Remarks by Martin King
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(SLIDE 1.)

Thank you, Nick. Good morning, ladies and gentlemen.

(SLIDE 2.)

This morning I will begin with an Operations overview. I will then talk about our cost focus and the opportunities in the optimization of our supply chain.

Next, I will cover our work to maintain innovation and quality leadership, followed by an outlook on our programs in Environment, Health and Safety, and by a description of our key people development initiative. I will end with a few conclusions.

(SLIDE 3.)

I will start with the overview of PMI Operations.

(SLIDE 4.)

We operate 58 production centers in 44 countries. These 58 production centers consist of 40 machine-made cigarette manufacturing facilities, and 18 facilities which produce hand-roll cigarettes, other tobacco products or "OTP" and process inputs to the cigarette manufacturing facilities. In addition, we have cooperation agreements with 30 third party manufacturers across a wide range of countries, and with 37 third party hand-made operators in Indonesia.

(SLIDE 5.)

Operations employs over 50,000 people worldwide, which includes nearly 20,000 direct hand-made employees in Indonesia. The remaining 31,000 people work in our machine made operations, in Product Development and in the Operations Center.

(SLIDE 6.)

Our ongoing focus on performance, automation and continuous improvement has allowed us to steadily reduce headcount, both fixed and variable, in our machine made operations.

(SLIDE 7.)

The total cost of sales in 2009 was approximately $9 billion.

Tobacco leaf represented 35% of the total; direct materials or non-tobacco materials represented 28%; and the remaining 37% was made up of variable labor and fixed costs, third party manufacturing costs and logistics.

(SLIDE 8.)

Over the past six years, our portfolio mix has changed. Traditional cigarette formats, mostly made up of standard king size cigarettes in soft, flip-top and round-corner packs have been relatively stable. At the same time, volumes from non-traditional formats, primarily made up of slim and super slim cigarettes and a variety of pack formats, have grown. In addition, other tobacco products have also grown.

This shift in our portfolio has added complexity to our operations as the factories have had to produce a wider range of products on more equipment configurations.

(SLIDE 9.)

The geographic sourcing of our products has also changed significantly.

We have in-sourced approximately 80 billion cigarettes, formerly produced in the United States, into our existing European factories and we have adapted our manufacturing footprint to support the growth of our business in the EEMA, Asia, and Latin America & Canada Regions.

(SLIDE 10.)

I will now describe our cost challenges and our strategies to address them.

(SLIDE 11.)

Leaf and direct materials are the key cost drivers, and their importance in our cost structure has increased over the past three years. This trend has impacted the whole industry, and is the result of specific market dynamics in the two categories and our focus on innovation. In the next few slides, I will share with you the key elements of our procurement strategies, starting with leaf.

(SLIDE 12.)

This chart shows our leaf purchases in 2009 by type of tobacco. Virginia tobacco represents the largest portion of our purchases with a 45% volume share. Burley tobacco, utilized in our American blends, is our second largest variety and constitutes 31% of the purchased volumes, followed by Oriental tobacco at 13%. Sun cured tobacco, mainly used in our kretek cigarettes in Indonesia, represents 8% of the total volume.

(SLIDE 13.)

Maintaining an appropriate geographic balance in our tobacco sourcing is important both for the specific individual taste characteristics of each origin, and to reduce our exposure to economic, weather and country risks.

As of 2009, no single origin constituted more than 20% of our purchases.

Brazil, one of the largest global producers of Virginia and Burley tobaccos, was 18%. The United States tobaccos, important for their taste and quality characteristics, accounted for 13%, while Indonesia accounted for 10%. Argentina and Malawi, important producers of Burley tobacco, were 7% each. Turkey, our most significant source of Oriental tobacco, represented 5%. Other key origins utilized in our blends are Mozambique and India.

(SLIDE 14.)

Market dynamics were one of the main causes for the substantial cost increases in leaf in the past few years, especially in 2008.

This slide shows the supply and demand trends in the global leaf market, excluding China.

