

# **CHIEF EXECUTIVES FOR CORPORATE PURPOSE - CECF**

**15th Annual Board of Boards and CEO Investor  
Forum**

**André Calantzopoulos, Philip Morris International,  
Long-Term Plan Presentation**

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## 15th Annual Board of Boards and CEO Investor Forum

MS. BASAK: Hi everyone. We only have a couple presentations left. Now we'll have Andre Calantzopoulos from Philip Morris International joining us. He's the CEO of the company. Andre, thank you.

MR. ANDRE CALANTZOPOULOS: Good evening, ladies and gentlemen. And thank you for giving me the opportunity to be here with you today. And I will talk about the new purpose of Philip Morris which is to deliver a smoke free future. Which essentially is a future without cigarettes. Now we will talk obviously a bit more about product and product transformation but I will cover all the other ESG topics during the presentation. So this the usually forward looking cautionary statements, I'm sure you are familiar with them and I encourage you to read them.

What is PMI? I would say PMI is known as a cigarette company. It is the largest cigarette company in the world. It was spun off from Altria. Altria Group used to own Kraft, Philip Morris International and the U.S. business. And PMI was spun off in 2008. So PMI operates everywhere in the world except for the United States. And in 2016 after having develop products that can replace cigarettes by providing lower harmful substances to consumers, we announced the new vision that our objective is to focus all the resources of the company in the development, scientific substantiation and commercialization of products that can replace cigarettes. And the common denominator is that none of this products - - so because it's the presence of combustion that creates the problem in cigarettes, and I'll come to this. Now our footprint is fairly large, we operate in 180 countries. We buy tobacco from 350,000 farmers directly or indirectly. And that's an important footprint. We have 150 million consumers that buy products from us. 73,000 employees and important also we collect 75 billion dollars as excise taxes for the various governments around the world. If you look at the industry totally it said including China and the U.S. it's about 860 billion retail business of which more than 540 billion are excise taxes.

So as I said the problem we tried to resolve here, because I believe in order to have an impact you need first to address to effect of the product you produce before looking at how you make the product, which is your supply chain footprint. So there are 1 billion people, more than 1 billion people who smoke today

around the world. And there are 35 million still in the United States. And the projection is that -- and that's the World Health Organization, that even in 2025 there will be still the same number of people as the -- of smoking are compensated by population growth. So, so far the public health efforts have been on restrictive measures, restrict the marketing, restrict access of the product, increasing taxation in an effort to prevent initiation and encourage smoking cessation. And the question here is can these measures only that they should not stop achieve a future without cigarettes. And maybe it's -- you wonder why I ask this question. But I would say what we all need to understand, as I said in the beginning, is that cigarette problem which is mobility and morbidity of posing disease in premature deaths, is caused by the fact that you burn organic matter that is tobacco. Nicotine is addictive but is not the primary cause for disease in cigarettes. And I'm sure we'll come to this conversation given all the developments in the U.S. regarding the E-Vapor products for sure, but even the FDA clearly says nicotine is the least of the problems except for its addiction. But not in disease genesis. And the tobacco per say is not a problem. The same way as fossil fuels are the not the problem. It's the fact that we burn them to create energy, that's creates the issue. So now that we have the technology and we have the scientific capabilities to evaluate these products, we put all our efforts to develop a portfolio of products, that I will explain later, that have a common denominator that they do not burn -- the organic matter if they don't burn tobacco. So one of them heat tobacco and one of those was recently authorized by the FDA for commercialization in the U.S. Or vaporize the liquid it's more known in the U.S. Or contain pure nicotine and all of them are not risk free. There is no product we can develop that is zero risk. But because you don't burn you reduce the toxicity very substantially. If we take for example heat the tobacco products, the one reviewed by the FDA, you have a 95% reduction in toxicity and carcinogenic substances compared to a cigarette just by heating at very low temperatures. And if you look at the E-Vapor products properly manufactured according to standards, we have reductions of 99% of the toxic substances. So that's the important part to retain. But at the same time because they are addictive and because they still contain some toxicity you cannot say there is zero risks.

