Philip Morris International Inc.
Form 10-Q
July 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 June 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 July 29, 2014, there were 1,562,131,077 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)

	June 30, 2014	December 31, 2013
ASSETS		
Cash and cash equivalents	$1,541	$2,154
Receivables (less allowances of $51 in 2014 and $53 in 2013)	4,081	3,853
Inventories:		
Leaf tobacco	3,582	3,709
Other raw materials	1,595	1,596
Finished product	3,094	4,541
	8,271	9,846
Deferred income taxes	414	502
Other current assets	403	497
Total current assets	14,710	16,852
Property, plant and equipment, at cost	14,071	13,957
Less: accumulated depreciation	7,423	7,202
	6,648	6,755
Goodwill (Note 5)	9,085	8,893
Other intangible assets, net (Note 5)	3,209	3,193
Investments in unconsolidated subsidiaries (Note 16)	1,508	1,536
Other assets	1,165	939
TOTAL ASSETS	$36,325	$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)

	June 30, 2014	December 31, 2013
LIABILITIES		
Short-term borrowings (Note 12)	$1,941	$2,400
Current portion of long-term debt (Note 12)	407	1,255
Accounts payable	1,109	1,274
Accrued liabilities:		
Marketing and selling	629	503
Taxes, except income taxes	5,008	6,492
Employment costs	1,267	949
Dividends payable	1,482	1,507
Other	1,099	1,382
Income taxes	536	1,192
Deferred income taxes	102	112
Total current liabilities	13,580	17,066
Long-term debt (Note 12)	27,161	24,023
Deferred income taxes	1,520	1,477
Employment costs	1,312	1,313
Other liabilities	599	563
Total liabilities	44,172	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	649	723
Earnings reinvested in the business	28,601	27,843
Accumulated other comprehensive losses	(4,314)	(4,190)
	24,936	24,376
Less: cost of repurchased stock (544,554,521 and 520,313,919 shares in 2014 and 2013, respectively)	34,228	32,142
Total PMI stockholders' deficit	(9,292)	(7,766)
Noncontrolling interests	1,445	1,492
Total stockholders' deficit	(7,847)	(6,274)
TOTAL LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY	$36,325	$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 Six Months Ended June 30,	
	2014	2013
Net revenues	$38,830	$39,010
Cost of sales	5,070	5,190
Excise taxes on products	24,116	23,509
Gross profit	9,644	10,311
Marketing, administration and research costs	3,263	3,527
Asset impairment and exit costs (Note 2)	512	8
Amortization of intangibles	44	48
Operating income	5,825	6,728
Interest expense, net	522	482
Earnings before income taxes	5,303	6,246
Provision for income taxes	1,528	1,825
Equity (income)/loss in unconsolidated subsidiaries, net	(36)	9
Net earnings	3,811	4,412
Net earnings attributable to noncontrolling interests	85	163
Net earnings attributable to PMI	$3,726	$4,249
Per share data (Note 8):		
Basic earnings per share	$2.35	$2.58
Diluted earnings per share	$2.35	$2.58
Dividends declared	$1.88	$1.70

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,	
	2014	2013
Net revenues	$21,051	$20,483
Cost of sales	2,696	2,701
Excise taxes on products	13,254	12,566
Gross profit	5,101	5,216
Marketing, administration and research costs	1,716	1,850
Asset impairment and exit costs (Note 2)	489	5
Amortization of intangibles	22	24
Operating income	2,874	3,337
Interest expense, net	254	246
Earnings before income taxes	2,620	3,091
Provision for income taxes	752	892
Equity (income)/loss in unconsolidated subsidiaries, net	(27)	5
Net earnings	1,895	2,194
Net earnings attributable to noncontrolling interests	44	70
Net earnings attributable to PMI	$1,851	$2,124
Per share data (Note 8):		
Basic earnings per share	$1.17	$1.30
Diluted earnings per share	$1.17	$1.30
Dividends declared	$0.94	$0.85

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 Six Months Ended June 30,	
	2014	2013
Net earnings	$3,811	$4,412
Other comprehensive earnings (losses), net of income taxes:		
Change in currency translation adjustment:		
Unrealized losses, net of income taxes of ($59) in 2014 and $24 in 2013	(114)	(722)
Change in net loss and prior service cost:		
Net losses and prior service costs, net of income taxes of $3 in 2014 and $- in 2013	(41)	—
Amortization of net losses, prior service costs and net transition costs, net of income taxes of ($26) in 2014 and ($27) in 2013	81	118
Change in fair value of derivatives accounted for as hedges:		
Gains transferred to earnings, net of income taxes of $2 in 2014 and $14 in 2013	(13)	(95)
(Losses) gains recognized, net of income taxes of $5 in 2014 and ($23) in 2013	(35)	156
Total other comprehensive losses	(122)	(543)
Total comprehensive earnings	3,689	3,869
Less comprehensive earnings attributable to:		
Noncontrolling interests	87	88
Redeemable noncontrolling interest (Note 7)	—	43
Comprehensive earnings attributable to PMI	$3,602	$3,738

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 June 30,	
	2014	2013
Net earnings	$1,895	$2,194
Other comprehensive earnings (losses), net of income taxes:		
Change in currency translation adjustment:		
Unrealized losses, net of income taxes of ($55) in 2014 and $52 in 2013	(77)	(488)
Change in net loss and prior service cost:		
Net losses and prior service costs, net of income taxes of $3 in 2014 and $- in 2013	(41)	—
Amortization of net losses, prior service costs and net transition costs, net of income taxes of ($14) in 2014 and ($13) in 2013	43	59
Change in fair value of derivatives accounted for as hedges:		
Gains transferred to earnings, net of income taxes of $1 in 2014 and $10 in 2013	(6)	(64)
(Losses) gains recognized, net of income taxes of $2 in 2014 and ($10) in 2013	(11)	60
Total other comprehensive losses	(92)	(433)
Total comprehensive earnings	1,803	1,761
Less comprehensive earnings attributable to:		
Noncontrolling interests	53	35
Redeemable noncontrolling interest (Note 7)	—	(3)
Comprehensive earnings attributable to PMI	$1,750	$1,729

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 Six Months Ended June 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			4,249			96 (a)	4,345 (a)
Other comprehensive earnings (losses), net of income taxes				(511)		(8) (a)	(519) (a)
Issuance of stock awards and exercise of stock options		(28)			134		106
Dividends declared ($1.70 per share)			(2,788)				(2,788)
Payments to noncontrolling interests						(169)	(169)
Common stock repurchased					(3,046)		(3,046)
Balances, June 30, 2013	$—	$ 1,306	$ 26,537	$ (4,115)	$ (29,194)	$ 241	$ (5,225)
Balances, January 1, 2014	$—	$ 723	$ 27,843	$ (4,190)	$ (32,142)	$ 1,492	$ (6,274)
Net earnings			3,726			85	3,811
Other comprehensive earnings (losses), net of income taxes				(124)		2	(122)
Issuance of stock awards and exercise of stock options		(74)			164		90
Dividends declared ($1.88 per share)			(2,968)				(2,968)
Payments to noncontrolling interests						(134)	(134)
Common stock repurchased					(2,250)		(2,250)
Balances, June 30, 2014	$—	$ 649	$ 28,601	$ (4,314)	$ (34,228)	$ 1,445	$ (7,847)

(a) For the six months ended June 30, 2013, net earnings attributable to noncontrolling interests exclude $67 million of earnings related to the redeemable noncontrolling interest, which were originally reported outside of the equity section in the condensed consolidated balance sheet at June 30, 2013. Other comprehensive earnings, net of income taxes, also exclude $24 million of net currency translation adjustment losses related to the redeemable noncontrolling interest at June 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 Six Months Ended June 30, 2014	2013
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES		
Net earnings	$3,811	$4,412
Adjustments to reconcile net earnings to operating cash flows:		
Depreciation and amortization	427	441
Deferred income tax provision	81	69
Asset impairment and exit costs, net of cash paid	282	(4)
Cash effects of changes, net of the effects from acquired companies:		
Receivables, net	(245)	(534)
Inventories	1,484	472
Accounts payable	2	61
Income taxes	(675)	(800)
Accrued liabilities and other current assets	(1,666)	154
Pension plan contributions	(82)	(56)
Other	1	285
Net cash provided by operating activities	3,420	4,500
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES		
Capital expenditures	(508)	(520)
Purchase of businesses, net of acquired cash	(103)	—
Investments in unconsolidated subsidiaries	(16)	(3)
Other	83	32
Net cash used in investing activities	(544)	(491)

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,	
	2014	2013
CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES		
Short-term borrowing activity by original maturity:		
Net repayments - maturities of 90 days or less	$(255)	$(101)
Issuances - maturities longer than 90 days	921	535
Repayments - maturities longer than 90 days	(1,094)	(139)
Long-term debt proceeds	3,632	5,205
Long-term debt repaid	(1,240)	(2,738)
Repurchases of common stock	(2,281)	(3,028)
Issuance of common stock	1	—
Dividends paid	(2,993)	(2,815)
Other	(178)	(218)
Net cash used in financing activities	(3,487)	(3,299)
Effect of exchange rate changes on cash and cash equivalents	(2)	(107)
Cash and cash equivalents:		
(Decrease) Increase	(613)	603
Balance at beginning of period	2,154	2,983
Balance at end of period	$1,541	$3,586

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 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 Six Months Ended June 30,		For the Three Months Ended June 30,	
	2014	2013	2014	2013
Separation programs:				
European Union	$359	$—	$359	$—
Asia	24	—	1	—
Total separation programs	383	—	360	—
Contract termination charges:				
Asia	—	8	—	5
Total contract termination charges	—	8	—	5
Asset impairment charges:				
European Union	129	—	129	—
Total asset impairment charges	129	—	129	—
Asset impairment and exit costs	$512	$8	$489	$5

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

(in millions)	
Liability balance, January 1, 2014	$308
Charges	383
Cash spent	(230)

Currency/other	(22)
Liability balance, June 30, 2014	$439

Cash payments related to exit costs at PMI were $230 million and $30 million for the six months and three months ended June 30, 2014, respectively, and $12 million and $7 million for the six months and three months ended June 30, 2013, respectively. Future cash payments for exit costs incurred to date are expected to be approximately $439 million, and will be substantially paid by the second 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 has reached an agreement with the trade unions and their members on a social plan, and plans to cease cigarette production by September 1, 2014. For the six months and three months ended June 30, 2014, total pre-tax asset impairment and exit costs of $488 million were recorded for this program in the European Union segment.

Other Exit Costs

Other Separation Program Charges

PMI recorded other pre-tax separation program charges of $24 million and $1 million for the six months and three months ended June 30, 2014, respectively, related to severance costs for a factory closure in Australia.