The reduction in volumes produced by the farmers and in inventories held by suppliers, turned the leaf over-supply situation of 2004 through 2006 into a shortage situation in 2007 and 2008, with the resulting increase in prices.

(SLIDE 15.)

This chart shows our leaf purchase price per kilogram indexed to our average price of leaf purchased in 2007.

In 2008, leaf prices were up 21% for a total increase of approximately $450 million versus 2007. In 2009 leaf prices stabilized.

(SLIDE 16.)

Our annual leaf purchase costs are reflected in our income statement over a number of years based on the usage percentage of the crop each year.

While only $40 million of the total $450 million leaf cost increase from the 2008 crop year was reflected in the year of purchase, the bulk of the cost increases from the 2008 crop was, and will be, reflected both in our income statement in 2009, with $179 million, and in our 2010 income statement, with an estimated $215 million.

(SLIDE 17.)

The previous chart illustrated the impact on our income statement of just the 2008 crop price increases. This chart shows the cumulative tobacco leaf cost increases for the period 2008 through 2010, which include the impact of multiple crop years.

We expect this cumulative increase to be in a range of approximately $600 to $650 million, as previously communicated.

(SLIDE 18.)

Our leaf strategy to address the challenging dynamics of the tobacco market is based on three elements.

First, securing stable availability of volumes and predictability of prices while maintaining our high quality standards. We strive to identify productivity across the entire leaf supply chain, balancing this with the need for sustainability of our farmers and of our suppliers.

Second, improving our leaf inventory management in order to reduce our working capital.

Third, promoting sustainability in the leaf supply chain by supporting environmental and social responsibility programs.

(SLIDE 19.)

As announced on Monday, we have signed separate agreements with Alliance One and Universal Leaf under which both suppliers will assign to PMI a total of approximately 17,000 farmer contracts, equivalent to 50% of our tobacco purchases in Brazil and approximately 10% of our 2010 worldwide leaf requirements. These agreements are subject to Brazilian competition approval authority and the transactions are expected to be completed by the end of the third quarter of this year.

The new organization will work in a similar way as our operation in the United States for US-sourced tobacco. We will engage in direct contracts with the farmers and will purchase green leaf directly from them. Alliance One and Universal Leaf will continue to process the resulting tobacco for PMI.

The remaining 50% of our purchases in Brazil will remain unchanged with Alliance One and Universal Leaf continuing to supply tobacco to PMI from their own contracted farmers in the country. These agreements will take our worldwide level of leaf vertical integration from 26% to 36% and we will explore additional opportunities in the future where it makes sense.

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Through the vertical integration agreements in Brazil, we expect to achieve more direct involvement with the farmers. This will deliver several key benefits.

We will be able to better align leaf supply and demand and gain more control of product quality and integrity upstream in the supply chain. We expect to have better cost efficiency, predictability and transparency, and finally, we will enhance our ability to have an impact on the long term sustainability of the tobacco growing communities.

(SLIDE 21.)

Turning to our direct materials procurement.

Three categories represent 77% of our yearly purchases of direct materials, which total approximately $2.5 billion.

The largest category, representing approximately 39% of our spending, is printed board and paper, which is used to manufacture our packs, cartons and bundles. It is followed by acetate tow, representing 22% of the spend, which is the key component of the cigarette filters. The third category, representing 16%, is fine paper, which consists of all the different paper types necessary to manufacture cigarette rods, filter rods, and to join them together to make the cigarette.

(SLIDE 22.)

One key challenge in direct materials procurement comes from the growing complexity of our portfolio, which requires new and more complex materials.

Additional challenges come from the requirement for reduced cigarette ignition propensity, or “RCIP”, cigarette papers. And finally some direct materials categories face relatively tight capacity.

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The three components of our direct materials strategy are:

first, securing volume availability and cost efficiency and predictability in all categories, including exploring available opportunities to source goods in low cost countries;

second, building alliances and partnerships with key suppliers. This includes entering, where necessary, into long-term agreements to provide business predictability; and

third, reinforcing our collaboration with suppliers to support innovation as part of our drive to develop new products.

(SLIDE 24.)

I will now illustrate some of our initiatives to deliver productivity, as part of our effort to manage cost.

