Philip Morris International Inc.
Form 10-Q
August 06, 2009
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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, 2009

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 (State or other jurisdiction of incorporation or organization)	13-3435103 (I.R.S. Employer Identification No.)
120 Park Avenue New York, New York (Address of principal executive offices)	10017 (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 ¨ 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 31, 2009, there were 1,934,458,475 shares outstanding of the registrant s common stock, no par value per share.

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PHILIP MORRIS INTERNATIONAL INC.

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In this report, PMI, we, us and our refers to Philip Morris International Inc. and subsidiaries.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

Philip Morris International Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in millions of dollars)

(Unaudited)

	June 30, 2009	December 31, 2008
ASSETS		
Cash and cash equivalents	$ 2,602	$ 1,531
Receivables (less allowances of $30 in 2009 and $14 in 2008)	3,171	2,848
Inventories:		
Leaf tobacco	3,731	3,924
Other raw materials	1,195	1,137
Finished product	3,303	4,603
	8,229	9,664
Deferred income taxes	284	322
Other current assets	445	574
Total current assets	14,731	14,939
Property, plant and equipment, at cost	11,562	11,700
Less: accumulated depreciation	5,441	5,352
	6,121	6,348
Goodwill	8,414	8,015
Other intangible assets, net	3,321	3,084
Other assets	540	586
TOTAL ASSETS	$ 33,127	$ 32,972

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, 2009	December 31, 2008
LIABILITIES		
Short-term borrowings	$ 399	$ 375
Current portion of long-term debt	195	209
Accounts payable	774	1,013
Accrued liabilities:		
Marketing	437	457
Taxes, except income taxes	4,925	4,502
Employment costs	571	665
Dividends payable	1,054	1,090
Other	867	1,167
Income taxes	263	488
Deferred income taxes	181	178
Total current liabilities	9,666	10,144
Long-term debt	13,480	11,377
Deferred income taxes	1,449	1,401
Employment costs	1,273	1,682
Other liabilities	572	464
Total liabilities	26,440	25,068
Contingencies (Note 11)		
STOCKHOLDERS EQUITY		
Common stock, no par value (2,109,316,331 shares issued in 2009 and 2008)		
Additional paid-in capital	1,457	1,581
Earnings reinvested in the business	14,251	13,354
Accumulated other comprehensive losses	(1,719)	(2,281)
	13,989	12,654
Less: cost of repurchased stock (167,611,677 and 102,053,271 shares	7,612	5,154

in 2009 and 2008, respectively)

Total PMI stockholders equity	6,377	7,500
Noncontrolling interests	310	404
Total stockholders equity	6,687	7,904
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 33,127	$ 32,972

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, 2009	For the Six Months Ended June 30, 2008
Net revenues	$ 28,499	$ 31,057
Cost of sales	4,156	4,643
Excise taxes on products	16,768	18,427
Gross profit	7,575	7,987
Marketing, administration and research costs	2,788	2,768
Asset impairment and exit costs	2	71
Amortization of intangibles	36	16
Operating income	4,749	5,132
Interest expense, net	351	136
Earnings before income taxes	4,398	4,996
Provision for income taxes	1,284	1,515
Net earnings	3,114	3,481
Net earnings attributable to noncontrolling interests	92	116
Net earnings attributable to PMI	$ 3,022	$ 3,365
Per share data (Note 9):		
Basic earnings per share	$ 1.53	$ 1.60
Diluted earnings per share	$ 1.52	$ 1.59

Dividends declared to public stockholders	$	1.08	$	0.46

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, 2009	For the Three Months Ended June 30, 2008
Net revenues	$ 15,213	$ 16,703
Cost of sales	2,185	2,462
Excise taxes on products	9,079	9,994
Gross profit	3,949	4,247
Marketing, administration and research costs	1,498	1,584
Asset impairment and exit costs	1	48
Amortization of intangibles	21	7
Operating income	2,429	2,608
Interest expense, net	193	61
Earnings before income taxes	2,236	2,547
Provision for income taxes	639	790
Net earnings	1,597	1,757
Net earnings attributable to noncontrolling interests	51	65
Net earnings attributable to PMI	$ 1,546	$ 1,692
Per share data (Note 9):		
Basic earnings per share	$ 0.79	$ 0.81
Diluted earnings per share	$ 0.79	$ 0.80

Dividends declared to public stockholders	$	0.54	$	0.46

See notes to condensed consolidated financial statements.

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Philip Morris International Inc. and Subsidiaries

Condensed Consolidated Statements of Stockholders Equity

for the Six Months Ended June 30, 2009 and 2008

(in millions of dollars, except per share amounts)

(Unaudited)

	PMI Stockholders Equity						
	Common Stock	Additional Paid-in Capital	Earnings Reinvested in the Business	Accumulated Other Comprehensive Earnings (Losses)	Cost of Repurchased Stock	Non controlling Interests	Total
Balances, January 1, 2008	$ -	$ 1,265	$ 12,642	$ 1,688	$ -	$ 418	$ 16,013
Comprehensive earnings:							
Net earnings			3,365			116	3,481
Other comprehensive earnings (losses), net of income taxes:							
Currency translation adjustments				654		16	670
Change in net loss and prior service cost, net of income taxes of $6				(2)			(2)
Change in fair value of derivatives accounted for as hedges, net of income taxes of $8				(111)			(111)
Total other comprehensive earnings							557
Total comprehensive earnings							4,038
Exercise of stock options and issuance of other stock awards		420			131		551
Dividends declared to Altria Group, Inc. ($1.43 per share)			(3,019)				(3,019)
Dividends declared to public stockholders ($0.46 per share)			(956)				(956)
Payments to noncontrolling interests						(236)	(236)
Common stock repurchased					(2,131)		(2,131)
Other		(79)				78	(1)
Balances, June 30, 2008	$ -	$ 1,606	$ 12,032	$ 2,229	$ (2,000)	$ 392	$ 14,259
Balances, January 1, 2009	$ -	$ 1,581	$ 13,354	$ (2,281)	$ (5,154)	$ 404	$ 7,904
Comprehensive earnings:							
Net earnings			3,022			92	3,114
Other comprehensive earnings (losses), net of income taxes:							
Currency translation adjustments				490		(7)	483
Change in net loss and prior service cost, net of income taxes of $(8)				28			28
				44			44

Change in fair value of derivatives accounted for as hedges, net of income taxes of $(4)							
Total other comprehensive earnings							555
Total comprehensive earnings							3,669
Exercise of stock options and issuance of other stock awards		(124)			278		154
Dividends declared ($1.08 per share)			(2,125)				(2,125)
Payments to noncontrolling interests						(179)	(179)
Common stock repurchased					(2,736)		(2,736)
Balances, June 30, 2009	$ -	$ 1,457	$ 14,251	$ (1,719)	$ (7,612)	$ 310	$ 6,687

Total comprehensive earnings were $2,886 million and $2,151 million for the quarters ended June 30, 2009 and 2008, respectively, including $90 million and $74 million related to noncontrolling interests, respectively.

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,	
	2009	2008
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES		
Net earnings	$ 3,114	$ 3,481
Adjustments to reconcile net earnings to operating cash flows:		
Depreciation and amortization	395	404
Deferred income tax provision (benefit)	77	(6)
Equity loss from RBH legal settlement		124
Colombian Investment and Cooperation Agreement charge	135	
Asset impairment and exit costs, net of cash paid	(35)	8
Cash effects of changes, net of the effects from acquired and divested companies:		
Receivables, net	(326)	169
Inventories	1,344	976
Accounts payable	(27)	(4)
Income taxes	(201)	(152)
Accrued liabilities and other current assets	358	115
Pension plan contributions	(362)	(121)
Changes in amounts due from Altria Group, Inc. and affiliates		37
Other	101	68
Net cash provided by operating activities	4,573	5,099
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES		
Capital expenditures	(323)	(574)
Purchases of businesses, net of acquired cash	(209)	(29)
Other	137	(370)
Net cash used in investing activities	(395)	(973)

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, 2009	2008
CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES		
Net repayment of short-term borrowings	$ (999)	$ (72)
Long-term debt proceeds	2,987	7,667
Long-term debt repaid	(1)	(5,736)
Changes in amounts due from Altria Group, Inc. and affiliates		721
Repurchases of common stock	(2,850)	(1,948)
Issuance of common stock	105	68
Dividends paid to Altria Group, Inc.		(3,019)
Dividends paid to public stockholders	(2,161)	
Other	(226)	(167)
Net cash used in financing activities	(3,145)	(2,486)
Effect of exchange rate changes on cash and cash equivalents	38	(113)
Cash and cash equivalents:		
Increase	1,071	1,527
Balance at beginning of period	1,531	1,501
Balance at end of period	$ 2,602	$ 3,028

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. Basis of Presentation and Separation from Altria Group, Inc.:

Basis of Presentation

The interim condensed consolidated financial statements of Philip Morris International Inc. and subsidiaries (PMI) are unaudited. These interim condensed consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles and such principles are applied on a consistent basis. It is the opinion of PMI s management that all adjustments necessary for a fair statement of the interim results presented have been reflected therein. All such adjustments were of a normal recurring nature. Net revenues and net earnings attributable to PMI for any interim period are not necessarily indicative of results that may be expected for the entire year.

These statements should be read in conjunction with the audited consolidated financial statements and related notes, which appear in PMI s Annual Report to Stockholders and which are incorporated by reference into PMI s Annual Report on Form 10-K for the year ended December 31, 2008 (the 2008 Form 10-K).

As discussed in the 2008 Form 10-K, certain of PMI s subsidiaries prior to 2008 reported their results up to ten days before the end of December, rather than on December 31. During 2008, these subsidiaries moved to a December 31, 2008 closing date, which impacted the first quarter and fourth quarter results of previous periods. As a result, certain amounts in the first quarter of 2008 have been revised to reflect this change. The impact of this change resulted in a decrease in net earnings attributable to PMI and diluted earnings per share (EPS) of $194 million and approximately $0.10, respectively, in the first six months of 2008.

As discussed in Note 18. *New Accounting Standards*, certain prior year balance sheet amounts related to noncontrolling interests have been reclassified to conform with the current year s presentation.

PMI has evaluated subsequent events through the time of filing for this Form 10-Q on August 6, 2009, which was the date of issuance of the interim condensed consolidated financial statements.

Separation from Altria Group, Inc.

As discussed in the 2008 Form 10-K, prior to March 28, 2008, PMI was a wholly-owned subsidiary of Altria Group, Inc. (Altria). On January 30, 2008, the Altria Board of Directors announced Altria s plans to spin off all of its interest in PMI to Altria s stockholders in a tax-free transaction pursuant to Section 355 of the U.S. Internal Revenue Code (the Spin-off). The distribution of all of the PMI shares owned by Altria was made on March 28, 2008 (the Distribution Date) to stockholders of record as of the close of business on March 19, 2008 (the Record Date). Altria distributed one share of PMI common stock for each share of Altria common stock outstanding as of the Record Date.

For additional information regarding PMI s transactions with Altria Group, Inc. and its affiliates after the Spin-off, see Note 3. *Transactions with Altria Group, Inc*.

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Philip Morris International Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

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, 2009	For the Six Months Ended June 30, 2008	For the Three Months Ended June 30, 2009	For the Three Months Ended June 30, 2008
Separation programs:				
European Union	$ 2	$ 56	$ 1	$ 48
Total separation programs	2	56	1	48
Contract termination charges:				
Eastern Europe, Middle East and Africa		1		
Asia		14		
Total contract termination charges	-	15	-	-
Asset impairment and exit costs	$ 2	$ 71	$ 1	$ 48

In 2008, PMI terminated its contract manufacturing arrangement with Philip Morris USA Inc. (PM USA), a U.S. tobacco subsidiary of Altria, and completed the process of shifting all of its PM USA contract manufactured production to PMI facilities in Europe during the fourth quarter of 2008. During the first quarter of 2008, PMI recorded exit costs of $15 million related to the termination of its manufacturing contract with PM USA. The 2009 and 2008 pre-tax separation program charges primarily related to severance costs.

Cash payments related to exit costs at PMI were $37 million and $15 million for the six months and three months ended June 30, 2009, respectively, and $63 million and $34 million for the six months and three months ended June 30, 2008, respectively. Future cash payments for exit costs incurred to date are expected to be approximately $76 million, which will be substantially paid by 2011.

The movement in the exit cost liabilities for the six months ended June 30, 2009 was as follows (in millions):

Liability balance, January 1, 2009	$ 115
Charges	2
Cash spent	(37)
Currency/other	(4)
Liability balance, June 30, 2009	$ 76

Note 3. Transactions with Altria Group, Inc.:

Operations

Prior to 2009, PMI had contracts with PM USA for the purchase of U.S.-grown tobacco leaf, the contract manufacture of cigarettes for export from the United States and certain research and development activities. Billings for services were generally based upon PM USA s cost to provide such services, plus a service fee. The cost of leaf purchases was the market price of the leaf plus a service fee. Fees paid have been included in operating cash flows on PMI s condensed consolidated statements of cash flows.

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Philip Morris International Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

As previously discussed, PMI terminated its contract manufacturing arrangement in 2008 with PM USA and completed the process of shifting all of its PM USA contract manufactured production to PMI facilities in Europe during the fourth quarter of 2008. During the first quarter of 2008, PMI recorded exit costs of $15 million related to the termination of its manufacturing contract with PM USA.

The goods and services purchased from PM USA were as follows (in millions):

	For the Six Months Ended June 30, 2008	For the Three Months Ended June 30, 2008
Contract manufacturing, cigarette volume	14,520	6,273
Contract manufacturing expense	$ 240	$ 107
Research and development, net of billings to PM USA	(2)	
Total pre-tax expense	$ 238	$ 107
Leaf purchases	$ 93	$ -

Contract manufacturing expense included the cost of cigarettes manufactured for PMI, as well as the cost of PMI s purchases of reconstituted tobacco and production materials. The expenses shown above also included total service fees of $11 million and $5 million for the six months and three months ended June 30, 2008, respectively.

Net amounts due from/(to) Altria Group, Inc. and affiliates related to ongoing operations consisted of the following (in millions):

	June 30, 2009	December 31, 2008
Net receivable from Altria Group, Inc. and affiliates	$ 69	$ 69
Payable for services from PM USA		(53)
Due from Altria Group, Inc. and affiliates	$ 69	$ 16

The amounts due from Altria Group, Inc. and affiliates are reflected in receivables on the condensed consolidated balance sheet and primarily relate to income taxes for years in which PMI was part of Altria s consolidated tax return. The amounts payable for services from PM USA are reflected in accounts payable on the condensed consolidated balance sheet.

Other

On March 28, 2008, PMI Global Services Inc. purchased from Altria s subsidiary, Altria Corporate Services, Inc. (ALCS), at a fair market value of $108 million, a subsidiary of ALCS, the principal assets of which are two Gulfstream airplanes. Given that the purchase was from an entity under common control, the planes were recorded at book value ($89 million) and a portion of the purchase price ($19 million) was treated as a dividend to Altria.

Note 4. Stock Plans:

Under the Philip Morris International Inc. 2008 Performance Incentive Plan (the Plan), PMI may grant to certain eligible employees stock options, stock appreciation rights, restricted stock, restricted stock units and deferred stock units and other stock-based awards based on PMI s common stock, as well as performance-based incentive awards. Up to 70 million shares of PMI s common stock may be issued under the Plan. At June 30, 2009, shares available for grant under the Plan were 33,363,977.

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Philip Morris International Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

PMI has also adopted the Philip Morris International Inc. 2008 Stock Compensation Plan for Non-Employee Directors (the Non-Employee Directors Plan). A non-employee director is defined as each member of the PMI Board of Directors who is not a full-time employee of PMI or of any corporation in which PMI owns, directly or indirectly, stock possessing at least 50% of the total combined voting power of all classes of stock entitled to vote in the election of directors in such corporation. Up to 1,000,000 shares of PMI common stock may be awarded under the Non-Employee Directors Plan. As of June 30, 2009, 866,494 shares were available for grant under the plan.

During the six months ended June 30, 2009, PMI granted 3.8 million shares of restricted stock and deferred stock awards to eligible employees at a weighted-average grant date fair value of $36.93. PMI recorded compensation expense for restricted stock and deferred stock awards of $44 million and $30 million during the six months ended June 30, 2009 and 2008, respectively, and $25 million and $20 million during the three months ended June 30, 2009 and 2008, respectively. As of June 30, 2009, PMI had $194 million of total unrecognized compensation cost related to non-vested restricted and deferred shares. The cost is recognized over the original restriction period of the awards, which is typically three years from the date of the original grant.

During the six months ended June 30, 2009, 1.4 million shares of PMI restricted stock and deferred stock awards vested. Of this amount 0.9 million shares went to PMI employees and the remainder went to Altria and Kraft employees who held PMI stock awards as a result of the Spin-off. The grant date fair value of all the vested shares was approximately $104 million or $73.92 per share. The total fair value of restricted stock and deferred stock awards that vested during the six months ended June 30, 2009 was approximately the same as the grant date fair value. The grant price information for restricted stock and deferred stock awarded prior to January 30, 2008 reflects historical market prices of Altria stock at date of grant and is not adjusted to reflect the Spin-off.

For the six months ended June 30, 2009, the total intrinsic value of the 5.4 million PMI stock options exercised was $102 million.

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Philip Morris International Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 5. Benefit Plans:

Pension coverage for employees of PMI s non-U.S. subsidiaries is provided, to the extent deemed appropriate, through separate plans, many of which are governed by local statutory requirements. Prior to the Spin-off, certain employees of PMI participated in the U.S. benefit plans offered by Altria. After the Distribution Date, the benefits previously provided by Altria are now provided by PMI. As a result, new postretirement and pension plans have been established by PMI, and the related plan assets (to the extent that the benefit plans were previously funded) and liabilities have been transferred to the new plans. In addition, PMI provides health care and other benefits to 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 (in millions):

	U.S. Plans For the Six Months Ended June 30,	Non-U.S. Plans For the Six Months Ended June 30,	
	2009	2009	2008
Service cost	$ 6	$ 62	$ 65
Interest cost	9	82	83
Expected return on plan assets	(6)	(107)	(128)
Amortization:			
Net loss	2	16	4
Prior service cost		3	3
Other	4		7
Net periodic pension cost	$ 15	$ 56	$ 34

	U.S. Plans For the Three Months Ended June 30,	Non-U.S. Plans For the Three Months Ended June 30,	
	2009	2009	2008
Service cost	$ 3	$ 31	$ 33
Interest cost	4	41	43
Expected return on plan assets	(3)	(54)	(66)
Amortization:			
Net loss	1	8	2
Prior service cost		2	1
Other			7
Net periodic pension cost	$ 5	$ 28	$ 20

Other above was primarily related to early retirement programs in 2009 and curtailment losses related to plan changes in 2008. The U.S. pension expense for the six months and three months ended June 30, 2008 was insignificant.

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Philip Morris International Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Employer Contributions

PMI presently makes, and plans to make, contributions, to the extent that they are tax deductible and meet funding requirements, in order to maintain plan assets in excess of the accumulated benefit obligation of its funded U.S. and non-U.S. plans. Employer contributions of $362 million were made to the pension plans during the six months ended June 30, 2009. Currently, PMI anticipates making additional contributions during the remainder of 2009 of approximately $156 million to its pension plans, based on current tax and benefit laws. However, this estimate is subject to change as a result of changes in tax and other benefit laws, as well as asset performance significantly above or below the assumed long-term rate of return on pension assets, or changes in interest rates.