And all the -- evaluations we have done and they have been submitted in many regulatory authorities including as I said the

U.S. FDA, show that you have reduction of exposure to toxicants, you have -- in our assessment we use the three-fold approach, you compare these products to cigarettes but we also compare them to cessation. When people quit completely the use of nicotine, because that's the only standard we have --, we know what happens to people who smoke, when they completely smoking. And the closer that your product is to the effects that you observed clinically post quitting completely nicotine, the more confident you are they're going to have a positive effect on public health. But at the same time to quantify exactly, which would not be confused and believed that 95% reduction in toxicity and exposure is 95% reduction in morbidity and mortality. That we need the -- over time to quantify. What we know to date is going to be significant but we don't know exactly how much it is.

So now to do this on one side clearly we'll have to develop the products and back in 2016 we commercialized the first product, heat the -- 2015, I'm sorry, commercialized the first product, had good acceptance and very highest reaching rates. It's called IQOS but that's the brand name, essentially it's an electronically heated tobacco. And we started in Japan. And what we observed is -- the product is very acceptable although it has a deficit in terms of taste compared to cigarettes because of the very absence also of the carcinogenic substances. But has very high adoption rates. People who bought the product switched completely out of cigarettes at 75% from the first month or even weeks. And that's much higher than the rates we achieved with E-Vapor products you are more familiar with because we have a deficit of taste that is even higher. So after that we had the scientific evidence, we had the portfolio of products and the proof of these products are capable of switching people. So our decision was that now we focus all resources of the company in order to commercialize these products and shift them away cigarettes. And you know the progress has been fairly significant I would say. But at the same time we had to transform the company. We introduced very many new disciplines, life sciences that we never had before. All the preclinical, clinical capabilities that are very similar to the pharmaceutical industry because the same process before you develop a drug then you break it to consumers. We are a trademark company, we had to create a lot of IP and we learned how you create IP and patents. Cigarettes have been a product that has not changed for decades or hundreds of years. So it was all about trademarks, here it's all about IPs, electronics

and so on.

Secondly, change in the supply chain. We do electronics. We don't do only an agricultural product, we do a mixture of two, refers logistics and so on. So we had to bring in significant new talent to the company because we just didn't have the skills. I mean the whole life sciences is people from pharma that they joined the company under one condition, they will never work on cigarettes and they never did. So then at the same time retrain the organization because now it's not the transactional product that you sell at the point of sale. It is something that you have to follow the consumer during their journey so that they don't fall back after one week, two weeks, three weeks, four weeks back into cigarettes. You have to digitalize the entire system because we started manually and we had already 5,000/10,000 increment of people on the ground dealing with people, explaining to them the product, what it is, what it's not. But you had to start digitalizing otherwise it's not scalable. So many new disciplines and we did it for a combination of bringing new talent in from the top but most importantly retraining the organization because I think that's the right thing. And you know I get the question very often, why didn't you just leave this product on the side and, you know, create a new company with the new products. Well if we say we're going to replace cigarettes over time, I believe that you cannot leave your organization behind. And this is not a line extension you put on the side when you say it's the whole effort of the company is to convince people to switch out of cigarettes. And the second thing is we will never have the access and the resources and that the cigarette business gave us to retain to consumers and initially obviously the cashflow. But that you can forget because the products today are still profitable.

So here is as I said the four platforms. One is heated tobacco electronically with all the connectivity that this may have. To help consumers during their journey, we have what we call platform form which is a more typical E-Vapor product and which by the way we will implement age verification for activation of the device because the technology exists now. So to minimize any impact on youth. Which means if you buy the product it doesn't operate until you have age verified registration. That's one of measure of course - -. So I will not spend much time on the platforms but they took a lot of time to develop because we're trying to make products that are as close to the - and taste of smokers as possible otherwise they just don't

switch. It's not that you just give them any nicotine product, it is not enough. You need to convince them and it takes a lot of time and effort. And as I said previously the most important thing here is when knew as a company that we have a deficit of trust regarding the science. That's for sure. And I knew very well we don't have a second chance. This time all the data is going to be under scrutiny. So we tried to do it in the best possible way bearing in mind that when we started this process the FDA had not even issued the guidelines on how you develop, evaluate and survey post market of these products. So we started assuming it's going to be like a pharma process. We were right at 95% so we didn't waste a lot of time and effort but it was a shot in the dark at the beginning.

