.4 billion. The $1.4 billion decrease was due primarily to the Argentine peso, Indonesian rupiah, Japanese yen, Russian ruble, Turkish lira and the Ukraine hryvnia, partially offset by the Euro.

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Net revenues include $1,516 million in 2014 and $1,389 million in 2013 related to sales of OTP. These net revenue amounts include excise taxes billed to customers. Excluding excises taxes, net revenues for OTP were $563 million in 2014 and $544 million in 2013.

Net revenues, which include excise taxes billed to customers, increased by $526 million (0.9%). Excluding excise taxes, net revenues decreased by $858 million (3.7%) to $22.6 billion. This decrease was due to:

- unfavorable currency ($1.4 billion) and
- unfavorable volume/mix ($844 million), partly offset by
- price increases ($1.4 billion) and
- the impact of acquisitions ($6 million).

Excise taxes on products increased by $1.4 billion (3.8%), due to:

- higher excise taxes resulting from changes in retail prices and tax rates ($3.9 billion), partly offset by
- favorable currency ($2.1 billion) and
- volume/mix ($461 million).

Governments have consistently increased excise taxes in most of the markets in which we operate. As discussed under the caption "Business Environment," we expect excise taxes to continue to increase.
Our cost of sales; marketing, administration and research costs; and operating income were as follows:

	For the Nine Months Ended September 30,			
(in millions)	2014	2013	Variance	%
Cost of sales	$7,804	$7,808	$(4)	(0.1)%
Marketing, administration and research costs	5,026	5,214	(188)	(3.6)%
Operating income	9,170	10,327	(1,157)	(11.2)%

Cost of sales decreased $4 million (0.1%), due to:

- favorable currency ($221 million) and
- volume/mix ($131 million), partly offset by
- higher manufacturing costs ($348 million, principally in Egypt, due to the impact of the change to our new business structure, and in Indonesia, and ongoing costs related to the factory closure in Australia and the decision to discontinue cigarette production in the Netherlands). For further details on our change in business structure in Egypt, see the "Acquisitions and Other Business Arrangements" section of this "Discussion and Analysis."

With regard to tobacco leaf prices, we continue to expect modest increases going forward as the market has now stabilized. However, we are incurring some cost increases in 2014, driven in large measure by historical leaf tobacco price changes that will continue to affect our product costs in the current year, higher prices for cloves and higher prices for a number of other direct materials we use in the production of our brands.

Marketing, administration and research costs decreased by $188 million (3.6%), due primarily to:

- favorable currency ($211 million), partly offset by
- higher expenses ($17 million, primarily higher marketing and selling expenses).

Operating income decreased by $1.2 billion (11.2%). This decrease was due primarily to:

- unfavorable currency ($977 million),

- unfavorable volume/mix ($713 million),

- higher pre-tax charges for asset impairment and exit costs ($495 million, primarily related to the decision to discontinue cigarette production in the Netherlands),
- higher manufacturing costs ($348 million) and
- higher marketing, administration and research costs ($17 million), partly offset by
- price increases ($1.4 billion).

Interest expense, net, of $789 million increased $68 million, due primarily to higher average debt levels, partially offset by lower average interest rates on debt.

Our effective tax rate increased by 0.3 percentage points to 29.2%. The effective tax rate for the nine months ended September 30, 2014 was unfavorably impacted by the asset impairment and exit costs related to the factory closures. The effective tax rate for the nine months ended September 30, 2013, was unfavorably impacted by the additional expense associated with the enactment of the American Taxpayer Relief Act of 2012. The effective tax rate is based on our full-year earnings mix by taxing jurisdiction and cash repatriation plans. Changes in our cash repatriation plans could have an impact on the effective tax rate, which we monitor each quarter. Significant judgment is required in determining income tax provisions and in evaluating tax positions.

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

Equity (income)/loss in unconsolidated subsidiaries, net, of $(74) million increased by $89 million, due primarily to higher earnings from our investments in North Africa and Russia, which are reflected in the Eastern Europe, Middle East & Africa segment.

Net earnings attributable to PMI of $5.9 billion decreased by $708 million (10.7%). This decrease was due primarily to an unfavorable currency impact on operating income and higher interest expense, net. Diluted and basic EPS of $3.73 decreased by 7.2%. Excluding an unfavorable currency impact of $0.52, diluted EPS increased by 5.7%.

Consolidated Operating Results for the Three Months Ended September 30, 2014

The following discussion compares our consolidated operating results for the three months ended September 30, 2014, with the three months ended September 30, 2013.

Our cigarette shipment volume of 222.3 billion units decreased by 824 million units (0.4%), due principally to:

- Asia, mainly Japan, partially offset by Indonesia and Pakistan; and
- Latin America & Canada, due largely to Canada and Mexico;

partially offset by:

- European Union, driven notably by Italy, and
- EEMA, driven mainly by the Middle East and North Africa, partly offset by Kazakhstan, Serbia and Ukraine.

Our market share increased in a number of key markets, including Algeria, Argentina, Austria, Brazil, Colombia, Czech Republic, Egypt, France, Germany, Italy, Kazakhstan, the Netherlands, the Philippines, Poland, Russia, Saudi Arabia, Spain and Switzerland.

Total cigarette shipments of Marlboro of 72.6 billion units decreased by 3.5%, due to the European Union, notably Italy and Poland, Asia, principally Japan, and Latin America & Canada, mainly Mexico. Total cigarette shipments of Marlboro increased in EEMA driven mainly by Algeria and Saudi Arabia, partly offset by Egypt, Russia and Ukraine. Total cigarette shipments of L&M of 24.0 billion units decreased by 0.6%, due to the European Union, mainly Poland and Spain, and Asia, due to Thailand, partly offset by EEMA, driven largely by North Africa and Ukraine. Total cigarette shipments of Bond Street of 12.0 billion units increased by 0.3%, driven predominantly by growth in EEMA and Asia, partly offset by the European Union. Total cigarette shipments of Philip Morris of 8.0 billion units decreased by 9.4%, primarily reflecting the morphing to Lark in Japan. Total cigarette shipments of Parliament of 12.9 billion units increased by 9.3%, driven by growth in all Regions, notably in EEMA by Russia and Turkey. Total cigarette shipments of Chesterfield of 11.6 billion units increased by 25.9%, driven primarily in the European Union by Italy and Poland. Total cigarette shipments of Lark of 9.0 billion units increased by 25.2%, driven predominantly by the morphing from Philip Morris in Japan, partly offset by Turkey.

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Total shipment volume of OTP, in cigarette equivalent units, increased by 7.6%, mainly reflecting growth in the fine cut category, notably in Czech Republic, France, Hungary, Italy and Poland, partly offset by Germany.
Total shipment volume for cigarettes and OTP, in cigarette equivalent units, decreased by 0.1%.
Our net revenues and excise taxes on products were as follows:

(in millions)	For the Three Months Ended September 30, 2014	2013	Variance	%
Net revenues	$21,335	$20,629	$706	3.4%
Excise taxes on products	13,479	12,702	777	6.1%
Net revenues, excluding excise taxes on products	$7,856	$7,927	$(71)	(0.9)%

Currency movements decreased net revenues by $964 million and net revenues, excluding excise taxes on products, by $394 million. The $394 million decrease was due primarily to the Argentine peso, Indonesian rupiah, Japanese yen, Russian ruble, Turkish lira and the Ukraine hryvnia, partially offset by the Euro.

Net revenues include $525 million in 2014 and $467 million in 2013 related to sales of OTP. These net revenue amounts include excise taxes billed to customers. Excluding excises taxes, net revenues for OTP were $195 million in 2014 and $181 million in 2013.

Net revenues, which include excise taxes billed to customers, increased by $706 million (3.4%). Excluding excise taxes, net revenues decreased by $71 million (0.9)% to $7.9 billion. This decrease was due to:

- unfavorable currency ($394 million) and
- unfavorable volume/mix ($174 million), partly offset by
- price increases ($491 million) and
- the impact of acquisitions ($6 million).

Excise taxes on products increased by $777 million (6.1%), due to:

- higher excise taxes resulting from changes in retail prices and tax rates ($1.5 billion), partly offset by
- favorable currency ($570 million) and
- volume/mix ($159 million).

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

(in millions)	For the Three Months Ended September 30, 2014	2013	Variance	%
Cost of sales	$2,734	$2,618	$116	4.4%
Marketing, administration and research costs	1,763	1,687	76	4.5%
Operating income	3,345	3,599	(254)	(7.1)%

Cost of sales increased by $116 million (4.4%), due to:

- higher manufacturing costs ($164 million, principally in Egypt, due to the impact of the change to our new business structure, and in Indonesia, and ongoing costs related to the factory closure in Australia and the decision to discontinue cigarette production in the Netherlands), partly offset by
- favorable currency ($40 million) and
- volume/mix ($8 million).

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Marketing, administration and research costs increased by $76 million (4.5%), due to:

- higher expenses ($51 million, primarily higher marketing and selling expenses),
- unfavorable currency ($19 million) and
- the impact of acquisitions ($6 million).

Operating income decreased by $254 million (7.1%), due primarily to:

- unfavorable currency ($373 million),
- unfavorable volume/mix ($166 million),
- higher manufacturing costs ($164 million) and
- higher marketing, administration and research costs ($51 million), partly offset by
- price increases ($491 million).

Interest expense, net, of $267 million increased $28 million, due primarily to higher average debt levels, partially offset by lower average interest rates on debt.

Our effective tax rate increased by 1.5 percentage points to 29.8%. The effective tax rate is based on our full-year earnings mix by taxing jurisdiction and cash repatriation plans. Changes in our cash repatriation plans could have an impact on the effective tax rate, which we monitor each quarter. Significant judgment is required in determining income tax provisions and in evaluating tax positions.

Equity (income)/loss in unconsolidated subsidiaries, net, of $(38) million increased by $44 million, due primarily to higher earnings from our investments in North Africa and Russia, which are reflected in the Eastern Europe, Middle East & Africa segment.

Net earnings attributable to PMI of $2.2 billion decreased by $185 million (7.9%). This decrease was due primarily to an unfavorable currency impact on operating income and higher interest expense, net. Diluted and basic EPS of $1.38 decreased by 4.2%. Excluding an unfavorable currency impact of $0.20, diluted EPS increased by 9.7%.

Operating Results by Business Segment

Business Environment

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

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

- fiscal challenges, such as excise tax increases and discriminatory tax structures;
- actual and proposed extreme regulatory requirements, including regulation of the packaging, marketing and sale of tobacco products, as well as the products themselves, that may reduce our competitiveness, eliminate our ability to communicate with adult smokers, ban certain of our products, limit our ability to differentiate our products from those of our competitors, and interfere with our intellectual property rights;
- illicit trade in cigarettes and other tobacco products, including counterfeit, contraband and so-called "illicit whites";
- intense competition, including from non-tax paid volume by local manufacturers;
- pending and threatened litigation as discussed in Note 10. Contingencies; and
- governmental investigations.

FCTC: The World Health Organization's ("WHO") Framework Convention on Tobacco Control ("FCTC"), an international public health treaty with the objective of reducing tobacco use, drives much of the regulation that shapes the business environment in which we operate. The treaty, to which 178 countries and the European Union are Parties, requires Parties to have in place various tobacco control measures and recommends others.