Note 6. Goodwill and Other Intangible Assets, net:

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

	Goodwill		Other Intangible Assets, net	
	June 30, 2009	December 31, 2008	June 30, 2009	December 31, 2008
European Union	$ 1,477	$ 1,456	$ 678	$ 469
Eastern Europe, Middle East and Africa	579	648	196	200
Asia	3,653	3,387	1,265	1,188
Latin America & Canada	2,705	2,524	1,182	1,227
Total	$ 8,414	$ 8,015	$ 3,321	$ 3,084

Goodwill is due primarily to PMI s acquisitions in Canada, Indonesia, Mexico, Greece, Serbia, Colombia and Pakistan. The movement in goodwill and the gross carrying amount of intangible assets from December 31, 2008, is as follows (in millions):

	Goodwill	Other Intangible Assets, gross
Balance at December 31, 2008	$ 8,015	$ 3,200
Changes due to:		
Acquisitions	116	137
Currency	283	138
Balance at June 30, 2009	$ 8,414	$ 3,475

The changes from acquisitions are due to the purchase price allocation for PMI s February 2009 purchase of the *Petterøes* tobacco business and its September 2008 acquisition of Rothmans Inc. in Canada. For further details on acquisitions, see Note 8. *Acquisitions.*

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

	June 30, 2009		December 31, 2008	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Non-amortizable intangible assets	$ 1,974		$ 1,878	
Amortizable intangible assets	1,501	$ 154	1,322	$ 116
Total other intangible assets	$ 3,475	$ 154	$ 3,200	$ 116

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Philip Morris International Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Non-amortizable intangible assets substantially consist of trademarks from PMI s acquisition in Indonesia in 2005 and Mexico in 2007. Amortizable intangible assets consist of certain trademarks, distribution networks and non-compete agreements associated with acquisitions. Pre-tax amortization expense for intangible assets during the six months ended June 30, 2009 and 2008 was $36 million and $16 million, respectively, and $21 million and $7 million for the three months ended June 30, 2009 and 2008, respectively. Amortization expense for each of the next five years is estimated to be $75 million or less, assuming no additional transactions occur that require the amortization of intangible assets.

During the first quarter of 2009, PMI completed its annual review of goodwill and non-amortizable intangible assets, and no impairment charges were required as a result of this review.

Note 7. Financial Instruments:

Overview

PMI operates in markets outside of the United States, with manufacturing and sales facilities in various locations around the world. PMI utilizes certain financial instruments to manage foreign currency exposure. Derivative financial instruments are used by PMI principally to reduce exposures to market risks resulting from fluctuations in foreign exchange rates by creating offsetting exposures. PMI is not a party to leveraged derivatives and, by policy, does not use derivative financial instruments for speculative purposes. Financial instruments qualifying for hedge accounting must maintain a specified level of effectiveness between the hedging instrument and the item being hedged, both at inception and throughout the hedged period. PMI formally documents the nature and relationships between the hedging instruments and hedged items, as well as its risk-management objectives, strategies for undertaking the various hedge transactions and method of assessing hedge effectiveness. Additionally, for hedges of forecasted transactions, the significant characteristics and expected terms of the forecasted transaction must be specifically identified, and it must be probable that each forecasted transaction will occur. If it were deemed probable that the forecasted transaction will not occur, the gain or loss would be recognized in earnings currently. PMI reports its net transaction losses and its net transaction gains in marketing, administration and research costs on the condensed consolidated statements of earnings.

PMI uses forward foreign exchange contracts, foreign currency swaps and foreign currency options, hereafter collectively referred to as foreign exchange contracts, to mitigate its exposure to changes in exchange rates from third-party and intercompany actual and forecasted transactions. The primary currencies to which PMI is exposed include the Euro, Indonesian rupiah, Japanese yen, Mexican peso, Russian ruble, Swiss franc and Turkish lira. At June 30, 2009, PMI had foreign exchange contracts with aggregate notional amounts of $9.2 billion. Of this amount, $0.8 billion related to cash flow hedges, $1.2 billion related to hedges of net investments in foreign operations and $7.2 billion related to other derivatives that primarily offset currency exposures on inter-company financing.

The fair value of PMI s foreign exchange contracts as of June 30, 2009, was as follows (in millions):

	Asset Derivatives		Liability Derivatives	
	Balance Sheet Classification	Fair Value	Balance Sheet Classification	Fair Value
Foreign exchange contracts designated as hedging instruments under SFAS No. 133	Other current assets	$ 53	Other accrued liabilities	$ 54

Foreign exchange contracts not designated as hedging instruments under SFAS No. 133	Other current assets	55	Other accrued liabilities	36
Total Derivatives		$ 108		$ 90

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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, 2009 (in millions):

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

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

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

Cash Flow Hedges

PMI has entered into foreign exchange contracts to hedge foreign currency exchange risk related to certain forecasted transactions. The effective portion of unrealized gains and losses associated with qualifying cash flow hedge contracts is deferred as a component of accumulated other comprehensive earnings (losses) until the underlying hedged transactions are reported in PMI s condensed consolidated statements of earnings. During the six months and three months ended June 30, 2009 and 2008, ineffectiveness related to cash flow hedges was not material. As of June 30, 2009, PMI has hedged forecasted transactions for periods not exceeding the next six months. The impact of these hedges is included in operating cash flows on PMI s condensed consolidated statement of cash flows.

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For the six months and three months ended June 30, 2009, foreign exchange contracts, which were designated as cash flow hedging instruments under SFAS No. 133, impacted the condensed consolidated statements of earnings and other comprehensive earnings as follows (pre-tax, in millions):

For the Six Months Ended June 30, 2009

Derivatives in SFAS No. 133 Cash Flow Hedging Relationship	Statement of Earnings Classification of Gain/(Loss) on Derivative	Amount of Gain/(Loss) Recognized in Earnings on Derivative	Statement of Earnings Classification of Gain/(Loss) Reclassified from Other Comprehensive Earnings into Earnings	Amount of Gain/(Loss) Reclassified from Other Comprehensive Earnings into Earnings	Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings on Derivative
Foreign exchange contracts					$ 68
			Net revenues	$ 48	
			Marketing, administration and research costs	13	
			Interest expense, net	(41)	
Total				$ 20	$ 68

For the Three Months Ended June 30, 2009

Derivatives in SFAS No. 133 Cash Flow Hedging Relationship	Statement of Earnings Classification of Gain/(Loss) on Derivative	Amount of Gain/(Loss) Recognized in Earnings on Derivative	Statement of Earnings Classification of Gain/(Loss) Reclassified from Other Comprehensive Earnings into Earnings	Amount of Gain/(Loss) Reclassified from Other Comprehensive Earnings into Earnings	Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings on Derivative
Foreign exchange contracts					$ (12)
			Net revenues	$ 16	
			Marketing, administration and research costs	(4)	
				(23)	

	Interest expense, net		
Total		$ (11)	$ (12)

Fair Value Hedges

PMI has entered into foreign exchange contracts to hedge the foreign currency exchange risk related to an inter-company loan between subsidiaries. For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative, as well as the offsetting gain or loss on the hedged item attributable to the hedged risk, is recognized in current earnings. For the six months and three months ended June 30, 2009, ineffectiveness related to fair value hedges was not material. Gains (losses) associated with qualifying fair value hedges are recorded

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in the condensed consolidated statement of earnings and were $42 million and ($4) million for the six months and three months ended June 30, 2009, respectively. The impact of fair value hedges is included in operating cash flows on PMI s condensed consolidated statement of cash flows. At June 30, 2009, all fair value hedges had matured and were settled.

For the six months and three months ended June 30, 2009, foreign exchange contracts, which were designated as fair value hedging instruments under SFAS No. 133, impacted the condensed consolidated statement of earnings as follows (pre-tax, in millions):

Derivative in SFAS No. 133 Fair Value Hedging Relationship	Statement of Earnings Classification of Gain/(Loss) on Derivative	Amount of Gain/(Loss) Recognized in Earnings on Derivative		Statement of Earnings Classification of Gain/(Loss) on Hedged Item	Amount of Gain/(Loss) Recognized in Earnings Attributable to the Risk Being Hedged	
		Six Months Ended June 30, 2009	Three Months Ended June 30, 2009		Six Months Ended June 30, 2009	Three Months Ended June 30, 2009
Foreign exchange contracts	Marketing, administration and research costs	$ 5	$ (24)	Marketing, administration and research costs	$ (5)	$ 24
	Interest expense, net	37	20	Interest expense, net		
Total		$ 42	$ (4)		$ (5)	$ 24

Hedges of Net Investments in Foreign Operations

PMI designates certain foreign currency denominated debt and forward exchange contracts as net investment hedges of its foreign operations. For the six months ended June 30, 2009 and 2008, these hedges of net investments resulted in gains, net of income taxes, of $22 million and $32 million, respectively. For the three months ended June 30, 2009 and 2008, these hedges of net investments resulted in losses, net of income taxes, of $165 million and $5 million, respectively. These gains (losses) were reported as a component of accumulated other comprehensive earnings (losses) within currency translation adjustments. Settlement of net investment hedges is included in other investing cash flows on PMI s condensed consolidated statement of cash flows.

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For the six months and three months ended June 30, 2009, foreign exchange contracts, which were designated as net investment hedging instruments under SFAS No. 133, impacted the condensed consolidated statements of earnings and other comprehensive earnings as follows (pre-tax, in millions):

For the Six Months Ended June 30, 2009

Derivatives in SFAS No. 133 Net Investment Hedging Relationship	Statement of Earnings Classification of Gain/(Loss) on Derivative	Amount of Gain/(Loss) Recognized in Earnings on Derivative	Statement of Earnings Classification of Gain/(Loss) Reclassified from Other Comprehensive Earnings into Earnings	Amount of Gain/(Loss) Reclassified from Other Comprehensive Earnings into Earnings	Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings on Derivative
Foreign exchange contracts		$ -	Interest expense, net	$ -	$ (19)

For the Three Months Ended June 30, 2009

Derivatives in SFAS No. 133 Net Investment Hedging Relationship	Statement of Earnings Classification of Gain/(Loss) on Derivative	Amount of Gain/(Loss) Recognized in Earnings on Derivative	Statement of Earnings Classification of Gain/(Loss) Reclassified from Other Comprehensive Earnings into Earnings	Amount of Gain/(Loss) Reclassified from Other Comprehensive Earnings into Earnings	Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings on Derivative
Foreign exchange contracts		$ -	Interest expense, net	$ -	$ (83)

Other Derivatives

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

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

Derivatives not Designated as Hedging Instruments under SFAS No.133	Statement of Earnings Classification of Gain/(Loss)	Amount of Gain/(Loss) Recognized in Earnings	
		Six Months Ended June 30, 2009	Three Months Ended June 30, 2009
Foreign exchange contracts			
	Marketing, administration and research costs	$ (1)	$ (1)
	Interest expense, net	(8)	(4)
Total		$ (9)	$ (5)

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

Derivative gains or losses reported in accumulated other comprehensive earnings (losses) are a result of qualifying hedging activity. Transfers of these gains or losses to earnings are offset by the corresponding gains or losses on the underlying hedged item. Hedging activity affected accumulated other comprehensive earnings (losses), net of income taxes, as follows (in millions):

	For the Six Months Ended June 30,		For the Three Months Ended June 30,	
	2009	2008	2009	2008
Loss at beginning of period	$ (68)	$ (10)	$ (25)	$ (182)
Derivative (gains) losses transferred to earnings	(17)	51	11	22
Change in fair value	61	(162)	(10)	39
Loss as of June 30	$ (24)	$ (121)	$ (24)	$ (121)

At June 30, 2009, PMI expects $42 million of after-tax derivative losses reported in accumulated other comprehensive earnings (losses) to be reclassified to the condensed consolidated statement of earnings within the next twelve months. Thereafter, PMI expects the remaining $18 million of after-tax derivative gains to be reclassified to the condensed consolidated statement of earnings. These losses and gains are expected to be substantially offset by the statement of earnings impact of the respective forecasted transactions.

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. PMI actively monitors its exposure to credit risk through the use of credit approvals and credit limits, and by selecting major international banks and financial institutions as counterparties.

Contingent features

PMI s derivative instruments do not contain contingent features.

See Note 14. *Fair Value Measurements* for disclosures related to the fair value of PMI s derivative financial instruments.

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Note 8. Acquisitions:

Rothmans:

On July 31, 2008, PMI announced that it had entered into an agreement with Rothmans Inc. (Rothmans), which is located in Canada, to purchase, by way of a tender offer, all of the outstanding common shares of Rothmans for CAD $30 per share in cash, or CAD $2.0 billion (approximately $1.9 billion based on exchange rates prevailing at the time of the acquisition). Prior to this agreement, Rothmans sole holding was a 60% interest in Rothmans, Benson & Hedges Inc. (RBH). The remaining 40% interest in RBH was owned by PMI. In October 2008, PMI completed the acquisition of all the Rothmans shares. From January 2008 to September 2008, PMI recorded equity earnings on its equity interest in RBH. After the completion of the acquisition, Rothmans became a wholly-owned subsidiary of PMI and, as a result, PMI recorded all of Rothmans earnings during the fourth quarter of 2008. Rothmans contributed $114 million of incremental operating income and $48 million of incremental net earnings attributable to PMI during the first six months of 2009, and $62 million of incremental operating income and $25 million of incremental net earnings attributable to PMI during the second quarter of 2009.

The final allocation of purchase price to Rothmans assets and liabilities at June 30, 2009 was principally as follows (in billions):

Goodwill	$ 1.9
Acquired cash	0.3
Inventories	0.2
Definite-lived brand names	0.3
Fixed assets	0.1
Other assets	0.1
Total assets	2.9
Short-term debt	0.2
Accrued settlement costs	0.4
Other liabilities	0.4
Total liabilities	1.0
Cash paid for Rothmans	$ 1.9

Other:

In February 2009, PMI purchased the *Petterøes* tobacco business. Assets purchased consist primarily of amortizable intangible assets related to brands primarily sold in Norway and Sweden.

In June 2008, PMI purchased the fine cut trademark *Interval* and certain other trademarks in the other tobacco products category from Imperial Tobacco Group PLC for $407 million. This purchase is reflected in other investing activities in the condensed consolidated statement of cash flows for the six months ended June 30, 2008.

The effect of these other acquisitions presented above was not material to PMI s consolidated financial position, results of operations or operating cash flows in any of the periods presented.

In July 2009, PMI announced that it had entered into an agreement to purchase 100% of the shares of privately owned Colombian cigarette manufacturer, Productora Tabacalera de Colombia, Protabaco Ltda., for $452 million. The transaction, which is subject to competition authority approval and final confirmatory due diligence, is expected to close within six months of the announcement.

In July 2009, PMI also entered into an agreement with Swedish Match AB to purchase its South African affiliate, Swedish Match South Africa (Proprietary) Limited, for ZAR 1.75 billion (approximately $222 million). The transaction is subject to South African regulatory approval and is expected to be completed by the end of the year.

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Note 9. Earnings Per Share:

Effective January 1, 2009, PMI adopted FASB Staff Position No. EITF 03-6-1 Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities (FSP 03-6-1). FSP 03-6-1 states that unvested share-based payment awards that contain nonforfeitable rights to dividends are participating securities and therefore shall be included in the earnings per share calculation pursuant to the two-class method described in SFAS No. 128, Earnings Per Share. FSP 03-6-1 requires the retrospective adjustment of all prior period earnings per share data. The adoption and retrospective application of FSP 03-6-1 did not have a material impact on PMI s basic and diluted EPS.

Basic and diluted EPS were calculated using the following (in millions):

	For the Six Months Ended June 30,		For the Three Months Ended June 30,	
	2009	2008	2009	2008
Net earnings attributable to PMI	$ 3,022	$ 3,365	$ 1,546	$ 1,692
Less distributed and undistributed earnings attributable to share-based payment awards	(11)	(6)	(6)	(4)
Net earnings for basic and diluted EPS	$ 3,011	$ 3,359	$ 1,540	$ 1,688
Weighted-average shares for basic EPS	1,974	2,101	1,955	2,095
Plus incremental shares from assumed conversions:				
Stock options	6	6	6	11
Weighted-average shares for diluted EPS	1,980	2,107	1,961	2,106

Note 10. 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 and 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 before general corporate expenses and amortization of intangibles. 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, 2009	For the Six Months Ended June 30, 2008	For the Three Months Ended June 30, 2009	For the Three Months Ended June 30, 2008
Net revenues:				
European Union	$ 13,205	$ 14,976	$ 7,155	$ 8,279
Eastern Europe, Middle East and Africa	6,231	7,085	3,400	3,802
Asia	5,804	6,146	2,947	3,170
Latin America & Canada	3,259	2,850	1,711	1,452
Net revenues	$ 28,499	$ 31,057	$ 15,213	$ 16,703
Earnings before income taxes:				
Operating companies income:				
European Union	$ 2,130	$ 2,454	$ 1,163	$ 1,287
Eastern Europe, Middle East and Africa	1,221	1,493	635	813
Asia	1,280	1,073	619	523
Latin America & Canada	226	172	71	23
Amortization of intangibles	(36)	(16)	(21)	(7)
General corporate expenses	(72)	(44)	(38)	(31)
Operating income	4,749	5,132	2,429	2,608
Interest expense, net	(351)	(136)	(193)	(61)
Earnings before income taxes	$ 4,398	$ 4,996	$ 2,236	$ 2,547

Items affecting the comparability of PMI s results from operations were as follows:

Asset Impairment and Exit Costs See Note 2. *Asset Impairment and Exit Costs* for a breakdown of asset impairment and exit costs by segment.

Equity loss from RBH Legal Settlement As discussed in Note 17. *RBH Legal Settlement*, operating companies income of the Latin America & Canada segment for the six months and three months ended June 30, 2008 included a $124 million charge related to the RBH settlement with the Government of Canada and all ten provinces.

Colombian Investment and Cooperation Agreement charge As discussed in Note 16. *Colombian Investment and Cooperation Agreement,* during the second quarter of 2009, PMI recorded a pre-tax charge of $135 million related to the Investment and Cooperation Agreement in Colombia. The charge was recorded in the operating companies income of the Latin America & Canada segment for the six months and three months ended June 30, 2009.

Note 11. Contingencies:

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 pay costs and some or all of judgments, if any, that may be entered against them. Altria Group, Inc. and PM USA are also indemnitees, in certain cases, pursuant to the terms of the Distribution Agreement between Altria Group, Inc. and PMI. Various types of claims are raised in these proceedings, including, among others, product liability, consumer protection, antitrust, and tax.

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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, Israel, Nigeria and Canada, range into the billions of 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 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, (i) management has concluded that it is not 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 that could result from an unfavorable outcome of any of the pending tobacco-related cases; and (iii) accordingly, management has not provided any amounts 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.

The table below lists the number of tobacco-related cases pending against us and/or our subsidiaries or indemnitees as of August 1, 2009, 2008 and 2007:

Type of Case	**Number of Cases Pending as of August 1, 2009**	**Number of Cases Pending as of August 1, 2008**	**Number of Cases Pending as of August 1, 2007**
Individual Smoking and Health Cases	119	125	138
Smoking and Health Class Actions	9 [1]	3	2
Health Care Cost Recovery Actions	10	9	7
Lights Class Actions	3	3	2
Individual Lights Cases (small claims court)[2]	1,990	2,011	2,043
Public Civil Actions	12	10	7

(1) Includes two cases due to the acquisition of Rothmans in Canada.

(2) The 1,990 cases are all pending in small claims courts in Italy where the maximum damage award claimed is approximately one thousand Euros per case. Of these 1,990 cases, 1,977, which were filed by the same plaintiffs attorney, have now been stayed pending an investigation by the public prosecutor into the conduct of that plaintiffs attorney. In May 2009, the case files in these cases were permanently confiscated by the court as

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a result of the investigation. As a consequence of the confiscation of these case files, the small claims courts in which the cases are pending have begun dismissing the cases, and the remainder of the cases should be dismissed in the coming months.