Contract Termination Charges

During the six months and three months ended June 30, 2013, PMI recorded exit costs of $8 million and $5 million, respectively, related to the termination of distribution agreements.

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 June 30, 2014, shares available for grant under the 2012 Plan were 24,799,330.

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 June 30, 2014, shares available for grant under the plan were 715,904.

During the six months ended June 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 six months ended June 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 $113 million and $124 million during the six months ended June 30, 2014 and 2013, respectively and $47 million and $52 million during the three months ended June 30, 2014 and 2013, respectively. As of June 30, 2014, PMI had $288 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 six months ended June 30, 2014, 3.4 million shares of PMI restricted stock and deferred stock awards vested. The grant date fair value of all the vested shares was approximately $205 million. The total fair value of restricted stock and deferred stock awards that vested during the six months ended June 30, 2014 was approximately $270 million.

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

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 Six Months Ended June 30,		Non-U.S. Plans For the Six Months Ended June 30,	
(in millions)	2014	2013	2014	2013
Service cost	$3	$4	$104	$127
Interest cost	8	8	103	84
Expected return on plan assets	(8)	(8)	(177)	(173)
Amortization:				
Net loss	3	6	57	102
Prior service cost	—	1	4	5
Net transition obligation	—	—	—	1
Net periodic pension cost	$6	$11	$91	$146

	U.S. Plans For the Three Months Ended June 30,		Non-U.S. Plans For the Three Months Ended June 30,	
(in millions)	2014	2013	2014	2013
Service cost	$2	$2	$52	$62
Interest cost	4	4	52	41
Expected return on plan assets	(4)	(4)	(89)	(86)
Amortization:				
Net loss	1	3	29	51
Prior service cost	—	1	2	3
Net transition obligation	—	—	—	1
Net periodic pension cost	$3	$6	$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 $82 million were made to the pension plans during the six months ended June 30, 2014. Currently, PMI anticipates making additional contributions during the remainder of 2014 of approximately $53 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 was as follows:

(in millions)	Goodwill June 30, 2014	December 31, 2013	Other Intangible Assets, net June 30, 2014	December 31, 2013
European Union	$1,609	$1,472	$620	$604
Eastern Europe, Middle East & Africa	584	617	225	228
Asia	4,039	3,960	1,260	1,251
Latin America & Canada	2,853	2,844	1,104	1,110
Total	$9,085	$8,893	$3,209	$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	153	—	—	—	153
Currency	(16)	(33)	79	9	39
Balances, June 30, 2014	$1,609	$584	$4,039	$2,853	$9,085

The increase in goodwill from acquisitions was due 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.

Additional details of other intangible assets were as follows:

(in millions)	June 30, 2014 Gross Carrying Amount	Accumulated Amortization	December 31, 2013 Gross Carrying Amount	Accumulated Amortization
Non-amortizable intangible assets	$1,818		$1,798	
Amortizable intangible assets	1,983	$592	1,940	$545
Total other intangible assets	$3,801	$592	$3,738	$545

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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 June 30, 2014, were as follows:

(dollars in millions)	Gross Carrying Amount	Initial Estimated Useful Lives	Weighted-Average Remaining Useful Life
Trademarks	$1,595	2 - 40 years	24 years
Distribution networks	162	20 - 30 years	14 years
Non-compete agreements	134	3 - 10 years	1 year
Other (including farmer contracts and intellectual property rights)	92	12.5 - 17 years	13 years
	$1,983		

Pre-tax amortization expense for intangible assets during the six months ended June 30, 2014 and 2013 was $44 million and $48 million, respectively, and $22 million and $24 million for the three months ended June 30, 2014 and 2013, respectively. Amortization expense for each of the next five years is estimated to be $88 million or less, assuming no additional transactions occur that require the amortization of intangible assets.
The increase in the gross carrying amount of other intangible assets from December 31, 2013, was due to currency movements, 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.
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 June 30, 2014, PMI had contracts with aggregate notional

amounts of $16.4 billion of which $3.8 billion related to cash flow hedges, $2.6 billion related to hedges of net investments in foreign operations and $10.0 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 June 30, 2014 and December 31, 2013, were as follows:

	Asset Derivatives			Liability Derivatives		
(in millions)	Balance Sheet Classification	Fair Value At June 30, 2014	At December 31, 2013	Balance Sheet Classification	Fair Value At June 30, 2014	At December 31, 2013
Foreign exchange contracts designated as hedging instruments	Other current assets	$66	$111	Other accrued liabilities	$6	$44
	Other assets	13	—	Other liabilities	44	46
Foreign exchange contracts not designated as hedging instruments	Other current assets	11	42	Other accrued liabilities	64	12
				Other liabilities	—	14
Total derivatives		$90	$153		$114	$116

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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, 2014 and 2013:

(in millions)	For the Six Months Ended June 30, 2014				
Gain (Loss)	Cash Flow Hedges	Net Investment Hedges	Other Derivatives	Income Taxes	Total
Statement of Earnings:					
Net revenues	$32		$—		$32
Cost of sales	—		—		—
Marketing, administration and research costs	(1)		—		(1)
Operating income	31		—		31
Interest expense, net	(16)		1		(15)
Earnings before income taxes	15		1		16
Provision for income taxes	(2)		—		(2)
Net earnings attributable to PMI	$13		$1		$14
Other Comprehensive Earnings/(Losses):					
Gains transferred to earnings	$(15)			$2	$(13)
Recognized losses	(40)			5	(35)
Net impact on equity	$(55)			$7	$(48)
Currency translation adjustments		$36		$(7)	$29

(in millions)	For the Six Months Ended June 30, 2013				
Gain (Loss)	Cash Flow Hedges	Net Investment Hedges	Other Derivatives	Income Taxes	Total
Statement of Earnings:					
Net revenues	$125		$—		$125
Cost of sales	6		—		6
Marketing, administration and research costs	—		—		—
Operating income	131		—		131
Interest expense, net	(22)		2		(20)
Earnings before income taxes	109		2		111
Provision for income taxes	(14)		1		(13)
Net earnings attributable to PMI	$95		$3		$98
Other Comprehensive Earnings/(Losses):					
Gains transferred to earnings	$(109)			$14	$(95)
Recognized gains	179			(23)	156
Net impact on equity	$70			$(9)	$61
Currency translation adjustments		$16		$(1)	$15

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(in millions)	For the Three Months Ended June 30, 2014				
Gain (Loss)	Cash Flow Hedges	Net Investment Hedges	Other Derivatives	Income Taxes	Total
Statement of Earnings:					
Net revenues	$17		$—		$17
Cost of sales	—		—		—
Marketing, administration and research costs	(1)		—		(1)
Operating income	16		—		16
Interest expense, net	(9)		3		(6)
Earnings before income taxes	7		3		10
Provision for income taxes	(1)		—		(1)
Net earnings attributable to PMI	$6		$3		$9
Other Comprehensive Earnings/(Losses):					
Gains transferred to earnings	$(7)			$1	$(6)
Recognized losses	(13)			2	(11)
Net impact on equity	$(20)			$3	$(17)
Currency translation adjustments		$11		$4	$15

(in millions)	For the Three Months Ended June 30, 2013				
Gain (Loss)	Cash Flow Hedges	Net Investment Hedges	Other Derivatives	Income Taxes	Total
Statement of Earnings:					
Net revenues	$84		$—		$84
Cost of sales	3		—		3
Marketing, administration and research costs	—		—		—
Operating income	87		—		87
Interest expense, net	(13)		2		(11)
Earnings before income taxes	74		2		76
Provision for income taxes	(10)		1		(9)
Net earnings attributable to PMI	$64		$3		$67
Other Comprehensive Earnings/(Losses):					
Gains transferred to earnings	$(74)			$10	$(64)
Recognized gains	70			(10)	60
Net impact on equity	$(4)			$—	$(4)
Currency translation adjustments		$13		$(1)	$12

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 six months and three months ended June 30, 2014 and 2013, ineffectiveness related to cash flow hedges was not material. As of June 30, 2014, subtantially all of PMI's hedged forecasted transactions are for periods not exceeding the next eighteen months with the exception of one foreign exchange contract that expires in May 2024. The impact of these hedges is included in operating cash flows on PMI's condensed consolidated statements of cash flows.

For the six months and three months ended June 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 Six Months Ended June 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				$ (40)	$ 179
	Net revenues	$32	$125		
	Cost of sales	—	6		
	Marketing, administration and research costs	(1)	—		
	Interest expense, net	(16)	(22)		
Total		$15	$109	$ (40)	$ 179

(pre-tax, in millions)	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/(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				$ (13)	$ 70
	Net revenues	$17	$84		
	Cost of sales	—	3		
	Marketing, administration and research costs	(1)	—		
	Interest expense, net	(9)	(13)		
Total		$7	$74	$ (13)	$ 70

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 six months ended June 30, 2014 and 2013, these hedges of net investments resulted in gains, net of income taxes of $93 million and $36 million, respectively. For the three months ended June 30, 2014 and 2013, these hedges of net investments resulted in gains (losses), net of income taxes, of $76 million and $(55) million, respectively. These gains (losses) were reported as a component of accumulated other comprehensive losses within currency translation adjustments. For the six months and three months ended June 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 six months and three months ended June 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 Six Months Ended June 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				$36	$16
	Interest expense, net	$—	$—		

(pre-tax, in millions)	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/(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				$11	$13
	Interest expense, net	$—	$—		

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 six months ended June 30, 2014 and 2013, the gains (losses) from contracts for which PMI did not apply hedge accounting were $94 million and $(20) million, respectively. For the three months ended June 30, 2014 and 2013, the gains from contracts for which PMI did not apply hedge accounting were $142 million and $70 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 six months and three months ended June 30, 2014 and 2013, these items impacted the condensed consolidated statements of earnings as follows:

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

Interest expense, net	$1	$2	$3	$2

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 Six Months Ended June 30,		For the Three Months Ended June 30,	
	2014	2013	2014	2013
Gain at beginning of period	$63	$92	$32	$157
Derivative (gains)/losses transferred to earnings	(13)	(95)	(6)	(64)
Change in fair value	(35)	156	(11)	60
Gain as of June 30,	$15	$153	$15	$153

At June 30, 2014, PMI expects $19 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 June 30, 2013 was $1,296 million. The movement in redeemable noncontrolling interest for the six months ended June 30, 2013 was as follows:

(in millions)	
Redeemable noncontrolling interest at December 31, 2012	$1,301
Share of net earnings	67
Dividend payments	(48)
Currency translation losses	(24)
Redeemable noncontrolling interest at June 30, 2013	$1,296

Note 8. Earnings Per Share:

Basic and diluted earnings per share ("EPS") were calculated using the following:

(in millions)	For the Six Months Ended June 30,		For the Three Months Ended June 30,	
	2014	2013	2014	2013
Net earnings attributable to PMI	$3,726	$4,249	$1,851	$2,124
Less distributed and undistributed earnings attributable to share-based payment awards	17	23	9	11
Net earnings for basic and diluted EPS	$3,709	$4,226	$1,842	$2,113
Weighted-average shares for basic and diluted EPS	1,577	1,639	1,571	1,631

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 Six Months Ended June 30,		For the Three Months Ended June 30,	
	2014	2013	2014	2013
Net revenues:				
European Union	$14,448	$13,768	$7,829	$7,245
Eastern Europe, Middle East & Africa	10,236	9,800	5,674	5,377
Asia	9,572	10,632	5,097	5,381
Latin America & Canada	4,574	4,810	2,451	2,480
Net revenues	$38,830	$39,010	$21,051	$20,483
Earnings before income taxes:				
Operating companies income:				
European Union	$1,689	$2,020	$711	$1,082
Eastern Europe, Middle East & Africa	2,014	1,880	1,087	945
Asia	1,815	2,470	900	1,128
Latin America & Canada	467	509	265	255
Amortization of intangibles	(44)	(48)	(22)	(24)
General corporate expenses	(80)	(112)	(40)	(54)
Less:				
Equity (income)/loss in unconsolidated subsidiaries, net	(36)	9	(27)	5
Operating income	5,825	6,728	2,874	3,337
Interest expense, net	(522)	(482)	(254)	(246)
Earnings before income taxes	$5,303	$6,246	$2,620	$3,091

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 only one judgment in a tobacco-related case. That judgment, including costs, was approximately €1,400 (approximately $1,900), 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 July 30, 2014, August 1, 2013 and August 1, 2012:

Type of Case	Number of Cases Pending as of July 30, 2014	Number of Cases Pending as of August 1, 2013	Number of Cases Pending as of August 1, 2012
Individual Smoking and Health Cases	63	63	74
Smoking and Health Class Actions	11	11	10
Health Care Cost Recovery Actions	15	15	14
Lights Class Actions	1	1	2
Individual Lights Cases	2	1	7
Public Civil Actions	2	4	3

Since 1995, when the first tobacco-related litigation was filed against a PMI entity, 422 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.

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 $5,800) 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 $44,800). Philip Morris Brasil has appealed this decision.

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 $450) 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 July 30, 2014, there were a number of smoking and health cases pending against us, our subsidiaries or indemnitees, as follows:

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63 cases brought by individual plaintiffs in Argentina (24), Brazil (23), Canada (2), Chile (6), Costa Rica (2), Greece (1), Italy (3), the Philippines (1) and Scotland (1), compared with 63 such cases on August 1, 2013, and 74 cases on August 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 August 1, 2013 and 10 such cases on August 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.

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. Plaintiff may appeal.

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 are scheduled to take place from September through November 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 are scheduled to take place from September through November 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 July 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 August 1, 2013 and 14 such cases on August 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 has begun.

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." Preliminary motions are pending.

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.

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. We have been served.

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 July 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 August 1, 2013 and 2 such cases on August 1, 2012; and
- 2 cases brought by individual plaintiffs in Chile (1) and Italy (1), compared with 1 such case on August 1, 2013, and 7 such cases on August 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. Hearings took place in November and December 2008 regarding whether the case meets the legal requirements necessary to allow it to proceed as a class action. The parties' briefing on class certification was completed in March 2011. In November 2012, the court denied class certification and dismissed the individual claims. Plaintiffs have appealed, and an oral hearing has been scheduled for September 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 July 30, 2014, there were 2 public civil actions pending against our subsidiaries in Argentina (1) and Venezuela (1), compared with 4 such cases on August 1, 2013, and 3 such cases on August 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 six months and three months ended June 30, 2014 were 28.8% and 28.7%, respectively. PMI's effective tax rates for the six months and three months ended June 30, 2013 were 29.2% and 28.9%, respectively. The effective tax rate for the six months ended June 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 six months ended June 30, 2014, as compared to the six months ended June 30, 2013, was primarily due to earnings mix and repatriation cost differences.

The effective tax rates are based on PMI's full-year geographic earnings mix projections and cash repatriation plans. Changes in earnings mix 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 June 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 $1,941 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 June 30, 2014 and December 31, 2013, PMI's long-term debt consisted of the following:

(in millions)	June 30, 2014	December 31, 2013
U.S. dollar notes, 0.277% to 6.375% (average interest rate 3.878%), due through 2043	$15,259	$16,500
Foreign currency obligations:		
Euro notes, 1.750% to 5.875% (average interest rate 3.104%), due through 2033	10,253	7,303
Swiss franc notes, 0.750% to 2.000% (average interest rate 1.217%), due through 2024	1,871	1,289
Other (average interest rate 3.644%), due through 2024	185	186
	27,568	25,278
Less current portion of long-term debt	407	1,255
	$27,161	$24,023

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

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PMI's debt issuances in the first six 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 June 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 June 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 $27,552 million at June 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.

The aggregate fair values of PMI's derivative financial instruments and debt as of June 30, 2014, were as follows:

(in millions)	Fair Value at June 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	$90	$—	$90	$—
Total assets	$90	$—	$90	$—
Liabilities:				
Debt	$29,444	$29,255	$189	$—
Foreign exchange contracts	114	—	114	—
Total liabilities	$29,558	$29,255	$303	$—

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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 June 30, 2014	At December 31, 2013	At June 30, 2013
Currency translation adjustments	$(2,323)	$(2,207)	$(1,021)
Pension and other benefits	(2,006)	(2,046)	(3,247)
Derivatives accounted for as hedges	15	63	153
Total accumulated other comprehensive losses	$(4,314)	$(4,190)	$(4,115)

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 six months and three months ended June 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 June 30, 2014						
Assets						
Foreign exchange contracts	$90	$—	$90	$(21)	$ (56)	$13
Liabilities						

Foreign exchange contracts	$114	$—	$114	$(21	)$ (89	) $4
At December 31, 2013						
Assets						
Foreign exchange contracts	$153	$—	$153	$(52	)$ (79	) $22
Liabilities						
Foreign exchange contracts	$116	$—	$116	$(52	)$ (47	) $17

Note 16. Investments in Unconsolidated Subsidiaries:

At June 30, 2014 and December 31, 2013, PMI had total investments in unconsolidated subsidiaries of $1,508 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 June 30, 2014 and December 31, 2013, PMI received year-to-date dividends from unconsolidated subsidiaries of $45 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 June 30, 2014 and December 31, 2013, PMI's investments in other unconsolidated subsidiaries were $40 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 Six Months Ended June 30, 2014	For the Three Months Ended June 30, 2014
Net revenues	$2,606	$1,420

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

(in millions)	At June 30, 2014	At December 31, 2013
Receivables	$584	$470
Notes receivable	$102	$100
Other liabilities	$90	$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. The purchase price allocation is expected to be completed by the third quarter 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 and other tobacco products in markets outside the United States of America. We manage our business in four segments:

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

Our products are sold in more than 180 markets and, in many of these markets, they hold the number one or number two market share position. We have a wide range of premium, mid-price and low-price brands. Our portfolio comprises both international and local brands.
We 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 Six Months Ended June 30, 2014 – The changes in our reported diluted earnings per share (“diluted EPS”) for the six months ended June 30, 2014, from the comparable 2013 amounts, were as follows:

	Diluted EPS	% Growth
For the six months ended June 30, 2013	$2.58	
2013 Asset impairment and exit costs	—	
2013 Tax items	0.01	
Subtotal of 2013 items	0.01	
2014 Asset impairment and exit costs	(0.25)	
2014 Tax items	—	
Subtotal of 2014 items	(0.25)	
Currency	(0.31)	
Interest	(0.02)	
Change in tax rate	0.03	
Impact of lower shares outstanding and share-based payments	0.09	
Operations	0.22	
For the six months ended June 30, 2014	$2.35	(8.9)%

Asset Impairment and Exit Costs – During the six months ended June 30, 2014, we recorded pre-tax asset impairment and exit costs of $512 million ($400 million after tax or $0.25 per share) related to the factory closures in the Netherlands and Australia. During the six months ended June 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 has reached an agreement with the trade unions and their members on a social plan, and plans to cease cigarette production by September 1, 2014. PMI expects to incur a total pre-tax charge of approximately $560 million for the total program, of which $488 million has been recorded as asset impairment and exit costs for the six months ended June 30, 2014. 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 six months ended June 30, 2014 decreased by 0.4 percentage points to 28.8%. The effective tax rate for the six months ended June 30, 2013 was unfavorably impacted by the additional expense associated with the enactment of the American Taxpayer Relief Act of 2012 ($17 million). The special tax item discussed in this paragraph decreased our diluted EPS by $0.01 in 2013. Excluding the impact of this special tax item, the change in tax rate that increased our diluted EPS by $0.03 per share in 2014 was primarily due to earnings mix 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, 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.

Operations – The increase in diluted EPS of $0.22 from our operations in the table above was due to the following segments:

- EEMA: Higher pricing and higher equity income in unconsolidated subsidiaries, partially offset by unfavorable volume/mix and higher manufacturing costs;

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- 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, partially offset by unfavorable volume/mix;

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 June 30, 2014 – The changes in our reported diluted EPS for the three months ended June 30, 2014, from the comparable 2013 amounts, were as follows:

	Diluted EPS	% Growth
For the three months ended June 30, 2013	$1.30	
2013 Asset impairment and exit costs	—	
2013 Tax items	—	
Subtotal of 2013 items	—	
2014 Asset impairment and exit costs	(0.24)	
2014 Tax items	—	
Subtotal of 2014 items	(0.24)	
Currency	(0.15)	
Interest	—	
Change in tax rate	0.03	
Impact of lower shares outstanding and share-based payments	0.03	
Operations	0.20	
For the three months ended June 30, 2014	$1.17	(10.0)%

Asset Impairment and Exit Costs – During the second quarter of 2014, we recorded pre-tax asset impairment and exit costs of $489 million ($384 million after tax or $0.24 per share) related to factory closures in the Netherlands and Australia. During the three months ended June 30, 2013, we recorded pre-tax asset impairment and exit costs of $5 million (less than one cent impact on diluted EPS) related to the termination of distribution agreements in Asia.

As previously discussed, on April 4, 2014, we announced the initiation by our affiliate, PMH, of consultations with employee representatives on a proposal to discontinue cigarette production at its factory located in Bergen op Zoom, the Netherlands. PMH has reached an agreement with the trade unions and their members on a social plan, and plans to cease cigarette production by September 1, 2014. PMI expects to incur a total pre-tax charge of approximately $560 million for the total program, of which $488 million has been recorded as asset impairment and exit costs for the three months ended June 30, 2014. 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 three months ended June 30, 2014 decreased by 0.2 percentage points to 28.7%. The change in tax rate that increased our diluted EPS by $0.03 per share in 2014 was primarily due to earnings mix 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, Russian ruble, Swiss franc, Turkish lira and the Ukraine hryvnia.

