Philip Morris International Inc.
Form 10-Q
August 06, 2010
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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 June 30, 2010

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

At July 30, 2010, there were 1,832,869,718 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 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)

	June 30, 2010	December 31, 2009
ASSETS		
Cash and cash equivalents	$ 1,584	$ 1,540
Receivables (less allowances of $29 in 2010 and $33 in 2009)	3,232	3,098
Inventories:		
Leaf tobacco	3,917	4,183
Other raw materials	1,183	1,275
Finished product	2,402	3,749
	7,502	9,207
Deferred income taxes	296	305
Other current assets	310	532
Total current assets	12,924	14,682
Property, plant and equipment, at cost	11,697	12,258
Less: accumulated depreciation	5,535	5,868
	6,162	6,390
Goodwill	9,790	9,112
Other intangible assets, net	3,779	3,546
Other assets	669	822
TOTAL ASSETS	$ 33,324	$ 34,552

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)

	June 30, 2010	December 31, 2009
LIABILITIES		
Short-term borrowings	$ 857	$ 1,662
Current portion of long-term debt	78	82
Accounts payable	871	670
Accrued liabilities:		
Marketing and selling	404	441
Taxes, except income taxes	4,438	4,824
Employment costs	627	752
Dividends payable	1,073	1,101
Other	950	955
Income taxes	517	500
Deferred income taxes	174	191
Total current liabilities	9,989	11,178
Long-term debt	14,296	13,672
Deferred income taxes	1,953	1,688
Employment costs	1,046	1,260
Other liabilities	490	609
Total liabilities	27,774	28,407
Contingencies (Note 10)		
Redeemable noncontrolling interests (Note 7)	1,173	
STOCKHOLDERS EQUITY		
Common stock, no par value (2,109,316,331 shares issued in 2010 and 2009)		
Additional paid-in capital	1,267	1,403
Earnings reinvested in the business	16,888	15,358
Accumulated other comprehensive losses	(1,301)	(817)
	16,854	15,944
Less: cost of repurchased stock (273,856,998 and 222,151,828 shares in 2010 and 2009, respectively)	12,789	10,228
Total PMI stockholders equity	4,065	5,716
Noncontrolling interests	312	429
Total stockholders equity	4,377	6,145

TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 33,324	$ 34,552

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 Six Months Ended June 30, 2010	For the Six Months Ended June 30, 2009
Net revenues	$ 32,970	$ 28,499
Cost of sales	4,922	4,156
Excise taxes on products	19,413	16,768
Gross profit	8,635	7,575
Marketing, administration and research costs	2,971	2,788
Asset impairment and exit costs		2
Amortization of intangibles	43	36
Operating income	5,621	4,749
Interest expense, net	446	351
Earnings before income taxes	5,175	4,398
Provision for income taxes	1,379	1,284
Net earnings	3,796	3,114
Net earnings attributable to noncontrolling interests	111	92
Net earnings attributable to PMI	$ 3,685	$ 3,022
Per share data (Note 8):		
Basic earnings per share	$ 1.97	$ 1.53
Diluted earnings per share	$ 1.97	$ 1.52
Dividends declared	$ 1.16	$ 1.08

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 June 30, 2010	For the Three Months Ended June 30, 2009
Net revenues	$ 17,383	$ 15,213
Cost of sales	2,550	2,185
Excise taxes on products	10,322	9,079
Gross profit	4,511	3,949
Marketing, administration and research costs	1,582	1,498
Asset impairment and exit costs		1
Amortization of intangibles	23	21
Operating income	2,906	2,429
Interest expense, net	223	193
Earnings before income taxes	2,683	2,236
Provision for income taxes	641	639
Net earnings	2,042	1,597
Net earnings attributable to noncontrolling interests	60	51
Net earnings attributable to PMI	$ 1,982	$ 1,546
Per share data (Note 8):		
Basic earnings per share	$ 1.07	$ 0.79
Diluted earnings per share	$ 1.07	$ 0.79
Dividends declared	$ 0.58	$ 0.54

See notes to condensed consolidated financial statements.