We support many of the FCTC regulatory policies, including measures that strictly prohibit the sale of tobacco products to minors, limit public smoking, require health warnings on tobacco packaging, regulate product content to prevent increased adverse health effects of smoking and establish a regulatory framework for reduced-risk products. We also support the use of tax and price policies to achieve public health objectives, as long as tax increases are not excessive, disruptive or discriminatory and do not result in increased illicit trade.

However, the FCTC governing body, the Conference of the Parties ("CoP"), has adopted non-binding guidelines and policy recommendations to certain articles of the FCTC, some of which we strongly oppose, including extreme measures such as point-of-sale display bans, plain packaging, bans on all forms of communications with adult smokers, ingredient restrictions or bans based on the concepts of palatability or attractiveness, and excessive taxation. Among other things, these measures would limit our ability to differentiate our products and disrupt competition, are not based on sound evidence of a public health benefit, are likely to lead to adverse consequences such as increased illicit trade and, in some cases, result in the expropriation of our trademarks and violate international treaties.

It is not possible to predict whether or to what extent measures recommended in the FCTC guidelines will be implemented. In some instances where these extreme measures have been adopted by national governments, we have commenced legal proceedings challenging them.

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

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

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- health warnings covering 65% of the front and back panels of packs with specific health warning dimensions that will in effect prohibit various pack formats, such as certain packs for slim cigarettes, even though the agreed text does not ban slim cigarettes. Member States would also have the option to further standardize tobacco packaging, including, under certain conditions, by introducing plain packaging;
- a ban on packs of fewer than 20 cigarettes;
- a ban on some characterizing flavors in tobacco products with a six-year transition period for menthol expiring in May 2020;
- tracking and tracing measures requiring tracking at pack level down to retail, which we believe will provide no incremental benefit in the fight against illicit trade; and
- a framework for the regulation of novel tobacco products and e-cigarettes (except for those found to be medicines or medical devices), including requirements for health warnings and information leaflets, prohibiting product packaging text related to reduced risk, and introducing notification requirements in advance of commercialization.

The revised Directive entered into force in May 2014. Member States are required to implement the Directive by May 2016.

In June 2014, two of our subsidiaries filed papers in the English High Court seeking judicial review of whether the Directive complies with existing EU Treaties. The claimants asked the English court to refer the case to the Court of Justice of the European Union. In July 2014, the government of Poland filed a complaint with the Court of Justice of the European Union challenging the validity of various provisions in the Directive that ban menthol cigarettes. It is not possible to predict the outcome of these legal proceedings, which could last as long as two to three years.

Plain Packaging: Australia's plain packaging regulation, which came into force in December 2012, bans the use of branding, logos and colors on packaging of all tobacco products other than the brand name and variant, which may be printed only in specified locations and in a uniform font. The remainder of the pack is reserved for health warnings and government messages about cessation. The branding of individual cigarettes is also prohibited under this regulation.

To date, only Australia has implemented plain packaging, although a few other countries are considering it. For example, the U.K. Parliament passed legislation that allows the Secretary of State for Health to implement plain packaging via regulations if he determines it may contribute to reducing the risk of harm or promoting the health or welfare of people. In June 2014, the U.K. Department of Health published draft regulations and launched a short public consultation on the introduction of regulations for plain packaging, which expired on August 7, 2014. A legislative plain packaging proposal in Ireland was published in June 2014, and is currently pending in Parliament. Both the UK and Irish governments have notified their respective plain packaging proposals to the European Commission under the revised EU Tobacco Products Directive and the EU Technical Standards Directive. The European Commission's website tracking these notifications indicates that, pursuant to the provisions of the EU Technical Standards Directive, the Irish government cannot adopt its proposal before December 2014 and the UK government cannot adopt its proposal before March 2015. It is not possible to predict whether these proposals will be adopted. In February 2014, draft plain packaging legislation in New Zealand had its first reading in Parliament. In August 2014, a Parliamentary Health Committee considered the draft and recommended passing the bill with minor amendments. It is not possible to predict whether Parliament will further consider the bill.

Australia's plain packaging legislation triggered three legal challenges. First, major tobacco manufacturers, including our Australian subsidiary, challenged the legislation's constitutionality in the High Court of Australia. Although the High Court found the legislation constitutional, a majority of the Justices concluded that plain packaging deprives tobacco manufacturers of their property, raising serious questions about the legality of similar proposals in other jurisdictions. Second, our Hong Kong subsidiary has initiated arbitration proceedings against the Australian government pursuant to the Hong Kong-Australia Bilateral Investment Treaty and is seeking substantial compensation for the deprivation of its investments in Australia. Third, several countries have initiated World Trade Organization ("WTO") dispute settlement proceedings against Australia. The ongoing legal challenges may take several years to complete, and it is not possible to predict their outcome.

We oppose plain packaging because it expropriates our valuable intellectual property by taking away our trademarks and moves the industry much closer to a commodity business where there is no distinction between brands and, therefore, the ability to compete for adult smoker market share is greatly reduced. Data from Australia appear to confirm that with plain packaging, adult smokers down-trade to lower price and lower margin brands and illicit products. According to recent industry-commissioned studies, the implementation of plain packaging in Australia had no impact on smoking prevalence among adults or youth, while illicit trade has increased, with a significant shift towards branded illicit products (away from unbranded loose tobacco).

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Restrictions and Bans on the Use of Ingredients: Currently, the WHO and some others in the public health community recommend restrictions or total bans on the use of some or all ingredients in tobacco products, including menthol. Some regulators have considered and rejected such proposals, while others have proposed and, in a few cases, adopted restrictions or bans. In particular, as mentioned above, the European Union has adopted a ban of characterizing flavors in tobacco products, subject to an exemption until May 2020 for menthol, while sweeping ingredient bans have been adopted only by Canada (with an exemption for menthol) and Brazil.

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

Broad restrictions and bans on the use of ingredients would require us to reformulate our American Blend tobacco products and could reduce our ability to differentiate these products in the market in the long term. Menthol bans would eliminate the entire category of mentholated tobacco products. We oppose broad bans or sweeping restrictions on the use of ingredients, as they are often based on the subjective and scientifically unsupported notion that ingredients make tobacco products more “attractive” or “palatable” and therefore could encourage tobacco consumption, and also because prohibiting entire categories of cigarettes, such as menthol, will lead to a massive increase in illicit trade.

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

Bans on Display of Tobacco Products at Retail: In a few of our markets, governments have banned or propose to ban the display of tobacco products at the point of retail sale. Other countries have rejected display ban proposals. We oppose display bans because they restrict competition by favoring established brands and encourage illicit trade, while not reducing smoking or otherwise benefiting public health. In some markets, our subsidiaries and, in some cases, individual retailers have commenced legal proceedings to overturn display bans.

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

In March 2013, the Ministry of Public Health in Thailand issued a regulation mandating health warnings covering 85% of the front and back of cigarette packs. While a lower court suspended this requirement pending the outcome of legal challenges by two of our affiliates, Thailand’s Supreme Administrative Court recently overturned this order and allowed the regulation to be implemented during the pendency of our affiliates’ claims. The legal challenges by our affiliates are still pending. It is not possible to predict the outcome of these proceedings.

We support health warning requirements designed to inform consumers of the risks of smoking. In fact, where health warnings are not required, we place them on packaging voluntarily in the official language or languages of the country. We defer to governments on the content of warnings except for content that vilifies tobacco companies or does not fairly represent the actual effects of smoking. However, we oppose excessively large health warnings, i.e., larger than 50%. The data show that disproportionately increasing the size of health warnings does not effectively reduce tobacco consumption. Yet, such health warnings impede our ability to compete in the market by leaving insufficient space for our distinctive trademarks and pack designs.

Other Packaging Restrictions: Some governments have passed, or are seeking to pass, restrictions on packaging and labeling, including standardizing the shape, format and lay-out of packaging, as well as imposing broad restrictions on how the space left for branding and product descriptions can be used. Examples include prohibitions on (1) the use of colors that are alleged to suggest that one brand is less harmful than others, (2) specific descriptive phrases deemed to be misleading, including, for example, “premium,” “full flavor,” “international,” “gold,” “silver,” and “menthol” and (3) in one country, all but one pack variation per brand. We oppose broad packaging restrictions because they unnecessarily limit brand and product differentiation, are anticompetitive, prevent us from providing consumers with information about our products, unduly restrict our intellectual property rights, and violate international trade agreements. In some instances, we have commenced litigation challenging such regulations. It is not possible to predict the outcome of these proceedings.

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Bans and Restrictions on Advertising, Marketing, Promotions and Sponsorships: For many years, the FCTC has called for, and countries have imposed, partial or total bans on tobacco advertising, marketing, promotions and sponsorships, including bans and restrictions on advertising on radio and television, in print and on the Internet. The FCTC also requires disclosure of expenditures on advertising, promotion and sponsorship where such activities are not prohibited. The FCTC guidelines recommend that governments adopt extreme and sweeping prohibitions, including all forms of communications to adult smokers. Where restrictions on advertising prevent us from communicating directly and effectively with adult smokers, they impede our ability to compete in the market. For this reason and because we believe that the available evidence does not show that marketing restrictions effectively reduce smoking, we oppose complete bans on advertising and communications that do not allow manufacturers to communicate directly and effectively with adult smokers.

Restrictions on Product Design: Anti-tobacco organizations and some regulators are calling for the further standardization of tobacco products by, for example, requiring that cigarettes have a certain minimum diameter, which amounts to a ban on slim cigarettes, or requiring the use of standardized filter and cigarette paper designs. We oppose such restrictions because they limit our ability to differentiate our products and because we believe that there is no correlation, let alone a causal link, between product design variations and smoking rates, nor is there any scientific evidence that these restrictions would improve public health.

Reduced cigarette ignition propensity standards are recommended by the FCTC guidelines, have been adopted in several of our markets (e.g., Australia, Canada, South Africa and the EU) and are being considered in several others. We believe that due to the costs to manufacturers of implementing such standards, their effectiveness at reducing the risk of cigarette-ignited fires in countries where they have been implemented should be examined before additional countries consider them.

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

While we believe outright bans are appropriate in many public places, such as schools, playgrounds, youth facilities, and many indoor public places, governments can and should seek a balance between the desire to protect non-smokers from environmental tobacco smoke and allowing adults who choose to smoke to do so. Owners of restaurants, bars, cafes, and other entertainment establishments should have the flexibility to permit, restrict, or prohibit smoking, and workplaces should be permitted to provide designated smoking rooms for adult smokers. Finally, we oppose bans on smoking outdoors (beyond places and facilities for children) and in private places.

Other Regulatory Issues: Some regulators are considering, or in some cases have adopted, regulatory measures designed to reduce the supply of tobacco. These include regulations intended to reduce the number of retailers selling tobacco by, for example, reducing the overall number of tobacco retail licenses available or banning the sale of tobacco within arbitrary distances of certain public facilities. We oppose such measures because they stimulate illicit trade and could arbitrarily deprive business owners and their employees of their livelihood with no indication that such restrictions would improve public health.

Regulators in some countries have also called for the exclusion of tobacco from free trade agreements, such as the Trans-Pacific Partnership Agreement, which is under negotiation. This could limit our ability to protect investments and intellectual property through these treaties. We oppose such measures because they unfairly discriminate against a legal industry and are at odds with fundamental principles of global trade.