As you know, at the time of Philip Morris International's spin-off we announced a program to deliver $1.55 billion in cumulative gross savings between 2008 and 2010. Operations' contribution to this program is $850 million, as shown on this slide. Several significant initiatives are contributing to this program.

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We put in place an "ideal product structure" matrix in order to address the proliferation of product specifications and to rationalize our portfolio. This initiative helps us adapt and reduce specifications, where possible, to better match product cost to the value perceived by our adult consumers.

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Specification changes, driven by the ideal product structure model, contribute nearly $300 million in productivity savings over the three year period of the program. The in-sourcing of the volumes formerly produced by Philip Morris USA delivered over $190 million in manufacturing productivity excluding associated G&A savings.
We are optimizing our footprint and sourcing and we have performed factory closures for an additional $120 million.

Finally, several manufacturing performance initiatives in our factories deliver more than $60 million in productivity. The remaining savings come from initiatives in other areas such as leaf, logistics and procurement.

We are keeping a high level of focus on the identification of new productivity initiatives, and have created a mindset where it is part of everyone's job to identify, propose and implement productivity opportunities both large and small.

(SLIDE 27.)

This slide shows the evolution of our equipment uptime, a strict measure of the percentage of time the equipment runs during available production hours. The increase in the complexity of our portfolio, and the US volume in-sourcing, have had an impact on our uptime.

Since 2008, however, we can see a sustained improvement trend, which is the result of a number of central and local actions aimed at mastering complexity and improving the efficiency of our factories. Some of our largest facilities are today running above 70% uptime, and this is one of our opportunities to deliver further productivity improvements going forward.

(SLIDE 28.)

I will now talk about the opportunities we have identified in our supply chain.

(SLIDE 29.)

As part of PMI's commitment to deliver the previously announced working capital improvements of $750 million to $1 billion over the next three years, Operations is focused on significantly reducing our finished goods and leaf inventories.

To support this effort, we are putting in place systems and processes designed to create visibility and transparency across the supply chain. These will enable us to integrate, collaborate and synchronize with supply chain partners. In the leaf supply chain, they will allow us to manage safety stocks according to the criticality of specific tobacco leaf grades.

(SLIDE 30.)

During the 2008-2009 period we have already delivered substantial reductions in inventories. Going forward we will continue to deliver improvements, while maintaining or improving customer service levels in finished goods, and keeping adequate leaf stocks to guarantee quality and security of supply.

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SCIPIO, the acronym for our key supply chain initiative, is a process and software based system aimed at linking demand and supply planning, and providing visibility of the supply chain including key inventories.

We are changing our supply chain process from a shipment forecast-driven model to a demand-driven one which will integrate and link markets, factories, suppliers and logistics providers.

We have organized the implementation in three waves, targeting first those markets and affiliates where we have the highest potential benefits. To date we have already rolled out our SCIPIO initiative in seven factories and forty markets covering a yearly volume of approximately 260 billion cigarettes. By the end of 2012 we plan to extend it to 29 factories covering 721 billion cigarettes.

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In line with our commitment to reduce working capital is our focus on capital expenditure controls.

During the past decade, we have invested significantly in factories and equipment.

We now have in place a robust manufacturing footprint and our current focus is on improving and automating the existing factories, and investing in productivity opportunities, such as the installation of more efficient tobacco processing equipment.

You can see this focus reflected in our capex-to-depreciation ratio, which reached 0.9 in 2009. Going forward, we will continue to target a 1:1 capex-to-depreciation ratio.

(SLIDE 33.)

Yesterday, you heard from André and our Regional Presidents about some of the initiatives that have re-energized many of our key brands. I will now share with you Operations' contribution to PMI's leadership in innovation and product quality.

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Our drive for product innovation continues, as shown by a 53% increase in the number of innovation projects performed by our Product Development organization between 2007 and 2009. Each project constituted an effort to develop and launch a new product in one or more markets.

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To make this increased innovation focus possible, we have invested in our Product Development organization. We have organized Product Development into 10 clusters worldwide, covering all of the regions in which we operate and working in close contact with the markets. The clusters are supported by our central Product Development organization based in Switzerland.