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Philip Morris International Inc. and Subsidiaries

Condensed Consolidated Statements of Stockholders Equity

for the Six Months Ended June 30, 2010 and 2009

(in millions of dollars, except per share amounts)

(Unaudited)

	PMI Stockholders Equity						
	Common Stock	Additional Paid-in Capital	Earnings Reinvested in the Business	Accumulated Other Comprehensive Earnings (Losses)	Cost of Repurchased Stock	Noncontrolling Interests	Total
Balances, January 1, 2009	$	$ 1,581	$ 13,354	$ (2,281)	$ (5,154)	$ 404	$ 7,904
Comprehensive earnings:							
Net earnings			3,022			92	3,114
Other comprehensive earnings (losses), net of income taxes:							
Currency translation adjustments, net of income taxes of ($6)				490		(7)	483
Change in net loss and prior service cost, net of income taxes of ($8)				28			28
Change in fair value of derivatives accounted for as hedges, net of income taxes of ($4)				44			44
Total other comprehensive earnings							555
Total comprehensive earnings							3,669
Exercise of stock options and issuance of other stock awards		(124)			278		154
Dividends declared ($1.08 per share)			(2,125)				(2,125)
Payments to noncontrolling interests						(179)	(179)
Common stock repurchased					(2,736)		(2,736)
Balances, June 30, 2009	$	$ 1,457	$ 14,251	$ (1,719)	$ (7,612)	$ 310	$ 6,687
Balances, January 1, 2010	$	$ 1,403	$ 15,358	$ (817)	$ (10,228)	$ 429	$ 6,145
Comprehensive earnings:							
Net earnings			3,685			102 [a]	3,787[a]
Other comprehensive earnings (losses), net of income taxes:							
Currency translation adjustments, net of income taxes of ($281)				(558)		(20) [a]	(578)
Change in net loss and prior service cost, net of income taxes of ($11)				36			36
Change in fair value of derivatives accounted for as hedges, net of income taxes of ($3)				47			47

Change in fair value of debt and equity securities				(9)			(9)
Total other comprehensive losses							(504)
Total comprehensive earnings							3,283
Exercise of stock options and issuance of other stock awards		(136)			277		141
Dividends declared ($1.16 per share)			(2,155)				(2,155)
Payments to noncontrolling interests						(199)	(199)
Common stock repurchased					(2,838)		(2,838)
Balances, June 30, 2010	$	$ 1,267	$ 16,888	$ (1,301)	$ (12,789)	$ 312	$ 4,377

(a) Net earnings attributable to noncontrolling interests exclude a $9 million gain related to the redeemable noncontrolling interest which is reported outside of the equity section in the condensed consolidated balance sheet at June 30, 2010. Currency translation adjustments also exclude ($1) million related to the redeemable noncontrolling interest at June 30, 2010.

Total comprehensive earnings were $1,257 million and $2,886 million for the quarters ended June 30, 2010 and 2009, respectively, including $23 million and $90 million related to noncontrolling interests, respectively. Total comprehensive earnings for the quarter ended June 30, 2010 exclude $7 million related to the redeemable noncontrolling interest.

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 Six Months Ended June 30, 2010	2009
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES		
Net earnings	$ 3,796	$ 3,114
Adjustments to reconcile net earnings to operating cash flows:		
Depreciation and amortization	447	395
Deferred income tax provision	23	77
Colombian Investment and Cooperation Agreement charge		135
Asset impairment and exit costs, net of cash paid	(33)	(35)
Cash effects of changes, net of the effects from acquired and divested companies:		
Receivables, net	(270)	(326)
Inventories	1,364	1,344
Accounts payable	120	(27)
Income taxes	14	(201)
Accrued liabilities and other current assets	159	358
Pension plan contributions	(164)	(362)
Other	(17)	101
Net cash provided by operating activities	5,439	4,573
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES		
Capital expenditures	(319)	(323)
Purchases of businesses, net of acquired cash	(1)	(209)
Other	69	137
Net cash used in investing activities	(251)	(395)

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 Six Months Ended June 30, 2010	2009
CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES		
Net repayment of short-term borrowings	$ (890)	$ (999)
Long-term debt proceeds	1,130	2,987
Long-term debt repaid	(68)	(1)
Repurchases of common stock	(2,828)	(2,850)
Issuance of common stock	90	105
Dividends paid	(2,183)	(2,161)
Other	(255)	(226)
Net cash used in financing activities	(5,004)	(3,145)
Effect of exchange rate changes on cash and cash equivalents	(140)	38
Cash and cash equivalents:		
Increase	44	1,071
Balance at beginning of period	1,540	1,531
Balance at end of period	$ 1,584	$ 2,602

As discussed in Note 7. *Acquisitions and Other Business Arrangements*, PMI s business combination in the Philippines is a non-cash transaction.