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.

Operations – The increase in diluted EPS of $0.20 from our operations in the table above was due primarily to the following segments:

-

EEMA: Higher pricing and higher equity income in unconsolidated subsidiaries, partially offset by unfavorable volume/mix and higher manufacturing costs;

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- LA&C: Higher pricing, partially offset by unfavorable volume/mix, higher manufacturing costs and higher marketing, administration and research costs; and
- European Union: Favorable volume/mix and higher pricing, partially offset by 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.

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 July 17, 2014, we reaffirmed our 2014 full-year reported diluted EPS forecast to be in a range of $4.87 to $4.97 versus $5.26 in 2013, as previously announced on June 26, 2014.
On an adjusted basis, diluted EPS are projected to increase in the range of 6% to 8% versus adjusted diluted EPS of $5.40 in 2013. This adjustment reflects:

- a $0.01 per share after-tax charge recorded as asset impairment and exit costs in the first quarter of 2014 relating to the decision to cease cigarette production in Australia by the end of 2014;
- a pre-tax charge, related to the decision to discontinue cigarette production in the Netherlands in 2014, of $488 million, or an after-tax charge of $0.24 per share, recorded as asset impairment and exit costs in the second quarter of 2014; and
- an unfavorable currency impact, at prevailing exchange rates, of approximately $0.61 for the full-year 2014.

This forecast includes a productivity and cost savings target of $300 million and a share repurchase target of $4.0 billion. Down-trading and heavy price discounting at the low end of the market in Australia, in combination with the impact of plain packaging, could place us at the lower end of our forecast for currency-neutral adjusted diluted EPS growth of 6% to 8% for the full year.
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 the 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 Six Months Ended June 30, 2014	2013	For the Three Months Ended June 30, 2014	2013
Cigarette volume:				
European Union	91,618	91,690	49,913	48,723
Eastern Europe, Middle East & Africa	136,176	143,132	74,170	76,298
Asia	146,454	153,207	75,653	80,588
Latin America & Canada	44,514	45,817	23,065	23,290
Total cigarette volume	418,762	433,846	222,801	228,899
Net revenues:				
European Union	$14,448	$13,768	$7,829	$7,245
Eastern Europe, Middle East & Africa	10,236	9,800	5,674	5,377
Asia	9,572	10,632	5,097	5,381
Latin America & Canada	4,574	4,810	2,451	2,480
Net revenues	$38,830	$39,010	$21,051	$20,483
Excise taxes on products:				
European Union	$10,042	$9,592	$5,436	$5,039
Eastern Europe, Middle East & Africa	5,944	5,576	3,391	3,196
Asia	5,079	5,150	2,786	2,689
Latin America & Canada	3,051	3,191	1,641	1,642
Excise taxes on products	$24,116	$23,509	$13,254	$12,566
Operating income:				
Operating companies income:				
European Union	$1,689	$2,020	$711	$1,082
Eastern Europe, Middle East & Africa	2,014	1,880	1,087	945
Asia	1,815	2,470	900	1,128
Latin America & Canada	467	509	265	255
Amortization of intangibles	(44)	(48)	(22)	(24)
General corporate expenses	(80)	(112)	(40)	(54)
Less:				
Equity (income)/loss in unconsolidated subsidiaries, net	(36)	9	(27)	5
Operating income	$5,825	$6,728	$2,874	$3,337

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 Six Months Ended June 30, 2014

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

Our cigarette shipment volume of 418.8 billion units decreased by 15.1 billion units (3.5%), due principally to:

- the European Union, reflecting lower total markets, partially offset by market share growth;
- EEMA, due mainly to a lower total market in Russia, and lower market share in Egypt, Serbia and Ukraine, partially offset by a higher total market and share of market in Algeria and a higher total market in Turkey;
- Asia, mainly reflecting a lower total market and share and unfavorable estimated inventory movements in Japan, and lower market share in Pakistan and Indonesia, partially offset by a higher market share in the Philippines; and
- Latin America & Canada, principally due to a lower total market in Mexico, driven by estimated trade inventory movements.

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

Total cigarette shipments of Marlboro of 139.0 billion units decreased by 1.5%, due primarily to Latin America & Canada, notably Mexico; the European Union, primarily France and Poland; and EEMA, mainly Russia and Ukraine; partially offset by Asia, driven primarily by Indonesia and the Philippines.

Total cigarette shipments of L&M of 45.2 billion units were down by 4.6%, due notably to Egypt, Poland, Saudi Arabia and Turkey, partially offset by Germany. Total cigarette shipments of Bond Street of 20.4 billion units decreased by 5.1%, due predominantly to Hungary, Kazakhstan and Serbia, partially offset by Australia. Total cigarette shipments of Parliament of 22.3 billion units were up by 4.7%, driven mainly by Turkey, partially offset by Kazakhstan, Russia and Ukraine. Total cigarette shipments of Philip Morris of 15.8 billion units decreased by 8.3%, due primarily to the morphing to Lark in Japan, partially offset by Argentina. Total cigarette shipments of Chesterfield of 20.6 billion units were up by 24.4%, due primarily to Italy, Poland and Turkey, partially offset by Russia and Ukraine. Total cigarette shipments of Lark of 13.7 billion units decreased by 7.1%, due primarily to Japan and 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 1.5% to 16.4 billion cigarette equivalent units, mainly due to growth in the fine cut category, principally in Belgium, Czech Republic and Hungary, partially offset by declines in France and Spain.

Total shipment volume for cigarettes and OTP, in cigarette equivalent units, was down by 3.3%.

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

(in millions)	For the Six Months Ended June 30, 2014	2013	Variance	%
Net revenues	$38,830	$39,010	$(180)	(0.5)%
Excise taxes on products	24,116	23,509	607	2.6%
Net revenues, excluding excise taxes on products	$14,714	$15,501	$(787)	(5.1)%

Currency movements decreased net revenues by $2.5 billion and net revenues, excluding excise taxes on products by $1.0 billion. The $1.0 billion decrease was due primarily to the Argentine peso, Australian dollar, Indonesian rupiah, Japanese yen, Russian ruble, Turkish lira and the Ukraine hryvnia, partially offset by the Euro.

Net revenues shown in the table above include $991 million in 2014 and $922 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 $368 million in 2014 and $363 million in 2013.

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Net revenues, which include excise taxes billed to customers, decreased by $180 million (0.5%). Excluding excise taxes, net revenues decreased by $787 million (5.1%) to $14.7 billion. This decrease was due to:

- unfavorable currency ($1.0 billion) and
- unfavorable volume/mix ($670 million), partly offset by
- price increases ($900 million).

Excise taxes on products increased by $607 million (2.6%), due to:

- higher excise taxes resulting from changes in retail prices and tax rates ($2.4 billion), partly offset by
- favorable currency ($1.5 billion) and
- volume/mix ($302 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 Six Months Ended June 30,			
(in millions)	2014	2013	Variance	%
Cost of sales	$5,070	$5,190	$(120)	(2.3)%
Marketing, administration and research costs	3,263	3,527	(264)	(7.5)%
Operating income	5,825	6,728	(903)	(13.4)%

Cost of sales decreased $120 million (2.3%), due to:

- favorable currency ($181 million) and
- volume/mix ($123 million), partly offset by
- higher manufacturing costs ($184 million, principally in Egypt due to the impact of the change in our new business structure). 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 anticipate some manufacturing 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 $264 million (7.5%), due to:

- favorable currency ($230 million) and
- lower expenses ($34 million, primarily lower corporate expenses).

Operating income decreased by $903 million (13.4%). This decrease was due primarily to:

- unfavorable currency ($604 million),
- unfavorable volume/mix ($547 million),
- higher pre-tax charges for asset impairment and exit costs ($504 million, primarily related to the decision to discontinue cigarette production in the Netherlands), and
- higher manufacturing costs ($184 million), partly offset by
- price increases ($900 million) and

- lower marketing, administration and research costs ($34 million).

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Interest expense, net, of $522 million increased $40 million, due primarily to higher average debt levels, partially offset by lower average interest rates on debt.

Our effective tax rate decreased by 0.4 percentage points to 28.8%. The effective tax rate for the six months ended June 30, 2013, was unfavorably impacted by the additional expense associated with the enactment of the American Taxpayer Relief Act of 2012 ($17 million). The effective tax rate is based on our full-year geographic earnings mix 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 ($36) million increased by $45 million, due primarily to higher earnings from our investments in the Eastern Europe, Middle East & Africa segment.

Net earnings attributable to PMI of $3.7 billion decreased by $523 million (12.3%). This decrease was due primarily to an unfavorable currency impact on operating income and higher interest expense, net, partially offset by a lower effective tax rate. Diluted and basic EPS of $2.35 decreased by 8.9%. Excluding an unfavorable currency impact of $0.31, diluted EPS increased by 3.1%.

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

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

Our cigarette shipment volume of 222.8 billion units decreased by 6.1 billion units (2.7%), due principally to:

- EEMA, due mainly to a lower total market in Russia that was partially offset by higher share, Egypt, Serbia and Ukraine, partially offset by Algeria and Turkey;
- Asia, mainly reflecting a lower total market and share in Japan, lower share in Pakistan due to the timing of trade inventory movements, and lower estimated tax-paid industry cigarette volumes in the Philippines partly offset by higher share; partially offset by Indonesia driven by a higher total market; and
- Latin America & Canada, due largely to the impact of tax-driven price increases in Canada,

partially offset by:

- European Union, driven notably by Germany, Italy and the United Kingdom, partly offset by France, Greece and Hungary.

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

Total cigarette shipments of Marlboro of 73.2 billion units increased by 1.0%, driven primarily by EEMA, notably Algeria and Saudi Arabia, and Asia, principally the Philippines. Total cigarette shipments of Marlboro were essentially flat in the European Union and down slightly in Latin America & Canada, predominantly due to Mexico. Total cigarette shipments of L&M of 24.2 billion units decreased by 3.5%, due to EEMA, mainly Egypt, Saudi Arabia and Turkey, partially offset by growth in each of the other Regions. Total cigarette shipments of Bond Street of 11.1 billion units decreased by 4.0%, due predominantly to Hungary, Kazakhstan, Serbia and Ukraine, partially offset by Russia. Total cigarette shipments of Parliament of 12.4 billion units increased by 7.6%, driven mainly by Turkey. Total cigarette shipments of Philip Morris of 7.8 billion units decreased by 11.1%, due predominantly to the morphing to Lark in Japan. Total cigarette shipments of Chesterfield of 11.8 billion units increased by 33.2%, due primarily to Italy, Poland and Turkey, partially offset by Russia and Ukraine. Total cigarette shipments of Lark of 6.9 billion units decreased by 13.1%, due to timing of shipments and a lower total market in Japan following the consumption tax-driven retail price increases of April 1, 2014.