Since 1995, when the first tobacco-related litigation was filed against a PMI entity, approximately 328[(3)] Smoking and Health, Lights, Health Care Cost Recovery cases and Public Civil Actions in which we and/or one of our subsidiaries and/or indemnitees was a defendant have been terminated in our favor. Eight cases have had decisions in favor of plaintiffs. Five of these cases have subsequently reached final resolution in our favor, one has been annulled and returned to the trial court for further proceedings, and two remain on appeal. To date, we have paid total judgments including costs of approximately six thousand Euros. These payments were made in order to appeal three Italian small claims cases, two of which were subsequently reversed on appeal and one of which remains on appeal. To date, no tobacco-related case has been finally resolved in favor of a plaintiff against us, our subsidiaries or indemnitees.

(3) Includes 130 individual lights cases filed in small claims courts in Italy.

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The table below lists the verdicts and post-trial developments in the two pending cases (excluding one individual case on appeal from Italian small claims court) in which verdicts were returned in favor of plaintiffs:

Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
February 2004	Brazil/The Smoker Health Defense Association (ADESF)	Class Action	The Civil Court of São Paulo found defendants liable without hearing evidence. The court did not assess moral or 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 $500) 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 still has not been estimated. Defendants appealed to the São Paulo Court of Appeals, and the case, including the execution of the judgment, was stayed pending appeal. On November 12, 2008, the São Paulo Court of Appeals annulled the ruling finding that the trial court had inappropriately ruled without hearing evidence and returned the case to the trial court for further proceedings. In addition, the defendants have filed a constitutional appeal to the Federal Supreme Court on the basis that the plaintiff did not have standing to bring the lawsuit. This appeal is still pending.

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Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
October 2003	Brazil/Da Silva	Individual Smoking and Health	The Court of Appeal of Rio Grande do Sul reversed the trial court ruling in favor of Philip Morris Brasil and awarded plaintiffs R$768,000 (approximately $383,000).	In December 2004, a larger panel of the Court of Appeal of Rio Grande do Sul overturned the adverse decision. Plaintiffs appealed to the Superior Court of Justice. In May 2009, a single judge in the Superior Court of Justice rejected plaintiffs appeal. Plaintiffs have filed a further appeal to the full panel of the Superior Court of Justice.

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 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 August 1, 2009, there were a number of smoking and health cases pending against our subsidiaries or indemnitees, as follows:

- 119 cases brought by individual plaintiffs against our subsidiaries (117) or indemnitees (2) in Argentina (42), Australia (2), Brazil (51), Canada (1), Chile (9), Costa Rica (1), Finland (2), Greece (1), Israel (1), Italy (6), Japan (1), the Philippines (1), and Scotland (1), compared with 125 such cases on August 1, 2008, and 138 cases on August 1, 2007; and

- 9 cases brought on behalf of classes of individual plaintiffs against our subsidiaries in Brazil (2), Bulgaria (1) and Canada (6), compared with 3 such cases on August 1, 2008, and 2 such cases on August 1, 2007.

In the individual cases in Finland, our two indemnitees (our former licensees now known as Amer Sports Corporation and Amerintie 1 Oy) and another member of the industry are defendants. Plaintiffs allege personal injuries as a result of smoking. All three cases were tried together before the District Court of Helsinki. Trial began in March 2008 and concluded in May 2008. In October 2008, the District Court issued decisions in favor of defendants in all three cases. Plaintiffs filed appeals. One of the three plaintiffs has since withdrawn her appeal, making the District Court s decision in favor of the defendant final. The other two plaintiffs continue to pursue their appeals. The appellate hearing, which is essentially a re-trial of these cases before the Appellate Court, is scheduled to start on August 31, 2009.

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. In February 2004, the trial court found defendants liable without hearing evidence. The court did not assess moral or 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

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2004, the court clarified its ruling, awarding moral damages of R$1,000 (approximately $500) 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 still has not been estimated. Defendants appealed to the São Paulo Court of Appeals, and the case, including the execution of the judgment, was stayed pending appeal. In November 2008, the São Paulo Court of Appeals annulled the ruling finding that the trial court had inappropriately ruled without hearing evidence and returned the case to the trial court for further proceedings. In addition, the defendants have filed a constitutional appeal to the Federal Supreme Court on the basis that the consumer association did not have standing to bring the lawsuit. This appeal is still pending.

In the second class action pending in Brazil, *Public Prosecutor of São Paulo v. Philip Morris Brasil Industria e Comercio Ltda, Civil Court of the City of São Paulo, Brazil,* filed August 6, 2007, our subsidiary is a defendant. The plaintiff, the Public Prosecutor of the State of São Paulo, is seeking (1) unspecified damages on behalf of all smokers nationwide, former smokers, and their relatives; (2) unspecified damages on behalf of people exposed to environmental tobacco smoke (ETS) nationwide, and their relatives; and (3) reimbursement of the health care costs allegedly incurred for the treatment of tobacco-related diseases by all 26 States, approximately 5,000 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. Our subsidiary was served with the claim in February 2008, and filed its answer to the complaint in March 2008. In December 2008, the trial court issued a decision declaring that it lacked jurisdiction and transferred the case to the Nineteenth Lower Civil Court in São Paulo where the *ADESF* case discussed above is pending.

In the class action in Bulgaria, *Yochkolovski v. Sofia BT AD, et al., Sofia City Court, Bulgaria,* filed March 12, 2008, our subsidiaries and other members of the industry are defendants. The plaintiff brought a collective claim on behalf of classes of smokers who were allegedly misled by tar and nicotine yields printed on packages and on behalf of a class of minors who were allegedly misled by marketing. Plaintiff seeks damages for economic loss, pain and suffering, medical treatment, and withdrawal from the market of all cigarettes that allegedly do not comply with tar and nicotine labeling requirements. The court dismissed the youth marketing claims, and plaintiff appealed that decision. The court also has ordered plaintiff to provide additional evidence in support of the remaining claims. Our subsidiaries have not been served with the complaint.

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 two other Canadian manufacturers are defendants. The plaintiff, an individual smoker, is seeking compensatory and unspecified punitive damages for each member of the class who is deemed addicted to smoking. The class was certified in 2005. Defendants motion to dismiss on statute-of-limitations grounds was denied in May 2008. Discovery is ongoing; no trial date has been set.

In the second class action pending in Canada, *Conseil Quebecois 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 two other Canadian manufacturers are defendants. The plaintiffs, an anti-smoking organization and an individual smoker, are seeking compensatory and unspecified punitive damages for each member of the class who suffers from certain smoking-related diseases. The class was certified in 2005. Discovery is ongoing; no trial date has been set.

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 Group, Inc.), 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 unspecified 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. We, our subsidiaries, and our indemnitees have been served with the complaint.

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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 Group, Inc.), 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 unspecified punitive damages on behalf of a proposed class comprised of all smokers who have smoked a minimum of 25,000 cigarettes and have suffered, or suffer, from COPD, emphysema, heart disease, or cancer. We, our subsidiaries, and our indemnitees have been served with the complaint.

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 Group, Inc.), 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 unspecified 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. We, our subsidiaries, and our indemnitees have been served with the complaint.

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 Group, Inc.), 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 unspecified 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. To date, we, our subsidiaries, and our indemnitees have not been properly served with the complaint.

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 August 1, 2009, there were a total of 10 health care cost recovery cases pending against us, our subsidiaries or indemnitees, compared with 9 such cases on August 1, 2008, and 7 such cases on August 1, 2007, as follows:

- 3 cases brought against us, our subsidiaries and our indemnitees in Canada (2) and in Israel (1); and

- 7 cases brought in Nigeria (6) and Spain (1) against our subsidiaries.

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 subsidiary, 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 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 and the case is in the early stages of litigation. At the request of the parties,

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the trial date scheduled for September 2010 has been cancelled. No new trial date has been set. Discovery is ongoing.

On March 13, 2008, a second health care cost recovery case was 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,* in which we, our subsidiary, our indemnitees (PM USA and Altria Group, Inc.), 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 very 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. Our subsidiary, indemnitees, and we have been served with the complaint. Preliminary motions are pending before the Court.

In the case in Israel, *Kupat Holim Clalit v. Philip Morris USA, et al., Jerusalem District Court, Israel,* filed September 28, 1998, we, our subsidiary, and our indemnitee (PM USA), together with other members of the industry are defendants. The plaintiff, a private health care provider, brought a claim seeking reimbursement of the cost of treating its members for alleged smoking-related illnesses for the years 1990 to 1998. Certain defendants filed a motion to dismiss the case. The motion was rejected, and those defendants filed a motion with the Israel Supreme Court for leave to appeal. The appeal was heard by the Supreme Court in March 2005, and the parties are awaiting the court s decision.

In the first 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 April 30, 2007, our subsidiary 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 2008, our subsidiary was served with a Notice of Discontinuance. The claim was formally dismissed in March 2008. However, the plaintiff has since refiled its claim. Our subsidiary has been served with the refiled complaint but is contesting service. We currently conduct no business in Nigeria.

In the second 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, our subsidiary 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. The case is in the early stages of litigation, and the defendants have filed various preliminary motions upon which the court is yet to rule. Our subsidiary is contesting service.

In the third 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 May 18, 2007, our subsidiary 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 July 2008, the court dismissed the case against all defendants based on the plaintiff s failure to comply with various procedural requirements when filing and serving the claim. The plaintiff did not appeal the dismissal. However, in October 2008, the plaintiff refiled its claim. Our subsidiary has not yet been served with the refiled complaint.

In the fourth 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, our subsidiary 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. The case is in the early stages of litigation, and the defendants have filed various preliminary motions upon which the court is yet to rule. Our subsidiary is contesting service.

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In the fifth case in Nigeria, *The Attorney General of the Federation v. British American Tobacco (Nigeria) Limited, et al., Federal High Court, Abuja, Nigeria,* filed July 25, 2007, our subsidiary 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. Our subsidiary has not yet been served with the claim.

In the sixth 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, our subsidiary 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. Our subsidiary was served with notice of the claim in December 2008, but is contesting service.

In the series of proceedings in Spain, *Junta de Andalucia, et al. v. Philip Morris Spain, et al., Court of First Instance, Madrid, Spain,* the first of which was filed February 21, 2002, our subsidiary and other members of the industry were defendants. The plaintiffs sought reimbursement for the cost of treating certain of their citizens for various smoking-related illnesses. In May 2004, the first instance court dismissed the initial case, finding that the State was a necessary party to the claim, and thus, the claim must be filed in the Administrative Court. The plaintiffs appealed. In February 2006, the appellate court affirmed the lower court s dismissal. The plaintiffs then filed notice that they intended to pursue their claim in the Administrative Court against the State. Because they were defendants in the original proceeding, our subsidiary and other members of the industry filed notices with the Administrative Court that they are interested parties in the case. In September 2007, the plaintiffs filed their complaint in the Administrative Court. In November 2007, the Administrative Court dismissed the claim. The plaintiffs asked the Administrative Court to reconsider its decision dismissing the case, and that request was rejected in a ruling rendered in February 2008. Plaintiffs appealed to the Supreme Court. In June 2008, our subsidiary filed a brief of appearance before the Supreme Court giving notice that it is an interested party in the appeal proceedings initiated by the plaintiffs. The Supreme Court has recognized our subsidiary as a party. Plaintiffs have filed a second claim in the Administrative Court against the Ministry of Economy. This second claim seeks the same relief as the original claim, but relies on a different procedural posture. The Administrative Court has recognized our subsidiary as a party.

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 August 1, 2009, there were a number of lights cases pending against our subsidiaries or indemnitees, as follows:

- 3 cases brought on behalf of various classes of individual plaintiffs (some overlapping) in Israel, compared with 3 such cases on August 1, 2008, and 2 such cases on August 1, 2007;

- 1,990 cases brought by individuals against our subsidiaries in the equivalent of small claims courts in Italy where the maximum damages claimed are approximately one thousand Euros per case, compared with 2,011 such cases on August 1, 2008, and 2,043 such cases on August 1, 2007.

In one 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 Menache H. Eliachar Ltd.) 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 will now file final briefs on class certification.

The claims in a second class action pending in Israel, *Navon, et al. v. Philip Morris Products USA, et al., District Court of Tel-Aviv/Jaffa, Israel*, filed December 5, 2004, against our indemnitee (our distributor M.H. Eliashar Distribution Ltd.) and other members of the industry are similar to those in *El-Roy,* and the case is currently stayed pending a ruling on class certification in *El-Roy*.

In the third class action pending in Israel, *Numberg, et al. v. Philip Morris Products S.A., et al., District Court of Tel Aviv/Jaffa, Israel,* filed May 19, 2008, our subsidiaries and our indemnitee (our distributor M.H. Eliashar Distribution Ltd.) and other members of the industry are defendants. The plaintiffs filed a purported class action claiming that the class members were misled by pack colors, terms such as slims or super slims or blue, and text describing tar and nicotine yields. Plaintiffs allege that these pack features misled consumers to believe that the cigarettes with those descriptors are safer than full flavor cigarettes. Plaintiffs seek recovery of the price of the brands at issue that were purchased from December 31, 2004 to the date of filing of the claim. They also seek compensation for mental anguish, punitive damages and injunctive relief. Our subsidiaries and our indemnitee have been served with the claim. Defendants filed their oppositions to class certification in March 2009.

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 August 1, 2009, there were 12 public civil actions pending against our subsidiaries in Argentina (1), Brazil (3), Colombia (7) and Venezuela (1), compared with 10 such cases on August 1, 2008, and 7 such cases on August 1, 2007.

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 the first public civil action in Brazil, *Osorio v. Philip Morris Brasil Industria e Comercio Ltda., et al., Federal Court of São Paulo, Brazil,* filed September 2003, our subsidiary, another member of the industry and various government entities are defendants. The plaintiff seeks a ban on the production and sale of cigarettes on the grounds that they are harmful to health and cause the government to spend money on health care. Plaintiff alleges that smoking violates the Brazilian constitutional right to health, that smokers have no free will because they are addicted, and that ETS is harmful. Plaintiff seeks the suspension of the defendants licenses to manufacture cigarettes, the revocation of any import licenses for tobacco-related products, the collection of all tobacco-containing products from the market, and a daily fine amounting to R$1 million (approximately $500,000) for any violation of the injunction order. Our subsidiary filed its answer in June 2004.

In the second public civil action in Brazil, *Associacao dos Consumidores Explorados do Distrito Federal v. Sampoerna Tabacos America Latina Ltda., State Trial Court of Brasilia, Brazil,* filed April 18, 2006, our subsidiary is a defendant. The plaintiff, a consumer association, seeks a ban on the production and sale of cigarettes on the grounds that they are harmful to health. Plaintiff s complaint also requests that a fine amounting to R$1 million (approximately $500,000) per day be imposed should the ban be granted and defendant continue to produce or sell cigarettes. Our subsidiary filed its answer in May 2006. The trial court dismissed the case in November 2007. Plaintiff appealed. In November 2008, the appellate court affirmed the trial court s dismissal. Plaintiff has filed a further appeal.

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In the third public civil action pending in Brazil, *The Brazilian Association for the Defense of Consumer Health (SAUDECON) v. Philip Morris Brasil Industria e Comercio Ltd and Souza Cruz S.A., Civil Court of City of Porto Alegre, Brazil,* filed November 3, 2008, our subsidiary is a defendant. The plaintiff, a consumer organization, is asking the court to establish a fund that will be used to provide treatment, for a minimum of two years, to smokers who claim to be addicted and who do not otherwise have access to smoking cessation treatment. Plaintiff requests that each defendant s liability be determined according to its market share. Our subsidiary filed its answer in January 2009. In May 2009, the trial court dismissed the case on the merits. Plaintiff has appealed.

In the first public civil action in Colombia, *Garrido v. Philip Morris Colombia S.A., Civil Court of Bogotá*, *Colombia,* filed August 28, 2006, our subsidiary is a defendant. The plaintiff seeks various forms of injunctive relief, including the ban of the use of lights descriptors, and requests that defendant be ordered to finance a national campaign against smoking. Our subsidiary filed its answer in April 2007.

In the second public civil action in Colombia, *Garrido v. Coltabaco (Garrido II), Civil Court of Bogotá, Colombia,* filed October 27, 2006, our subsidiary is a defendant. The plaintiff s claims are identical to those in *Garrido*, above. Our subsidiary filed its answer in April 2007.

In the third public civil action in Colombia, *Morales v. Philip Morris Colombia S.A. and Colombian Government, Administrative Court of Bogotá, Colombia,* filed February 12, 2007, our subsidiary and a government entity are defendants. The plaintiff alleges violations of the collective right to a healthy environment, public health rights, and the rights of consumers, and that the government failed to protect those rights. Plaintiff seeks various monetary damages and other relief, including a ban on descriptors and a ban on cigarette advertising. Our subsidiary filed its answer in March 2007.

In the fourth public civil action in Colombia*, Morales, et al. v. Coltabaco (Morales II), Civil Court of Bogotá, Colombia,* filed February 5, 2008, our subsidiary, which was served in June 2008, is a defendant. The plaintiffs allege misleading advertising, product defect, failure to inform, and the targeting of minors in advertising and marketing. Plaintiffs seek various monetary relief including a percentage of the costs incurred by the state each year for treating tobacco-related illnesses to be paid to the Ministry of Social Protection (from the date of incorporation of Coltabaco). After this initial payment, plaintiffs seek a fixed annual contribution to the government of $50 million. Plaintiffs also request that a statutory incentive award be paid to them for filing the claim. Our subsidiary filed its answer in July 2008.

In the fifth public civil action in Colombia, *Morales, et al. v. Productora Tabacalera de Colombia S.A. (Protabaco), et al., (Morales III), Administrative Court of Bogotá, Colombia*, filed December 19, 2007, two of our subsidiaries, which were served in July and August 2008, other members of the industry, and various government entities are defendants. The plaintiffs claims are identical to those in *Morales II*, above. Our subsidiaries filed their answers in August 2008.

In the sixth public civil action in Colombia, *Guzman v. Coltabaco, et al., Administrative Court of Bogotá, Colombia,* filed May 8, 2007, our subsidiary, another member of the industry, and various government entities are defendants. The plaintiff is seeking economic restitution to the country, an increase in sales tax for cigarettes, as well as various forms of injunctive relief. Our subsidiary filed its answer in June 2007.

In the seventh public civil action in Colombia, *Roche v. Philip Morris Colombia S.A., Civil Court of Bogotá, Colombia,* filed November 14, 2008, our subsidiary is a defendant. Plaintiff alleges violations of the collective right to health because the defendant failed to include information about ingredients and their toxicity on cigarette packs. Plaintiff asks the court to order our subsidiary to immediately cease manufacture and/or distribution of cigarettes until information on ingredients and their toxicity is included on packs. Our subsidiary filed its answer in January 2009.

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*

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Supreme Court, filed April 29, 2008, we were not named as a defendant, but the plaintiff 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 claims 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.

Other Litigation: Other litigation includes an antitrust suit and various tax and individual employment cases:

Antitrust: One case brought on behalf of a class of individual plaintiffs in the state of Kansas in the United States against us and other members of the industry alleging price-fixing;

Tax: In Brazil, there are 99 tax cases involving Philip Morris Brasil S.A. relating to the payment of state tax on the sale and transfer of goods and services, federal social contributions, excise, social security and income tax, and other matters. Thirty-eight of these cases are under administrative review by the relevant fiscal authorities and 61 are under judicial review by the courts; and

Employment: Our subsidiaries, Philip Morris Brasil S.A. and Philip Morris Brasil LTDA, are defendants in various individual employment cases resulting, among other things, from the termination of employment in connection with the shut-down of one of our factories in Brazil.

In the antitrust class action in Kansas, *Smith v. Philip Morris Companies, Inc., et al., District Court of Seward County, Kansas,* filed February 7, 2000, we and other members of the industry are defendants. The plaintiff asserts that the defendant cigarette companies engaged in an international conspiracy to fix wholesale prices of cigarettes and sought certification of a class comprised of all persons in Kansas who were indirect purchasers of cigarettes from the defendants. The plaintiff claims unspecified economic damages resulting from the alleged price-fixing, trebling of those damages under the Kansas price-fixing statute and counsel fees. The trial court granted plaintiff s motion for class certification and refused to permit the defendants to appeal. The case is now in the discovery phase. No trial date has yet been set.