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 and other tobacco products in markets outside of the U.S.A. Throughout these financial statements, the term PMI refers to Philip Morris International Inc. and its subsidiaries.

As discussed in Note 4. *Transactions with Altria Group, Inc.* of our 2009 audited consolidated financial statements and related notes, which are incorporated by reference into our Annual Report on Form 10-K for the year ended December 31, 2009 (the 2009 Form 10-K), prior to March 28, 2008, PMI was a wholly-owned subsidiary of Altria Group, Inc. (Altria). On January 30, 2008, the Altria Board of Directors announced Altria s plans to spin off all of its interest in PMI to Altria s stockholders in a tax-free distribution pursuant to Section 355 of the U.S. Internal Revenue Code. The distribution of all of the PMI shares owned by Altria (the Spin-off) was made on March 28, 2008 (the Distribution Date) to stockholders of record as of the close of business on March 19, 2008 (the Record Date). Altria distributed one share of our common stock for each share of Altria common stock outstanding on the Record Date.

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.

These statements should be read in conjunction with the audited consolidated financial statements and related notes, which are incorporated by reference into PMI s 2009 Form 10-K.

Note 2. Asset Impairment and Exit Costs:

During the six months and three months ended June 30, 2010, PMI did not record any pre-tax asset impairment and exit costs. PMI recorded pre-tax asset impairment and exit costs of $2 million and $1 million for the six months and three months ended June 30, 2009, respectively. These charges were reflected in the operating results of the European Union segment.

Cash payments related to exit costs at PMI were $33 million and $4 million for the six months and three months ended June 30, 2010, respectively, and $37 million and $15 million for the six months and three months ended June 30, 2009, respectively. Future cash payments for exit costs incurred to date are expected to be approximately $43 million, which will be substantially paid by 2012.

The movement in the exit cost liabilities for the six months ended June 30, 2010 was as follows (in millions):

Liability balance, January 1, 2010	$ 84
Charges	
Cash spent	(33)
Currency/other	(8)
Liability balance, June 30, 2010	$ 43

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Philip Morris International Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 3. Stock Plans:

Under the Philip Morris International Inc. 2008 Performance Incentive Plan (the Plan), PMI may grant to certain eligible employees stock options, stock appreciation rights, restricted stock, restricted stock units, deferred stock and deferred stock units and other stock-based awards based on PMI s common stock, as well as performance-based incentive awards. Up to 70 million shares of PMI s common stock may be issued under the Plan. At June 30, 2010, 30,800,211 shares were available for grant under the Plan.

PMI has also 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 each 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 1,000,000 shares of PMI common stock may be awarded under the Non-Employee Directors Plan. As of June 30, 2010, 840,196 shares were available for grant under the plan.

During the six months ended June 30, 2010, PMI granted 3.5 million shares of restricted and deferred stock awards to eligible employees at a weighted-average grant date fair value of $47.52. PMI recorded compensation expense for restricted stock and deferred stock awards of $63 million and $44 million during the six months ended June 30, 2010 and 2009, respectively, and $36 million and $25 million during the three months ended June 30, 2010 and 2009, respectively. As of June 30, 2010, PMI had $239 million of total unrecognized compensation cost related to non-vested restricted and deferred stock awards. The cost is recognized over the original restriction period of the awards, which is typically three years from the date of the original grant.

During the six months ended June 30, 2010, 1.7 million shares of PMI restricted stock and deferred stock awards vested. Of this amount, 1.2 million shares went to PMI employees and the remainder went to Altria employees who held PMI stock awards as a result of the Spin-off. The grant date fair value of all the vested shares was approximately $111 million. The total fair value of restricted stock and deferred stock awards that vested during the six months ended June 30, 2010 was approximately the same as the grant date fair value. The grant price information for restricted stock and deferred stock awarded prior to January 30, 2008 reflects historical market prices of Altria stock at date of grant and is not adjusted to reflect the Spin-off.

For the six months ended June 30, 2010, the total intrinsic value of the 4.4 million PMI stock options exercised was approximately $129 million.