So that's the good thing. All the data is available on PMI science and anybody can buy the products and verify because they exist today in plenty of markets. The other important factor is the conversion capability of the product. Because to have an impact of - - is sufficient to have a reduce harm product, you need people to adopt it. The same way it's not that it's good to have solar panels, you need people to use them. And for this to need to incentivize them and you need to put all the commercial effort and emphasis behind your products. Once you're convinced that they are better than the previous ones. So after four years essentially we are in 52 markets already worldwide, not fully covering all the countries as we enter new countries gradually. But we cover already 45% of the world consumption and expanding constantly. And the most important part is 71% of the marketing and sales money is behind these products while they only represented last year 19% of our earnings. So at least I think we are putting our money where our mouth is. And the results are good so far. We had 14 million people who used just the first platform - -. And close to 10 million have fully switched out of cigarettes. So they don't use cigarettes anymore.

And - - Japan that was the first market, the heated tobacco category in Japan is already 25% of total cigarette consumption. And the good thing we didn't reverse the trend of - - decline but we made an enormous difference in terms of reduction in consumption of cigarettes which is the biggest public health effect ever achieved in terms of cigarette consumption and reduction in the world. So these interventions can have an impact.

I was saying this before, this transformation changes the

company from every angle. From the employees, and I talked about them, the products themselves, the commercial effort. But then we look at our supply chain. All these products use less tobacco. So not only we'll have a natural decline of cigarettes that is very gradual, 1% to 2% a year worldwide, it affects the farmers. But at the same time now we have products that use half or one-third of the tobacco. So a key constituency here is the farming communities and how you help them do proper diversifications, change -- because it's not so easy. Tobacco has one big advantage for farmers. It's a cash crop and they sell what they produce. And there's no price fluctuation because it's not a commodity. It's not a stock market traded commodity. So to convince them to move to other things is not the simplest thing on earth. And that's a lot of effort, that's what requires a lot of collaboration with society in regulators that - - to this.

And I mentioned also from an organizational perspective, we are dealing now with electronic products. We had no idea how to do electronic products to be frank with you. I mean we didn't call centers, we didn't have reverse logistics. We had to do all kinds of things of recycling and - - as we go forward and so on. So I think it's a big change and we've managed to carry the organization along during that change.

So to be very, you know, I believe that if you don't measure things they don't happen. So this is the metrics we have in terms of the product transformation. I'm not talking about all the other ESG aspects. We have plenty of those and I'll come to them. So we have 98% of our R&D expenditures are already in the new products. I'm talking about commercial expenditures. And our objective is to be say at 38% to 40% of our revenues and more than 40 million people that have switched out of cigarettes into our products by 2025. That is what we can achieve alone. Meaning without regulatory intervention and what change in the existing regulatory regimes that do not differentiate in the vast majority products from each other. So if we move -- before I go to the external environment, the question is why does it make sense for us and for our shareholders? Well already we have 55% of all these new categories in terms of - -. We have the first mover advantage, in we establish a new brand. Our brand used to be a cigarette brand Marlboro, known by everybody almost. Here we are creating a new brand that will have most of these platforms under it, heated tobacco, E-Vapor, whatever. And already if you look at our retained share of cigarettes outside of the U.S. and China is 30%, we already have 55%. So

it makes sense. At the marginal level it's better because some of these products are recognized not being cigarettes so they are taxed - - but of course we had all the infrastructure expenses.