We are increasingly focused on adult consumer preferences as direct input to developing a pipeline of relevant products. We have also expanded our Product Development capabilities by creating a team of highly skilled scientists focused on conventional cigarettes.

I will now show you some examples of package and cigarette innovations, and the work performed to support our new *Marlboro* architecture.

(SLIDE 36.)

Our package development initiatives include, among others, the development and commercialization of new pack formats, such as the sliding-top pack used in *Marlboro Filter Plus*, the *Virginia Slims Uno* style pack, and the various *Marlboro* new architecture packs.

(SLIDE 37.)

We have also launched cigarette innovations, including a line-up of features and constructions in filters. Some examples are the multi-section tobacco plug filter used in *Marlboro Flavor Plus*, the triple filter used in *L&M*, colored-thread menthol filters, recessed filters and capsules delivering an on-demand freshness boost.

To support these developments and others, we have improved our ability to efficiently produce complex filters on a large scale by leveraging the know-how in our dedicated filter development center.

(SLIDE 38.)

Supporting the *Marlboro* new architecture initiative has been one of the key innovation efforts in Operations. We have done so by developing sensory features like the tactile surface on the pack.

(SLIDE 39.)

And by providing a line up of cigarette and pack options, as in the case of the new *Marlboro* Gold family. This includes the *Marlboro Gold Touch* and *Marlboro Gold Edge* offerings with slimmer 7.1 millimeter and 5.4 millimeter diameters.

(SLIDE 40.)

Continuously improving product quality is one of our most important responsibilities. This slide shows one of our internal quality metrics, the Market Visual Quality Index, which measures the visual quality of our products. The index compares our pack and cigarette quality to that of our competitors across a wide range of different parameters.

We represent in blue those markets where we outperform our competitors in 100% of the compared products. In green are those markets where we outperform competition in more than 50% of the products benchmarked and, in orange, the markets where we are comparable in quality to the competition. Finally, in red, are those markets where the competition offers better visual quality. As you can see, between 2004 and 2009, we have significantly improved, and our focus going forward will be on the 7% of markets where we are still at par with or below the competition.

(SLIDE 41.)

A few words about our Environment, Health and Safety programs.

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Our Environment, Health and Safety performance over the past few years has been improving across several key metrics.

In safety, our lost time injury rate, or "LTI," has significantly improved and we will continue to work to achieve world class safety in all our work environments.

Our vehicle fleet injury rate has also been improving, and during the next few years we will focus on achieving world class standards in this area as well.

Energy and water consumption, CO_2 and recycling rates have also all been improving significantly over the past few years. However, we realize that we can do even better in these areas, so we are setting ambitious targets to further improve each of these metrics by an additional 20% by 2013 versus our 2009 results.

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I will now briefly describe our key people development initiative.

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The Operations Performance and ENgagement program, or "OPEN," is our strategy to fully involve our 50,000 employees by developing their capabilities and leveraging their ingenuity and passion.

To implement our OPEN model, we are improving our organizational structures at the factory and business unit level, providing clearer objectives, and increasing the ownership and accountability for results. We are also implementing specific processes, tools and the training necessary to help our people work better and smarter. Finally, we are recognizing and rewarding superior performance through a series of monetary and non-monetary means.

OPEN has already shown results. Some of our most complex facilities have significantly improved their performance in terms of uptime, product quality, and productivity overall after implementing this model.

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I will conclude with a few key take-aways.

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Going forward, we will continue to focus on maintaining cost leadership in the industry through the implementation of our plans in leaf and direct materials, and through a relentless focus on productivity.

We will further integrate our supply chain and reduce our inventories, which will deliver a substantial contribution to PMI's working capital improvement targets over the next three years.

We will continue our product development efforts to maintain and reinforce our industry leadership in innovation, and we will continue to deliver the best quality products.

Last, but not least, we will develop and engage our people to overcome our current and future business challenges.

(SLIDE 47.)

Thank you for your interest. I will be happy to answer your questions.