Note 4. Benefit Plans:

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

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Philip Morris International Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Pension Plans

Components of Net Periodic Benefit Cost

Net periodic pension cost consisted of the following (in millions):

	U.S. Plans For the Six Months Ended June 30,		Non-U.S. Plans For the Six Months Ended June 30,	
	2010	2009	2010	2009
Service cost	$ 3	$ 6	$ 82	$ 62
Interest cost	8	9	96	82
Expected return on plan assets	(7)	(6)	(144)	(107)
Amortization:				
Net loss	2	2	21	16
Prior service cost			4	3
Other		4		
Net periodic pension cost	$ 6	$ 15	$ 59	$ 56

	U.S. Plans For the Three Months Ended June 30,		Non-U.S. Plans For the Three Months Ended June 30,	
	2010	2009	2010	2009
Service cost	$ 1	$ 3	$ 41	$ 31
Interest cost	4	4	48	41
Expected return on plan assets	(3)	(3)	(72)	(54)
Amortization:				
Net loss	1	1	10	8
Prior service cost			2	2
Other				
Net periodic pension cost	$ 3	$ 5	$ 29	$ 28

Other above was primarily related to early retirement programs.

Employer Contributions

PMI presently 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 $164 million were made to the pension plans during the six months ended June 30, 2010. Currently, PMI anticipates making additional contributions during the remainder of 2010 of approximately $64 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.

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Philip Morris International Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 5. Goodwill and Other Intangible Assets, net:

Goodwill and other intangible assets, net, by segment were as follows (in millions):

	Goodwill		Other Intangible Assets, net	
	June 30, 2010	December 31, 2009	June 30, 2010	December 31, 2009
European Union	$ 1,320	$ 1,539	$ 648	$ 699
Eastern Europe, Middle East & Africa	651	743	246	253
Asia	4,900	3,926	1,643	1,346
Latin America & Canada	2,919	2,904	1,242	1,248
Total	$ 9,790	$ 9,112	$ 3,779	$ 3,546

Goodwill is due primarily to PMI s acquisitions in Canada, Indonesia, Mexico, Greece, Serbia, Colombia and Pakistan, and a business combination in the Philippines in February 2010. The movement in goodwill from December 31, 2009, is as follows (in millions):

	European Union	Eastern Europe, Middle East & Africa	Asia	Latin America & Canada	Total
Balance at December 31, 2009	$ 1,539	$ 743	$ 3,926	$ 2,904	$ 9,112
Changes due to:					
Philippines business combination			830		830
Currency	(219)	(92)	144	15	(152)
Balance at June 30, 2010	$ 1,320	$ 651	$ 4,900	$ 2,919	$ 9,790

For further details on the business combination in the Philippines, see Note 7. *Acquisitions and Other Business Arrangements*.

Additional details of other intangible assets were as follows (in millions):

	June 30, 2010		December 31, 2009	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Non-amortizable intangible assets	$ 2,131		$ 2,080	

Amortizable intangible assets	1,867	$	219	1,663	$	197
Total other intangible assets	$ 3,998	$	219	$ 3,743	$	197

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Philip Morris International Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Non-amortizable intangible assets substantially consist of trademarks from PMI s acquisitions in Indonesia in 2005 and Mexico in 2007. Amortizable intangible assets consist of certain trademarks, distribution networks and non-compete agreements associated with business combinations. The range of useful lives as well as the weighted-average remaining useful life of amortizable intangible assets at June 30, 2010 is as follows:

Description	Estimated Useful Lives	Weighted-Average Remaining Useful Life
Trademarks	2 - 40 years	28 years
Distribution networks	20 - 30 years	18 years
Non-compete agreements	3 - 10 years	5 years

Pre-tax amortization expense for intangible assets during the six months ended June 30, 2010 and 2009 was $43 million and $36 million, respectively, and $23 million and $21 million for the three months ended June 30, 2010 and 2009, respectively. Amortization expense for each of the next five years is estimated to be $90 million or less, assuming no additional transactions occur that require the amortization of intangible assets.

The increase in other intangible assets from December 31, 2009 was due primarily to a business combination in the Philippines and currency movements. For further details, see Note 7. *Acquisitions and Other Business Arrangements*.

During the first quarter of 2010, 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, with manufacturing and sales facilities in various locations around the world. PMI utilizes certain financial instruments to manage foreign currency exposure. Derivative financial instruments are used by PMI principally to reduce exposures to market risks resulting from fluctuations in foreign 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.