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

Illicit Trade: The illicit tobacco trade creates a cheap and unregulated supply of tobacco products, undermines efforts to reduce smoking, especially among youth, damages legitimate businesses, stimulates organized crime, increases corruption and reduces government tax revenue. Illicit trade may account for as much as 10% of global cigarette consumption; this includes counterfeit, contraband and the growing problem of "illicit whites," which are unique cigarette brands manufactured predominantly for smuggling. We estimate that illicit trade in the European Union accounted for more than 10% of total cigarette consumption in 2013.

A number of jurisdictions are considering regulatory measures and government action to prevent illicit trade. In November 2012, the FCTC adopted the Protocol to Eliminate Illicit Trade in Tobacco Products (the “Protocol”), which includes supply chain control

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measures, such as licensing of manufacturers and distributors, enforcement in free trade zones, controls on duty free and Internet sales and the implementation of tracking and tracing technologies. The Protocol will come into force once the 40^{th} country ratifies it, after which countries must implement its measures via national legislation. To date, four countries have ratified the Protocol. It is not possible to predict whether other countries will do so.

Additionally, we and our subsidiaries have entered into cooperation agreements with governments and authorities to support their anti-illicit trade efforts. For example, in 2004 we entered into a 12-year cooperation agreement with the EU and its member states that provides for cooperation with European law enforcement agencies on anti-contraband and on anti-counterfeit efforts. Under the terms of this agreement we make financial contributions of approximately $75 million per year (recorded as an expense in cost of sales when product is shipped) to support these efforts. We are also required to pay the excise taxes, VAT and customs duties on qualifying seizures of up to 450 million genuine PMI products in the EU in a given year, and five times the applicable taxes and duties if seizures exceed this threshold in a given year. To date, our payments for product seizures have been immaterial.

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

In June 2012, we committed €15 million to INTERPOL over a three-year period to support the agency's global initiative to combat trans-border crime involving illicit goods, including tobacco products. This initiative funds the coordination of information gathering, training programs for law enforcement officials, development of product authentication standards and public information campaigns.

Reduced-Risk Products: We use the term Reduced-Risk Products (“RRPs”) to refer to products with the potential to reduce individual risk and population harm in comparison to smoking combustible cigarettes. One of our strategic priorities is to develop, assess and commercialize a portfolio of innovative RRPs. Our RRPs are in various stages of development, and we are conducting extensive and rigorous scientific studies to determine whether we can support claims for such products of reduced exposure to harmful and potentially harmful constituents in smoke, and ultimately claims of reduced disease risk, when compared to smoking combustible cigarettes. Before making any such claims, we will need to rigorously evaluate the full set of data from the relevant scientific studies to determine whether they substantiate reduced risk. Any such claims may also be subject to government review and approval, as is the case in the U.S. today. We draw upon a team of world-class scientists from a broad spectrum of scientific disciplines, and our efforts are guided by the following three key objectives:

- to develop RRPs that provide adult smokers the taste, sensory experience, nicotine delivery profile and ritual characteristics that are similar to those currently provided by combustible cigarettes;
- to substantiate the reduction of risk for the individual adult smoker and the reduction of harm to the population as a whole, based on robust scientific evidence derived from well-established assessment processes; and
- to advocate for the development of science-based regulatory frameworks for the approval and commercialization of RRPs, including the communication of substantiated health benefits to adult smokers.

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

Our approach to individual risk assessment is to use cessation as the benchmark, because the short-term and long-term effects of smoking cessation are well known, and the closer the clinical data derived from adult smokers who switch to an RRP resemble the data from those who quit, the more confident one can be that the product reduces risk.

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

- Platform 1 uses a precisely controlled heating device into which a specially designed tobacco product is inserted to generate an aerosol. Eight clinical trials for Platform 1 were initiated in 2013. The final results for six short-term clinical studies are expected by the end of 2014, and results from two longer-term reduced exposure studies will be available in the first quarter of 2015. We plan to initiate a long-term exposure response study in December 2014, with the final results anticipated by mid-2016.

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- Platform 2 uses a pressed carbon heat source to generate an aerosol by heating tobacco. Platform 2 is closer to the format, feel and ritual of a cigarette. The product is currently in the pre-clinical testing phase, and we plan to begin clinical trials in the second quarter of 2015.
- Platform 3 is based on technology we acquired from Professor Jed Rose of Duke University and his co-inventors in May 2011. This product creates an aerosol of nicotine salt formed by the chemical reaction of nicotine with a weak organic acid. We are exploring two routes for this platform, one with electronics and one without. The product replicates the feel and ritual of smoking without tobacco and without burning. We have begun pre-clinical testing of this product.
- Platform 4 covers e-vapor products, which are battery powered devices that produce an aerosol by vaporizing a liquid nicotine solution. Our e-vapor products comprise devices using current generation technology, and we are working on developing the next generation of e-vapor technologies to address the challenges presented by the e-vapor products currently on the market, ranging from consumer satisfaction to product consistency.

We are also developing other potential product platforms.

We are proceeding with the commercialization of RRPs. In January 2014, we announced an investment of up to €500 million in our first manufacturing facility in the European Union and an associated pilot plant near Bologna, Italy, to produce our RRPs. We plan for the factory to initially manufacture Platform 1 tobacco products (HeatSticks). When fully operational by 2016, and together with the pilot plant that was opened for production in October 2014, we expect to reach an annual production capacity of up to 30 billion units.

In the United States, an established regulatory framework for assessing “Modified Risk Tobacco Products” (“MRTPs”) exists under the jurisdiction of the Food and Drug Administration (“FDA”). We expect that future FDA actions are likely to influence the regulatory approach of other interested governments. Our assessment approach and the studies conducted to date reflect the rigorous evidentiary standards set forth in the FDA’s Draft Guidance for Modified Risk Tobacco Product Applications (2012). We have shared our approach and studies with the FDA’s Center for Tobacco Products. In parallel, we are engaging with regulators in several EU member countries, as well as in a number of other countries. We expect to submit a Modified Risk Tobacco Product application for Platform 1 when we believe we have met the evidentiary standards set forth in the Draft Guidance.

As we work to develop evidence to substantiate the risk reduction potential of our products, we will review our ability to make claims of reduced exposure or disease risk based on applicable laws and regulations and, as we are already doing, engage with regulators and share the evidence with them. There can be no assurance that we will succeed in our efforts or that regulators will permit the marketing of our RRPs with substantiated claims of reduced exposure, individual risk or population harm.

We plan to commercialize the Platform 1 electronic system under the iQOS brand name, for use with specially-made tobacco sticks, under the Marlboro HeatSticks brand and other brand names. We plan to introduce the iQOS system in a city test in Nagoya, Japan on November 4, 2014 and in Milan, Italy later in the fourth quarter of 2014, to expand nationally in those two countries in 2015, and to launch the product in several other markets thereafter. This product will not be marketed with claims of reduced exposure or disease risk pending the outcome of our scientific studies and, where required, governmental review and approval.

In December 2013, we established a strategic framework with Altria Group, Inc. ("Altria") under which Altria will make available its e-vapor products exclusively to us for commercialization outside the United States, and we will make available two of our candidate reduced-risk tobacco products exclusively to Altria for commercialization in the

United States. The agreements also provide for cooperation on the scientific assessment of these products and for the sharing of improvements to the existing generation of RRPs.

In June 2014, we acquired 100% of Nicocigs Limited, a leading U.K.-based e-vapor company whose principal brand is Nicolites.

Other Legislation, Regulation or Governmental Action: In Argentina, the National Commission for the Defense of Competition issued a resolution in May 2010, in which it found that our affiliate's establishment in 1997 of a system of exclusive zonified distributors ("EZDs") in Buenos Aires city and region was anticompetitive, despite having issued two prior decisions (in 1997 and 2000) in which it had found the establishment of the EZD system was not anticompetitive. The resolution is not a final decision, and our Argentinean affiliate has opposed the resolution and submitted additional evidence.

In Germany, in October 2013, the Administrative District Office Munich, acting under the policy supervision of the Bavarian Ministry of Health and Environment, sent our German affiliate an order alleging that certain components of its Marlboro advertising campaign do not comply with the applicable tobacco advertising law, which required our affiliate to stop this particular campaign throughout Germany and remove all outdoor advertisements within one month from the effective date of the order and point-of-

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sale materials within three months. Our affiliate does not believe the allegations properly reflect the facts and the law and filed a challenge in the Munich Administrative Court against the order. At a hearing held in April 2014, at the Bavarian Higher Administrative Court, the parties agreed that our affiliate can continue the campaign with certain limitations on image visuals and text slogans for the duration of the court proceedings.

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

Governmental Investigations

From time to time, we are subject to governmental investigations on a range of matters. As part of an investigation by the Department of Special Investigations ("DSI") of the government of Thailand into alleged under declaration of import prices by Thai cigarette importers, the DSI proposed to bring charges against our subsidiary, Philip Morris (Thailand) Limited, Thailand Branch ("PM Thailand") for alleged underpayment of customs duties and excise taxes of approximately $2 billion covering the period from July 28, 2003, to February 20, 2007 ("2003-2007 Investigation"). In September 2009, the DSI submitted the case file to the Public Prosecutor for review. The DSI also commenced an informal inquiry alleging underpayment by PM Thailand of customs duties and excise taxes of approximately $1.8 billion, covering the period 2000-2003. In early 2011, the Public Prosecutor's office issued a non-prosecution order in the 2003-2007 Investigation. In August 2011, the Director-General of DSI publicly announced that he disagreed with the non-prosecution order. Thus, the matter was referred for resolution to the Attorney General, whose deputy subsequently stated that the Attorney General has made a ruling to proceed with a prosecution order. Based on available information, it is probable that criminal charges will be filed. PM Thailand has been cooperating with the Thai authorities and believes that its declared import prices are in compliance with the Customs Valuation Agreement of the WTO and Thai law.

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

Acquisitions and Other Business Arrangements

In June 2014, we acquired 100% of Nicocigs Limited, a leading U.K.-based e-vapor company, for $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. The purchase price allocation is expected to be completed by the end of 2014. For additional information, see Note 13. Fair Value Measurements to our condensed consolidated financial statements. The effect of this acquisition was not material to our consolidated financial position, results of operations or cash flows in any of the periods presented.

In the fourth quarter of 2013, as part of our initiative to enhance profitability and growth in North African and Middle Eastern markets, we decided to restructure our business in Egypt. The new business model entails a new contract manufacturing agreement with our long-standing, strategic business partner, Eastern Company S.A.E., the creation of a new PMI affiliate in Egypt and a new distribution agreement with Trans Business for Trading and Distribution LLC. To accomplish this restructuring and to ensure a smooth transition to the new model, we recorded, in the fourth quarter of 2013, a charge to our 2013 full-year reported diluted EPS of approximately $0.10 to reflect the discontinuation of existing contractual arrangements.

In May 2013, we announced that Grupo Carso, S.A.B. de C.V. ("Grupo Carso") would sell to us its remaining 20% interest in our Mexican tobacco business. The sale was completed on September 30, 2013 for $703 million. As a result, we now own 100% of the Mexican tobacco business. A director of PMI has an affiliation with Grupo Carso. The final purchase price is subject to a potential 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 addition, upon declaration, we agreed to pay a dividend of approximately $38 million to Grupo Carso related to the earnings of the Mexican tobacco business for the nine months ended September 30, 2013. In March 2014, the dividend was declared and paid. The purchase of the remaining 20% interest resulted in a decrease to our additional paid in capital of $672 million.