Guarantees

At June 30, 2009, PMI s third-party guarantees, which are primarily related to excise taxes, were $48 million, of which $43 million have no specific expiration dates. The remainder ($5 million) expires through 2013, with no guarantees expiring through June 30, 2010. PMI is required to perform under these guarantees in the event that a third party fails to make contractual payments. PMI does not have a liability on its condensed consolidated balance sheet at June 30, 2009, as the fair value of these guarantees is insignificant due to the fact that the probability of future payments under these guarantees is remote.

Under the terms of the Distribution Agreement between Altria and PMI, liabilities concerning tobacco products will be allocated based in substantial part on the manufacturer. PMI will indemnify Altria and PM USA for liabilities related to tobacco products manufactured by PMI or contract manufactured for PMI by PM USA, and PM USA will indemnify PMI for liabilities related to tobacco products manufactured by PM USA, excluding tobacco products contract manufactured for PMI. PMI does not have a liability recorded on its balance sheet at June 30, 2009, as the fair value of this indemnification is insignificant since the probability of future payments under this indemnification is remote.

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Note 12. Income Taxes:

PMI accounts for income taxes in accordance with SFAS No. 109, Accounting for 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.

PMI s effective tax rates for the six months and three months ended June 30, 2009 were 29.2% and 28.6%, respectively. PMI s effective tax rates for the six months and three months ended June 30, 2008 were 30.3% and 31.0%, respectively. The 2008 tax rates were unfavorably impacted by 0.7 percentage points for the six months and by 1.4 percentage points for the three months due to the after-tax charge of $124 million related to the RBH settlement with the Government of Canada and all ten provinces. The effective tax rates are based on PMI s full year geographical 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. It is reasonably possible that within the next 12 months certain tax examinations will close, which could result in a decrease in unrecognized tax benefits along with related interest and penalties. An estimate of the range of the possible decrease cannot be made at this time.

Note 13. Indebtedness:

At June 30, 2009 and December 31, 2008, PMI s long-term debt consisted of the following (in millions):

	June 30, 2009	December 31, 2008
Short-term borrowings, reclassified as long-term debt	$ -	$ 1,020
Notes, 4.875% to 6.875% (average interest rate 5.796%), due through 2038	7,196	7,193
Foreign currency obligations:		
Euro notes payable (average interest rate 5.240%), due through 2016	5,216	2,484
Swiss Franc notes payable (average interest rate 3.625%), due through 2013	915	473
Other (average interest rate 5.038%), due through 2014	348	416
	13,675	11,586
Less current portion of long-term debt	(195)	(209)
	$ 13,480	$ 11,377

In March 2009, PMI issued Euro 2.0 billion (approximately $2.6 billion) of notes. The Euro notes bear the following terms:

Euro 1.25 billion total principal due March 2012 at a fixed interest rate of 4.250%.

Euro 750 million total principal due March 2016 at a fixed interest rate of 5.750%.

In March 2009, PMI also issued CHF 500 million (approximately $431 million) of 3.250% bonds, due in March 2013.

The net proceeds of these offerings were used to repay commercial paper borrowings and for general corporate purposes.

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Note 14. Fair Value Measurements:

On January 1, 2008, PMI adopted SFAS No. 157 Fair Value Measurements (SFAS No. 157). SFAS No. 157 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. SFAS No. 157 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 standard describes three levels of input that may be used to measure fair value:

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

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

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.

Debt

The fair value of PMI s outstanding debt, as utilized solely for disclosure purposes, is determined by utilizing 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 capital leases obligations, was $13,425 million at June 30, 2009.

Derivative Financial Instruments

PMI assesses the fair value of its derivative financial instruments using internally developed models that use, as their basis, readily observable future amounts, such as cash flows, earnings, and the current market expectations of those future amounts. These derivatives include forward foreign exchange contracts, foreign currency swaps and foreign currency options. Derivative financial instruments have been classified within Level 2. See Note 7. *Financial Instruments* for additional discussion on derivative financial instruments.

The aggregate fair value of PMI s debt and derivative financial instruments as of June 30, 2009, was as follows (in millions):

	June 30, 2009	Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Derivatives - Assets	$ 108	$ -	$ 108	$ -
Debt	$ 14,299	$ 14,202	$ 97	$ -

Derivatives	Liabilities	$ 90	$ -	$ 90	$ -

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Philip Morris International Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 15. Accumulated Other Comprehensive Earnings (Losses):

PMI s accumulated other comprehensive earnings (losses) consisted of the following (in millions):

	At June 30, 2009	At December 31, 2008	At June 30, 2008
Currency translation adjustments	$ (278)	$ (768)	$ 2,452
Pension and other benefits	(1,416)	(1,444)	(102)
Derivatives accounted for as hedges	(24)	(68)	(121)
Debt and equity securities	(1)	(1)	
Total accumulated other comprehensive earnings (losses)	$ (1,719)	$ (2,281)	$ 2,229

Note 16. Colombian Investment and Cooperation Agreement:

On June 19, 2009, PMI announced that it had signed an agreement with the Republic of Colombia, together with the Departments of Colombia and the Capital District of Bogota, to promote investment and cooperation with respect to the Colombian tobacco market and to fight counterfeit and contraband tobacco products. The Investment and Cooperation Agreement provides $200 million in funding to the Colombian governments over a 20-year period to address issues of mutual interest, such as combating the illegal cigarette trade, including the threat of counterfeit tobacco products, and increasing the quality and quantity of locally grown tobacco. As a result of the Investment and Cooperation Agreement, PMI recorded a pre-tax charge of $135 million in the operating results of the Latin America & Canada segment during the second quarter of 2009. This pre-tax charge, which represents the net present value of the payments prescribed by the agreement, is reflected in marketing, administration and research costs on the condensed consolidated statements of earnings.

Note 17. RBH Legal Settlement:

On July 31, 2008, Rothmans announced the finalization of a CAD $550 million (or $475 million) settlement between itself and RBH on the one hand and the Government of Canada and all ten provinces on the other hand. The settlement resolves the Royal Canadian Mounted Police s investigation relating to products exported from Canada by RBH during the 1989-1996 period. Rothmans sole holding was a 60% interest in RBH. The remaining 40% interest in RBH was owned by PMI.

As a result of the finalization of the settlement, PMI recorded a charge of $124 million in the operating results of the Latin America & Canada segment during the second quarter of 2008. The charge represented the present value of PMI s 40% equity interest in RBH s portion of the settlement.

Subsequent to the finalization of the settlement, PMI announced on July 31, 2008 that it had entered into an agreement with Rothmans to purchase, by way of a tender offer, all of the outstanding common shares of Rothmans. See Note 8. *Acquisitions* for more details regarding this acquisition.

At June 30, 2009, PMI had $225 million of discounted accrued settlement charges associated with the RBH legal settlement. These accrued settlement charges are reflected in other accrued liabilities ($25 million) and other long-term liabilities ($200 million) on the condensed consolidated balance sheet.

Philip Morris International Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

At December 31, 2008, PMI had $207 million of discounted accrued settlement charges associated with the RBH legal settlement. These accrued settlement charges are reflected in other accrued liabilities ($15 million) and other long-term liabilities ($192 million) on the condensed consolidated balance sheet.

Note 18. New Accounting Standards:

As previously discussed in Note 9. *Earnings Per Share*, PMI adopted FSP 03-6-1 Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities.

Effective January 1, 2009, PMI adopted SFAS No. 160 Noncontrolling Interests in Consolidated Financial Statements (SFAS No. 160). SFAS No. 160 changed the reporting for minority interest by requiring that noncontrolling interests be reported within equity. Additionally, SFAS No. 160 requires that any transaction between an entity and a noncontrolling interest be accounted for as an equity transaction. SFAS No. 160 has been applied prospectively, except for the presentation and disclosure requirements which have been adjusted retrospectively for all periods presented.

Effective January 1, 2009, PMI adopted SFAS No. 141 (Revised 2007) Business Combinations (SFAS No. 141(R)). SFAS No. 141(R) requires the recognition of assets acquired, liabilities assumed and any noncontrolling interest in the acquiree to be measured at fair value as of the acquisition date. Additionally, costs incurred to effect the acquisition are to be recognized separately from the acquisition and expensed as incurred.

Effective January 1, 2009, PMI adopted SFAS No. 161 Disclosures about Derivative Instruments and Hedging Activities (SFAS No. 161). SFAS No. 161 changes the disclosure requirements for derivative instruments and hedging activities. SFAS No. 161 requires disclosures about how and why a company uses derivative instruments, how derivative instruments and related hedged items are accounted for and how derivative instruments and related hedged items affect the company s financial position, financial performance, and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years beginning after November 15, 2008. PMI has amended its disclosures accordingly.

The adoption of these new accounting standards did not have a material impact on PMI s consolidated financial position, results of operations or cash flows.

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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 and Africa (EEMA);
- Asia; and
- Latin America & Canada.

Our products are sold in approximately 160 countries and, in many of these countries, 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 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 volume in more profitable markets versus volume in less profitable markets (geographic mix). We often collect excise taxes from our customers and then remit them to local governments, and, in those circumstances, we include excise taxes as a component of net revenues and as part of our cost of sales. Aside from excise taxes, 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 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 selling and marketing expenses, which relate to the cost of our sales force as well as to the advertising and promotion of our products.

We are 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 claims 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.

As discussed in Note 1. *Background and Basis of Presentation* of our 2008 audited consolidated financial statements and related notes, which are incorporated by reference into our Annual Report on Form 10-K for the year ended December 31, 2008 (the 2008 Form 10-K), certain of our subsidiaries prior to 2008 reported their results up to ten days before the end of December, rather than on December 31. During 2008, these subsidiaries moved to a December 31, 2008 closing date, which impacted the first quarter and fourth quarter results of previous periods. As a result, certain amounts in the first quarter of 2008 have been revised to reflect this change. The impact of this change resulted in a decrease in net earnings attributable to PMI and diluted earnings per share (diluted EPS) of $194 million and approximately $0.10, respectively, in the first six months of 2008.

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Separation from Altria Group, Inc.

As discussed in the 2008 Form 10-K, prior to March 28, 2008, we were a wholly-owned subsidiary of Altria Group, Inc. (Altria). On January 30, 2008, the Altria Board of Directors announced Altria s plans to spin off all of its interest in PMI to Altria s stockholders in a tax-free distribution pursuant to Section 355 of the U.S. Internal Revenue Code. The distribution of all of the PMI shares owned by Altria (the Spin-off) was made on March 28, 2008 (the Distribution Date) to stockholders of record as of the close of business on March 19, 2008 (the Record Date). Altria distributed one share of our common stock for each share of Altria common stock outstanding on the Record Date.

For additional information regarding our transactions with Altria Group, Inc. and affiliates after the Spin-off, see Note 3. *Transactions with Altria Group, Inc*.

Executive Summary

The following executive summary is intended to provide you with the significant highlights from the Discussion and Analysis that follows.

Consolidated Operating Results for the Six Months Ended June 30, 2009 The changes in our reported net earnings attributable to PMI and diluted EPS for the six months ended June 30, 2009, from the comparable 2008 amounts, were as follows (in millions, except per share data):

	Reported	
	Net Earnings Attributable to PMI	Diluted EPS
For the six months ended June 30, 2008	$ 3,365	$ 1.59
2008 Asset impairment and exit costs	46	0.02
2008 Equity loss from RBH legal settlement	124	0.06
Subtotal of 2008 items	170	0.08
2009 Asset impairment and exit costs	(1)	
2009 Colombian Investment and Cooperation Agreement charge	(93)	(0.04)
Subtotal of 2009 items	(94)	(0.04)
Currency	(730)	(0.35)
Interest	(157)	(0.07)
Change in tax rate	22	0.01
Impact of lower shares outstanding and share-based payments		0.09
Operations	446	0.21
For the six months ended June 30, 2009	$ 3,022	$ 1.52

See the discussion of events affecting the comparability of statement of earnings amounts in the Consolidated Operating Results section of the following Discussion and Analysis.

Asset Impairment and Exit Costs We recorded pre-tax asset impairment and exit costs primarily related to the streamlining of various administrative functions and operations. During the six months ended June 30, 2009, we recorded pre-tax asset impairment and exit costs of $2 million ($1 million after-tax). During the six months ended June 30, 2008, we recorded pre-tax asset impairment and exit costs of $71 million ($46 million after-tax). *For further details, see Note 2. Asset Impairment and Exit Costs to the condensed consolidated financial statements.*

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Equity loss from RBH legal settlement In the second quarter of 2008, we recorded a $124 million charge related to the Rothmans, Benson & Hedges Inc. (RBH) settlement with the Government of Canada and all ten provinces. This equity loss was included in the operating companies income of the Latin America & Canada segment. *For further details, see Note 17. RBH Legal Settlement to the condensed consolidated financial statements.*

Colombian Investment and Cooperation Agreement charge During the second quarter of 2009, we recorded a pre-tax charge of $135 million ($93 million after-tax) related to the Investment and Cooperation Agreement in Colombia. The charge was recorded in the operating companies income of the Latin America & Canada segment. *For further details, see Note 16. Colombian Investment and Cooperation Agreement to the condensed consolidated financial statements.*

Currency The unfavorable currency impact is due primarily to the strengthening of the U.S. dollar versus the Euro, the Australian dollar and many emerging market currencies, in particular the Indonesian rupiah, Mexican peso, Russian ruble, Turkish lira and Ukrainian hryvnia. This impact was partially offset by the weakness of the U.S. dollar versus the Japanese yen.

Interest The unfavorable impact of interest was due primarily to higher average debt levels.

Lower shares outstanding and share-based payments The favorable impact of lower shares outstanding and share-based payments was due primarily to the repurchases of our common stock pursuant to the $13.0 billion two-year share repurchase program (since inception, 178.1 million shares were repurchased at a cost of $8.1 billion).

Income taxes Our effective income tax rate for the six months ended June 30, 2009 decreased 1.1 percentage points to 29.2%, reflecting a favorable comparison to the first half of 2008, which was adversely affected by the charge for the RBH legal settlement.

Operations The increase in our operations reflected in the table above was due primarily to the following:

Eastern Europe, Middle East and Africa. Higher income due primarily to higher pricing, partially offset by higher marketing, administration and research costs and lower volume/mix;

Asia. Higher income due primarily to higher pricing and higher volume/mix, partially offset by higher marketing, administration and research costs;

Latin America & Canada. Higher income due primarily to the favorable impact of acquisitions and higher pricing, partially offset by lower volume/mix and higher marketing, administration and research costs; and

European Union. Higher income due primarily to higher pricing and the favorable impact of acquisitions, partially offset by lower volume/mix and higher marketing, administration and research costs.

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Consolidated Operating Results for the Three Months Ended June 30, 2009 The changes in our reported net earnings attributable to PMI and diluted EPS for the three months ended June 30, 2009, from the comparable 2008 amounts, were as follows (in millions, except per share data):

	Reported	
	Net Earnings Attributable to PMI	Diluted EPS
For the three months ended June 30, 2008	$ 1,692	$ 0.80
2008 Asset impairment and exit costs	27	0.01
2008 Equity loss from RBH legal settlement	124	0.06
Subtotal of 2008 items	151	0.07
2009 Colombian Investment and Cooperation Agreement charge	(93)	(0.04)
Currency	(406)	(0.19)
Interest	(99)	(0.04)
Change in tax rate	31	0.01
Impact of lower shares outstanding and share-based payments		0.05
Operations	270	0.13
For the three months ended June 30, 2009	$ 1,546	$ 0.79

See the discussion of events affecting the comparability of statement of earnings amounts in the Consolidated Operating Results section of the following Discussion and Analysis.

Asset Impairment and Exit Costs We recorded pre-tax asset impairment and exit costs primarily related to the streamlining of various administrative functions and operations. During the three months ended June 30, 2009, we recorded pre-tax asset impairment and exit costs of $1 million ($0.7 million after-tax). During the three months ended June 30, 2008, we recorded pre-tax asset impairment and exit costs of $48 million ($27 million after-tax). *For further details, see Note 2. Asset Impairment and Exit Costs to the condensed consolidated financial statements.*

Equity loss from RBH legal settlement As previously discussed, in the second quarter of 2008, we recorded a $124 million charge related to the RBH settlement with the Government of Canada and all ten provinces. This equity loss was included in the operating companies income of the Latin America & Canada segment. *For further details, see Note 17. RBH Legal Settlement to the condensed consolidated financial statements.*

Colombian Investment and Cooperation Agreement charge As previously discussed, we recorded a pre-tax charge of $135 million ($93 million after-tax) related to the Investment and Cooperation Agreement in Colombia. The charge was recorded in the operating companies income of the Latin America & Canada segment. *For further details, see Note 16. Colombian Investment and Cooperation Agreement to the condensed consolidated financial statements.*

Currency The unfavorable currency impact is due primarily to the strengthening of the U.S. dollar versus the Euro, the Australian dollar and many emerging market currencies, in particular the Indonesian rupiah, Mexican peso, Russian ruble, Turkish lira and Ukrainian hryvnia. This impact was partially offset by the weakness of the U.S. dollar versus the Japanese yen.

Interest The unfavorable impact of interest was due primarily to higher average debt levels.

Lower shares outstanding and share-based payments The favorable impact of lower shares outstanding and share-based payments was due primarily to the repurchases of our common stock pursuant to the $13.0 billion two-year share repurchase program.

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Income taxes Our effective income tax rate for the three months ended June 30, 2009 decreased 2.4 percentage points to 28.6%, reflecting a favorable comparison to the second quarter of 2008, which was adversely affected by the charge for the RBH legal settlement.

Operations The increase in our operations reflected in the table above was due primarily to the following:

- Asia. Higher income due primarily to higher pricing, partially offset by higher marketing, administration and research costs;

- Eastern Europe, Middle East and Africa. Higher income due primarily to higher pricing, partially offset by higher marketing, administration and research costs and lower volume/mix;

- European Union. Higher income due primarily to higher pricing and the favorable impact of acquisitions, partially offset by lower volume/mix and higher marketing, administration and research costs; and

- Latin America & Canada. Higher income due primarily to the favorable impact of acquisitions and higher pricing.

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

2009 Forecasted Results The current worldwide economic recession has affected the markets in which we operate. While we have not seen a broad-based trend towards consumer down-trading on a global basis, we expect to face some unfavorable overall product mix and softer volume reflecting lower consumption levels this year. We have factored these assumptions into our forecasted results for 2009. On July 23, 2009, we raised our forecast for 2009 full-year diluted EPS to a range of $3.10 to $3.20, from $2.85 to $3.00, which includes, at current exchange rates, an unfavorable currency impact of $0.55 per share compared to $0.80 per share in the February 2009 forecast. Excluding currency, diluted EPS is projected to increase by approximately 10%-13%. This guidance includes the pre-tax charge of $135 million ($93 million after-tax), equivalent to $0.04 per share, relating to the Colombian Investment and Cooperation Agreement announced during the second quarter of 2009, and excludes the impact of any potential future acquisitions, asset impairment and exit cost charges, 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 70-74 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,		For the Three Months Ended June 30,	
	2009	2008	2009	2008
Cigarette volume:				
European Union	117,840	121,868	62,900	64,817
Eastern Europe, Middle East and Africa	144,328	146,174	76,650	78,300
Asia	114,747	112,405	57,979	56,843
Latin America & Canada	49,625	46,189	25,636	23,209
Total cigarette volume	426,540	426,636	223,165	223,169
Net revenues:				
European Union	$ 13,205	$ 14,976	$ 7,155	$ 8,279
Eastern Europe, Middle East and Africa	6,231	7,085	3,400	3,802
Asia	5,804	6,146	2,947	3,170
Latin America & Canada	3,259	2,850	1,711	1,452
Net revenues	$ 28,499	$ 31,057	$ 15,213	$ 16,703
Excise taxes on products:				
European Union	$ 8,938	$ 10,086	$ 4,875	$ 5,635
Eastern Europe, Middle East and Africa	3,139	3,490	1,760	1,869
Asia	2,641	3,039	1,374	1,566
Latin America & Canada	2,050	1,812	1,070	924
Excise taxes on products	$ 16,768	$ 18,427	$ 9,079	$ 9,994
Operating income:				
Operating companies income:				
European Union	$ 2,130	$ 2,454	$ 1,163	$ 1,287
Eastern Europe, Middle East and Africa	1,221	1,493	635	813
Asia	1,280	1,073	619	523
Latin America & Canada	226	172	71	23
Amortization of intangibles	(36)	(16)	(21)	(7)
General corporate expenses	(72)	(44)	(38)	(31)
Operating income	$ 4,749	$ 5,132	$ 2,429	$ 2,608

As discussed in Note 10. *Segment Reporting*, we evaluate segment performance and allocate resources based on operating companies income, which we define as operating income before general corporate expenses and amortization of intangibles. 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 in this Discussion and Analysis section are our estimates based on a number of internal and external sources.