PMI uses forward foreign exchange contracts, foreign currency swaps and foreign currency options, hereafter collectively referred to as foreign exchange contracts, to mitigate its exposure to changes in exchange rates from third-party and intercompany actual and forecasted transactions. The primary currencies to which PMI is exposed include the Euro, Indonesian rupiah, Japanese yen, Mexican peso, Russian ruble, Swiss franc and Turkish lira. At June 30, 2010, PMI had contracts with aggregate notional amounts of $8.7 billion. Of this amount, $2.5 billion related to cash flow hedges and $6.2 billion related to other derivatives that primarily offset currency exposures on intercompany financing.

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Philip Morris International Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

The fair value of PMI s foreign exchange contracts included in the condensed consolidated balance sheet as of June 30, 2010 and December 31, 2009 were as follows (in millions):

	Asset Derivatives			Liability Derivatives		
	Balance Sheet Classification	Fair Value		Balance Sheet Classification	Fair Value	
		At June 30, 2010	At December 31, 2009		At June 30, 2010	At December 31, 2009
Foreign exchange contracts designated as hedging instruments	Other current assets	$ 67	$ 140	Other accrued liabilities	$ 6	$ 27
	Other assets	12		Other liabilities	6	
Foreign exchange contracts not designated as hedging instruments	Other current assets	11	71	Other accrued liabilities	167	107
				Other liabilities	5	
Total Derivatives		$ 90	$ 211		$ 184	$ 134

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 six months and three months ended June 30, 2010 and 2009 (in millions):

	For the Six Months Ended June 30, 2010					
Gain (Loss)	Cash Flow Hedges	Fair Value Hedges	Net Investment Hedges	Other Derivatives	Income Taxes	Total
Statement of Earnings:						
Net revenues	$ 24	$		$		$ 24
Cost of sales	(31)					(31)
Marketing, administration and research costs				(1)		(1)
Operating income	(7)			(1)		(8)
Interest expense, net	(23)			(1)		(24)
Earnings before income taxes	(30)			(2)		(32)
Provision for income taxes	2					2
Net earnings attributable to PMI	$ (28)	$		$ (2)		$ (30)

Other Comprehensive Earnings:				
Losses transferred to earnings	$ 30		$ (2)	$ 28
Recognized	20		(1)	19
Net impact	$ 50		$ (3)	$ 47
Cumulative translation adjustment	$ (4)	$ 25	$ (10)	$ 11

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Philip Morris International Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Gain (Loss)	Cash Flow Hedges	Fair Value Hedges	Net Investment Hedges	Other Derivatives	Income Taxes	Total
	For the Six Months Ended June 30, 2009					
Statement of Earnings:						
Net revenues	$ 48	$		$		$ 48
Marketing, administration and research costs	13			(1)		12
Operating income	61			(1)		60
Interest expense, net	(41)	37		(8)		(12)
Earnings before income taxes	20	37		(9)		48
Provision for income taxes	(3)	(3)		3		(3)
Net earnings attributable to PMI	$ 17	$ 34		$ (6)		$ 45
Other Comprehensive Earnings:						
Gains transferred to earnings	$ (20)				$ 3	$ (17)
Recognized	68				(7)	61
Net impact	$ 48				$ (4)	$ 44
Cumulative translation adjustment			$ (19)		$ 10	$ (9)

Gain (Loss)	Cash Flow Hedges	Fair Value Hedges	Net Investment Hedges	Other Derivatives	Income Taxes	Total
	For the Three Months Ended June 30, 2010					
Statement of Earnings:						
Net revenues	$ 14	$		$		$ 14
Cost of sales	1					1
Marketing, administration and research costs				(1)		(1)
Operating income	15			(1)		14
Interest expense, net	(12)			1		(11)
Earnings before income taxes	3					3
Provision for income taxes	(1)					(1)
Net earnings attributable to PMI	$ 2	$		$		$ 2
Other Comprehensive Earnings:						
Gains transferred to earnings	$ (3)				$ 1	$ (2)

Recognized	1		1	2
Net impact	$ (2)		$ 2	$
Cumulative translation adjustment		$	$ (6)	$ (6)