Total shipment volume of OTP, in cigarette equivalent units, increased by 4.2% to 8.4 billion cigarette equivalent units, mainly reflecting growth in the fine cut category, notably in Belgium, Czech Republic and Hungary, partly offset by France and Spain.

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Total shipment volume for cigarettes and OTP, in cigarette equivalent units, decreased by 2.4%.

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

	For the Three Months Ended June 30,			
(in millions)	2014	2013	Variance	%
Net revenues	$21,051	$20,483	$568	2.8 %
Excise taxes on products	13,254	12,566	688	5.5 %
Net revenues, excluding excise taxes on products	$7,797	$7,917	$(120)	(1.5)%

Currency movements decreased net revenues by $1.2 billion and net revenues, excluding excise taxes on products, by $475 million. The $475 million decrease was due primarily to the Argentine peso, Australian dollar, Indonesian rupiah, Japanese yen, Russian ruble, Turkish lira and the Ukraine hryvnia, partially offset by the Euro.

Net revenues shown in the table above include $521 million in 2014 and $472 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 $191 million in 2014 and $184 million in 2013.

Net revenues, which include excise taxes billed to customers, increased by $568 million (2.8%). Excluding excise taxes, net revenues decreased by $120 million (1.5)% to $7.8 billion. This decrease was due to:

- unfavorable currency ($475 million) and
- unfavorable volume/mix ($139 million), partly offset by
- price increases ($494 million).

Excise taxes on products increased by $688 million (5.5%), due to:

- higher excise taxes resulting from changes in retail prices and tax rates ($1.4 billion) and
- volume/mix ($72 million), partly offset by
- favorable currency ($749 million).

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

	For the Three Months Ended June 30,			
(in millions)	2014	2013	Variance	%
Cost of sales	$2,696	$2,701	$(5)	(0.2)%
Marketing, administration and research costs	1,716	1,850	(134)	(7.2)%
Operating income	2,874	3,337	(463)	(13.9)%

Cost of sales decreased by $5 million (0.2%), due to:

- favorable currency ($65 million) and
- volume/mix ($30 million), partly offset by
- higher manufacturing costs ($90 million, principally in Egypt due to the impact of the change in our new business structure).

Marketing, administration and research costs decreased by $134 million (7.2%), due to:

- favorable currency ($122 million) and
- lower expenses ($12 million, primarily lower corporate expenses).

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Operating income decreased by $463 million (13.9%), due primarily to:

- higher pre-tax charges for asset impairment and exit costs ($484 million, primarily related to the decision to discontinue cigarette production in the Netherlands),
- unfavorable currency ($287 million),
- unfavorable volume/mix ($109 million) and
- higher manufacturing costs ($90 million), partly offset by
- price increases ($494 million) and
- lower marketing, administration and research costs ($12 million).

Interest expense, net, of $254 million increased $8 million, due primarily to higher average debt levels, partially offset by lower average interest rates on debt.

Our effective tax rate decreased by 0.2 percentage points to 28.7%. The effective tax rate is based on our full-year geographic earnings mix 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 ($27) million increased by $32 million, due primarily to higher earnings from our investments in the Eastern Europe, Middle East & Africa segment.

Net earnings attributable to PMI of $1.9 billion decreased by $273 million (12.9%). This decrease was due primarily to an unfavorable currency impact on operating income. Diluted and basic EPS of $1.17 decreased by 10.0%. Excluding an unfavorable currency impact of $0.15, diluted EPS increased by 1.5%.

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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 177 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 and ingredient restrictions or bans based on the concepts of palatability or attractiveness. 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 Council of Ministers and the European Parliament approved the text of a significantly revised EU Tobacco Products Directive that 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 from the date the revised Directive enters into force;
- 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. It is not possible to predict the outcome of this legal proceeding, 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 runs until August 7, 2014.

In February 2014, draft plain packaging legislation in New Zealand had its first reading in Parliament and is now being considered by a Parliamentary Health Committee, although the government has indicated that the legislation is unlikely to be passed until the legal challenges to Australia’s plain packaging law are resolved.

A legislative plain packaging proposal in Ireland was published in June 2014, and is currently pending in the parliamentary process.

It is not possible to predict whether these or other legislative plain packaging proposals will be enacted.

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, illicit trade in Australia has increased since the implementation of plain packaging, with a significant shift towards branded illicit products (away from unbranded loose tobacco), and no impact on smoking prevalence among adults or youth.

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 product category. 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.

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: Tobacco control advocates 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 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, one country -- Nicaragua -- has ratified the Protocol. It is not possible to predict whether or when 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 (except Croatia) 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 in qualifying seizures of up to 90 million genuine PMI products in the EU in a given year, and five times the applicable taxes and duties if seizures exceed 90 million cigarettes 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: One of our strategic priorities is to develop, assess and commercialize a portfolio of innovative products with the potential to reduce individual risk and population harm in comparison to smoking combustible cigarettes. Reduced-Risk Products (“RRPs”) is the term we use to refer to products in various stages of development for which we are conducting extensive and rigorous scientific studies to determine whether we can support claims 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 the second half of 2014, with the final results anticipated by mid-2016.

- 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 later this year.

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- 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 and, when fully operational by 2016, and together with the pilot plant, 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.

In April 2014, the FDA issued a notice of a proposed rule deeming e-cigarettes (including e-vapor products) and certain other tobacco products to be “tobacco products” subject to its jurisdiction under the Family Smoking Prevention and Tobacco Control Act. Deemed tobacco products would be subject to, among other things, ingredient reporting requirements, a descriptor ban, a specific warning requirement, premarket approval and a ban on sale to minors. These products would not be subject to a ban on characterizing flavors. Public comments on the proposed deeming regulations are due on August 8, 2014.

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 brands and other brand names. We plan to introduce the iQOS system in Japan and Italy in city tests 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-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 third quarter of 2014. 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

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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.

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 has reached an agreement with the trade unions and their members on a social plan and plans to cease cigarette production by September 1, 2014. We expect to incur a total pre-tax charge of approximately $560 million, of which $488 million has been recorded as asset impairment and exit costs for the six months and three months ended June 30, 2014. This amount includes employee separation costs of $359 million and $129 million related to asset impairment costs. In addition, up to $72 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. Excluding asset impairment costs, substantially all of these charges will result in cash expenditures, with approximately $181 million expected to be paid in 2014.

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.

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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.

Operating Results – Six Months Ended June 30, 2014

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

European Union. Net revenues, which include excise taxes billed to customers, increased by $680 million (4.9%). Excluding excise taxes, net revenues increased by $230 million (5.5%) to $4.4 billion. This increase was due to:

- favorable currency ($179 million) and
- price increases ($66 million), partly offset by
- unfavorable volume/mix ($15 million).

The net revenues of the European Union segment include $819 million in 2014 and $752 million in 2013 related to sales of OTP. Excluding excise taxes, OTP net revenues for the European Union segment were $282 million in 2014 and $264 million in 2013.

Operating companies income of $1.7 billion decreased by $331 million (16.4%). This decrease was due primarily to:

- the 2014 pre-tax charge for asset impairment and exit costs ($488 million) related to the decision to discontinue cigarette production in the Netherlands, and
- unfavorable volume/mix ($22 million), partly offset by
- favorable currency ($109 million) and
- price increases ($66 million).

The total cigarette market in the European Union declined by 3.4% to 226.6 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 and favorable estimated trade inventory movements. Excluding the impact of the estimated trade inventory movements, the total cigarette market in the European Union is estimated to have declined by approximately 3.6%. Although our cigarette shipment volume in the European Union declined by 0.1% to 91.6 billion units, predominantly reflecting a lower total market, our market share was up by 1.0 share point to 39.9%. The total OTP market in the European Union of 80.0 billion cigarette equivalent units increased by 0.1%, principally reflecting a stable total fine cut market, which was flat at 69.7 billion cigarette equivalent units.

While shipment volume of Marlboro of 44.1 billion units decreased by 1.8%, mainly due to a lower total market, market share increased by 0.3 share points to 19.3%, driven notably by Czech Republic, Italy and Spain. Shipment volume of L&M increased by 1.9% to 16.1 billion units and market share increased by 0.3 share points to 7.1%, driven notably by Germany. Shipment volume of Chesterfield of 12.9 billion units increased by 40.6% and market share increased by 1.0 share point to 5.4%, driven notably by Italy and Poland. Shipment volume of Philip Morris of 4.9 billion units increased by 3.6% and market share increased by 0.1 share point to 2.1%, driven notably by Lithuania and Italy.

Our shipments of OTP of 11.2 billion cigarette equivalent units increased by 4.0%, driven principally by higher share. Our OTP total market share was 14.3%, up by 0.9 share points, reflecting gains in the fine cut category, notably in Czech Republic, up 12.0 share points to 29.0%, Hungary, up by 7.3 share points to 18.9%, Italy, up by 7.4 share points to 41.8%, Poland, up by 14.5 share points to 36.0%, and Spain, up by 2.1 share points to 15.1%.

In France, the total cigarette market of 22.3 billion units decreased by 6.7%, mainly reflecting the unfavorable impact of tax-driven price increases in July 2013 and January 2014, as well as the growth of e-vapor products. Our shipments of 9.4 billion units decreased by 5.5%. Our market share increased by 0.9 share points to 41.2%, mainly driven by

Marlboro and Philip Morris, up by 0.6 and 0.3 share points to 25.3% and 9.4%, 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 6.6 billion cigarette equivalent units decreased by 5.0%. Our market share of the category decreased by 0.4 share points to 26.4%.

In Germany, the total cigarette market of 39.1 billion units increased by 1.8%, partly reflecting a favorable comparison with 2013 that witnessed a reversal of trade purchases of competitive products. Excluding the favorable impact of these estimated trade inventory movements, the total cigarette market grew by approximately 0.8%. Our shipments of 14.4 billion units increased by

2.0%. Market share increased by 0.1 share point to 36.9%, driven by L&M, up by 1.1 share points to 11.8%, mostly offset by Marlboro, down by 0.9 share points to 21.9%. Our share of Chesterfield was flat 1.7%. The total industry fine cut category of 20.3 billion cigarette equivalent units decreased by 0.4%. Our market share of the category was down by 1.9 share points to 13.0%.