The following events that occurred during the six months and three months ended June 30, 2009 and 2008, affected the comparability of our statement of earnings amounts.

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Asset Impairment and Exit Costs For the six months and three months ended June 30, 2009 and 2008, pre-tax asset impairment and exit costs consisted of the following:

	For the Six Months Ended June 30,		For the Three Months Ended June 30,	
	2009	2008	2009	2008
Separation programs:				
European Union	$ 2	$ 56	$ 1	$ 48
Total separation programs	2	56	1	48
Contract termination charges:				
Eastern Europe, Middle East and Africa		1		
Asia		14		
Total contract termination charges	-	15	-	-
Asset impairment and exit costs	$ 2	$ 71	$ 1	$ 48

For further details see Note 2. Asset Impairment and Exit Costs to our condensed consolidated financial statements.

Equity loss from RBH legal settlement As previously discussed, the operating companies income of the Latin America & Canada segment for the six months and three months ended June 30, 2008, included a $124 million charge related to the RBH settlement with the Government of Canada and all ten provinces. *For further details, see Note 17. RBH Legal Settlement to the condensed consolidated financial statements.*

Colombian Investment and Cooperation Agreement charge As previously discussed, the operating companies income of the Latin America & Canada segment for the six months and three months ended June 30, 2009, included a pre-tax charge of $135 million related to the Investment and Cooperation Agreement in Colombia. *For further details, see Note 16. Colombian Investment and Cooperation Agreement to the condensed consolidated financial statements.*

Consolidated Operating Results for the Six Months Ended June 30, 2009

The following discussion compares our consolidated operating results for the six months ended June 30, 2009, with the six months ended June 30, 2008.

Our cigarette volume of 426.5 billion units was essentially unchanged. Gains in Asia, driven by Indonesia, Korea and Pakistan, and Latin America & Canada, driven by acquisitions, were offset by declines primarily in the European Union, particularly in Italy, Poland and Spain, and EEMA, mainly in Romania, Ukraine and Duty Free. Excluding acquisitions, our cigarette shipment volume was down 1.1%.

We achieved market share gains in a number of markets, including Algeria, Argentina, Belgium, Brazil, Bulgaria, Canada, Colombia, the Dominican Republic, Egypt, France, Germany, Greece, Hungary, Korea, Mexico, the Netherlands, the Philippines, Portugal, Romania, Russia, Spain, Turkey and Ukraine.

Despite growth in Asia, total cigarette shipments of *Marlboro* of 149.4 billion units were down 1.7%, primarily due to market declines in the European Union and EEMA, a 0.2 market share point decline in the European Union, a reduction in our Duty Free volume, reflecting the unfavorable impact of the global economy on travel, and a softening of the premium segment in Russia and Ukraine. Total cigarette shipments of *L&M* of 44.6 billion units were down 3.6%, with growth in the European Union offset by a decline in other regions. Driven by a decrease in shipments in EEMA, total cigarette shipments of *Chesterfield* declined 4.9%. Total cigarette shipments of *Parliament* recorded growth, up 3.4%, driven by gains in EEMA. Total cigarette shipments of *Virginia Slims* declined 5.3%. Total cigarette shipments of *Lark* increased 11.6%, driven by growth in EEMA.

Total shipment volume of other tobacco products (in cigarette equivalent units) grew 30.3%, as growth in France, Poland and the Nordics was partially offset by the decline of cigarillo volume in Germany. Excluding acquisitions, shipment volume of other tobacco products was flat. Total shipment volume for cigarettes and other tobacco products was up 0.4%, and down 1.1% excluding acquisitions.

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Net revenues, which include excise taxes billed to customers, decreased $2.6 billion or 8.2%. Excluding excise taxes, net revenues decreased $899 million (7.1%) to $11.7 billion. This decrease was due to unfavorable currency ($1.9 billion) and lower volume/mix ($266 million), partially offset by net price increases ($907 million) and the impact of acquisitions ($323 million).

Excise taxes on products decreased $1.7 billion (9.0%), due primarily to currency movements ($3.6 billion), partially offset by higher excise tax rates ($1.5 billion) and acquisitions. As discussed under the caption Business Environment, governments have consistently increased excise taxes in most of the markets in which we operate. We expect excise taxes to continue to increase.

Cost of sales decreased $487 million (10.5%), due primarily to currency movements ($605 million), partially offset by the impact of acquisitions ($97 million) and higher leaf tobacco costs.

Marketing, administration and research costs increased $20 million (0.7%), due primarily to higher marketing and sales expenses ($151 million), the 2009 charge related to the Colombian Investment and Cooperation Agreement ($135 million), acquisitions ($72 million), higher general and administrative expenses ($56 million), higher general corporate expenses ($30 million) and higher research and development expenses ($13 million), partially offset by currency ($308 million) and the 2008 charge related to the RBH legal settlement ($124 million).

Operating income decreased $383 million (7.5%). This decrease was due primarily to unfavorable currency ($947 million), lower volume/mix ($234 million) and higher marketing and sales expenses. These decreases were partially offset by net price increases ($907 million), the impact of acquisitions ($154 million) and lower asset impairment and exit costs ($69 million).

Currency movements decreased net revenues by $5.4 billion ($1.9 billion, after excluding the impact of currency movements on excise taxes) and operating income by $947 million. These decreases were due primarily to the strengthening of the U.S. dollar versus the Euro, the Australian dollar and many emerging market currencies, in particular the Indonesian rupiah, Mexican peso, Russian ruble, Turkish lira and Ukrainian hryvnia. This impact was partially offset by the weakness of the U.S. dollar versus the Japanese yen.

Interest expense, net, of $351 million increased $215 million, due primarily to higher average debt levels.

Our effective tax rate decreased 1.1 percentage points to 29.2%, which is presently the estimated effective tax rate for the full year 2009. The 2008 tax rate was unfavorably impacted by 0.7 percentage points due to the after-tax charge of $124 million related to the RBH settlement with the Government of Canada and all ten provinces. The effective tax rate is based on our full year geographic earnings mix projections and cash repatriation plans. Changes in our earnings mix or in 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. It is reasonably possible that within the next 12 months certain tax examinations will close, which could result in a decrease in unrecognized tax benefits along with related interest and penalties. An estimate of the range of the possible decrease cannot be made at this time.

Net earnings attributable to PMI of $3.0 billion decreased $343 million (10.2%). This decrease was due primarily to lower operating income (attributable to unfavorable currency, partially offset by higher results from operations) and higher interest expense, net. Diluted and basic EPS of $1.52 and $1.53, respectively, decreased by 4.4%. Excluding unfavorable currency of $0.35, diluted EPS increased 17.6%.

Consolidated Operating Results for the Three Months Ended June 30, 2009

The following discussion compares our consolidated operating results for the three months ended June 30, 2009, with the three months ended June 30, 2008.

Our cigarette volume of 223.2 billion units was unchanged, with gains in Asia, driven by Indonesia, Korea and Pakistan, and Latin America & Canada, offset by declines primarily in the European Union, particularly in Italy,

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Poland and Spain, and EEMA, mainly in Romania, Ukraine and Duty Free. Excluding acquisitions, our cigarette shipment volume was down 1.1%.

We achieved market share gains in a number of markets, including Algeria, Argentina, Australia, Austria, Belgium, Brazil, Bulgaria, Canada, Colombia, the Dominican Republic, Egypt, France, Germany, Greece, Hungary, Japan, Korea, Mexico, the Netherlands, the Philippines, Romania, Russia, Spain, Turkey, Ukraine and the United Kingdom.

Despite growth in Asia, total cigarette shipments of *Marlboro* of 78.3 billion units were down 1.1%, primarily due to market declines in the European Union and EEMA, a reduction in our Duty Free volume, reflecting the unfavorable impact of the global economy on travel, and a softening of the premium segment in Russia and Ukraine. Total cigarette shipments of *L&M* of 23.2 billion units were down 6.3%, with growth in the European Union offset by a decline in other regions. Driven by a decrease in shipments in EEMA, total cigarette shipments of *Chesterfield* declined 9.4%. Total cigarette shipments of *Parliament* recorded growth, up 1.3%, driven by gains in EEMA. Total cigarette shipments of *Virginia Slims* declined 7.5%. Total cigarette shipments of *Lark* increased 20.5%, driven by growth in EEMA and Asia.

Total shipment volume of other tobacco products (in cigarette equivalent units) grew 21.6%, fueled by growth in France and the Nordics. Excluding acquisitions, shipment volume of other tobacco products was down 12.2%, primarily due to lower cigarillo volume in Germany where the whole segment has declined. Total shipment volume for cigarettes and other tobacco products was up 0.3%, and down 1.3% excluding acquisitions.

Net revenues, which include excise taxes billed to customers, decreased $1.5 billion or 8.9%. Excluding excise taxes, net revenues decreased $575 million (8.6%) to $6.1 billion. This decrease was due to unfavorable currency ($1.2 billion) and lower volume/mix ($141 million), partially offset by net price increases ($549 million) and the impact of acquisitions ($183 million).

Excise taxes on products decreased $915 million (9.2%), due primarily to currency movements ($2.1 billion), partially offset by higher excise tax rates ($940 million) and acquisitions.

Cost of sales decreased $277 million (11.3%), due primarily to currency movements ($362 million), partially offset by the impact of acquisitions ($54 million) and higher leaf tobacco costs.

Marketing, administration and research costs decreased $86 million (5.4%), due primarily to currency ($254 million) and the 2008 charge related to the RBH legal settlement ($124 million), partially offset by the 2009 charge related to the Colombian Investment and Cooperation Agreement ($135 million), higher marketing and sales expenses ($65 million), acquisitions ($41 million), higher general and administrative expenses ($31 million), higher research and development expenses ($10 million) and higher general corporate expenses.

Operating income decreased $179 million (6.9%). This decrease was due primarily to unfavorable currency ($548 million), lower volume/mix ($125 million) and higher marketing and sales expenses. These decreases were partially offset by net price increases ($549 million), the impact of acquisitions ($88 million) and lower asset impairment and exit costs ($47 million).

Currency movements decreased net revenues by $3.3 billion ($1.2 billion, after excluding the impact of currency movements on excise taxes) and operating income by $548 million. These decreases were due primarily to the strengthening of the U.S. dollar versus the Euro, the Australian dollar and many emerging market currencies, in particular the Indonesian rupiah, Mexican peso, Russian ruble, Turkish lira and Ukrainian hryvnia. This impact was partially offset by the weakness of the U.S. dollar versus the Japanese yen.

Interest expense, net, of $193 million increased $132 million, due primarily to higher average debt levels.

Our effective tax rate decreased 2.4 percentage points to 28.6%. The 2008 tax rate was unfavorably impacted by 1.4 percentage points due to the after-tax charge of $124 million related to the RBH settlement with the Government of Canada and all ten provinces. The effective tax rate is based on our full year geographic earnings mix projections and cash repatriation plans. Changes in our earnings mix or in 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.

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As previously discussed, we are regularly examined by tax authorities around the world. It is reasonably possible that within the next 12 months certain tax examinations will close, which could result in a decrease in unrecognized tax benefits along with related interest and penalties. An estimate of the range of the possible decrease cannot be made at this time.

Net earnings attributable to PMI of $1.5 billion decreased $146 million (8.6%). This decrease was due primarily to lower operating income (attributable to unfavorable currency, partially offset by higher results from operations). Diluted and basic EPS of $0.79 decreased by 1.3% and 2.5%, respectively. Excluding unfavorable currency of $0.19, diluted EPS increased 22.5%.

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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 faces 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:

- actual and proposed tobacco legislation and regulation;
- actual and proposed excise tax increases as well as changes in excise tax structures;
- price gaps and changes in price gaps between premium and lower price brands;
- the diminishing prevalence of smoking;
- increased efforts by tobacco control advocates to further restrict smoking;
- pending and threatened litigation as discussed in Note 11. *Contingencies*;
- actual and proposed requirements for the disclosure of cigarette ingredients and other proprietary information without adequate trade secret protection, as well as testing requirements and performance standards;
- actual and proposed restrictions on imports in certain jurisdictions;
- actual and proposed restrictions affecting tobacco manufacturing, packaging, marketing, advertising, product display and sales;
- governmental and private bans and restrictions on smoking;
- the sale of counterfeit cigarettes by third parties;
- the sale of cigarettes by third parties over the Internet and by other means designed to avoid the collection of applicable taxes;
- diversion into one market of cigarettes intended for sale in another;

the outcome of proceedings and investigations, and the potential assertion of claims, and proposed regulation relating to contraband shipments of cigarettes; and

governmental investigations.

In the ordinary course of business, many factors can affect the timing of sales to customers, including the timing of holidays and other annual or special events, the timing of promotions, customer incentive programs and customer inventory programs, as well as the actual or speculated timing of pricing actions and tax-driven price increases.

Excise Taxes: Cigarettes are subject to substantial excise taxes and to other taxation worldwide. Significant increases in cigarette-related taxes or fees have been proposed or enacted and are likely to continue to be proposed or enacted. In addition, in certain jurisdictions, our products are subject to tax structures that discriminate against premium price products and manufactured cigarettes.

Tax increases and discriminatory tax structures are expected to continue to have an adverse impact on our sales of cigarettes, due to lower consumption levels and to a shift in consumer purchases from the premium to non-premium or discount segments or other low-price or low-taxed tobacco products such as fine-cut tobacco products and/or counterfeit and contraband products.

Minimum Retail Selling Price Laws: Several EU Member States (Austria, France, Ireland, and Italy) have enacted laws establishing a minimum retail selling price for cigarettes and, in some cases, other tobacco products. The European Commission has filed actions against these Member States in the European Court of Justice claiming that these countries minimum retail selling price systems infringed EU law. The court hearing in the actions against

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Austria, France and Ireland took place in June 2009. A ruling could be expected by the end of 2009 or early 2010. Should the European Commission prevail in the European Court of Justice, excise tax levels and/or price gaps in those markets could be adversely affected.

Framework Convention on Tobacco Control: The World Health Organization s Framework Convention for Tobacco Control (FCTC) entered into force on February 27, 2005. As of August 2009, 165 countries, as well as the European Community, have become Parties to the FCTC. The FCTC is the first international public health treaty and its objective is to establish a global agenda for tobacco regulation with the purpose of reducing initiation of tobacco use and encouraging cessation. The treaty recommends (and, in certain instances, requires) Parties to have in place or enact legislation that would:

- establish specific actions to prevent youth smoking;
- restrict and/or eliminate all tobacco product advertising, marketing, promotions and sponsorships;
- initiate public education campaigns to inform the public about the health consequences of smoking and the benefits of quitting;
- implement regulations imposing product testing, disclosure and performance standards;
- impose health warning requirements on packaging;
- adopt measures that would eliminate cigarette smuggling and counterfeit cigarettes;
- restrict smoking in public places;
- implement public health-based fiscal policies (tax and price increases);
- adopt and implement measures that ensure that packaging and labeling, including descriptive terms, do not create the false impression that one brand of cigarettes is safer than another;
- phase out or restrict duty free tobacco sales; and
- encourage litigation against tobacco product manufacturers.

We view the FCTC as a catalyst for comprehensive regulation, and the speed at which tobacco regulation is being adopted in our markets has increased as a result of the treaty. In many respects, the areas of regulation we support mirror provisions of the FCTC. However, we disagree with the provisions requiring a total ban on marketing, a total ban on public smoking, a ban on the sale of duty free cigarettes, and the use of litigation against the tobacco industry. We also believe that excessive taxation can have significant adverse unintended consequences.

In November 2008, the Conference of the Parties, the governing body of the FCTC, adopted Guidelines that provide non-binding recommendations to the Parties supplementing specific Articles of the Treaty, including details on tobacco packaging, labeling and marketing. Several of the recommendations in the Guidelines, such as plain packaging, point of sale display bans, a ban on the use of colors in packaging, a ban on all forms of communications to adult smokers and limiting tobacco industry involvement in the development of tobacco policy and regulations, reflect extreme applications of the provisions of the Treaty, many of which are punitive measures against the tobacco industry and untethered to public health objectives. If governments choose to implement these recommendations, they may adversely affect our business, volume, results of operations, cash flows and financial position. It is not possible to predict whether or to what extent the Guidelines will be adopted by governments.

Tar and Nicotine Test Methods and Brand Descriptors: A number of public health organizations throughout the world, including WHO, have determined that the existing International Standards Organization (ISO) machine-based methods for measuring tar and nicotine yields provide misleading information about tar and nicotine inhaled by the smoker, and that the ISO-based numbers should not be displayed. We have expressed the view that ISO numbers do not accurately reflect human smoking, and we therefore supported recommendations to supplement the ISO test method with the more intensive Health Canada method. The Health Canada method blocks ventilation holes, increases the puffs taken per minute and the volume of smoke in each puff. We believe that a combination of the two methods would better illustrate the wide variability in the delivery of tar, nicotine and carbon monoxide, depending upon how an individual smokes a cigarette. The WHO s Study Group on Tobacco Regulation (TobReg) (its expert committee on regulation) and the Conference of the Parties Working Group on tobacco regulation have recommended the use of ISO and Health Canada methods for testing smoke constituent yields. Both

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the WHO and the Conference of the Parties Working Group continue to recommend that yields of tar, nicotine, carbon monoxide and other constituents should not be disclosed to consumers.

In light of public health concerns about the limitations of current machine measurement methodologies, governments and public health organizations have increasingly prohibited the use of descriptors such as light, mild and low tar. Many countries, including the entire EU, prohibit or are in the process of prohibiting descriptors such as lights. The FCTC requires the Parties to adopt and implement measures to ensure that tobacco product packaging and labeling, including descriptive terms, do not create the false impression that a particular tobacco product is less harmful than other tobacco products. In most countries where descriptors are banned, tar, nicotine and carbon monoxide yields are still required to be printed on packs of cigarettes. We believe that it is inconsistent to ban descriptors while also mandating the printing of tar, nicotine and carbon monoxide yields on packs. Thus, we have agreed with public health advocates that governments should prohibit the printing of tar, nicotine and carbon monoxide yields on packs of cigarettes. Alternatively, consistent with our support of requiring testing using both the ISO and Health Canada test methods, we would support requiring the printing of both yields which would reflect a range of smoke intake.