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Investments in Unconsolidated Subsidiaries

On September 30, 2013, we acquired a 49% equity interest in United Arab Emirates-based Arab Investors-TA (FZC) (“AITA”) for approximately $625 million. As a result of this transaction, we hold an approximate 25% economic interest in Société des Tabacs Algéro-Emiratie (“STAEM”), an Algerian joint venture which is 51% owned by AITA and 49% by the Algerian state-owned enterprise Société Nationale des Tabacs et Allumettes SpA. STAEM manufactures and distributes under license some of our brands. The initial investment in AITA was recorded at cost and is included in investments in unconsolidated subsidiaries on the condensed consolidated balance sheets.
On December 12, 2013, we acquired from Megapolis Investment BV a 20% equity interest in Megapolis Distribution BV, the holding company of CJSC TK Megapolis ("Megapolis"), our 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 us if the performance criteria are satisfied. We have also agreed to provide Megapolis Investment BV with a $100 million interest-bearing loan. We and Megapolis Investment BV have agreed to set off any future contingent payments owed by us 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 us on March 31, 2017. At December 31, 2013, we 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.
Asset Impairment and Exit Costs

On April 4, 2014, we announced the initiation by our affiliate, Philip Morris Holland B.V. ("PMH"), of consultations with employee representatives on a proposal to discontinue cigarette production at its factory located in Bergen op Zoom, the Netherlands. PMH reached an agreement with the trade unions and their members on a social plan, and ceased cigarette production on September 1, 2014. We expect to incur a total pre-tax charge of approximately $542 million for the total program. This amount includes employee separation costs of $343 million and $129 million related to asset impairment costs. In addition, up to $70 million of pre-tax implementation costs, primarily related to notice period payments, will be reflected in cost of sales and marketing, administration and research costs on our condensed consolidated statement of earnings. For the nine months ended September 30, 2014, we recorded pre-tax asset impairment and exit costs of $472 million, net of $16 million in reversals during the third quarter due to a change in estimate. Excluding asset impairment costs, substantially all of these charges will result in cash expenditures expected to be paid by the third quarter of 2015.

Trade Policy

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

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

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

We do not sell products in Cuba, Iran and Syria.

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

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

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Operating Results – Nine Months Ended September 30, 2014

The following discussion compares operating results within each of our reportable segments for the nine months ended September 30, 2014, with the nine months ended September 30, 2013.

European Union. Net revenues, which include excise taxes billed to customers, increased by $970 million (4.6%). Excluding excise taxes, net revenues increased by $306 million (4.7%) to $6.8 billion. This increase was due to:

- favorable currency ($243 million),
- price increases ($71 million) and
- the impact of acquisitions ($5 million), partly offset by
- unfavorable volume/mix ($13 million).

The net revenues of the European Union segment include $1,250 million in 2014 and $1,132 million in 2013 related to sales of OTP. Excluding excise taxes, OTP net revenues for the European Union segment were $432 million in 2014 and $398 million in 2013.

Operating companies income of $2.9 billion decreased by $352 million (10.9%). This decrease was due primarily to:

- the 2014 pre-tax charge for asset impairment and exit costs ($472 million) related to the decision to discontinue cigarette production in the Netherlands,
- unfavorable volume/mix ($25 million),
- higher marketing, administration and research costs ($24 million) and
- higher manufacturing costs ($21 million), partly offset by
- favorable currency ($117 million) and
- price increases ($71 million).

The total cigarette market in the European Union declined by 3.4% to 352.7 billion units, due primarily to the impact of tax-driven price increases, the unfavorable economic and employment environment and the prevalence of non-duty paid products, with some key geographies showing moderating total market declines, resulting from a deceleration in the growth of the e-vapor category, relatively lower out-switching to the fine cut category, and a moderation in the level of illicit trade. Our cigarette shipment volume in the European Union increased by 0.1% to 140.8 billion units, and market share was up by 1.0 share point to 39.8%. The total OTP market in the European Union of 122.7 billion cigarette equivalent units increased by 0.4%, principally reflecting a stable total fine cut market, which was up 0.2% to 106.8 billion cigarette equivalent units.

While shipment volume of Marlboro of 67.8 billion units decreased by 2.0%, mainly due to a lower total market, market share increased by 0.2 share points to 19.2%, driven notably by Czech Republic, Italy and Spain. Shipment volume of L&M was stable at 24.8 billion units and market share increased by 0.2 share points to 7.1%, driven notably by Germany. Shipment volume of Chesterfield of 20.3 billion units increased by 42.4% and market share increased by 1.1 share points to 5.5%, driven notably by Italy and Poland. Shipment volume of Philip Morris of 7.6 billion units increased by 4.3% and market share increased by 0.1 share point to 2.1%, driven notably by Italy.

Our shipments of OTP of 17.1 billion cigarette equivalent units increased by 6.7%, driven principally by higher share. Our OTP total market share was 14.2%, up by 0.9 share points, reflecting gains in the fine cut category, notably in Belgium, up 0.7 share points to 17.0%, Czech Republic, up 9.7 share points to 27.6%, Hungary, up by 7.5 share points to 18.7%, Italy, up by 4.9 share points to 41.5% and Poland, up by 13.5 share points to 35.4%.

In France, the total cigarette market of 34.0 billion units decreased by 5.7%, mainly reflecting the unfavorable impact of tax-driven price increases in July 2013 and January 2014. Our shipments of 14.1 billion units decreased by 3.7%. Our market share increased by 0.7 share points to 40.9%, mainly driven by Marlboro and Philip Morris, up by 0.4 and 0.2 share points to 25.1% and 9.3%, respectively. Market share of L&M increased by 0.1 share point to 2.6%, and share of Chesterfield was flat at 3.4%. The total industry fine cut category of 10.1 billion cigarette equivalent units decreased by 3.0%. Our market share of the category decreased by 0.5 share points to 26.2%.

In Germany, the total cigarette market of 60.7 billion units increased by 0.6%, partly reflecting the favorable impact of estimated trade purchases of competitive products. Excluding the impact of these estimated trade inventory movements, the total cigarette market declined by approximately 0.4%. Our shipments of 22.0 billion units increased by 1.4%. Market share increased by 0.3 share points to 36.3%, driven by L&M, up by 0.9 share points to 11.6%, partially offset by Marlboro, down by 0.5 share points to 21.5%. Our share of Chesterfield was flat at 1.7%. The total industry fine cut category of 30.9 billion cigarette equivalent units decreased by 1.2%. Our market share of the category was down by 1.5 share points to 13.0%.

In Italy, the total cigarette market of 56.1 billion units increased by 0.7%, mainly reflecting a stabilization in the prevalence of illicit trade, a lower incidence of e-vapor products and continued growth of the low-price segment. Our shipments of 31.3 billion units increased by 5.1%. Our market share increased by 1.5 share points to 54.8%, due primarily to: Chesterfield, up by 5.4 share points to 8.9%, benefiting from its repositioning in February 2014 into the €4.00/pack price segment, and Philip Morris, up by 0.1 share point to 2.4%, partially offset by Diana in the low-price segment which was down 2.9 share points to 8.7%, impacted by the growth of the super-low price segment, and Marlboro, down by 0.7 share points to 25.2%. The total industry fine cut category of 4.5 billion cigarette equivalent units increased by 2.5%, and our market share of the category increased by 4.9 share points to 41.5%, driven by Marlboro.

In Poland, the total cigarette market of 32.9 billion units decreased by 9.5%, reflecting the growth of e-vapor products and the prevalence of illicit trade and non-duty paid OTP products. Although our shipments of 12.8 billion units decreased by 1.9%, our market share increased by 2.3 share points to 39.6%, driven by L&M, up by 0.3 share points to 17.7%, and Chesterfield, up by 2.1 share points to 7.6%, benefiting from the morphing of Red & White in the fourth quarter of 2013, partially offset by Marlboro, down by 0.4 share points to 10.9%. The total industry fine cut category of 2.8 billion cigarette equivalent units increased by 3.1%. Our market share of the category increased by 13.5 share points to 35.4%.

In Spain, the total cigarette market of 35.8 billion units decreased by 2.2%, mainly due to the unfavorable impact of a price increase in the third quarter of 2013. This rate of decline was moderated by lower out-switching to the OTP category. Our shipments of 11.3 billion units increased by 0.6%. Our market share increased by 0.9 share points to 32.0%, driven by higher share of Marlboro and Philip Morris, up by 1.1 and 0.2 share points to 15.8% and 0.9%, respectively, partially offset by L&M, down 0.2 share points to 6.1%. Market share of Chesterfield was flat at 9.2%. While the total industry fine cut category of 7.4 billion cigarette equivalent units decreased by 12.3%, partly reflecting the narrowing of price gaps with the cigarette category since July 2013, our market share of the fine cut category increased by 1.5 share points to 14.9%.

Eastern Europe, Middle East & Africa. Net revenues, which include excise taxes billed to customers, increased by $1.0 billion (6.5%). Excluding excise taxes, net revenues increased by $217 million (3.3%) to $6.7 billion. This increase was due to:

- price increases ($863 million), partly offset by
- unfavorable currency ($477 million) and
- unfavorable volume/mix ($169 million).

Operating companies income of $3.2 billion increased by $250 million (8.4%). This increase was due to:

- price increases ($863 million) and
- higher equity income in unconsolidated subsidiaries ($91 million), partly offset by
- unfavorable currency ($368 million),
- higher manufacturing costs ($190 million, principally related to the impact of the change to our new business structure in Egypt),
- unfavorable volume/mix ($136 million) and
- higher marketing, administration and research costs ($10 million).

Our cigarette shipment volume in EEMA decreased by 3.0% to 213.4 billion units, mainly due to a lower total market in Russia, and a lower market and share in Kazakhstan, Serbia and Ukraine, partially offset by higher volume in Algeria and Turkey, and higher share in Russia. Our cigarette shipment volume of premium brands increased by 2.0%, due principally to Parliament, up by 7.0% to 25.9 billion units and Marlboro, up by 0.4% to 63.1 billion units.

In North Africa, the estimated total cigarette market increased by 2.5% to 103.5 billion units, driven mainly by Algeria and Egypt, partially offset by Libya. Our shipment volume of 27.0 billion units increased by 0.5%, driven largely by Marlboro in Algeria. Our market share decreased by 1.2 share points to 25.7%, due to lower share of Marlboro and L&M, which decreased by 0.1 share point and 0.7 share points to 15.1% and 8.8%, respectively.

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In Russia, the estimated total cigarette market declined by 9.4% to 230.0 billion units, mainly due to the unfavorable impact of the tax-driven price increases and the prevalence of illicit trade. Our shipment volume of 63.5 billion units decreased by 4.5%. Our market share of 27.0%, as measured by Nielsen, was up by 0.9 share points. Market share of Parliament, L&M and Bond Street increased by 0.4, 0.3 and 0.9 share points to 3.7%, 3.1% and 7.4%, respectively, partially offset by Chesterfield and Marlboro, down by 0.2 share points each to 2.8% and 1.5%, respectively.
In Turkey, the total estimated cigarette market increased by 3.5% to 68.7 billion units, reflecting an increase in the adult population, a lower prevalence of illicit trade and the timing of trade inventory movements when compared with 2013. Excluding the net impact of estimated trade inventory movements, the total cigarette market increased by approximately 2.3%. Our shipment volume of 33.7 billion units increased by 4.0%. Our market share, as measured by Nielsen, decreased by 1.3 share points to 44.0%, mainly due to Marlboro, mid-price Muratti, low-price L&M and Lark, down by 0.3, 1.2, 1.3 and 2.1 share points to 8.6%, 5.7%, 6.2% and 9.4%, respectively, partially offset by premium Parliament and low-price Chesterfield, up by 1.2 and 2.5 share points to 11.0% and 3.0%, respectively.
In Ukraine, the estimated total cigarette market decreased by 2.0% to 55.9 billion units, mainly reflecting the impact of the 2013 and 2014 price increases and business disruption due to the political instability in the east of the country, partially offset by a lower prevalence of illicit trade. Our shipment volume of 17.8 billion units decreased by 8.0%, principally due, in addition to the aforementioned factors, to a decrease in our market share, as measured by Nielsen, down by 0.8 share points to 32.7%, with Chesterfield, Marlboro and Parliament down by 1.0 share point, 0.7 and 0.3 share points to 5.1%, 4.9% and 3.0%, respectively. The decrease in our market share was partially offset by growth from our low-price Bond Street and President brands.