In Italy, the total cigarette market of 36.0 billion units increased by 1.1%, mainly reflecting a stabilization in the prevalence of illicit trade, a lower incidence of e-vapor products and relatively lower out-switching to the fine cut category. Our shipments of 20.5 billion units increased by 4.7%. Our market share increased by 0.9 share points to 54.2%, due primarily to: Chesterfield, up by 4.1 share points to 7.7%, benefiting from its repositioning in February 2014 into the €4.00/pack price segment, and Philip Morris, up by 0.2 share points to 2.4%, partially offset by Diana in the low-price segment which was down 2.6 share points to 9.2%, impacted by the growth of the super-low price segment, and Marlboro, down by 0.4 share points to 25.3%. While the total industry fine cut category of 2.9 billion cigarette equivalent units decreased by 0.2%, our market share of the category increased by 7.4 share points to 41.8%, driven by Marlboro following its launch in the first quarter of 2013.

In Poland, the total cigarette market of 21.6 billion units decreased by 8.8%, reflecting the growth of e-vapor products and the prevalence of non-duty paid OTP products. Although our shipments of 8.2 billion units decreased by 1.6%, our market share increased by 2.4 share points to 38.8%, driven by L&M, up by 0.5 share points to 17.1%, and Chesterfield, up by 1.9 share points to 7.5%, benefiting from the morphing of Red & White in the fourth quarter of 2013, partially offset by Marlboro, down by 0.4 share points to 10.6%. The total industry fine cut category of 1.9 billion cigarette equivalent units increased by 0.6%. Our market share of the category increased by 14.5 share points to 36.0%.

In Spain, the total cigarette market of 22.8 billion units decreased by 2.3%, mainly due to the unfavorable impact of a price increase in the third quarter of 2013, partially offset by lower out-switching to the OTP category. Excluding the impact of the estimated trade inventory movements, the total cigarette market decreased by approximately 3.5%. Our shipments of 7.5 billion units increased by 1.7%, including favorable estimated trade inventory movements. Our market share increased by 0.4 share points to 31.6%, driven by higher share of Marlboro, up by 1.0 share point to 15.5%, partially offset by Chesterfield and L&M, down 0.1 share point and 0.3 share points to 9.3% and 6.2%, respectively. While the total industry fine cut category of 4.8 billion cigarette equivalent units decreased by 15.6%, partly reflecting the narrowing of price gaps with the cigarette category since July 2013, our market share of the fine cut category increased by 2.1 share points to 15.1%.

Eastern Europe, Middle East & Africa. Net revenues, which include excise taxes billed to customers, increased by $436 million (4.4%). Excluding excise taxes, net revenues increased by $68 million (1.6%) to $4.3 billion. This increase was due to:

- price increases ($557 million), partly offset by
- unfavorable currency ($322 million) and
- unfavorable volume/mix ($167 million).

Operating companies income of $2.0 billion increased by $134 million (7.1%). This increase was due primarily to:

- price increases ($557 million) and
- higher equity income in unconsolidated subsidiaries ($49 million), partly offset by
- unfavorable currency ($210 million),
- higher manufacturing costs ($138 million, principally related to the impact of the change to our new business structure in Egypt) and
- unfavorable volume/mix ($134 million).

Our cigarette shipment volume in EEMA decreased by 4.9% to 136.2 billion units, mainly due to a lower total market and unfavorable inventory movements in Russia, and lower share in Egypt, Serbia and Ukraine, partially offset by

Algeria and Turkey. Our cigarette shipment volume of premium brands increased by 0.3%, due principally to Parliament, up by 5.6% to 16.1 billion units, partially offset by Marlboro, down by 1.0% to 40.3 billion units.

In North Africa, the total cigarette market increased by 1.8% to an estimated 69.5 billion units, driven mainly by Algeria. Our shipment volume of 17.8 billion units decreased by 3.9%, principally reflecting lower production of our products as part of the transition to the new business structure in Egypt. Our market share decreased by 1.9 share points to 25.1%, due to lower share in Egypt, partially offset by gains in Algeria. Market share of Marlboro increased by 0.7 share points to 14.9%, while share of L&M decreased by 2.4 share points to 8.3%.

In Russia, the total cigarette market declined by 8.5% to an estimated 147.3 billion units, mainly due to the impact of the tax-driven price increases of June 2013 and January 2014 and the prevalence of illicit trade. Our shipment volume of 40.5 billion units decreased by 6.7%. Our market share of 26.8%, as measured by Nielsen, was up by 0.7 share points. Market share of Parliament, L&M and Bond Street increased by 0.3, 0.4 and 0.7 share points to 3.6%, 3.1% and 7.2%, respectively, partially offset by Marlboro and Chesterfield, down by 0.2 share points each to 1.6% and 2.9%, respectively.

In Turkey, the total cigarette market increased by 0.4% to an estimated 42.0 billion units, partially reflecting lower trade inventory movements when compared with 2013. Excluding the impact of estimated trade inventory movements, the total cigarette market was essentially flat. Our shipment volume of 21.2 billion units increased by 6.8%. Our market share, as measured by Nielsen, decreased by 0.4 share points to 44.4%, mainly due to Marlboro, mid-price Muratti and low-price L&M, down by 0.3, 1.0 and 1.2 share points to 8.5%, 5.9% and 6.4%, respectively, partially offset by premium Parliament, up by 1.2 share points to 10.7%.

In Ukraine, the total cigarette market decreased by 1.3% to an estimated 36.5 billion units, mainly reflecting the impact of the 2013 price increase, a worsening economy and business disruption due to the political instability in the east of the country, partly offset by trade inventory movements ahead of excise-tax driven price increases in July 2014 and a lower prevalence of illicit trade. Excluding the impact of estimated trade inventory movements, the total cigarette market decreased by approximately 3.6%. Our shipment volume of 11.3 billion units decreased by 9.1%, principally due, in addition to the aforementioned factors, to a decrease in our market share, as measured by Nielsen, down by 0.9 share points to 32.7% as a result of price competition and down-trading, with Marlboro and Parliament down by 0.7 and 0.3 share points to 4.9% and 3.0%, respectively. The decrease in our market share was partially offset by growth from our low-price segment brands of Bond Street and President.

Asia. Net revenues, which include excise taxes billed to customers, decreased by $1.1 billion (10.0%). Excluding excise taxes, net revenues decreased by $989 million (18.0%) to $4.5 billion. This decrease was due to:

- unfavorable currency ($651 million) and
- unfavorable volume/mix ($414 million), partly offset by
- price increases ($76 million).

Operating companies income of $1.8 billion decreased by $655 million (26.5%). This decrease was due to:

- unfavorable currency ($396 million),
- unfavorable volume/mix ($317 million),
- higher manufacturing costs ($25 million) 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 ($76 million) and
- lower marketing, administration and research costs ($23 million).

Our cigarette shipment volume of 146.5 billion units decreased by 4.4%, due primarily to: unfavorable estimated inventory movements in Japan, lower share in Pakistan driven by an unfavorable comparison with 2013 due to the timing of trade inventory movements, and lower share in Indonesia; partially offset by a higher market share in the Philippines driven by a favorable comparison with 2013, which was significantly impacted by a disruptive excise tax increase. Shipment volume of Marlboro of 37.4 billion units was up by 0.7%, driven by Indonesia and the Philippines, partially offset by Japan.

In Indonesia, the total cigarette market increased by 2.0% to 155.8 billion units. Our shipment volume of 54.1 billion units decreased by 2.0%, primarily due to lower market share, down by 1.5 share points to 34.7% as a result of: the share decline of the Dji Sam Soe brand family, which decreased by 1.1 share points to 5.9%, due to the continuing decline of the hand-rolled kretek segment and an unfavorable impact resulting from 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, which reached a market share of 0.6% in the second quarter following its launch in April 2014; 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; and increased competition in the machine-made LTLN (low-tar, low-nicotine) segment. Market share of Sampoerna A, in the premium machine-made LTLN segment was flat at 14.2%, while mid-price U Mild, was up by 1.2 share points to 5.4%. Marlboro's market share was up 0.1 share point to 5.3% and its share of the “white” cigarettes segment, representing 6.5% of the total cigarette market, increased by 4.2 share points to 79.8%.

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In Japan, the total cigarette market decreased by 2.8% to 90.9 billion units. Our shipment volume of 25.2 billion units decreased by 12.6%, principally due to the adverse timing of our shipments and lower market share. Our market share decreased by 1.3 share points to 25.9%, with share of Marlboro, Lark, and Virginia S. down by 0.5, 0.4 and 0.2 share points to 11.7%, 9.8% and 1.9%, respectively. Market share of Parliament was flat at 2.2%.
In Korea, the total cigarette market decreased by 1.7% to 41.8 billion units, mainly due to an unfavorable comparison with the first quarter of 2013 resulting from trade inventory movements ahead of an anticipated excise tax increase in 2013 that did not materialize. Although our shipment volume of 8.2 billion units was flat, market share increased by 0.3 share points to 19.7%, with share of Marlboro, up by 0.1 share point to 7.8%, and Parliament, up by 0.3 share points to 7.2%, driven by Parliament Hybrid 5mg and the launch in October 2013 of Parliament Hybrid 1mg, partially offset by Virginia S., down by 0.1 share point to 4.0%. Market share of Lark was flat at 0.7%.
In the Philippines, the total tax-paid industry cigarette volume increased by 0.8% to an estimated 38.8 billion units, reflecting the impact of inventory movements, and higher market share, partially offset by the prevalence of domestic non-duty paid products. Excluding the impact of estimated inventory movements, the total tax-paid industry cigarette volume declined by an estimated 1.2%. Our shipment volume of 33.4 billion units increased by 2.4%. Our market share of the total estimated tax-paid industry of 86.1% increased by 1.4 share points. Marlboro's market share increased by 1.3 share points to 18.7%. Share of Fortune decreased by 2.4 share points to 34.6%, which was more than offset by gains from our other local brands.

Latin America & Canada. Net revenues, which include excise taxes billed to customers, decreased by $236 million (4.9%). Excluding excise taxes, net revenues decreased by $96 million (5.9%) to $1.5 billion. This decrease was due to:

- unfavorable currency ($223 million) and
- unfavorable volume/mix ($74 million), partly offset by
- price increases ($201 million).

Operating companies income of $467 million decreased by $42 million (8.3%). This decrease was due to:

- unfavorable currency ($111 million),
- unfavorable volume/mix ($74 million),
- higher marketing, administration and research costs ($39 million) and
- higher manufacturing costs ($19 million), partly offset by
- price increases ($201 million).