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	For the Three Months Ended June 30, 2009					
Gain (Loss)	Cash Flow Hedges	Fair Value Hedges	Net Investment Hedges	Other Derivatives	Income Taxes	Total
Statement of Earnings:						
Net revenues	$ 16	$		$		$ 16
Marketing, administration and research costs	(4)			(1)		(5)
Operating income	12			(1)		11
Interest expense, net	(23)	20		(4)		(7)
Earnings before income taxes	(11)	20		(5)		4
Provision for income taxes		(2)		2		
Net earnings attributable to PMI	$ (11)	$ 18		$ (3)		$ 4
Other Comprehensive Earnings:						
Losses transferred to earnings	$ 11				$	$ 11
Recognized	(12)				2	(10)
Net impact	$ (1)				$ 2	$ 1
Cumulative translation adjustment			$ (83)		$ 10	$ (73)

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 unrealized gains and losses associated with qualifying cash flow hedge contracts is deferred as a component of accumulated other comprehensive earnings (losses) until the underlying hedged transactions are reported in PMI s condensed consolidated statements of earnings. During the six months and three months ended June 30, 2010 and 2009, ineffectiveness related to cash flow hedges was not material. As of June 30, 2010, PMI has hedged forecasted transactions for periods not exceeding the next eighteen months. The impact of these hedges is included in operating cash flows on PMI s condensed consolidated statement of cash flows.

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For the six months and three months ended June 30, 2010 and 2009, foreign exchange contracts that were designated as cash flow hedging instruments impacted the condensed consolidated statements of earnings and other comprehensive earnings as follows (pre-tax, in millions):

For the Six Months Ended June 30,

Derivatives in Cash Flow Hedging Relationship	Statement of Earnings Classification of Gain/(Loss) Reclassified from Other Comprehensive Earnings into Earnings	Amount of Gain/(Loss) Reclassified from Other Comprehensive Earnings into Earnings 2010	2009	Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings on Derivative 2010	2009
Foreign exchange contracts				$ 20	$ 68
	Net revenues	$ 24	$ 48		
	Cost of sales	(31)			
	Marketing, administration and research costs		13		
	Interest expense, net	(23)	(41)		
Total		$ (30)	$ 20	$ 20	$ 68

For the Three Months Ended June 30,

Derivatives in Cash Flow Hedging Relationship	Statement of Earnings Classification of Gain/(Loss) Reclassified from Other Comprehensive Earnings into Earnings	Amount of Gain/(Loss) Reclassified from Other Comprehensive Earnings into Earnings 2010	2009	Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings on Derivative 2010	2009
Foreign exchange contracts				$ 1	$ (12)
	Net revenues	$ 14	$ 16		
	Cost of sales	1			

	Marketing, administration and research costs		(4)		
	Interest expense, net	(12)	(23)		
Total		$ 3	$ (11)	$ 1	$ (12)

Fair Value Hedges

In 2009, PMI had entered into foreign exchange contracts to hedge the foreign currency exchange risk related to an intercompany loan between subsidiaries. For a derivative instrument that is designated and qualifies as a fair value hedge, the gain or loss on the derivative, as well as the offsetting gain or loss on the hedged item attributable to the hedged risk, is recognized in current earnings. At June 30, 2009, all fair value hedges matured and were settled.

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Since June 30, 2009, there were no outstanding fair value hedges. For the six months and three months ended June 30, 2009, ineffectiveness related to fair value hedges was not material. Gains (losses) associated with qualifying fair value hedges were recorded in the condensed consolidated statements of earnings and were $42 million and ($4) million for the six months and three months ended June 30, 2009, respectively. The impact of fair value hedges is included in operating cash flows on PMI s condensed consolidated statement of cash flows.

For the six months and three months ended June 30, 2010 and 2009, foreign exchange contracts that were designated as fair value hedging instruments impacted the condensed consolidated statement of earnings as follows (pre-tax, in millions):

		For the Six Months Ended June 30,				
Derivative in Fair Value Hedging Relationship	Statement of Earnings Classification of Gain/(Loss) on Derivative	Amount of Gain/(Loss) Recognized in Earnings on Derivative		Statement of Earnings Classification of Gain/(Loss) on Hedged Item	Amount of Gain/(Loss) Recognized in Earnings Attributable to the Risk Being Hedged	
		2010	2009		2010	2009
Foreign exchange contracts	Marketing, administration and research costs	$	$ 5	Marketing, administration and research costs	$	$ (5)
	Interest expense, net		37	Interest expense, net		
Total		$	$ 42		$	$ (5)