Asia. Net revenues, which include excise taxes billed to customers, decreased by $1.3 billion (8.0%). Excluding excise taxes, net revenues decreased by $1.3 billion (16.2%) to $6.7 billion. This decrease was due to:

- unfavorable currency ($861 million) and
- unfavorable volume/mix ($564 million), partly offset by
- price increases ($125 million).

Operating companies income of $2.6 billion decreased by $953 million (26.7%). This decrease was due primarily to:

- unfavorable currency ($544 million),
- unfavorable volume/mix ($451 million),
- higher manufacturing costs ($100 million, mainly due to higher costs in Indonesia) and
- higher pre-tax charges for asset impairment and exit costs ($16 million, principally due to the factory closure in Australia), partly offset by
- price increases ($125 million) and
- lower marketing, administration and research costs ($34 million).

Our cigarette shipment volume of 218.8 billion units decreased by 3.4%, due primarily to: a lower total market and unfavorable estimated inventory movements in Japan, and lower share in Indonesia, Japan and Pakistan, partially offset by a higher total market in Indonesia and a higher share in the Philippines. Shipment volume of Marlboro of 54.5 billion units was down by 3.9%, driven by Japan, partially offset by Indonesia and the Philippines.
In Indonesia, the estimated total cigarette market increased by 2.9% to 233.8 billion units. Our shipment volume of 81.8 billion units decreased by 0.7%, primarily due to lower market share, down by 1.3 share points to 35.0% as a result of: the share decline of Sampoerna Hijau, down 0.8 share points to 3.5%, the share decline of the Dji Sam Soe brand family, which decreased by 0.7 share points to 6.2%, due to the continuing decline of the hand-rolled kretek segment and the unfavorable impact of the brand's hand-rolled variant crossing a critical price point ahead of competition, partially offset by the growth of machine-made Dji Sam Soe Magnum Blue, which reached a year-to-date market share of 0.4% following its launch in April 2014; and the withdrawal of our ultra-low price brands Trend Mild and Vegas Mild following the implementation of excise tax legislation relating to sister companies in the

fourth quarter of 2013. Market share of Sampoerna A, in the premium machine-made lighter-tasting kretek segment was flat at 14.4%, while mid-price U Mild, was up by 1.2 share points to 5.4%. Marlboro's market share was down 0.1 share point to 5.2% and its share of the “white” cigarettes segment, representing 6.5% of the total cigarette market, increased by 3.2 share points to 79.6%.

In Japan, the total cigarette market decreased by 3.2% to 138.8 billion units, partly reflecting the unfavorable impact of the consumption tax-driven retail price increases of April 1, 2014. Our shipment volume of 37.4 billion units decreased by 11.8%,

principally due to the adverse timing of our shipments compared to 2013 and lower market share. Excluding the impact of distributor inventory movements, our shipment volume decreased by 6.3%. Our market share decreased by 1.0 share point to 25.9%, with share of Lark, and Virginia S. down by 0.2 share points each to 9.9% and 1.9%, respectively, and Marlboro down by 0.6 share points to 11.6%. Market share of Parliament was flat at 2.2%.
In Korea, the total cigarette market increased by 0.4% to 66.4 billion units, reflecting speculative trade inventory movements ahead of an anticipated excise tax increase effective January 1, 2015. Although our shipment volume of 12.9 billion units was up 0.3%, market share was essentially flat at 19.3%, with share of Marlboro and Virginia S., down by 0.1 and 0.2 share points to 7.6% and 4.0%, respectively, partially offset by Parliament and Lark, up by 0.1 share point each to 7.0%, and 0.7%, respectively.
In the Philippines, the total estimated tax-paid industry cigarette volume decreased by 0.8% to 60.8 billion units, reflecting the prevalence of domestic non-duty paid products. Our shipment volume of 50.9 billion units increased by 1.0%. Our market share of the total estimated tax-paid industry of 83.7% increased by 1.5 share points. Marlboro's market share increased by 1.3 share points to 18.0%. Share of Fortune increased by 0.3 share points to 33.9%. Our share data is inflated by the high prevalence of domestic non-duty paid products.

Latin America & Canada. Net revenues, which include excise taxes billed to customers, decreased by $184 million (2.5%). Excluding excise taxes, net revenues decreased by $81 million (3.3%) to $2.4 billion. This decrease was due primarily to:

- unfavorable currency ($316 million) and
- unfavorable volume/mix ($98 million), partly offset by
- price increases ($332 million).

Operating companies income of $734 million decreased by $42 million (5.4%). This decrease was due primarily to:

- unfavorable currency ($184 million),
- unfavorable volume/mix ($101 million),
- higher marketing, administration and research costs ($44 million),
- higher manufacturing costs ($37 million) and
- the 2014 pre-tax charge for asset impairment and exit costs related to a leaf processing facility closure in Canada ($7 million), partly offset by
- price increases ($332 million).

Our cigarette shipment volume in Latin America & Canada of 68.0 billion units decreased by 2.5%, principally due to Canada and Mexico. Shipment volume of Marlboro of 26.2 billion units decreased by 4.7%, due predominantly to Mexico.
In Argentina, the total cigarette market decreased by 1.6% to 30.7 billion units. Our cigarette shipment volume of 23.7 billion units increased by 0.7%, and market share increased by 1.6 share points to 76.9%, driven by mid-price Philip Morris, up by 2.2 share points to 43.3%, reflecting the positive impact of its capsule variants, partially offset by low-price Next, down by 0.6 share points to 2.0%. Market share of Marlboro was up by 0.2 share points to 24.0%.
In Canada, the total cigarette market decreased by 5.4% to 20.4 billion units, mainly due to the impact of federal and provincial tax-driven price increases in the first half of 2014. While our cigarette shipment volume of 7.7 billion units decreased by 4.0%, market share increased by 0.7 share points to 37.9%, with premium brand Belmont up by 0.3 share points to 2.9%, and Benson & Hedges flat at 2.4%. Market share of mid-price Canadian Classics was up by 0.3 share points to 10.5%. Market share of low-price Next was up by 0.9 share points to 10.7%, partially offset by mid-price Number 7 and low-price Accord, down by 0.3 and 0.4 share points to 4.0% and 2.5%, respectively.
In Mexico, the total cigarette market decreased by 3.5% to 23.9 billion units, mainly due to the depletion of estimated trade inventory levels built up ahead of our price increase in December 2013. Excluding the impact of estimated inventory movements, the total cigarette market declined by approximately 0.6%. Our cigarette shipment volume of

16.7 billion units decreased by 7.2%. Our market share decreased by 2.7 share points to 70.1%. While market share of Marlboro was down by 2.9 share points to 48.8% and share of Benson & Hedges was down by 0.5 share points to 5.1%, reflecting consumer down-trading, our share of the premium price segment was up by 1.1 share points to 91.5%. Market share of Delicados was essentially flat at 11.0%.

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Operating Results – Three Months Ended September 30, 2014
The following discussion compares operating results within each of our reportable segments for the three months ended September 30, 2014, with the three months ended September 30, 2013.
European Union. Net revenues, which include excise taxes billed to customers, increased by $290 million (3.9%). Excluding excise taxes, net revenues increased by $76 million (3.3%) to $2.4 billion. This increase was due to:

- favorable currency ($64 million),
- price increases ($5 million),
- the impact of acquisitions ($5 million) and
- favorable volume/mix ($2 million).

The net revenues of the European Union segment include $431 million in 2014 and $380 million in 2013 related to sales of OTP. Excluding excise taxes, OTP net revenues for the European Union segment were $150 million in 2014 and $134 million in 2013.
Operating companies income of $1.2 billion decreased by $21 million (1.7%). This decrease was due primarily to:

- higher marketing, administration and research costs ($30 million),
- higher manufacturing costs ($19 million) and
- unfavorable volume/mix ($3 million), partly offset by
- the 2014 reversal of pre-tax asset impairment and exit costs ($16 million) due to a change in estimate associated with our decision to discontinue cigarette production in the Netherlands,
- favorable currency ($8 million) and
- price increases ($5 million).

The total cigarette market in the European Union of 126.0 billion units decreased by 3.4%, partly reflecting, in certain key geographies: moderating total market declines compared to the same period last year, resulting from a deceleration in the growth of the e-vapor category, relatively lower out-switching to the fine cut category, and a moderation in the level of illicit trade; coupled with net favorable estimated trade inventory movements compared to the third quarter of 2013. Excluding the impact of the estimated trade inventory movements, the total cigarette market in the European Union is estimated to have declined by approximately 4.0%. The total OTP market in the European Union in the quarter of 42.5 billion cigarette equivalent units increased by 0.7%, reflecting a higher total fine cut market, up by 0.4% to 37.0 billion cigarette equivalent units.
Our cigarette shipment volume of 49.2 billion units increased by 0.5%, and market share increased by 1.2 share points to 39.7%. While shipment volume of Marlboro decreased by 2.3% to 23.7 billion units, market share increased by 0.2 share points to 19.1%. While shipment volume of L&M decreased by 3.4% to 8.7 billion units, market share was flat at 7.0%. Shipment volume of Chesterfield of 7.3 billion units increased by 45.7%, and market share increased by 1.4 share points to 5.8%, driven mainly by Italy and Poland. Shipment volume of Philip Morris of 2.6 billion units increased by 5.6%, and market share increased by 0.1 share point to 2.1%.
Our shipments of OTP of 6.0 billion cigarette equivalent units increased by 12.2%, driven principally by a higher total market and share. Our total OTP market share was 14.0%, up by 0.8 share points, reflecting gains in the fine cut category, notably in Belgium, up by 0.4 share points to 16.7%, Czech Republic, up by 5.1 share points to 24.6%, Hungary, up by 8.1 share points to 18.5%, Italy, up by 0.8 share points to 41.2%, Poland, up by 11.3 share points to 34.1%, and Spain, up by 0.3 share points to 14.5%, partially offset by Germany, down by 0.7 share points to 13.0%, and Portugal, down by 7.6 share points to 23.3%.
In France, the total cigarette market of 11.7 billion units decreased by 3.8%, mainly reflecting the unfavorable impact of price increases in July 2013 and January 2014. Our shipments of 4.8 billion units increased by 0.2% and market share increased by 0.4 share points to 40.4%, mainly driven by Marlboro and premium Philip Morris, up by 0.1 share point and 0.3 share points to 24.7% and 9.2%, respectively. Market shares of L&M and Chesterfield were flat at 2.6% and 3.4%, respectively. The total industry fine cut category of 3.5 billion cigarette equivalent units increased by 0.9%.