Some public health advocates, governments, and the Guidelines issued by the FCTC s Conference of the Parties have called for a ban or restriction on the use of colors which they claim are also used to signify that some brands provide lower yields of tar, nicotine and other smoke constituents. Others have banned or sought to ban any descriptive terms, including terms such as premium or full flavor, and one has banned all but one pack variation per brand arguing that such terms or pack variations are inherently misleading. We believe such regulations are unreasonably broad, go beyond the scope and intent of legislation designed to prevent consumers from falsely believing that one brand is less harmful than another, unduly restrict our intellectual property and other rights, and violate international trade commitments. As such, we oppose these types of regulations and, where appropriate, we have commenced litigation to challenge their constitutionality.

Testing and Reporting of Other Smoke Constituents: Brazil, Canada, Taiwan and Venezuela require manufacturers to test and report to regulators certain by-brand yields of other smoke constituents from the 45 to 80 that have been identified as potential causes of tobacco-related diseases. Testing and reporting of some of these constituents is being considered by the FCTC s Conference of the Parties Working Group on product regulation, TobReg, national regulators and the public health community. We measure many of these constituents for our product research and development purposes, and support efforts to develop reasonable regulation in this area. However, there is no international consensus on which smoke constituents cause the full range of diseases associated with tobacco use, and no validated analytical methods to measure the constituents yields in the smoke. Moreover, there is extremely limited capacity to conduct by-brand testing on a global basis. In its 2008 progress report on these issues, the Conference of the Parties Working Group, following a proposal by TobReg, identified nine smoke constituents for which methods for testing and measuring yields should be validated as a priority, and estimated that validation of the applicable methods for these constituents (and for certain ingredients) would take five and a half years. It is not certain when actual testing requirements will be recommended by the Conference of the Parties and whether individual countries will adopt them, although bills to require testing of a wide range of smoke constituent yields are pending in some countries. The cost of by-brand testing could be significant, and public health groups, including the Conference of the Parties Working Group, have recommended that the industry should be required to bear the burden of testing expenses.

Ceilings on Tar, Nicotine, Carbon Monoxide and Other Smoke Constituents: Despite the fact that public health authorities have questioned the significance of ISO-measured tar, nicotine and carbon monoxide yields, a number of countries, including all EU Member States, have established maximum yields of tar, nicotine and/or carbon monoxide, as measured by the ISO standard test method, and none of them have suggested that ISO-based ceilings be eliminated. Nor has any country to date proposed ceilings based on an alternative test method or for other smoke constituents. However, in February 2009, TobReg published a report in which it recommended that governments establish ceilings for nine specific smoke constituents, including tobacco-specific nitrosamines (TSNAs). The TobReg proposal would set ceilings based on the median yield for each constituent in the market determined by

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testing all brands sold in the market. Although this concept of selective constituent reduction is supported by some public health officials, several public health advocates and scientists have criticized the proposal on the grounds that selectively reducing *some* constituents in conventional cigarettes will not lead to a meaningful reduction in disease and thus will not benefit public health and/or will mislead consumers into believing that conventional cigarettes with regulated (i.e., reduced) levels of these constituents are safer. In fact, TobReg recognizes that it cannot prove that its proposed ceilings will result in reduced risk of disease or reduced harm, but argues that its proposal is appropriate because it is based on the precautionary principle. As stated above, in its 2008 progress report, the Conference of the Parties Working Group identified the nine TobReg smoke constituents as priorities for which methods for testing and measuring yields should be validated, but did not comment on performance standards or ceilings.

Ingredient Disclosure Laws: 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 cigarettes and, in certain cases, to provide toxicological information about those ingredients. While we believe the public health objectives of these requests can be met without providing exact by-brand formulae, we have made and will continue to make full disclosures to governments where adequate assurances of trade secret protection are provided. For example, under the EU Tobacco Products Directive, tobacco companies are required to disclose ingredients and toxicological information to each Member State. In May 2007, the Commission published guidelines for full by-brand reporting requirements. We have made ingredient disclosures in compliance with the laws of all EU Member States, and have followed the guidelines in most Member States, making full by-brand disclosures in a manner that protects trade secrets in those Member States. In some jurisdictions, however, appropriate assurances of trade secret protection may be impossible to obtain. In such circumstances, we will seek to resolve the matter with governments through alternative options.

Restrictions and Bans on the Use of Ingredients: Some governments have prohibited the use of certain ingredients, and public health authorities, including the European Commission, are considering further prohibitions. For example, the FCTC s Conference of the Parties is developing guidelines that will provide detailed product regulation requirements, which could eventually include standards for the use of tobacco product ingredients, including flavorings. However, in 2007, the Conference of the Parties Working Group stated that testing and measuring of toxicity of cigarette [ingredients] . . . is an emerging field and refrained from recommending a course of action pending more work to develop a better understanding of these issues. Similarly, TobReg stated in 2008 that the existing science is currently not sufficient to establish standards for regulating ingredients and other product design characteristics. In May 2009, the Canadian federal government introduced a bill the purported intent of which, among other things, is to ban the use of candy and fruit flavors in little cigars, which are sold in small packages or by the stick and thus claimed to be attractive to minors. However, the language of the bill, as written, is overly broad and would ban virtually all ingredients not only in little cigars, but also in cigarettes. If adopted, the bill would have the effect of banning American Blend cigarettes in Canada. It is currently pending in the Parliament. It is not possible to determine the outcome of the legislation. We support regulations requiring all manufacturers to determine whether their ingredients increase the overall toxicity of tobacco smoke and, if internationally accepted test methods become available, whether ingredients increase the addictiveness of smoke. We would also support legislation that would allow regulators to ban ingredients that significantly increase either the toxicity or addictiveness of cigarette smoke. We oppose, however, bans of ingredients that are not tied to science-based public health considerations, such as the overly broad language proposed in Canada, and bans of ingredients based on palatability or consumer appeal as these are inherently subjective standards and not appropriate bases for regulation.

Bans and Restrictions on Advertising, Marketing, Promotions and Sponsorships: For many years, countries have imposed partial or total bans on tobacco advertising, marketing and promotion. The FCTC calls for a comprehensive ban on advertising, promotion and sponsorship and requires governments that have no constitutional constraints to ban all forms of advertising. Where constitutional constraints exist, the FCTC requires governments to restrict or ban radio, television, print media, other media, including the Internet, and sponsorships of international events within five years. We oppose complete bans on advertising but support limitations on marketing, provided that manufacturers retain the ability to communicate directly to adult smokers. The FCTC also requires disclosure of expenditures on advertising, promotion and sponsorship where such activities are not prohibited. Some governments and public health groups have called for bans of product displays at point of sale, which some countries have adopted. We oppose product display bans on the grounds that evidence does not show that they have any material impact on public health, and that they will encourage lower prices, unnecessarily restrict non-price competition, and encourage illicit trade - all of which undermine public health objectives.

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Plain Packaging: In 2008, the UK Department of Health raised for comment the possibility of mandating plain (generic) packaging, which would eliminate the ability of manufacturers to use any distinctive trademarks, trade dress, logos, or designs on tobacco product packaging. It was argued that plain packaging would reduce youth smoking, decrease smoking initiation, increase cessation and contribute to the de-normalization of tobacco use. We strongly oppose plain packaging because there is no sound evidentiary basis to conclude that it would lead to a reduction in youth smoking or any other public health benefit, is likely to encourage illicit trade and lower prices (both of which undermine the government s public health and revenue objectives), disproportionately infringes free speech, amounts to expropriation of manufacturers intellectual property rights, and unduly limits competition. As noted above, the Conference of the Parties adopted Guidelines recommending plain packaging. However, in December 2008 and again in June 2009, the UK government stated that it would not pursue plain packaging at this time due in part to the lack of evidentiary support for the public health benefit of such a measure. The Australian National Preventative Health Taskforce has also issued a report on regulation of tobacco, alcohol and obesity which recommends, among other things, requiring plain packaging. The Ministry of Health has the report under consideration, but to date has not taken any action.

Health Warning Requirements: Many countries require substantial health warnings on cigarette packs. In the EU, for example, health warnings must cover 30% of the front and 40% of the back of cigarette packs. The FCTC requires health warnings that cover, at a minimum, 30% of the front and back of the pack, and recommends warnings covering 50% or more of the front and back of the pack. We support health warning requirements and, with certain exceptions, defer to the governments on the content of the warnings. In countries where health warnings are not required, we place them on packaging voluntarily in the official language or languages of the country. For example, we are voluntarily placing health warnings in many African countries in official local languages occupying 30% of the front and back of the pack. We oppose disproportionate warning size requirements, such as a Uruguayan decree published in June 2009 mandating health warnings that cover 80% of the front and back of the pack, because such requirements go beyond warning consumers about the health effects of smoking, instead infringing on our intellectual property rights and depriving us of our ability to use distinctive trademarks and pack designs to differentiate our products from those of our competitors. In Uruguay our subsidiary has filed an administrative appeal challenging the 80% warnings. It is not possible to predict the outcome of the challenge. We also oppose regulations that would require the placement of health warnings in the middle of the front and back of the pack as such placement serves no purpose other than to disrupt our trademarks and pack design. While we believe that textual warnings are sufficient, we do not oppose graphic warnings except for images that vilify tobacco companies and their employees or do not accurately represent the health effects of tobacco use, such as, for instance, certain government-mandated graphic health warnings in Brazil. In Brazil, our subsidiary has commenced litigation against the government with respect to these warnings. It is not possible to predict the outcome of this action.

We support government initiatives to educate the public on the serious health effects of smoking. We have established a website that includes, among other things, the views of public health authorities on smoking, disease causation in smokers, addiction and exposure to environmental tobacco smoke (ETS). The site reflects our agreement with the medical and scientific consensus that cigarette smoking is addictive, and causes lung cancer, heart disease, emphysema and other serious diseases in smokers. The website advises the public to rely on the messages of public health authorities in making all smoking-related decisions. The website s address is www.pmintl.com. The information on our website is not, and shall not be deemed to be, a part of this document or incorporated into any filings we make with the SEC.

Restrictions on Public Smoking: Reports with respect to the health effects of exposure to ETS have been publicized for many years, and many countries have restricted smoking in public places. The pace and scope of public smoking restrictions have increased significantly in most of our markets, particularly in the EU, where Italy, Ireland, the UK, the Netherlands, France, Finland and Sweden have banned virtually all indoor public smoking. In June 2009, the European Commission adopted a proposal for a non-binding Council Recommendation calling on all EU Member States to introduce, by 2012, comprehensive public smoking restrictions covering all closed public places, workplaces and public transport. Other countries around the world have adopted or are likely to adopt substantial public smoking restrictions. Some public health groups have called for, and some municipalities have adopted or proposed, bans on smoking in outdoor places, and some tobacco control groups have advocated banning smoking in cars with minors in them. The FCTC requires Parties to the treaty to adopt restrictions on public smoking, and the Conference of the Parties adopted guidelines on public smoking based on the premise that any exposure to ETS is harmful; the Guidelines call for total bans in all indoor public places, defining indoor broadly, and reject any exemptions based on type of venue (e.g., nightclubs). On private place smoking, such as in cars and homes, the Guidelines recommend increased education on the risk of exposure to ETS.

We support a single, consistent public health message on the health effects of exposure to ETS. Our website states that the conclusions of public health authorities on secondhand smoke warrant public health measures that regulate smoking in public places and that outright bans are appropriate in many places. For example, we support banning smoking in schools, playgrounds and other facilities for youth and in indoor public places where general public services are provided such as public transportation vehicles, supermarkets, public spaces in indoor shopping centers, cinemas, banks and post offices. We believe, however, that governments can and should seek a balance between the desire to protect non-smokers from exposure to secondhand smoke and allowing the millions of people who smoke to do so in some public places. In the hospitality sector, such as restaurants, bars, cafés and other entertainment establishments, the law should grant private business owners the flexibility to permit, restrict or prohibit smoking. Business owners can take into account their desire to cater to their customers preferences. In the workplace, designated smoking rooms can provide places for adults to smoke. Finally, we oppose legislation that would prohibit smoking in private places such as homes and apartments.

Reduced Cigarette Ignition Propensity Legislation: Reduced ignition propensity standards have been adopted in Canada and Australia, and are being considered in several other countries, notably New Zealand and the EU. On March 25, 2008, the European Commission formally adopted a decision to mandate the development, through the General Product Safety Directive, of reduced cigarette ignition propensity standards such as those implemented in New York, other American states and Canada. Finland has adopted its own national ignition propensity legislation requiring all cigarettes to be compliant by April 2010. We believe that reduced ignition propensity standards should be the same as those applied in New York and other jurisdictions to ensure that they are uniform and technically feasible, and that they are applied equally to all manufacturers and all tobacco products.

Illicit Trade: Regulatory measures and related governmental actions to prevent the illicit manufacture and trade of tobacco products are being considered by a number of jurisdictions. Article 15 of the FCTC requires Parties to the treaty to take steps to eliminate all forms of illicit trade, including counterfeiting, and states that national, regional and global agreements on this issue are essential components of tobacco control. The Conference of the Parties established an Intergovernmental Negotiating Body (INB) to negotiate a protocol on the illicit trade in tobacco products pursuant to Article 15 of the FCTC. The INB s Chairperson has drafted a text for the protocol, which includes the following main topics:

- licensing schemes for participants in the tobacco business;
- know your customer requirements; measures to eliminate money laundering and the development of an international system for the tracking and tracing of tobacco products and tobacco manufacturing equipment;
- the implementation of laws governing record-keeping, security and preventive measures, and Internet sales of tobacco products;
- measures to prohibit tax, regulatory and other advantages that apply in free trade areas, including a ban on duty free sales to individual customers;
- enforcement mechanisms, including the criminalization of participation in illicit trade in various forms and measures to strengthen the abilities of law enforcement agencies to fight illicit trade;
- obligations for tobacco manufacturers to control their supply chain with penalties for those that fail to do so; and
- programs to increase cooperation and technical assistance with respect to investigation and prosecutions and the sharing of information.

A session of the INB took place from June 28 until July 5, 2009, without leading to an agreed protocol. The next session is slated to take place in early 2010.

We support strict regulations and enforcement measures to prevent all forms of illicit trade in tobacco products, including tracking, tracing, labeling and record-keeping requirements, which could be best implemented through strict licensing systems. We agree that manufacturers should implement state-of-the-art monitoring systems of their sales and distribution practices, and we agree that where appropriately confirmed, manufacturers should stop supplying vendors who are shown to be knowingly engaged in illicit trade. However, we disagree with some of the

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draft protocol s provisions, including the proposed ban of duty free sales and measures that would impose payments on tobacco product manufacturers in an amount of lost taxes and duties from seized contraband tobacco products regardless of any fault on the manufacturers part. We are also working with a number of governments around the world on specific agreements and memoranda of understanding to address the illegal trade in cigarettes.

Cooperation Agreements to Combat Illicit Trade of Cigarettes: In July 2004, we entered into an agreement with the European Commission (acting on behalf of the European Community) that provides for broad cooperation with European law enforcement agencies on anti-contraband and anti-counterfeit efforts. All 27 Member States of the EU have signed the agreement. The agreement resolved all disputes between the European Community and the Member States, on the one hand, and us and certain affiliates, on the other hand, relating to these issues. Under the terms of the agreement, we agreed to make 13 payments over 12 years. Commencing in July 2007, we began making payments of approximately $75 million a year over the final 10 years of the agreement, each of which is to be adjusted based on certain variables, including our market share in the EU in the year preceding payment. We record these payments as an expense in cost of sales when product is shipped. We are also required to pay the excise taxes, VAT and customs duties on qualifying product seizures of up to 90 million cigarettes and are subject to payments of five times the applicable taxes and duties if product seizures exceed 90 million cigarettes in a given year. To date, our supplemental payments related to product seizures have been immaterial.

In July 2008, prior to its acquisition, our Canadian subsidiary Rothmans Inc. (Rothmans), entered into a settlement agreement between itself and RBH on the one hand and the Government of Canada and all ten provinces on the other hand to resolve the Royal Canadian Mounted Police s investigation relating to products exported from Canada by RBH during the 1989-1996 period. The terms of the settlement required, among other payments, the payment of CAD $50 million (or $41 million) towards a new government Contraband Tobacco Enforcement Strategy, which amount was paid by RBH in December 2008. *See Note 17. RBH Legal Settlement to the condensed consolidated financial statements.*

In June 2009, our subsidiaries Philip Morris Colombia and Coltabaco entered into an Investment and Cooperation Agreement with the Republic of Colombia, together with the Departments of Colombia and the Capital District of Bogotá, to promote investment and cooperation with respect to the Colombian tobacco market and to fight counterfeit and contraband tobacco products. The agreement provides $200 million in funding to the Colombian governments over a 20-year period to address issues of mutual interest, such as combating the illegal cigarette trade, including the threat of counterfeit tobacco products, and increasing the quality and quantity of locally grown tobacco. *See Note 16. Colombian Investment and Cooperation Agreement to the condensed consolidated financial statements.*

Other Legislation or Governmental Initiatives: 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 cigarettes, 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 and cash flows.

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 underdeclaration of import prices by Thai cigarette importers, the branch office of our subsidiary, Philip Morris (Thailand) Limited (PM Thailand), has been informed of DSI s proposal to bring charges against the branch office for alleged underpayment of customs duties and excise taxes of approximately $2 billion covering the period from July 28, 2003 to February 20, 2007. We have been cooperating with the DSI and believe that PM Thailand declared import prices in compliance with the Customs Valuation Agreement of the World Trade Organization, Thai law, and valuation methodologies previously agreed upon between the branch office and the Thai Customs Department. We are in the process of seeking clarification from the DSI on these issues.

Manufacturing Optimization Program

In 2008, we terminated our contract manufacturing arrangement with Philip Morris USA Inc. (PM USA). We completed the process of shifting all of our PM USA contract manufactured production to our facilities in Europe during the fourth quarter of 2008. During the first quarter of 2008, we recorded exit costs of $15 million related to the termination of our manufacturing contract with PM USA.

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Asset Impairment and Exit Costs

We recorded pre-tax asset impairment and exit cost charges of $2 million and $71 million (including the charges associated with the Manufacturing Optimization Program discussed above) during the six months ended June 30, 2009 and 2008, respectively, and $1 million and $48 million during the three months ended June 30, 2009 and 2008, respectively. The 2009 and 2008 pre-tax separation program charges primarily related to severance costs.

Cash payments related to our exit costs were $37 million and $15 million for the six months and three months ended June 30, 2009, respectively, and $63 million and $34 million for the six months and three months ended June 30, 2008, respectively. Future cash payments for exit costs incurred to date are expected to be approximately $76 million, which will be substantially paid by 2011.

Acquisitions

In July 2009, we announced that we had entered into an agreement to purchase 100% of the shares of privately owned Colombian cigarette manufacturer, Productora Tabacalera de Colombia, Protabaco Ltda., for $452 million. The transaction, which is subject to competition authority approval and final confirmatory due diligence, is expected to close within six months of the announcement. We project this acquisition to be marginally accretive to our earnings per share immediately.

In July 2009, we also entered into an agreement with Swedish Match AB to purchase its South African affiliate, Swedish Match South Africa (Proprietary) Limited, for ZAR 1.75 billion (approximately $222 million). The transaction is subject to South African regulatory approval and is expected to be completed by the end of the year. We anticipate that this acquisition will be marginally accretive to our earnings per share immediately.

In February 2009, we purchased the *Petterøes* tobacco business. Assets purchased consist primarily of amortizable intangible assets related to brands primarily sold in Norway and Sweden. The effect of this acquisition was not material to our consolidated financial position, results of operations or operating cash flows in any of the periods presented.

In February 2009, we entered into an agreement with Swedish Match AB (SWMA) to establish an exclusive joint venture to commercialize Swedish style snus and other smoke-free tobacco products worldwide, outside of Scandinavia and the United States. We and SWMA will license exclusively to the joint venture an agreed list of trademarks and intellectual property. The joint venture started operations on April 1, 2009. The effect of this agreement is not expected to be material to our 2009 consolidated financial position, results of operations or operating cash flows.