		For the Three Months Ended June 30,				
Derivative in Fair Value Hedging Relationship	Statement of Earnings Classification of Gain/(Loss) on Derivative	Amount of Gain/(Loss) Recognized in Earnings on Derivative		Statement of Earnings Classification of Gain/(Loss) on Hedged Item	Amount of Gain/(Loss) Recognized in Earnings Attributable to the Risk Being Hedged	
		2010	2009		2010	2009
Foreign exchange contracts	Marketing, administration and research costs	$	$ (24)	Marketing, administration and research costs	$	$ 24
	Interest expense, net		20	Interest expense, net		

Total	$	$ (4)	$	$ 24

Hedges of Net Investments in Foreign Operations

PMI designates certain foreign currency denominated debt and forward exchange contracts as net investment hedges of its foreign operations. For the six months ended June 30, 2010 and 2009, these hedges of net investments resulted in gains, net of income taxes, of $518 million and $22 million, respectively. For the three months ended June 30, 2010 and 2009, these hedges of net investments resulted in gains (losses), net of income taxes, of $295 million and ($165) million, respectively. These gains (losses) were reported as a component of accumulated other comprehensive earnings (losses) within currency translation adjustments. For the six and three months ended June 30, 2010 and

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2009, ineffectiveness related to net investment hedges was not material. Settlement of net investment hedges is included in other investing cash flows on PMI s condensed consolidated statement of cash flows.

For the six months and three months ended June 30, 2010 and 2009, foreign exchange contracts that were designated as net investment hedging instruments impacted the condensed consolidated statements of earnings and other comprehensive earnings as follows (pre-tax, in millions):

For the Six Months Ended June 30,

Derivatives in Net Investment Hedging Relationship	Statement of Earnings Classification of Gain/(Loss) Reclassified from Other Comprehensive Earnings into Earnings	Amount of Gain/(Loss) Reclassified from Other Comprehensive Earnings into Earnings		Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings on Derivative	
		2010	2009	2010	2009
Foreign exchange contracts	Interest expense, net	$	$	$ 25	$ (19)

For the Three Months Ended June 30,

Derivatives in Net Investment Hedging Relationship	Statement of Earnings Classification of Gain/(Loss) Reclassified from Other Comprehensive Earnings into Earnings	Amount of Gain/(Loss) Reclassified from Other Comprehensive Earnings into Earnings		Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings on Derivative	
		2010	2009	2010	2009
Foreign exchange contracts	Interest expense, net	$	$	$	$ (83)

Other Derivatives

PMI has entered into foreign exchange contracts to hedge the foreign currency exchange risks related to inter-company loans between certain subsidiaries and third-party loans. While effective as economic hedges, no hedge accounting is applied for these contracts and, therefore, the unrealized gains (losses) relating to these contracts are reported in PMI s condensed consolidated statements of earnings. For the six months ended June 30, 2010 and 2009, the gains (losses) from contracts for which PMI did not apply hedge accounting were ($77) million and $285 million, respectively. For the three months ended June 30, 2010 and 2009, the gains (losses) from contracts for which PMI did not apply hedge accounting were ($115) million and ($134) 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.

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As a result, for the six months and three months ended June 30, 2010 and 2009, these items affected the condensed consolidated statement of earnings as follows (pre-tax, in millions):

Derivatives not Designated as Hedging Instruments	Statement of Earnings Classification of Gain/(Loss)	Amount of Gain/(Loss) Recognized in Earnings			
		Six Months Ended June 30,		Three Months Ended June 30,	
		2010	2009	2010	2009
Foreign exchange contracts					
	Marketing, administration and research costs	$ (1)	$ (1)	$ (1)	$ (1)
	Interest expense, net	(1)	(8)	1	(4)
Total		$ (2)	$ (9)	$	$ (5)

Qualifying Hedging Activities Reported in Accumulated Other Comprehensive Earnings (Losses)

Derivative gains or losses reported in accumulated other comprehensive earnings (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 earnings (losses), net of income taxes, as follows (in millions):

	For the Six Months Ended, June 30,		For the Three Months Ended June 30,	
	2010	2009	2010	2009
Gain (loss) at beginning of period	$ 19	$ (68)	$ 66	$ (25)
Derivative losses (gains) transferred to earnings	28			