Our market share of the category decreased by 0.6 points to 25.8%.

In Germany, the total cigarette market of 21.6 billion units decreased by 1.5%, partially reflecting the net favorable impact of estimated trade purchases of competitive products. Excluding the impact of these estimated trade inventory movements, the total cigarette market declined by approximately 2.7%. Our shipments of 7.6 billion units increased by 0.3%, and market share increased by 0.6 share points to 35.1%, driven by Marlboro, up by 0.3 share points to 20.8%, and L&M, up by 0.5 share points to 11.2%.

Market share of Chesterfield decreased by 0.1 share point to 1.6%. The total industry fine cut category of 10.6 billion cigarette equivalent units decreased by 2.5%. Our market share of the category decreased by 0.7 share points to 13.0%.

In Italy, the total cigarette market of 20.1 billion units decreased by 0.1%, mainly reflecting a lower incidence of e-vapor products and continued growth of the low-price segment. Our shipments in the quarter of 10.8 billion units increased by 5.8%. Our market share increased by 2.5 share points to 55.8%, due primarily to: Chesterfield, up by 7.4 share points to 10.9%, benefiting from its price repositioning in February 2014, partially offset by Marlboro, down by 1.0 share point to 25.2%, and Diana in the low-price segment, down by 3.2 share points to 7.9%, impacted by the growth of the super-low price segment. Market share of Philip Morris decreased by 0.2 share points to 2.3%. The total industry fine cut category of 1.6 billion cigarette equivalent units increased by 5.8%, and our market share of the category increased by 0.8 share points to 41.2%, driven by Marlboro.

In Poland, the total cigarette market of 11.3 billion units decreased by 10.8%, reflecting the prevalence of e-cigarettes, illicit trade and non-duty paid OTP products. Our shipments of 4.6 billion units decreased by 2.5%. Our market share increased by 1.8 share points to 40.9%, driven by Chesterfield, up by 2.7 share points to 7.9%, benefiting from the morphing of Red & White in the fourth quarter of 2013, partially offset by Marlboro, down by 0.4 share points to 11.5%, and L&M, down by 0.1 share point to 18.7%. The total industry fine cut category of 913 million cigarette equivalent units increased by 8.8%, and our market share of the category increased by 11.3 share points to 34.1%.

In Spain, the total cigarette market of 13.0 billion units decreased by 1.9%. This rate of decline was moderated by an improving economic environment and lower out-switching to the OTP category. While our shipments of 3.8 billion units decreased by 1.6%, market share increased by 1.5 share points to 32.6%, driven by higher share of Marlboro, up by 1.2 share points to 16.4%, Chesterfield, up by 0.1 share point to 9.0%, and Philip Morris, up by 0.4 share points to 1.2%. Market share of L&M was flat at 6.0%. The total industry fine cut category of 2.6 billion cigarette equivalent units decreased by 5.3%, partly reflecting the narrowing of price gaps with the cigarette category since July 2013. Our market share of the fine cut category increased by 0.3 share points to 14.5%.

Eastern Europe, Middle East & Africa. Net revenues, which include excise taxes billed to customers, increased by $565 million (10.2%). Excluding excise taxes, net revenues increased by $149 million (6.5%) to $2.4 billion. This increase was due to:

- price increases ($306 million), partly offset by
- unfavorable currency ($155 million) and
- unfavorable volume/mix ($2 million).

Operating companies income of $1.2 billion increased by $116 million (10.7%). This increase was due primarily to:

- price increases ($306 million) and
- higher equity income in unconsolidated subsidiaries ($42 million), partly offset by
- unfavorable currency ($158 million),
- higher manufacturing costs ($52 million, principally related to the impact of the change to our new business structure in Egypt),
- higher marketing, administration and research costs ($20 million) and
- unfavorable volume/mix ($2 million).

Our cigarette shipment volume of 77.3 billion units increased by 0.5%, mainly due to the Middle East, notably Saudi Arabia, and North Africa, notably Algeria, partially offset by Kazakhstan, Serbia and Ukraine. Our cigarette shipment volume of premium brands increased by 5.1%, due principally to Marlboro, up by 2.9% to 22.9 billion units, and Parliament, up by 9.4% to 9.8 billion units.

In North Africa, the estimated total cigarette market increased by 3.2% to 33.7 billion units, driven mainly by Algeria and Egypt, partially offset by Libya. Our shipment volume of 9.3 billion units increased by 10.1%, driven largely by Marlboro in Algeria and L&M in Egypt. Our market share increased by 0.6 share points to 27.1%, mainly reflecting gains in Algeria. Market share of Marlboro decreased by 1.9 share points to 15.6%, due largely to a decline in Egypt partially offset by a gain in Algeria, while share of L&M increased by 2.8 share points to 9.7%.

In Russia, the estimated total cigarette market declined by 10.2% to 83.5 billion units, mainly due to the unfavorable impact of the tax-driven price increases and the prevalence of illicit trade. Our shipment volume of 23.0 billion units decreased by 0.4%. Our market share of 27.4%, as measured by Nielsen, was up by 1.3 share points. Market share of Parliament, L&M and Bond

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Street increased by 0.4, 0.2 and 1.3 share points to 3.8%, 3.1% and 7.7%, respectively, partially offset by Marlboro and Chesterfield, down by 0.2 and 0.3 share points to 1.5% and 2.7%, respectively.

In Turkey, the estimated total cigarette market increased by 7.7% to 26.5 billion units, mainly reflecting a lower prevalence of illicit trade, an increase in the adult population and the timing of trade inventory movements compared to the third quarter of 2013. Excluding the net impact of estimated trade inventory movements, the total cigarette market increased by approximately 5.5%. Our shipment volume of 12.5 billion units decreased by 0.5%. Our market share, as measured by Nielsen, decreased by 3.0 share points to 43.2%, mainly due to: Marlboro, mid-price Muratti, low-price L&M and Lark, down by 0.4, 1.7, 1.5 and 2.8 share points to 8.7%, 5.2%, 5.8% and 8.4%, respectively, partially offset by Parliament, up by 1.3 share points to 11.6%.

In Ukraine, the estimated total cigarette market decreased by 3.3% to 19.4 billion units, mainly reflecting estimated trade inventory deloading following the excise tax-driven price increases in July 2014, and business disruption due to the political instability in the east of the country, partially offset by a lower prevalence of illicit trade. Our shipment volume of 6.5 billion units decreased by 6.1%, principally due to a lower total market and a decrease in our market share, as measured by Nielsen, down by 0.6 share points to 32.7%, with Marlboro, Parliament, Bond Street and Chesterfield, down by 0.8, 0.3, 0.2 and 0.5 share points to 4.7%, 3.0%, 8.8% and 5.0%, respectively. The decrease in our market share was partially offset by growth from L&M, up by 0.6 share points to 2.7%, and our low-price segment brand, President, up by 2.8 share points to 5.5%.

Asia. Net revenues, which include excise taxes billed to customers, decreased by $201 million (3.9%). Excluding excise taxes, net revenues decreased by $311 million (12.2%) to $2.2 billion. This decrease was due to:

- unfavorable currency ($210 million) and
- unfavorable volume/mix ($150 million), partly offset by
- price increases ($49 million).

Operating companies income of $799 million decreased by $298 million (27.2%). This decrease was due primarily to:

- unfavorable currency ($148 million),
- unfavorable volume/mix ($134 million) and
- higher manufacturing costs ($75 million, mainly due to higher costs in Indonesia), partly offset by
- price increases ($49 million) and
- lower marketing, administration and research costs ($11 million).

Our cigarette shipment volume of 72.4 billion units decreased by 1.3%, due primarily to a lower total market, lower share and the timing of distributor inventory movements in Japan, partially offset by a higher total market in Indonesia. Shipment volume of Marlboro of 17.0 billion units decreased by 12.8%, due predominantly to Japan.

In Indonesia, the estimated total cigarette market increased by 4.9% to 78.1 billion units, reflecting strong growth of the machine-made kretek segment. Our shipment volume of 27.7 billion units increased by 2.1%. Our market share decreased by 0.9 share points to 35.5%, predominantly due to the share decline of Sampoerna Hijau, down by 1.0 share point to 3.2% and the withdrawal of ultra-low price brands Trend Mild and Vegas Mild. Market share of the brand family Dji Sam Soe was flat at 6.7%, reflecting the continuing decline of the hand-rolled kretek segment, compounded by the unfavorable impact of the brand's hand-rolled variant crossing a critical price point ahead of competition, offset by the growth of machine-made Dji Sam Soe Magnum Blue which was launched in April 2014 and reached a market share of 0.6% in the quarter. Market share of Sampoerna A, in the premium machine-made lighter-tasting kretek segment, was flat at 14.7%, while mid-price U Mild was up by 1.2 share points to 5.5%. Although Marlboro's market share decreased by 0.3 share points to 5.1%, its share of the “white” cigarettes segment, which represented 6.5% of the total cigarette market, increased by 0.9 share points to 79.1%.

In Japan, the total cigarette market decreased by 4.0% to 48.0 billion units, partly reflecting the unfavorable impact of the consumption tax-driven retail price increases of April 1, 2014. Our shipment volume of 12.2 billion units decreased by 10.0%, principally due to the unfavorable timing of distributor inventory movements compared to the third quarter of 2013. Excluding the impact of these inventory movements, our shipment volume decreased by 6.3%. Our market share decreased by 0.6 share points to 25.9%, with share of Marlboro and Virginia S. down by 0.6 share points and 0.1 share point to 11.6% and 1.9%, respectively. Market share of Lark increased by 0.1 share point to 10.0%, including the successful morphing of Philip Morris.

In Korea, the total cigarette market increased by 4.0% to 24.6 billion units, reflecting speculative trade inventory movements ahead of an anticipated excise tax increase effective January 1, 2015. Our shipment volume of 4.6 billion units increased by 0.9%

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and market share decreased by 0.8 share points to 18.6% due to Parliament, Marlboro and Virginia S., down by 0.2, 0.3 and 0.5 share points to 6.7%, 7.4% and 3.8%, respectively, reflecting the impact of the aforementioned trade inventory movements.

In the Philippines, estimated total tax-paid industry cigarette volumes decreased by 3.2% to 22.0 billion units. Our shipment volume of 17.5 billion units decreased by 1.7%. Our market share of the total estimated tax-paid industry of 79.2% was up by 1.3 share points. Marlboro's market share increased by 1.4 share points to 16.8% and share of Fortune increased by 4.7 share points to 32.4%. Our share data is inflated by the high prevalence of domestic non-duty paid products.

Latin America & Canada. Net revenues, which include excise taxes billed to customers, increased by $52 million (2.1%). Excluding excise taxes, net revenues increased by $15 million (1.8%) to $833 million. This increase was due primarily to:

- price increases ($131 million), partly offset by
- unfavorable currency ($93 million) and
- unfavorable volume/mix ($24 million).

Operating companies income of $267 million was flat, due to:

- price increases ($131 million), essentially offset by
- unfavorable currency ($73 million),
- unfavorable volume/mix ($27 million),
- higher manufacturing costs ($18 million),
- the 2014 pre-tax charge for asset impairment and exit costs related to a leaf processing facility closure in Canada ($7 million), and
- higher marketing, administration and research costs ($5 million).