On July 31, 2008, we announced that we had entered into an agreement with Rothmans, which is located in Canada, to purchase, by way of a tender offer, all of the outstanding common shares of Rothmans for CAD $30 per share in cash, or CAD $2.0 billion ($1.9 billion based on the exchange rate prevailing at the time of the acquisition). Prior to this agreement, Rothmans sole holding was a 60% interest in RBH. The remaining 40% interest in RBH was owned by us. In October 2008, we completed the acquisition of all the Rothmans shares.

In June 2008, we purchased the fine cut trademark *Interval* and certain other trademarks in the other tobacco products category from Imperial Tobacco Group PLC for $407 million.

Trade Policy

It is our policy to comply with applicable laws of the United States and the laws of the countries in which we do business that prohibit trade with certain countries, organizations or individuals. We do not sell products or have a current intent to sell products in Cuba or North Korea. Certain of our subsidiaries have established commercial arrangements involving Syria, Iran, Myanmar and Sudan, in each case in compliance with our trade policy and applicable U.S. law.

A subsidiary sells products that are exported to Syria for sale in the domestic market in compliance with exemptions under applicable U.S. laws and regulations. Such sales are quantitatively not material, amounting to well below

0.5% of our consolidated annual volume and operating companies income in each of the past three years. We have no employees, operations or assets in Syria. Duty free sales to Syria have been suspended since a Managing Director and shareholder of the sole Syrian duty free customer of our subsidiary s distributor was placed on the Office of Foreign Assets Control s Specially Designated Nationals (SDN) list in February 2008. The distributor s customer itself was placed on the SDN list in July 2008.

In January 2007, a subsidiary received a license from the U.S. Office of Foreign Assets Control to export cigarettes to Iran. Our subsidiary received new licenses for 2008 and 2009; however, we have not made any sales to Iran pursuant to these licenses. We have no employees, operations or assets in Iran.

A subsidiary sells products to a duty free customer that resells those products to its respective customers, some of which have duty free operations in Myanmar. Another 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 Sudan. All such sales are in compliance with exemptions under applicable U.S. laws and regulations and are de minimis in volume and value. We have no employees, operations or assets in Myanmar or Sudan.

We do not believe that exempt or licensed sales of our products, which are agricultural products under U.S. law, and are not technological or strategic in nature, for ultimate resale in Syria, Iran, Myanmar or Sudan in compliance with U.S. laws, will or would present a material risk to our stockholders, our reputation or the value of our shares. To our knowledge, none of the governments of Syria, Myanmar or Sudan, nor entities controlled by those governments, receive cash or act as intermediaries in connection with these transactions, except that in Syria, the state tobacco monopoly, which is the only entity permitted to import tobacco products, purchases products from our customer for resale in the domestic market.

Certain states have enacted legislation permitting state pension funds to divest or abstain from future investment in stocks of companies that do business with 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, 2009

The following discussion compares operating results within each of our reportable segments for the six months ended June 30, 2009, with the six months ended June 30, 2008.

European Union. Net revenues, which include excise taxes billed to customers, decreased $1.8 billion or 11.8%. Excluding excise taxes, net revenues decreased $623 million (12.7%) to $4.3 billion. This decrease was due to unfavorable currency ($704 million) and lower volume/mix ($171 million), partially offset by net price increases ($214 million) and the impact of acquisitions ($38 million).

Operating companies income decreased $324 million (13.2%). This decrease was due primarily to unfavorable currency ($425 million), lower volume/mix ($144 million) and higher marketing, administration and research costs ($44 million), partially offset by net price increases ($214 million), lower pre-tax charges for asset impairment and exit costs ($54 million) and the impact of acquisitions ($27 million).

The total cigarette market in the European Union declined 3.2%. Adjusted for the favorable impact of a trade inventory distortion in the Czech Republic in anticipation of the January 2008 excise tax increase, the total cigarette market declined by 4.9%. The decline primarily reflects the impact of the 2008 tax-driven price increases and down-trading to other tobacco products in Poland, lower retail trade inventories and worsening economic conditions in Spain, and trade inventory movements ahead of price increases in June 2008 and the impact of price increases in the first quarter of 2009 in Italy. Our cigarette shipment volume decreased 3.3%, reflecting a lower total market, partially offset by distributor inventory adjustments and higher shipments in the Czech Republic, reflecting a favorable comparison with 2008. Our market share in the European Union was down 0.2 points to 38.9% as market share gains, primarily in Austria, Belgium, Germany, Greece, Hungary, the Netherlands, the Nordics and Portugal were offset by share declines in Italy and Poland. *Marlboro* s share in the European Union was down 0.2 points.

In the Czech Republic, total industry shipments were up over 60%, reflecting lower shipments in 2008 as a result of the 2007 trade inventory movements in anticipation of the January 2008 excise tax increase. Adjusted for this distortion, the total market is estimated to have declined 11.1%, due to tax-driven price increases in the third quarter of 2008, and market share increased 1.0 point to 51.9%. Our shipments were up 30.7%.

In France, the total cigarette market was up 2.7%. Our shipments were up 3.9% and market share increased slightly by 0.1 point to 41.0%, reflecting higher share for the *Philip Morris* brand, *Chesterfield* and *L&M*, partially offset by *Marlboro*, down 0.7 points to 26.9%.

In Germany, the total cigarette market was down 1.4%. Our shipments were down 0.3% and market share increased 0.4 points to 37.4%, mainly reflecting higher share for *L&M*, offset by lower *Marlboro* share, down 0.5 share points to 23.9%.

In Italy, the total cigarette market was down 3.7%, reflecting the impact of price increases in 2008 and in the first quarter of 2009. Our shipments declined 4.2%, reflecting a lower total market and a lower share, which declined 0.6 share points to 54.0%. *Marlboro* s share was down 0.2 share points to 22.3%.

In Poland, the total cigarette market was down 13.7%, primarily reflecting the impact of the 2008 European Union tax harmonization-driven price increases. Our shipments declined 19.8% and market share declined 2.7 share points to 35.8%, primarily reflecting the share loss incurred by our mid and low-price brands due to intense price competition. *Marlboro* share was up 0.1 share point to 8.8%.

In Spain, the total cigarette market was down by 8.0%, primarily due to a one-off reduction of retail trade inventories driven by working capital requirements, the worsening economic environment and consumer down-trading to roll-your-own products. Our shipments were down 5.6%, reflecting the lower total market, partially offset by favorable distributor inventory movements. Our market share increased 0.1 share point to 31.8%, mainly reflecting higher share of *L&M* and *Chesterfield*, offset by lower *Marlboro* share, down 0.6 points to 15.5%.

Eastern Europe, Middle East and Africa. Net revenues, which include excise taxes billed to customers, decreased $854 million (12.1%). Excluding excise taxes, net revenues decreased $503 million (14.0%) to $3.1 billion. This decrease was due primarily to unfavorable currency ($773 million) and lower volume/mix ($74 million), partially offset by net price increases ($341 million).

Operating companies income decreased $272 million (18.2%). This decrease was due primarily to unfavorable currency ($468 million), higher marketing, administration and research costs ($76 million) and lower volume/mix ($68 million), partially offset by net price increases ($341 million).

Our cigarette shipment volume decreased 1.3%, due in part to: Ukraine, driven by the unfavorable impact of a series of tax-driven price increases and a worsening economy; Duty Free, reflecting the continuing impact of the global economic crisis on travel; and Romania, reflecting a total market decline following tax-driven price increases and the impact of the economic crisis. These declines were partially offset by increased cigarette shipment volume in Egypt and Turkey.

In Russia, our shipment volume was down 0.7%. Shipment volume of our premium portfolio was down 9.4%, primarily due to a decline in *Marlboro* of 17.1%, reflecting down-trading from the premium segment. *Parliament* shipment volume was unchanged. In the mid-price segment, shipment volumes of *Chesterfield* and *L&M* were down 11.7% and 22.3%, respectively, partially offset by *Muratti*, up 6.0%. In the low-price segment, shipment volumes of *Bond Street* and *Optima*, were up by 31.5% and 20.5%, respectively. According to a new retail audit panel implemented with AC Nielsen this year, which more accurately reflects the coverage of the market, our market share of 25.2% was up 0.4 points. In our premium segment, *Parliament* was up 0.2 share points and *Marlboro* was flat. A share decline in the mid-price segment, mainly due to *L&M*, was offset by share gains within the value and low-price segment, primarily led by *Bond Street* and *Optima*.

In Turkey, our shipment volume was up 9.2%, driven by trade inventory movements ahead of price increases in early July 2009 and the growth of *Parliament* and *Marlboro*, as well as the success of recently launched *Lark Recess Blue*. Our market share of 42.6% grew 1.7 points, driven by the strong performance of *Parliament*, up 1.4 share points, and *Lark Recess Blue*, launched in the fourth quarter of 2008, with a share of 2.7%.

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In Ukraine, our shipment volume was down 7.5%, reflecting the impact of tax-driven price increases and a worsening economy. Our market share rose 1.1 share points to 36.0%, reflecting share gains of 0.6 points for premium *Parliament* and 0.7 points for mid-price *Chesterfield*.

Asia. Net revenues, which include excise taxes billed to customers, decreased $342 million (5.6%). Excluding excise taxes, net revenues increased $56 million (1.8%) to $3.2 billion. This increase was due to net price increases ($228 million) and higher volume/mix ($16 million), partially offset by unfavorable currency ($188 million).

Operating companies income increased $207 million (19.3%). This increase was due primarily to net price increases ($228 million), favorable currency ($23 million), higher volume/mix ($14 million), and the 2008 pre-tax charges for asset impairment and exit costs ($14 million), partially offset by higher marketing, administration and research costs ($65 million) and higher manufacturing costs.

Our shipment volume increased 2.1%, mainly due to gains in Indonesia, Korea and Pakistan. The increase in Pakistan was due primarily to the cigarette excise tax-driven trade inventory movements in the second quarter of 2009. Shipment volume of *Marlboro* grew by 7.2%, reflecting strong performance across the region, particularly in Indonesia, Japan, Korea and the Philippines.

In Indonesia, our shipment volume rose by 2.0%, reflecting growth from *Marlboro* up 8.2%, helped by the launch of *Marlboro Black Menthol* in March, and *A Mild*. Bolstered by the continuing strong performance of *A Volution*, the first super slims kretek in the Indonesian market, shipment volume for the *A Mild* family increased by 13.7%.

In Japan, the total cigarette market declined by 6.5%. Adjusting for various factors, including the impact of the nationwide implementation of vending machine age verification in July 2008 and trade inventory movements, the total market is estimated to have declined by approximately 3.9%. Our shipments were down by 1.4%, primarily due to the total market decline and the impact of the vending machine age verification mentioned above, partially offset by favorable inventory movements as of the start of 2009 linked to a sourcing strategy change from the United States to Europe. Our market share of 23.9% was flat and market share of *Marlboro* increased 0.7 points to 10.5%, driven by the August 2008 launch of *Marlboro Black Menthol*, the November 2008 launch of *Marlboro Filter Plus One* and the June 2009 launch of *Marlboro Black Menthol One*. Share of *Lark* was down 0.2 share points to 6.5%, partly offset by the March 2009 national roll-out of *Lark Classic Milds*, and the introduction of *Lark Mint Splash* in test markets in certain parts of Japan.

In Korea, the total market was up 1.5%. Our shipment volume increased 21.4%, driven by market share increases. Our market share reached 13.7%, up 2.3 share points, driven by strong performances from *Marlboro*, up 1.1 share points, *Parliament*, up 1.0 share point, and *Virginia Slims*, up 0.2 share points.

Latin America & Canada. Net revenues, which include excise taxes billed to customers, increased $409 million (14.4%). Excluding excise taxes, net revenues increased $171 million (16.5%) to $1.2 billion. This increase was due to the impact of the Rothmans acquisition in Canada ($282 million) and net price increases ($124 million), partially offset by unfavorable currency ($198 million) and lower volume/mix ($37 million).

Operating companies income increased $54 million (31.4%). This increase was due primarily to the impact of the Rothmans acquisition in Canada ($125 million), net price increases ($124 million) and the 2008 charge related to the RBH legal settlement ($124 million), partially offset by the 2009 charge related to the Colombian Investment and Cooperation Agreement ($135 million), unfavorable currency ($82 million), lower volume/mix ($36 million), higher marketing, administration and research costs ($30 million) and higher manufacturing costs.

Cigarette shipment volume of 49.6 billion units increased by 7.4%, reflecting the Rothmans acquisition in Canada. Excluding acquisition volume, shipments decreased by 2.4%, primarily due to the impact of market contraction and unfavorable distributor inventory levels in Colombia, and tax-driven price increases in Mexico, partly offset by a higher market share in Argentina.

In Argentina, our cigarette shipment volume increased 2.4% and our market share increased 2.8 points to 73.3%, fueled by the *Philip Morris* brand, up 3.7 share points. *Marlboro* s share increased 0.2 share points.

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In Canada, the total cigarette market was down 1.3%. Assuming we had owned RBH for the first six months of 2008, our cigarette shipment volume would have been essentially flat and market share would have grown 0.6 points to 33.6%, led by premium price *Belmont*, up 0.3 points, and low-price *Accord* and *Quebec Classiques,* up 1.2 points and 0.7 points, respectively, partially offset by mid-price *Number 7*, down 1.2 share points.

In Mexico, the total cigarette market was down 6.0%, reflecting the impact of tax-driven price increases in January and December 2008. Although our cigarette shipment volume declined 3.1%, market share increased 2.0 points to 69.1%, fueled by *Delicados*, up 1.6 points, and by *Benson & Hedges*, up 0.5 points.

Operating Results Three Months Ended June 30, 2009

The following discussion compares operating results within each of our reportable segments for the three months ended June 30, 2009, with the three months ended June 30, 2008.

European Union. Net revenues, which include excise taxes billed to customers, decreased $1.1 billion (13.6%). Excluding excise taxes, net revenues decreased $364 million (13.8%) to $2.3 billion. This decrease was due to unfavorable currency ($453 million) and lower volume/mix ($77 million), partially offset by net price increases ($144 million) and the impact of acquisitions ($22 million).

Operating companies income decreased $124 million (9.6%). This decrease was due primarily to unfavorable currency ($241 million), lower volume/mix ($68 million) and higher marketing, administration and research costs ($26 million), partially offset by net price increases ($144 million), lower pre-tax charges for asset impairment and exit costs ($47 million) and the impact of acquisitions ($16 million).

The total cigarette market in the European Union declined 2.6%. Adjusted for the favorable impact of a trade inventory distortion in the Czech Republic in anticipation of the January 2008 excise tax increase, the total cigarette market declined by 4.0%. The decline primarily reflects the impact of tax-driven price increases in Poland, trade inventory movements ahead of price increases in June 2008 and the impact of price increases in the first quarter of 2009 in Italy, and worsening economic conditions in Spain. Our cigarette shipment volume decreased 3.0%, reflecting a lower total market as described above, particularly in Italy, Poland and Spain. Our market share in the European Union was essentially flat at 39.3% as market share gains, primarily in Austria, Germany, Greece, the Netherlands, the Nordics, Portugal and the United Kingdom, were offset by share declines in Italy, Poland and Switzerland. *Marlboro* s share in the European Union was essentially unchanged, aided by the roll-out of a number of initiatives, including *Marlboro Gold Original* in France, Italy, Norway, Sweden and Switzerland, *Marlboro Gold Touch* in Austria, Italy and Greece, *Marlboro Flavor Plus* in Belgium, and *Marlboro Intense* in Finland.

In the Czech Republic, total industry shipments were up 39.5%, reflecting lower shipments in 2008 as a result of 2007 trade inventory movements in anticipation of the January 2008 excise tax increase. Adjusted for this distortion, the total market is estimated to have declined 9.2%, due to tax-driven price increases in the third quarter of 2008, and our market share increased 1.9 points to 51.3%. Our shipments were up 5.8%.

In France, the total cigarette market was up 3.6%. Our shipments were up 6.6%, and market share increased 0.1 point to 41.0%, reflecting higher share for the *Philip Morris* brand and *L&M*, partially offset by *Marlboro*, down 0.7 points to 26.9%, but in line with its share in the first quarter of 2009 and fourth quarter of 2008.

In Germany, the total cigarette market was essentially flat. Our shipments were up 2.2% and market share increased 0.8 points to 38.8%, mainly reflecting higher share for *L&M* and trade inventory movements, offset by lower *Marlboro* share, down 0.3 share points to 24.8%.

In Italy, the total cigarette market was down 3.7%, reflecting trade inventory movements ahead of price increases in June 2008 and the impact of price increases in the first quarter of 2009. Our shipments declined 3.1%, partially offset by favorable distributor inventory movements. Our market share declined 0.3 share points to 54.3%. *Marlboro* s share was essentially stable at 22.7%.

In Poland, the total cigarette market was down 11.7%, primarily reflecting the impact of the 2008 European Union tax harmonization-driven price increases. Our shipments declined 16.6% and market share declined 2.1 share points to 36.5%, primarily reflecting the share loss incurred by our mid and low-price brands due to intense price competition. *Marlboro* s share was up 0.6 points to 9.5% and up 1.5 points versus the first quarter of 2009.

In Spain, the total cigarette market was down by 6.2%, primarily due to the worsening economic environment and consumer down-trading to roll-your-own products. Our shipments were down 6.9%, reflecting the lower total market and the impact of unfavorable distributor inventory movements. Our market share was up 0.2 points to 31.8%, mainly reflecting higher share for *L&M* and *Chesterfield*, up 0.7 and 0.2 share points, respectively, offset by lower *Marlboro* share, down 0.7 points to 15.4%.

Eastern Europe, Middle East and Africa. Net revenues, which include excise taxes billed to customers, decreased $402 million (10.6%). Excluding excise taxes, net revenues decreased $293 million (15.2%) to $1.6 billion. This decrease was due primarily to unfavorable currency ($461 million) and lower volume/mix ($50 million), partially offset by net price increases ($215 million).

Operating companies income decreased $178 million (21.9%). This decrease was due primarily to unfavorable currency ($267 million), higher marketing, administration and research costs ($61 million), lower volume/mix ($44 million) and higher manufacturing costs, partially offset by net price increases ($215 million).

Our cigarette shipment volume decreased 2.1%, principally due to: Ukraine, which suffered from the unfavorable impact of a series of tax-driven price increases, the largest of which was implemented in May of this year; Romania, reflecting a total market decline and unfavorable trade inventory movements following tax-driven price increases in April 2009; and Duty Free, reflecting the continuing impact of the global economic crisis on travel. These declines were partially offset by increased cigarette shipment volume in Egypt and Turkey.

In Russia, our shipment volume decreased 1.3%. Shipment volume of our premium portfolio was down 12.3%, primarily due to declines in *Marlboro* and *Parliament* of 19.1% and 4.3%, respectively, reflecting down-trading from the premium segment. In the mid-price segment, shipment volumes of *Chesterfield* and *L&M* were down 15.7% and 23.1%, respectively, partially offset by *Muratti*, up 9.4%. In the low-price segment, shipment volumes of *Bond Street* and *Optima* were up by 34.5% and 23.0%, respectively. According to a new retail audit panel implemented with AC Nielsen this year, which more accurately reflects the coverage of the market, our market share of 25.2% was up 0.5 points. In our premium segment, *Parliament* was up 0.1 share point and *Marlboro* was essentially flat.

In Turkey, our shipment volume was up 14.4%, partly driven by trade inventory movements ahead of price increases in early July 2009, fueled by growth of *Marlboro* and *Parliament*, as well as the success of *Lark Recess Blue*. Our market share of 42.8% grew 1.7 points, driven by the strong performance of *Parliament*, up 1.2 share points, and *Lark Recess Blue*, launched in the fourth quarter of 2008, with a share of 3.2%.