Our cigarette shipment volume in Latin America & Canada of 44.5 billion units decreased by 2.8%, principally due to the timing of estimated trade inventory movements in Mexico. Shipment volume of Marlboro of 17.2 billion units decreased by 6.1%.
In Argentina, the total cigarette market decreased by 1.0% to 20.6 billion units. Our cigarette shipment volume of 15.9 billion units increased by 1.4%, and market share increased by 1.8 share points to 76.7%, driven by mid-price Philip Morris, up by 2.6 share points to 43.1%, reflecting the positive impact of its capsule variants, partially offset by low-price Next, down by 0.7 share points to 2.1%. Market share of Marlboro was up by 0.1 share point to 24.0%.
In Canada, the total cigarette market decreased by 7.1% to 12.9 billion units, mainly due to the impact of federal and provincial tax-driven price increases in the first and second quarters of 2014. While our cigarette shipment volume of 4.9 billion units decreased by 3.1%, market share increased by 1.9 share points to 38.3%, with premium brands Benson & Hedges flat at 2.4% and Belmont up by 0.4 share points to 2.9%. Market share of mid-price Canadian Classics was up by 0.5 share points to 10.5%. Market share of low-price Next was up by 1.6 share points to 10.9%, partially offset by mid-price Number 7 and low-price Accord, down by 0.2 and 0.3 share points to 4.1% and 2.6%, respectively.

In Mexico, the total cigarette market decreased by 4.8% to 15.6 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 0.2%. Our cigarette shipment volume of 10.9 billion units decreased by 9.5%. Our market share decreased by 3.6 share points to 69.5%. While market share of Marlboro was down by 4.1 share points to 48.2% and share of Benson & Hedges was down by 0.5 share points to 5.2%, reflecting consumer down-trading and the timing of price increases by our principal competitor, our share of the premium price segment was up by 1.2 share points to 91.3%. Market share of Delicados, the second best-selling brand in the market, increased by 0.3 share points to 11.1%.

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Operating Results – Three Months Ended June 30, 2014

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

European Union. Net revenues, which include excise taxes billed to customers, increased by $584 million (8.1%). Excluding excise taxes, net revenues increased by $187 million (8.5%) to $2.4 billion. This increase was due to:

- favorable currency ($128 million),
- favorable volume/mix ($45 million) and
- price increases ($14 million).

The net revenues of the European Union segment include $432 million in 2014 and $386 million in 2013 related to sales of OTP. Excluding excise taxes, OTP net revenues for the European Union segment were $148 million in 2014 and $135 million in 2013.

Operating companies income of $711 million decreased by $371 million (34.3%). This decrease was due primarily to:

- the 2014 pre-tax charge for asset impairment and exit costs ($488 million) related to the decision to discontinue cigarette production in the Netherlands, and
- higher marketing, administration and research costs ($13 million), partly offset by
- favorable currency ($81 million),
- favorable volume/mix ($37 million) and
- price increases ($14 million).

The total cigarette market in the European Union of 120.4 billion units decreased by 1.2%, partly reflecting, in certain key geographies: 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, lower price elasticity, and improved economic conditions; and, overall, favorable estimated trade inventory movements compared to the second quarter of 2013, notably in Germany, Spain and the United Kingdom. Excluding the impact of the estimated trade inventory movements, the total cigarette market in the European Union is estimated to have declined by approximately 2.4%. Our cigarette shipment volume of 49.9 billion units increased by 2.4%, and market share increased by 0.9 share points to 40.4%. The total OTP market in the European Union of 41.6 billion cigarette equivalent units increased by 1.0%, reflecting a higher total fine cut market, up by 0.8% to 36.1 billion cigarette equivalent units.

Shipment volume of Marlboro was flat at 23.9 billion units, and market share increased by 0.1 share point to 19.4%. Shipment volume of L&M increased by 2.6% to 8.7 billion units and market share increased by 0.3 share points to 7.2%, driven notably by Germany. Shipment volume of Chesterfield of 7.5 billion units increased by 52.4% 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 4.1% and market share increased by 0.1 share point to 2.2%.

Our shipments of OTP of 5.8 billion cigarette equivalent units increased by 6.0%, driven principally by a higher total market and share. Our OTP total market share was 14.3%, up by 0.6 share points, reflecting gains in the fine cut category, notably in Hungary, up by 6.7 share points to 19.0%, Italy, up by 4.4 share points to 42.3%, Poland, up by 12.9 share points to 36.4%, and Spain, up by 2.0 share points to 14.7%, partially offset by Germany, down by 1.9 share points to 13.0%, and Portugal, down by 2.5 share points to 30.3%.

In France, the total cigarette market of 11.8 billion units decreased by 4.6%, mainly reflecting the unfavorable impact of tax-driven price increases in July 2013 and January 2014, and the growth of e-vapor products. While our shipments of 4.8 billion units decreased by 3.1% in the quarter, market share increased by 0.9 share points to 41.4%, mainly driven by Marlboro and premium Philip Morris, up by 0.5 and 0.3 share points to 25.5% and 9.4%, 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 3.5 billion cigarette equivalent units decreased by 3.9%. Our market share of the category decreased by 0.5 share points to 26.7%.

In Germany, the total cigarette market of 20.9 billion units increased by 6.4%, partially reflecting a favorable comparison with the second quarter of 2013 that witnessed a reversal of trade purchases of competitive products made in the first quarter of 2013. Excluding the favorable impact of these estimated trade inventory movements, the total cigarette market grew by approximately 3.5%. While our shipments of 7.7 billion units increased by 4.5%, market share decreased by 0.7 share points to 36.9%, reflecting the impact of the inventory movements, with Marlboro, down by 1.5 points to 21.8%, partially offset by L&M, up by 1.1 share

points to 11.9%. Market share of Chesterfield was flat at 1.7%. The total industry fine cut category of 10.4 billion cigarette equivalent units was flat. Our market share of the category decreased by 1.9 share points to 13.0%.
In Italy, the total cigarette market of 19.2 billion units increased by 2.5%, mainly reflecting a lower incidence of e-vapor products and relatively lower out-switching to the fine cut category. Our shipments in the quarter of 11.4 billion units increased by 8.0%. Our market share increased by 2.0 share points to 55.3%, due primarily to: Chesterfield, up by 6.5 share points to 10.0%, benefiting from its repositioning in February 2014 into the €4.00/pack price segment, partially offset by Marlboro, down by 0.8 share points to 25.0%, and Diana in the low-price segment, down by 3.1 share points to 8.5%, impacted by the growth of the super-low price segment. Market share of Philip Morris, increased by 0.1 share point to 2.4%. The total industry fine cut category of 1.5 billion cigarette equivalent units increased by 1.7% and our market share of the category increased by 4.4 share points to 42.3%, driven by Marlboro.
In Poland, the total cigarette market of 11.1 billion units decreased by 7.0%, reflecting the growth of e-vapor products and the prevalence of non-duty paid OTP products. Our shipments in the quarter of 4.5 billion units increased by 2.4%. Our market share increased by 2.1 share points to 40.4%, driven by L&M, up by 0.3 share points to 17.8%, and Chesterfield, up by 2.2 share points to 7.9%, benefiting from the morphing of Red & White in the fourth quarter of 2013, partially offset by Marlboro, down by 0.9 share points to 10.9%. Although the total industry fine cut category of 848 million cigarette equivalent units decreased by 6.4%, our market share of the category increased by 12.9 share points to 36.4%.
In Spain, the total cigarette market of 12.3 billion units decreased by 1.2%, reflecting an improving economic environment and lower out-switching to the OTP category, as well as favorable estimated trade inventory movements compared to the second quarter of 2013. Excluding the impact of estimated trade inventory movements, the total cigarette market decreased by approximately 4.7% in the quarter. Our shipments in the quarter of 4.3 billion units increased by 0.7%. Our market share increased by 0.2 share points to 32.0%, driven by higher share of Marlboro, up by 1.0 share point to 15.8%, partially offset by L&M, down 0.5 share points to 6.1%, and Chesterfield, down by 0.5 points to 9.2%. The total industry fine cut category of 2.5 billion cigarette equivalent units decreased by 17.8%, partly reflecting the narrowing of price gaps with the cigarette category since July 2013. Our market share of the fine cut category increased by 2.0 share points to 14.7%.

Eastern Europe, Middle East & Africa. Net revenues, which include excise taxes billed to customers, increased by $297 million (5.5%). Excluding excise taxes, net revenues increased by $102 million (4.7%) to $2.3 billion. This increase was due to:

- price increases ($323 million), partly offset by
- unfavorable currency ($196 million) and
- unfavorable volume/mix ($25 million).

Operating companies income of $1.1 billion increased by $142 million (15.0%). This increase was due to:

- price increases ($323 million),
- higher equity income in unconsolidated subsidiaries ($34 million) and
- lower marketing, administration and research costs ($9 million), partly offset by
- unfavorable currency ($130 million),
- higher manufacturing costs ($65 million, principally related to the impact of the change to our new business structure in Egypt) and
- unfavorable volume/mix ($29 million).

Our cigarette shipment volume of 74.2 billion units decreased by 2.8%, mainly due to Egypt, Russia, Serbia and Ukraine, partially offset by Algeria and Turkey. Our cigarette shipment volume of premium brands increased by 3.4%, due principally to Marlboro, up by 3.6% to 21.8 billion units, and Parliament, up by 6.5% to 9.0 billion units.

In North Africa, the estimated total cigarette market increased by 1.2% to 35.4 billion units, driven mainly by Algeria. Our shipment volume in the quarter of 9.2 billion units decreased by 4.3%, principally reflecting temporarily lower production of our products in Egypt as part of the transition to the new business structure. Our market share decreased by 2.4 share points to 24.9%, due to lower share in Egypt, partially offset by gains in Algeria. Market share of Marlboro was flat at 14.5%, and share of L&M decreased by 2.1 share points to 8.6%.

In Russia, the estimated total cigarette market declined by 9.9% to 80.4 billion units, mainly due to the unfavorable impact of the tax-driven price increases of June 2013 and January 2014 and the prevalence of illicit trade. Our shipment volume in the quarter

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of 21.9 billion units decreased by 4.8%. Our market share of 26.9%, as measured by Nielsen, was up by 0.9 share points. Market share of Parliament, L&M and Bond Street increased by 0.3, 0.4 and 0.9 share points to 3.6%, 3.1% and 7.4%, respectively, partially offset by Marlboro and Chesterfield, down by 0.1 share point and 0.2 share points to 1.6% and 2.8%, respectively.

In Turkey, the estimated total cigarette market increased by 2.5% to 23.8 billion units, partially reflecting lower trade inventory movements compared to the second quarter of 2013. Excluding the impact of estimated trade inventory movements, the total cigarette market increased by approximately 1.6% in the quarter. Our shipment volume of 12.2 billion units increased by 4.8%. Our market share, as measured by Nielsen, decreased by 0.6 share points to 44.4%, mainly due to Marlboro, mid-price Muratti and low-price L&M, down by 0.3, 1.4 and 1.2 share points to 8.5%, 5.6% and 6.3%, respectively, partially offset by premium Parliament, up by 1.2 share points to 10.9%.