Our cigarette shipment volume of 23.5 billion units decreased by 2.0%, due largely to Canada and Mexico. Shipment volume of Marlboro of 9.0 billion units decreased by 1.9%, due predominantly to Brazil and Mexico.

In Argentina, the total cigarette market decreased by 2.8% to 10.0 billion units. While our cigarette shipment volume of 7.8 billion units decreased by 0.8%, market share increased by 1.2 share points to 77.2%, driven by Marlboro, up by 0.5 share points to 24.2%, and mid-price Philip Morris, up by 1.4 share points to 43.6%, reflecting the positive impact of its capsule variants, partially offset by low-price Next, down by 0.5 share points to 1.9%.

In Canada, the total cigarette market decreased by 4.2% to 7.3 billion units, mainly due to the impact of federal and provincial tax-driven price increases in the first and second quarters of 2014. Our cigarette shipment volume of 2.8 billion units decreased by 5.5%. Our market share decreased by 0.7 share points to 38.0%, with premium brands Benson & Hedges down by 0.1 share point to 2.4% and Belmont up by 0.3 share points to 3.1%. Market share of mid-price Canadian Classics was flat at 10.7% and mid-price Number 7 was down by 0.4 share points to 3.9%. Market share of low-price Next was flat at 10.6%, and low-price Accord was down by 0.6 share points to 2.3%.

In Mexico, the total cigarette market decreased by 1.1% to 8.3 billion units. Our cigarette shipment volume in the quarter of 5.9 billion units decreased by 2.8%. Our market share decreased by 1.3 share points to 71.1%. Market share of Marlboro was down by 0.6 share points to 49.9% and share of premium Benson & Hedges was down by 0.4 share points to 5.1%, reflecting consumer down-trading. Our share of the premium segment, representing 59.9% of the total cigarette market, increased by 0.9 share points to 91.8%. Market share of Delicados decreased by 0.9 share points to 10.8%.

Financial Review

Net Cash Provided by Operating Activities

Net cash provided by operating activities of $6.4 billion during the first nine months of 2014 decreased by $1.4 billion from the comparable 2013 period. The decrease was due primarily to lower net earnings, an increase in our working capital requirements and higher cash payments related to exit costs.

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The unfavorable movements in working capital were due primarily to the following:

- more cash used for accrued liabilities and other current assets ($1.6 billion), largely due to the timing of payments for excise taxes and the fair value movement of financial instruments; partially offset by
- more cash provided by inventories ($780 million), primarily related to lower leaf tobacco and finished goods inventory levels.

Net Cash Used in Investing Activities

Net cash used in investing activities of $773 million during the first nine months of 2014 decreased by $698 million from the comparable 2013 period, due primarily to less cash spent on investments in unconsolidated subsidiaries and higher cash proceeds from the sale of fixed assets, partially offset primarily by the purchase of Nicocigs Limited.

In June 2014, we acquired 100% of Nicocigs Limited, a leading U.K.-based e-vapor company, for $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. For further details, see Note 17. Acquisitions and Other Business Arrangements.

In September 2013, we acquired a 49% equity interest in United Arab Emirates-based Arab Investors-TA (FZC) ("AITA") for approximately $625 million. For further details, see Note 16. Investments in Unconsolidated Subsidiaries.

Our capital expenditures were $804 million and $821 million during the nine months ended September 30, 2014 and 2013, respectively. The 2014 expenditures were primarily related to investments in productivity-enhancing programs, equipment for new products, including RRPs, and the expansion of our capacity in Indonesia for machine-made kretek cigarettes.

Net Cash Used in Financing Activities

During the first nine months of 2014, net cash used in financing activities was $5.6 billion, compared with net cash used in financing activities of $5.9 billion during the first nine months of 2013. During the first nine months of 2014, we used a total of $10.2 billion to repurchase our common stock, pay dividends and repay debt. These uses were partially offset by proceeds from our debt offerings and short-term borrowings in 2014 of $4.8 billion. During the first nine months of 2013, we used a total of $12.7 billion to repurchase our common stock, pay dividends, repay debt and purchase subsidiary shares from noncontrolling interests. These uses were partly offset by proceeds from our debt offerings and short-term borrowings in 2013 of $7.0 billion.

Dividends paid in the first nine months of 2014 and 2013 were $4.5 billion and $4.2 billion, respectively. The increase reflects a higher dividend rate in 2014, partially offset by lower shares outstanding as a result of our share repurchase program.

Debt and Liquidity

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

Credit Ratings - The cost and terms of our financing arrangements as well as our access to commercial paper markets may be affected by applicable credit ratings. At September 30, 2014, our credit ratings and outlook by major credit rating agencies were as follows:

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

Credit Facilities – On January 31, 2014, we extended the term of our existing $2.0 billion 364-day revolving credit facility until February 10, 2015. On February 28, 2014, we replaced our $2.5 billion multi-year revolving credit facility, expiring March 31, 2015, with a new $2.5 billion multi-year credit facility, expiring on February 28, 2019. At September 30, 2014, our committed credit facilities and commercial paper outstanding were as follows:

(in billions)

Type	Committed Credit Facilities	Commercial Paper
364-day revolving credit, expiring February 10, 2015	$2.0	
Multi-year revolving credit, expiring February 28, 2019	2.5	
Multi-year revolving credit, expiring October 25, 2016	3.5	
Total facilities	$8.0	
Commercial paper outstanding		$0.8

At September 30, 2014, there were no borrowings under the committed credit facilities, and the entire committed amounts were available for borrowing.

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

Each of these facilities requires us to maintain a ratio of consolidated earnings before interest, taxes, depreciation and amortization (“consolidated EBITDA”) to consolidated interest expense of not less than 3.5 to 1.0 on a rolling four-quarter basis. At September 30, 2014, our ratio calculated in accordance with the agreements was 13.2 to 1.0. These facilities do not include any credit rating triggers, material adverse change clauses or any provisions that could require us to post collateral. We expect to continue to meet our covenants. The terms “consolidated EBITDA” and “consolidated interest expense,” both of which include certain adjustments, are defined in the facility agreements previously filed with the U.S. Securities and Exchange Commission.

In addition to the committed credit facilities discussed above, certain of our subsidiaries maintain short-term credit arrangements to meet their respective working capital needs. These credit arrangements, which amounted to approximately $2.8 billion at September 30, 2014 and $2.4 billion at December 31, 2013, are for the sole use of our subsidiaries. Borrowings under these arrangements amounted to $1.3 billion at September 30, 2014, and $1.0 billion at December 31, 2013.

Commercial Paper Program - We have commercial paper programs in place in the U.S. and in Europe. At September 30, 2014 and December 31, 2013, we had $834 million and $1.4 billion, respectively, of commercial paper outstanding.

Effective April 19, 2013, our commercial paper program in the U.S. was increased by $2.0 billion. As a result, our commercial paper programs in place in the U.S. and in Europe currently have an aggregate issuance capacity of $8.0 billion.

The existence of the commercial paper program and the committed credit facilities, coupled with our operating cash flows, will enable us to meet our liquidity requirements.

Debt - Our total debt was $28.8 billion at September 30, 2014 and $27.7 billion at December 31, 2013.

On February 21, 2014, we filed a new shelf registration statement with the U.S. Securities and Exchange Commission, under which we may from time to time sell debt securities and/or warrants to purchase debt securities over a three-year period.

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Our debt issuances in the first nine months of 2014 were as follows:
(in millions)

Type		Face Value [d]	Interest Rate		Issuance	Maturity
EURO notes	[a]	€750 (approximately $1,029)	1.875	%	March 2014	March 2021
EURO notes	[a]	€1,000 (approximately $1,372)	2.875	%	March 2014	March 2026
EURO notes	[b]	€500 (approximately $697)	2.875	%	May 2014	May 2029
Swiss franc notes	[c]	CHF275 (approximately $311)	0.750	%	May 2014	December 2019
Swiss franc notes	[b]	CHF250 (approximately $283)	1.625	%	May 2014	May 2024

[a] Interest on these notes is payable annually in arrears beginning in March 2015.
[b] Interest on these notes is payable annually in arrears beginning in May 2015.
[c] Interest on these notes is payable annually in arrears beginning in December 2014.
[d] U.S. dollar equivalents for foreign currency notes were calculated based on exchange rates on the date of issuance.

The net proceeds from the sale of the securities listed in the table above will be used for general corporate purposes.

Guarantees - At September 30, 2014, we were contingently liable for $0.9 billion of guarantees of our own performance, which were primarily related to excise taxes on the shipment of our products. There is no liability in the condensed consolidated financial statements associated with these guarantees. At September 30, 2014, our third-party guarantees were insignificant.

Equity and Dividends

As discussed in Note 3. Stock Plans to our condensed consolidated financial statements, during the nine months ended September 30, 2014, we granted 2.4 million shares of deferred stock awards to eligible employees at a weighted-average grant date fair value of $77.74 per share. Equity awards generally vest three or more years after the date of the award, subject to earlier vesting on death or disability or normal retirement, or separation from employment by mutual agreement after reaching age 58.

In May 2012, our stockholders approved the Philip Morris International Inc. 2012 Performance Incentive Plan (the “2012 Plan”). The 2012 Plan replaced the 2008 Performance Incentive Plan (the “2008 Plan”) and, as a result, there will be no additional grants under the 2008 Plan. Under the 2012 Plan, we may grant to eligible employees restricted stock, restricted stock units and deferred stock units, performance-based cash incentive awards and performance-based equity awards. Up to 30 million shares of our common stock may be issued under the 2012 Plan. At September 30, 2014, shares available for grant under the 2012 Plan were 24,799,010.

On August 1, 2012, we began repurchasing shares under a three-year $18.0 billion share repurchase program that was authorized by our Board of Directors in June 2012. From August 1, 2012 through September 30, 2014, we repurchased 135.3 million shares of our common stock at a cost of $11.9 billion under this repurchase program. During the first nine months of 2014, we repurchased 35.9 million shares at a cost of $3.0 billion. During the third quarter of 2014, we repurchased 8.9 million shares at a cost of $750 million.

As previously announced on February 6, 2014, we have a share repurchase target amount for 2014 of $4.0 billion.

Dividends paid in the first nine months of 2014 were $4.5 billion. During the third quarter of 2014, our Board of Directors approved a 6.4% increase in the quarterly dividend to $1.00 per common share. As a result, the present annualized dividend rate is $4.00 per common share.

Market Risk

Counterparty Risk - We predominantly work with financial institutions with strong short- and long-term credit ratings as assigned by Standard & Poor’s and Moody’s. These banks are also part of a defined group of relationship banks. Non-investment grade institutions are only used in certain emerging markets to the extent required by local business needs. We have a conservative approach when it comes to choosing financial counterparties and financial instruments.

As such we do not invest or hold investments in any structured or equity-linked products. The majority of our cash and cash equivalents is currently invested in bank deposits maturing within less than 30 days.

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

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Derivative Financial Instruments - We operate in markets outside of the United States, with manufacturing and sales facilities in various locations throughout the world. Consequently, we use certain financial instruments to manage our foreign currency and interest rate exposure. We use derivative financial instruments principally to reduce our exposure to market risks resulting from fluctuations in foreign exchange rates by creating offsetting exposures. We are not a party to leveraged derivatives and, by policy, do not use derivative financial instruments for speculative purposes. See Note 6. Financial Instruments, Note 13. Fair Value Measurements, and Note 15. Balance Sheet Offsetting to our condensed consolidated financial statements for further details on our derivative financial instruments and the related collateral arrangements.