In Ukraine, although our shipment volume declined 14.1%, reflecting the impact of tax-driven price increases and a worsening economy, our market share rose 1.0 share point to 36.2%, driven by share gains of 0.6 points for both premium *Parliament* and mid-price *Chesterfield.*

Asia. Net revenues, which include excise taxes billed to customers, decreased $223 million (7.0%). Excluding excise taxes, net revenues decreased $31 million (1.9%) to $1.6 billion. This decrease was due to unfavorable currency ($139 million) and lower volume/mix ($10 million), partially offset by net price increases ($118 million).

Operating companies income increased $96 million (18.4%). This increase was due primarily to net price increases ($118 million), partially offset by higher marketing, administration and research costs ($11 million) and lower volume/mix ($5 million).

Our shipment volume increased 2.0%, mainly due to gains in Indonesia, Korea and Pakistan, the latter resulting from cigarette excise tax-driven trade inventory movements. Shipment volume of *Marlboro* grew by 4.1%, reflecting a strong performance across the region, particularly in Indonesia, Korea and the Philippines.

In Indonesia, our shipment volume rose by 1.3%, reflecting growth from *Marlboro*, up 5.4%, helped by the launch of *Marlboro Black Menthol* in March, and *A Mild*. Bolstered by the continuing strong performance of *A Volution*, the first super slims kretek in the Indonesian market, shipment volume for the *A Mild* family increased by 14.8%.

In Japan, the total cigarette market declined by 7.4%. Adjusting for various factors, including the impact of the nationwide implementation of vending machine age verification in July 2008 and trade inventory movements, the total market is estimated to have declined by approximately 3.9%. Our shipments were down by 2.6%, primarily due to the total market decline and the impact of the vending machine age verification mentioned above, partially offset by favorable inventory movements linked to a sourcing strategy change from the United States to Europe. Our market share of 24.0% was up 0.1 point and market share of *Marlboro* increased 0.8 points to 10.6%, driven by the August 2008 launch of *Marlboro Black Menthol*, the November 2008 launch of *Marlboro Filter Plus One* and the June 2009 launch of *Marlboro Black Menthol One*. Share of *Lark* was down 0.3 share points to 6.4%, partially offset by the March 2009 national roll-out of *Lark Classic Milds*, and the introduction of *Lark Mint Splash* in test markets in certain parts of Japan.

In Korea, the total market was up by 2.8%. Our shipment volume increased 17.9%, driven by market share increases. Our market share reached 13.7%, up 1.9 share points, driven by strong performances from *Marlboro*, up 0.8 share points, *Parliament*, up 0.7 share points, and *Virginia Slims*, up 0.2 share points.

Latin America & Canada. Net revenues, which include excise taxes billed to customers, increased $259 million (17.8%). Excluding excise taxes, net revenues increased $113 million (21.4%) to $641 million. This increase was due to the impact of the Rothmans acquisition in Canada ($158 million) and net price increases ($72 million), partially offset by unfavorable currency ($113 million) and lower volume/mix ($4 million).

Operating companies income increased $48 million (100+%). This increase was due primarily to the 2008 charge related to the RBH legal settlement ($124 million), net price increases ($72 million) and the impact of the Rothmans acquisition in Canada ($70 million), partially offset by the 2009 charge related to the Colombian Investment and Cooperation Agreement ($135 million), unfavorable currency ($47 million), lower volume/mix ($8 million), higher marketing, administration and research costs ($10 million) and higher manufacturing costs.

Cigarette shipment volume of 25.6 billion units increased by 10.5%, reflecting the Rothmans acquisition in Canada. Excluding acquisition volume, shipments decreased by 0.2%.

In Argentina, our cigarette shipment volume increased 3.6% and our market share increased 2.8 points to 73.0%, fueled by the *Philip Morris* brand, up 3.3 share points. *Marlboro* s share was up 0.3 share points.

In Canada, the total cigarette market was down 0.7%, primarily reflecting the impact of price increases, particularly in the low-price segment. Assuming we had owned RBH for the second quarter of 2008, our cigarette shipment volume would have been essentially flat and market share would have grown 0.3 points to 33.4%, led by *Belmont*, up 0.3 points, and *Accord* and *Quebec Classiques*, up 1.0 and 0.9 share points, respectively, partially offset by mid-price *Number 7*, down 1.2 share points.

In Mexico, the total cigarette market was down 4.2%, reflecting the impact of tax-driven price increases in January and December 2008. Although our cigarette shipment volume declined 1.7%, market share increased 1.8 points to 69.0%, fueled by *Delicados*, up 1.5 points, and by *Benson & Hedges*, up 0.5 points.

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Financial Review

Net Cash Provided by Operating Activities

Net cash provided by operating activities of $4,573 million during the first six months of 2009 decreased $526 million from the comparable 2008 period. The decrease was due primarily to lower net earnings attributable to PMI ($343 million, comprising higher results from operations more than offset by $730 million of unfavorable currency) and higher contributions to pension plans ($241 million), partially offset by a lower use of cash to fund working capital ($44 million).

The lower use of cash for working capital was due primarily to the following:

- inventories, primarily due to stock movements related to tax-driven price increases, as well as lower leaf inventory levels; and
- accrued liabilities, primarily due to the timing of interest payments, partially offset by;
- accounts receivables, reflecting the timing of cash collections; and
- higher tax payments, reflecting the timing of payments.

Net Cash Used in Investing Activities

One element of our growth strategy is to strengthen our brand portfolio and/or expand our geographic reach through an active program of selective acquisitions. We are constantly evaluating potential acquisition opportunities. From time to time we may engage in confidential acquisition negotiations that are not publicly announced unless and until those negotiations result in a definitive agreement.

Net cash used in investing activities of $395 million during the first six months of 2009 decreased $578 million from the comparable 2008 period due primarily to lower capital expenditures ($251 million), the 2008 purchase of the *Interval* trademark, and higher cash proceeds from the settlement of net investment hedges ($119 million), partially offset by higher cash used for acquisitions ($180 million).

In February 2009, we purchased the *Petterøes* tobacco business.

In June 2008, we purchased the fine cut trademark *Interval* and certain other trademarks in the other tobacco products category from Imperial Tobacco Group PLC for $407 million. The cost of this purchase is reflected in other investing activities in the condensed consolidated statement of cash flows for the six months ended June 30, 2008.

Net Cash Used in Financing Activities

During the first six months of 2009, net cash used in financing activities was $3.1 billion, compared with net cash used in financing activities of $2.5 billion during the first six months of 2008. During the first six months of 2009, we used a total of $6.0 billion to repurchase our common stock, pay dividends to our public stockholders, and repay debt. These uses were partially offset by proceeds from our debt offerings in 2009 of $3.0 billion. For further details on our debt offerings, see Note 13. *Indebtedness* to our condensed consolidated financial statements. During the first six months of 2008, we used a total of $3.1 billion to pay dividends to Altria and repurchase our common stock, partially offset by increased net borrowings.

On May 1, 2008, we began a $13.0 billion two-year share repurchase program. Since May 2008, we have repurchased 178.1 million shares of our common stock at a cost of $8.1 billion ($45.67 per share). During the first six months of 2009, we repurchased 71.4 million shares of our common stock at a cost of $2.7 billion. From May 1, 2008 through June 30, 2008, we repurchased 41.4 million shares of our common stock at a cost of $2.1 billion.

Dividends paid to public stockholders in the first six months of 2009 were $2.2 billion.

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Debt and Liquidity

We define cash and cash equivalents as short-term, highly liquid investments, readily convertible to known amounts of cash which mature within 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 and a short-term rating of A-1/P-1.

Credit Ratings At June 30, 2009, our debt 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+	Negative

We do not expect the Fitch negative outlook to have a significant impact on our borrowing costs or our ability to access the global capital markets.

Credit Lines At June 30, 2009, our committed credit lines were as follows (in billions of dollars):

Type	Committed Credit Lines	Commercial Paper
3-year revolving credit, expiring December 4, 2010	$ 0.9	
5-year revolving credit, expiring December 4, 2012	2.7	
Euro 5-year revolving credit, expiring May 12, 2010	2.7	
Total facilities	$ 6.3	
Commercial paper outstanding		$ -

At June 30, 2009, there were no borrowings under the committed credit lines.

Certain subsidiaries of Lehman Brothers Holdings Inc. (Lehman) were credit providers under the revolving credit facilities expiring on May 12, 2010, December 4, 2010 and December 4, 2012 in the total amount of $0.5 billion. Lehman filed for bankruptcy protection on September 15, 2008. The commitments of its relevant affiliate under the facilities expiring on December 4, 2010 and December 4, 2012 have been terminated and steps are ongoing to terminate the commitment of the relevant affiliate under the facility expiring on May 12, 2010. The committed credit lines shown in the table above exclude all amounts related to Lehman.

All banks participating in our committed revolving credit facilities are highly rated by the credit rating agencies. We are monitoring the credit quality of our banking group and at this time we are not aware of any other potential non-performing credit provider.

These facilities require us to maintain a ratio of earnings before interest, taxes, depreciation and amortization (EBITDA) to interest of not less than 3.5 to 1.0 on a rolling twelve month basis. At June 30, 2009, our ratio calculated in accordance with the agreements was 15.3 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.

These facilities can be used to support the issuance of commercial paper in Europe and the United States. The multi-year facilities enable us to reclassify short-term debt to long-term debt.

In addition to the above, certain of our subsidiaries maintain credit lines to meet their respective working capital needs. These credit lines, which amounted to approximately $2.6 billion at June 30, 2009, are for the sole use of these businesses. Borrowings on these lines amounted to $399 million at June 30, 2009 and $375 million at December 31, 2008.

Commercial Paper Facilities We have two $6 billion commercial paper programs in place, one in the U.S. and one in Europe. Our recent issuances have shown that our A-1/P-1/F1 ratings have allowed us to maintain full access to the Tier-1 commercial paper market at competitive rates despite the current market turmoil.

The $6.3 billion of committed revolving credit facilities are more than adequate to back-stop our commercial paper issuance needs. The existence of these facilities, coupled with our operating cash flows, will enable us to meet our liquidity requirements.

Debt Our total debt was $14.1 billion at June 30, 2009 and $12.0 billion at December 31, 2008.

On April 25, 2008, we filed a shelf registration statement with the 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.

In March 2009, we entered into a Euro Medium Term Note Program under which we may from time to time issue unsecured notes. Under this program, we issued Euro 2.0 billion (approximately $2.6 billion) of notes in March 2009. The Euro notes bear the following terms:

- Euro 1.25 billion total principal due March 2012 at a fixed interest rate of 4.250%.
- Euro 750 million total principal due March 2016 at a fixed interest rate of 5.750%.

In March 2009, we also issued CHF 500 million (approximately $431 million) of 3.250% bonds, due in March 2013.

Guarantees As discussed in Note 11. *Contingencies* to our condensed consolidated financial statements, at June 30, 2009, our third-party guarantees, which are primarily related to excise taxes, were $48 million, of which $43 million have no specified expiration dates. The remainder ($5 million) expires through 2013, with no guarantees expiring through June 30, 2010. We are required to perform under these guarantees in the event that a third party fails to make contractual payments. We do not have a liability on our condensed consolidated balance sheet at June 30, 2009, as the fair value of these guarantees is insignificant due to the fact that the probability of future payment under these guarantees is remote.

Under the terms of the Distribution Agreement between Altria and us, liabilities concerning tobacco products will be allocated based in substantial part on the manufacturer. We will indemnify Altria and PM USA for liabilities related to tobacco products manufactured by us or contract manufactured for us by PM USA, and PM USA will indemnify us for liabilities related to tobacco products manufactured by PM USA, excluding tobacco products contract manufactured for us. We do not have a liability recorded on our balance sheet at June 30, 2009, as the fair value of this indemnification is insignificant since the probability of future payments under this indemnification is remote.

At June 30, 2009, we are also contingently liable for $3.7 billion of guarantees related to our own performance, consisting of the following:

- $3.2 billion of guarantees of excise tax and import duties related primarily to the shipment of our products. In these agreements, a financial institution provides a guarantee of tax payments to the respective government agency. We then issue guarantees to the respective financial institution for the payment of the

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taxes. These are revolving facilities that are integral to the shipment of our products, and the underlying taxes payable are recorded on our condensed consolidated balance sheet.

$0.5 billion of other guarantees, consisting principally of guarantees of tax payments directly granted to respective government agencies and of guarantees of lines of credit for certain of our subsidiaries.

Although these guarantees of our own performance are frequently short-term in nature, they are expected to be replaced, upon expiration, with similar guarantees of similar amounts. These items have not had, and are not expected to have, a significant impact on our liquidity.

Equity and Dividends

As discussed in Note 1. *Basis of Presentation and Separation from Altria Group, Inc.*, on March 28, 2008, Altria distributed all of its interest in our company to Altria stockholders of record as of the close of business on March 19, 2008 in a tax-free transaction pursuant to Section 355 of the U.S. Internal Revenue Code. The distribution resulted in a net increase to our stockholders equity of $449 million during March 2008, reflecting payments to us for stock-based compensation under the terms of the Employee Matters Agreement with Altria.

As discussed in Note 4. *Stock Plans*, during the six months ended June 30, 2009, we granted 3.8 million shares of restricted stock and deferred stock awards at a weighted-average grant date fair value of $36.93. The restricted stock and deferred stock awards will not vest until the completion of the original restriction period, which is typically three years from the date of the original grant.

On May 1, 2008, we began a $13.0 billion two-year share repurchase program. Since May 2008, we have repurchased 178.1 million shares of our common stock at a cost of $8.1 billion. During the first six months of 2009, we repurchased 71.4 million shares of our common stock at a cost of $2.7 billion. During the second quarter of 2009, we repurchased 34.7 million shares of our common stock at a cost of $1.4 billion.

Dividends paid to public stockholders in the first six months of 2009 were $2.2 billion. During the third quarter of 2008, our Board of Directors approved a 17.4% increase in the quarterly dividend to $0.54 per common share. As a result, the present annualized dividend rate is $2.16 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. 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 are currently invested in bank deposits maturing within less than 30 days.

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

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 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 7. *Financial Instruments* and Note 14. *Fair Value Measurements* to our condensed consolidated financial statements for further details on our derivative financial instruments.

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New Accounting Standards

See Note 9. *Earnings Per Share* and Note 18. *New Accounting Standards* to our condensed consolidated financial statements for a discussion of new accounting standards.

Contingencies

See Note 11. *Contingencies* to the condensed consolidated financial statements for a discussion of contingencies.

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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 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 sections preceding our discussion of operating results of our business. 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 affect our profitability disproportionately 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 and counterfeit.

The European Commission is seeking to alter minimum retail selling price systems.

Several EU Member States have enacted laws establishing a minimum retail selling price for cigarettes and, in some cases, other tobacco products. The European Commission has commenced proceedings against these Member States, claiming that minimum retail selling price systems infringe EU law. If the European Commission s infringement actions are successful, they could adversely impact excise tax levels and/or price gaps in those markets.

Our business faces significant governmental action aimed at increasing regulatory requirements with the goal of 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 actions will continue to reduce consumption levels. Significant regulatory developments will take place over the next few years

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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 with the purpose of reducing initiation of tobacco use and encouraging cessation. In addition, the FCTC has led to increased efforts by tobacco control advocates and public health organizations to reduce the palatability and appeal of tobacco products to adult smokers. Regulatory initiatives that have been proposed, introduced or enacted include:

- 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 generic packaging;
- 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;
- requirements regarding testing, disclosure and use 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 allowances for travelers; and
- encouraging litigation against tobacco companies.

Partly because of some or a combination of these measures, unit sales of tobacco products in certain markets, principally Western Europe and Japan, have been in general decline and we expect this trend to continue. Our operating income could be significantly affected by any significant decrease in demand for our products, any significant increase in the cost of complying with new regulatory requirements and requirements that lead to a commoditization of tobacco products.

Litigation related to cigarette smoking and exposure to ETS 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 of the tobacco-related litigation are significant and, in certain cases in Brazil, Israel, Nigeria and Canada, range into the billions of 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 11. *Contingencies* to our 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, 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 low-price products or innovative products, higher cigarette taxes, higher absolute prices and larger gaps between 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, government-owned tobacco enterprises, principally in China, Egypt, Thailand, Taiwan, Vietnam and Algeria. Industry consolidation and privatizations of governmental enterprises

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have led to an overall increase in competitive pressures. Some competitors have different profit and volume objectives and some international competitors are less susceptible to changes in currency exchange rates.

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

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 could disrupt our supply chain 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. In certain markets, we are dependent on governmental approvals of various actions such as price changes.

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 international partners and employees.

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, high-price and mid-price brands and our profitability could suffer accordingly.

We lose revenue as a result of counterfeiting, contraband and cross-border purchases.

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 amount of revenue we lose as a result of this activity. In addition, our revenues are reduced by contraband and legal cross-border purchases.

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 custom duties and/or excise taxes, and allegations of false and misleading usage of descriptors such as lights and ultra lights. 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 governmental investigations to which we are subject.

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We may be unsuccessful in our attempts to produce cigarettes with the potential to reduce the risk of smoking-related diseases.

We continue to seek ways to develop commercially viable new product technologies that may reduce the risk of smoking. Our goal is to develop products whose potential for risk reduction can be substantiated and meet adult smokers taste expectations. We may not succeed in these efforts. If we do not succeed, but one or more of our competitors do, we may be at a competitive disadvantage. Further, we cannot predict whether regulators will permit the marketing of tobacco products with claims of reduced risk to consumers, which could significantly undermine the commercial viability of these products.

Our reported results could be adversely affected by 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 will translate 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.

Because we are a U.S. holding company, our most significant source of funds will be 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 in the years such distributions take place. Additionally, the Obama Administration has indicated that it favors changes in U.S. tax law, which 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.

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.

We may be unable to expand our portfolio through successful acquisitions.

One element of our growth strategy is to strengthen our brand portfolio and market positions through selective acquisitions. Acquisition opportunities are limited and acquisitions 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 will be accretive to earnings.

Government mandated prices, production control programs, shifts in crops driven by economic conditions and adverse weather patterns 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. 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.

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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.

We could incur significant indemnity obligations if our action or failure to act causes the Spin-off to be taxable.

Under the tax sharing agreement between Altria and us, we have agreed to indemnify Altria and its affiliates if we take, or fail to take, any action where such action, or failure to act, precludes the Spin-off from qualifying as a tax-free transaction. For a discussion of these restrictions, please see The Distribution U.S. Federal Income Tax Consequences of the Distribution, which is included in our Registration Statement on Form 10.

Your percentage ownership of our common shares may be diluted by future acquisitions.

To the extent we issue new shares of common stock to fund acquisitions, your percentage ownership of our shares will be diluted. There is no assurance that the effect of this dilution will be offset by accretive earnings from the acquisition.

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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 11. *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 Report on Form 10-K for the year ended December 31, 2008. 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, 2009 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, 2009 April 30, 2009 (1)	11,109,400	$ 36.85	154,578,464	$ 5,852,447,504
May 1, 2009 May 31, 2009 (1)	15,142,404	$ 41.29	169,720,868	$ 5,227,196,524
June 1, 2009 June 30, 2009 (1)	8,404,744	$ 43.18	178,125,612	$ 4,864,306,413
Pursuant to Publicly Announced Plans or Programs	34,656,548	$ 40.33		
April 1, 2009 April 30, 2009 (3)	4,993	$ 34.74		
May 1, 2009 May 31, 2009 (3)	295,848	$ 41.43		
June 1, 2009 June 30, 2009 (3)	20,566	$ 41.51		
For the Quarter Ended June 30, 2009	34,977,955	$ 40.34		

(1) On January 30, 2008, we adopted and announced a $13.0 billion two-year share repurchase program that began on May 1, 2008. These share repurchases have been made pursuant to this program.

(2) Aggregate number of shares repurchased under the 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 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 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 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 Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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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/ HERMANN WALDEMER

Hermann Waldemer

Chief Financial Officer

August 6, 2009