In Ukraine, the estimated total cigarette market increased by 2.8% to 21.3 billion units, mainly reflecting significant estimated trade loading ahead of excise tax-driven price increases in July 2014, and a lower prevalence of illicit trade, partially offset by business disruption due to the political instability in the east of the country. Excluding the impact of estimated trade inventory movements, the total cigarette market decreased by approximately 2.6% in the quarter. Our shipment volume of 6.2 billion units decreased by 8.5%, principally due, in addition to the aforementioned factors, to a decrease in our market share, as measured by Nielsen, down by 0.7 share points to 32.5%, with Marlboro and Parliament down by 0.8 and 0.4 share points to 4.8% and 3.0%, respectively. The decrease in our market share was partially offset by growth from our low-price segment brands, Bond Street and President, up by 0.1 share point and 2.6 share points to 8.9% and 4.8%, respectively.

Asia. Net revenues, which include excise taxes billed to customers, decreased by $284 million (5.3%). Excluding excise taxes, net revenues decreased by $381 million (14.2%) to $2.3 billion. This decrease was due to:

- unfavorable currency ($285 million) and
- unfavorable volume/mix ($138 million), partly offset by
- price increases ($42 million).

Operating companies income of $900 million decreased by $228 million (20.2%). This decrease was due primarily to:

- unfavorable currency ($181 million),
- unfavorable volume/mix ($91 million) and
- higher manufacturing costs ($12 million, mainly related to the optimization from hand-rolled to machine-made production in Indonesia), partly offset by
- price increases ($42 million) and
- lower marketing, administration and research costs ($10 million).

Our cigarette shipment volume of 75.7 billion units decreased by 6.1%, due primarily to: a lower total market and share in Japan; lower share in Pakistan reflecting an unfavorable comparison with the second quarter of 2013 due to the timing of trade inventory movements; and lower estimated tax-paid industry volumes in the Philippines, partially offset by higher market share. Shipment volume of Marlboro of 18.5 billion units increased by 0.7%, driven by the Philippines.

In Indonesia, the total cigarette market increased by 4.9% to 82.0 billion units. Our shipment volume in the quarter of 28.6 billion units increased by 1.3%. Our market share decreased by 1.2 points to 34.9% predominantly as a result of the share decline of the Dji Sam Soe brand family, which decreased by 0.6 share points to 6.3% due to the continuing decline of the hand-rolled kretek segment, compounded by the unfavorable impact resulting from the brand's hand-rolled variant crossing a critical price point ahead of competition. This decline was partially offset by the growth of machine-made Dji Sam Soe Magnum Blue, which reached a market share of 0.6% in the quarter since its launch in April 2014. Market share of Sampoerna A, in the premium machine-made LTLN kretek segment, was flat at 14.1%, while mid-price U Mild was up by 1.3 share points to 5.6%. Although Marlboro's market share decreased by 0.2 share points to 5.2%, its share of the “white” cigarettes segment, which represented 6.5% of the total cigarette market, increased by 2.7 share points to 79.3%.

In Japan, the total cigarette market decreased by 14.4% to 41.5 billion units, mainly driven by unfavorable retail trade inventory movements following the consumption tax-driven retail price increases of April 1, 2014. Our shipment volume in the quarter of 11.8 billion units decreased by 16.4%, principally due to the lower total market. Our market share decreased by 0.5 share points to 26.4%, with share of Marlboro, and Virginia S. down by 0.7 and 0.2 share points to 11.5% and 1.9%, respectively. Market share of Lark grew by 0.3 share points to 10.4%, supported by the successful morphing of Philip Morris.

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In Korea, the total cigarette market increased by 1.7% to 22.4 billion units. Our shipment volume of 4.4 billion units increased by 3.1%, and market share increased by 0.1 share point to 19.6%. Market share of Parliament was up by 0.2 share points to 7.2%, driven by Parliament Hybrid 5mg and the successful launch in October 2013 of Parliament Hybrid 1mg, while market share of Marlboro was down by 0.2 points to 7.6%, and share of Virginia S. was down 0.1 share point to 4.0%.
In the Philippines, total estimated tax-paid industry cigarette volumes decreased by 13.4% to 20.1 billion units, primarily reflecting a lower declaration of volume for excise tax purposes by our principal local competitor. Our shipment volume of 17.2 billion units decreased by 9.8%. Our market share of the total estimated tax-paid industry of 85.9% was up by 3.4 share points. Marlboro's market share increased by 3.4 share points to 18.0% and share of Fortune increased by 3.3 share points to 35.9%.

Latin America & Canada. Net revenues, which include excise taxes billed to customers, decreased by $29 million (1.2%). Excluding excise taxes, net revenues decreased by $28 million (3.3%) to $810 million. This decrease was due to:

- unfavorable currency ($122 million) and
- unfavorable volume/mix ($21 million), partly offset by
- price increases ($115 million).

Operating companies income of $265 million increased by $10 million (3.9%). This increase was due primarily to:

- price increases ($115 million), partly offset by
- unfavorable currency ($59 million),
- unfavorable volume/mix ($26 million),
- higher manufacturing costs ($11 million) and
- higher marketing, administration and research costs ($10 million).

Our cigarette shipment volume in Latin America & Canada of 23.1 billion units decreased by 1.0%. Shipment volume of Marlboro of 9.0 billion units decreased by 1.8%.
In Argentina, the total cigarette market decreased by 1.2% to 10.0 billion units. Our cigarette shipment volume of 7.7 billion units increased by 0.6% and market share increased by 1.1 share points to 76.3%, driven by mid-price Philip Morris, up by 2.0 share points to 42.9%, reflecting the positive impact of its capsule variants, partially offset by low-price Next, down by 0.8 share points to 2.0%. Share of Marlboro was flat at 23.8%.
In Canada, the total cigarette market decreased by 6.7% to 7.1 billion units, mainly due to the impact of federal and provincial tax-driven price increases in the first and second quarters of 2014. While our cigarette shipment volume of 2.7 billion units decreased by 3.5%, market share increased by 1.4 share points to 38.0%, with premium brands Benson & Hedges flat at 2.4% and Belmont up by 0.5 share points to 3.0%. Market share of mid-price Canadian Classics was up by 0.2 share points to 10.1%. Market share of low-price Next was up by 1.5 share points to 11.0%, partially offset by mid-price Number 7 and low-price Accord, down by 0.3 share points and 0.4 share points to 3.9% and 2.5%, respectively.
In Mexico, the total cigarette market increased by 1.5% to 8.4 billion units, partially reflecting a lower incidence of illicit trade. Our cigarette shipment volume of 6.0 billion units decreased by 0.8%. Our market share decreased by 1.6 share points to 71.0%. Our market share of Marlboro was down by 2.2 share points to 49.3%, and share of premium Benson & Hedges was down by 0.4 share points to 5.2%, reflecting consumer down-trading and the timing of price increases by our principal competitor. Our share of the premium segment increased by 1.0 share point to 91.4%. Our market share of Delicados, the second best-selling brand in the market, increased by 0.3 share points to 11.5%.

Financial Review
Net Cash Provided by Operating Activities

Net cash provided by operating activities of $3.4 billion during the first six months of 2014 decreased by $1.1 billion from the comparable 2013 period. The decrease was due primarily to higher cash payments related to exit costs, an increase in our working capital requirements and lower net earnings.

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

- more cash used for accrued liabilities and other current assets ($1.8 billion), largely due to the timing of payments for excise taxes; partially offset by
- more cash provided by inventories ($1.0 billion), primarily related to the timing of finished goods inventory purchases by the trade and lower leaf tobacco inventory levels;
- less cash used for accounts receivable ($289 million), primarily due to the timing of cash collections; and
- less cash used for income taxes ($125 million), primarily due to the movements in income tax liabilities.

Net Cash Used in Investing Activities

Net cash used in investing activities of $544 million during the first six months of 2014 increased by $53 million from the comparable 2013 period, due primarily to the purchase of Nicocigs Limited, partially offset by higher cash proceeds from the sale of fixed assets and lower capital expenditures.

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.

Our capital expenditures were $508 million and $520 million during the six months ended June 30, 2014 and 2013, respectively. The 2014 expenditures were primarily related to investments in productivity-enhancing programs, equipment for new products and the expansion of our capacity in Indonesia for machine-made kretek.

Net Cash Used in Financing Activities

During the first six months of 2014, net cash used in financing activities was $3.5 billion, compared with net cash used in financing activities of $3.3 billion during the first six months of 2013. During the first six months of 2014, we used a total of $7.9 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 $4.6 billion. During the first six months of 2013, we used a total of $8.8 billion to repurchase our common stock, pay dividends and repay debt. These uses were partly offset by proceeds from our debt offerings and short-term borrowings in 2013 of $5.7 billion.

Dividends paid in the first six months of 2014 and 2013 were $3.0 billion and $2.8 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 June 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

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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 June 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		$1.0

At June 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 June 30, 2014, our ratio calculated in accordance with the agreements was 13.7 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 $2.5 billion at June 30, 2014 and $2.4 billion at December 31, 2013, are for the sole use of our subsidiaries. Borrowings under these arrangements amounted to $957 million at June 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 June 30, 2014 and December 31, 2013, we had $984 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 $29.5 billion at June 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.

Our debt issuances in the first six 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 June 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 June 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 six months ended June 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 June 30, 2014, shares available for grant under the 2012 Plan were 24,799,330.

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 June 30, 2014, we repurchased 126.5 million shares of our common stock at a cost of $11.1 billion under this repurchase program. During the first six months of 2014, we repurchased 27.0 million shares at a cost of $2.25 billion. During the second quarter of 2014, we repurchased 11.6 million shares at a cost of $1.0 billion.

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 six months of 2014 were $3.0 billion. During the third quarter of 2013, our Board of Directors approved a 10.6% increase in the quarterly dividend to $0.94 per common share. As a result, the present annualized dividend rate is $3.76 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.

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, or 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, 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 June 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
April 1, 2014 – April 30, 2014 (1)	3,349,337	$83.60	118,195,196	$7,617,040,290
May 1, 2014 – May 31, 2014 (1)	4,550,386	$86.15	122,745,582	$7,225,025,706
June 1, 2014 – June 30, 2014 (1)	3,710,683	$88.39	126,456,265	$6,897,045,921
Pursuant to Publicly Announced Plans or Programs	11,610,406	$86.13		
April 1, 2014 – April 30, 2014 (3)	454	$81.00		
May 1, 2014 – May 31, 2014 (3)	2,888	$85.65		
June 1, 2014 – June 30, 2014 (3)	62,494	$85.48		
For the Quarter Ended June 30, 2014	11,676,242	$86.13		

(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 restricted and deferred stock awards, or exercised stock options, and used shares to pay all, or a portion of, the related taxes and/or option exercise price.

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Item 6. Exhibits.

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

July 31, 2014