Contingencies

See Note 10. Contingencies to our condensed consolidated financial statements for a discussion of contingencies.

Cautionary Factors That May Affect Future Results

Forward-Looking and Cautionary Statements

We may from time to time make written or oral forward-looking statements, including statements contained in filings with the SEC, in reports to stockholders and in press releases and investor webcasts. You can identify these forward-looking statements by use of words such as "strategy," "expects," "continues," "plans," "anticipates," "believes," "will," "estimates," "intends," "projects," "goals," "targets" and other words of similar meaning. You can also identify them by the fact that they do not relate strictly to historical or current facts.

We cannot guarantee that any forward-looking statement will be realized, although we believe we have been prudent in our plans and assumptions. Achievement of future results is subject to risks, uncertainties and inaccurate assumptions. Should known or unknown risks or uncertainties materialize, or should underlying assumptions prove inaccurate, actual results could vary materially from those anticipated, estimated or projected. Investors should bear this in mind as they consider forward-looking statements and whether to invest in or remain invested in our securities.

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

Risks Related to Our Business and Industry

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

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

Increases in cigarette taxes are expected to continue to have an adverse impact on our sales of cigarettes, due to resulting lower consumption levels, a shift in sales from manufactured cigarettes to other tobacco products and from the premium-price to the mid-price or low-price cigarette categories, where we may be under-represented, from local sales to legal cross-border purchases of lower price products, or to illicit products such as contraband, counterfeit and "illicit whites."

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

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

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

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

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

There is litigation related to tobacco products pending in certain jurisdictions. Damages claimed in some tobacco-related litigation are significant and, in certain cases in Brazil, Canada, Israel and Nigeria, range into the billions of U.S. dollars. We anticipate that new cases will continue to be filed. The FCTC encourages litigation against tobacco product manufacturers. It is possible that our consolidated results of operations, cash flows or financial position could be materially affected in a particular fiscal quarter or fiscal year by an unfavorable outcome or settlement of certain pending litigation. Please see Note 10. Contingencies to our condensed consolidated financial statements for a discussion of tobacco-related litigation.

We face intense competition, and our failure to compete effectively could have a material adverse effect on our profitability and results of operations.

We compete primarily on the basis of product quality, brand recognition, brand loyalty, taste, innovation, packaging, service, marketing, advertising and price. We are subject to highly competitive conditions in all aspects of our business. The competitive environment and our competitive position can be significantly influenced by weak economic conditions, erosion of consumer confidence, competitors' introduction of lower-price products or innovative products, higher tobacco product taxes, higher absolute prices and larger gaps between retail price categories, and product regulation that diminishes the ability to differentiate tobacco products. Competitors include three large international tobacco companies and several regional and local tobacco companies and, in some instances, state-owned tobacco enterprises, principally in Algeria, China, Egypt, Taiwan, Thailand and Vietnam. Industry consolidation and privatizations of state-owned enterprises have led to an overall increase in competitive pressures. Some competitors have different profit and volume objectives and some international competitors are susceptible to changes in different currency exchange rates.

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

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

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

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

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

We may be unable to anticipate changes in consumer preferences or to respond to consumer behavior influenced by economic downturns.

Our tobacco business is subject to changes in consumer preferences, which may be influenced by local economic conditions. To be successful, we must:

- promote brand equity successfully;
- anticipate and respond to new consumer trends;
- develop new products and markets and broaden brand portfolios;
- improve productivity; and
- be able to protect or enhance margins through price increases.

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

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

Large quantities of counterfeit cigarettes are sold in the international market. We believe that Marlboro is the most heavily counterfeited international cigarette brand, although we cannot quantify the revenues we lose as a result of this activity. In addition, our revenues are reduced by contraband, legal cross-border purchases and non-tax paid volume produced by local manufacturers.

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

We continue to seek ways to develop commercially viable new product technologies with the potential to reduce exposure to harmful constituents in smoke and individual risk and population harm in comparison to smoking combustible cigarettes. Our goal is to develop products whose potential to reduce exposure, individual risk and population harm can be substantiated by rigorous scientific studies and that provide adult smokers the taste, sensory experience, nicotine delivery profile and ritual characteristics that are similar to those currently provided by combustible cigarettes. We may not succeed in these efforts. If we do not succeed, but others do, we may be at a competitive disadvantage. Furthermore, we cannot predict whether regulators will permit the marketing of tobacco products or other nicotine-containing products with claims of reduced exposure or disease risk. A prohibition on any such claims could significantly undermine the commercial viability of these products.
Our reported results could be adversely affected by unfavorable currency exchange rates, and currency devaluations could impair our competitiveness.
We conduct our business primarily in local currency and, for purposes of financial reporting, the local currency results are translated into U.S. dollars based on average exchange rates prevailing during a reporting period. During times of a strengthening U.S. dollar, our reported net revenues and operating income will be reduced because the local currency translates into fewer U.S. dollars. During periods of local economic crises, foreign currencies may be devalued significantly against the U.S. dollar, reducing our margins. Actions to recover margins may result in lower volume and a weaker competitive position.
The repatriation of our foreign earnings, changes in the earnings mix, and changes in U.S. tax laws may increase our effective tax rate. Our ability to receive payments from foreign subsidiaries or to repatriate royalties and dividends could be restricted by local country currency exchange controls.
Because we are a U.S. holding company, our most significant source of funds is distributions from our non-U.S. subsidiaries. Under current U.S. tax law, in general we do not pay U.S. taxes on our foreign earnings until they are repatriated to the U.S. as distributions from our non-U.S. subsidiaries. These distributions may result in a residual U.S. tax cost. It may be advantageous to us in certain circumstances to significantly increase the amount of such distributions, which could result in a material increase in our overall effective tax rate. Additionally, the Obama Administration has indicated that it favors changes in U.S. tax law that would fundamentally change how our earnings are taxed in the U.S. If enacted and depending upon its precise terms, such legislation could increase our overall effective tax rate. Certain countries in which we operate have adopted or could institute currency exchange controls that limit or prohibit our local subsidiaries' ability to make payments outside the country.
Our ability to grow may be limited by our inability to introduce new products, enter new markets or to improve our margins through higher pricing and improvements in our brand and geographic mix.
Our profitability may suffer if we are unable to introduce new products or enter new markets successfully, to raise prices or maintain an acceptable proportion of our sales of higher margin products and sales in higher margin geographies.

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We may be unable to expand our brand portfolio through successful acquisitions or the development of strategic business relationships.

One element of our growth strategy is to strengthen our brand portfolio and market positions through selective acquisitions and the development of strategic business relationships. Acquisition and strategic business development opportunities are limited and present risks of failing to achieve efficient and effective integration, strategic objectives and anticipated revenue improvements and cost savings. There is no assurance that we will be able to acquire attractive businesses on favorable terms, or that future acquisitions or strategic business developments will be accretive to earnings.

Government mandated prices, production control programs, shifts in crops driven by economic conditions and the impact of climate change may increase the cost or reduce the quality of the tobacco and other agricultural products used to manufacture our products.

As with other agricultural commodities, the price of tobacco leaf and cloves can be influenced by imbalances in supply and demand, and crop quality can be influenced by variations in weather patterns, including those caused by climate change. Tobacco production in certain countries is subject to a variety of controls, including government mandated prices and production control programs. Changes in the patterns of demand for agricultural products could cause farmers to plant less tobacco. Any significant change in tobacco leaf and clove prices, quality and quantity could affect our profitability and our business.

Our ability to implement our strategy of attracting and retaining the best global talent may be impaired by the decreasing social acceptance of cigarette smoking.

The tobacco industry competes for talent with consumer products and other companies that enjoy greater societal acceptance. As a result, we may be unable to attract and retain the best global talent.

The failure of our information systems to function as intended or their penetration by outside parties with the intent to corrupt them could result in business disruption, litigation and regulatory action, and loss of revenue, assets or personal or other sensitive data.

We use information systems to help manage business processes, collect and interpret business data and communicate internally and externally with employees, suppliers, customers and others. Some of these information systems are managed by third-party service providers. We have backup systems and business continuity plans in place, and we take care to protect our systems and data from unauthorized access. Nevertheless, failure of our systems to function as intended, or penetration of our systems by outside parties intent on extracting or corrupting information or otherwise disrupting business processes, could result in loss of revenue, assets or personal or other sensitive data, litigation and regulatory action, cause damage to our reputation and that of our brands and result in significant remediation and other costs to us.

We may be required to replace third-party contract manufacturers or service providers with our own resources.

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

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Item 4. Controls and Procedures.

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

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Part II - OTHER INFORMATION

Item 1. Legal Proceedings.

See Note 10. Contingencies of the Notes to the Condensed Consolidated Financial Statements included in Part I – Item 1 of this report for a discussion of legal proceedings pending against Philip Morris International Inc. and its subsidiaries.

Item 1A. Risk Factors.

Information regarding Risk Factors appears in “MD&A – Cautionary Factors That May Affect Future Results,” in Part I – Item 2 of this Form 10-Q and in Part I – Item 1A. Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2013. There have been no material changes to the risk factors disclosed in our Annual Report on Form 10-K.

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

Our share repurchase activity for each of the three months in the quarter ended September 30, 2014 was as follows:

Period	Total Number of Shares Repurchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)	Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs
July 1, 2014 – July 31, 2014 (1)	3,057,361	$85.07	129,513,626	$6,636,955,345
August 1, 2014 – August 31, 2014 (1)	3,245,917	$84.11	132,759,543	$6,363,931,814
September 1, 2014 – September 30, 2014 (1)	2,568,434	$84.44	135,327,977	$6,147,045,929
Pursuant to Publicly Announced Plans or Programs	8,871,712	$84.54		
July 1, 2014 – July 31, 2014 (3)	7,459	$83.40		
August 1, 2014 – August 31, 2014 (3)	1,740	$82.52		
September 1, 2014 – September 30, 2014 (3)	440	$83.68		
For the Quarter Ended September 30, 2014	8,881,351	$84.54		

(1) On June 13, 2012, our Board of Directors authorized a share repurchase program of $18 billion over three years. The program commenced on August 1, 2012 after the completion of the three-year $12 billion program in July 2012. These share repurchases have been made pursuant to the $18 billion program.

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

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

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Item 6. Exhibits.

3.1	Amended and Restated By-Laws of Philip Morris International Inc. (effective as of September 9, 2014) (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K filed September 10, 2014).
10.1	Philip Morris International Inc. 2008 Stock Compensation Plan for Non-Employee Directors (as amended and restated as of September 9, 2014) (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed September 10, 2014).
10.2	Modification Agreement to Anti-Contraband and Anti-Counterfeit Agreement and General Release dated July 9, 2004. The Anti-Contraband and Anti-Counterfeit Agreement and General Release was previously filed as Exhibit 10.7 to the Registration Statement on Form 10 filed February 7, 2008 and is incorporated by reference to this Exhibit 10.2.
12	Statement regarding computation of ratios of earnings to fixed charges.
31.1	Certification of the Registrant's Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Registrant's Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Registrant's Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of the Registrant's Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase.
101.DEF	XBRL Taxonomy Extension Definition Linkbase.
101.LAB	XBRL Taxonomy Extension Label Linkbase.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase.

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Signature

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

PHILIP MORRIS INTERNATIONAL INC.

/s/ JACEK OLCZAK

Jacek Olczak
Chief Financial Officer

October 31, 2014