Now the products are creative to the bottom line, so it makes sense to do it financially. And yes, I recognized we had to build a different infrastructure for the reasons I explained. It's all the research, develop - - without just incremental marketing, spent \$7.2 billion accumulative so far. But now that we have the infrastructure we can leverage it to have much more products and must more fast -- and faster to consumers, all the expenditures just incremental.

And I was talking about the support now to accelerate the pace by the regulatory community and governments and public health. And I might say these products are polarizing in public health, especially given the recent events the U.S. where there is a real problem which is the increase in experimentation of young people with nicotine products or the cigarettes decline, we had a real jump in use of E-Vapor products by youth. That's a real problem. And then the recent unfortunate deaths and disease we had with the lung diseases, where initially people thought this is E-Vapor -- traditional E-Vapor products and the reality was unfortunately people took open systems for others and put oils, cannabis oils. And the lung system is not made to dissolve fats. So it was an unfortunate situation but this has nothing to do with what happened with E-Vapor products.

Now clearly there was a lot of misinformation around this and then this information led to the fact that the categories stopped growing. Not only in the U.S. but worldwide. And there is all -- because there are people opposing this product, saying it's not - - innovation and new things, you will have always people - -. Fact of life. But the reality is 50% of people smoke in the U.S. and roughly the same rest of the world, believe thought E-Vapor products are equally dangerous to cigarettes or even worse. And that's inaccurate. So in the confusion it very often leads to people continuing to spoke. And some people because of the confusion recently went back to cigarettes, which is not really something we would like to have in public health. So I think that is very important that we have cooperation on these and support from public health, I'm sure there will be questions for that so I will not elaborate, because that can accelerate quite dramatically what we tried to achieve here. And it has to be transparent from both sides.

Now we've done a - - reality analysis and not surprisingly the three things that came up most strong were the product change, the responsible marketing and youth use of the product and the third is the farming community and everything comes after, which is expected, so. And we have prioritized four areas with private E metrics for all these areas. I will let you read it and we have attached all the metrics to our presentation. So if - - interested we have the sustainability report all there. We measure much more than that in terms of impact but these are the primary things society told us you need to focus and that's where we're focusing. And for four categories we have very clear objectives very clear objectives. I talked about the first two which is youth prevention and unintended on - - use. And the 40 million as a minimum, people that would like to switch by 2025 if we continue under the current regulation. The third one is 100% of farmers making a living so we can eliminate child labor. We have very good agricultural labor practices product -- program. I think it's probably one of the best in FMCG categories. We still have -- we have a 97% farmer compliance with child labor practices and false labor sometimes. We still need to work with - - but that's an anonymous progress. And in certain countries the tradition is so strong of using children during school holidays, that it's not so easy to fix. But I think that's the objective by 2025 and the scope 1 and 2 category neutral by 2030. And obviously the entire value chain by 2050, earlier if possible. And we are making very good progress on all of those.

In terms of governments, we have the full support in this transformation of the board of directors clearly. Yes, we have separated roles of Chairman and Chief Executive Officer. I think the board has experience in many fields and clearly as we transform the company, there is common understanding that we have to continue renewing the board and bringing also new board skills in that's necessary. And you can read the rest. But -- and the last thing is both our short and long-term compensation, mine and the senior team, are all linked to the transformation of the company and related metrics.

So I would say our priorities, clearly our priorities is the product and the commercial effort behind it. The second thing is we are doing a lot of things in the ESG area but we have not talked about this because we gave priority to the product. I think we need to increase much more the engagement with ESG investors. I know that there are discussions of excluding entirely sectors from ESG investment. I don't think personally

that's going to change anything in terms of consumer behavior and people's behavior. Because excluding a sector does mean -- say tobacco, it doesn't mean that the people who smoke will quit or excluding certain oil sectors doesn't mean people will stop consuming energy. I think by including companies in the investment that try to do the right things and working with them and encourage them and sometimes giving feedback on how do we do better, I think that's the better approach to have real impact long-term if we believe in this.

So essentially I believe it makes sense for us from a shareholder perspective to do what we do. Definitely it makes sense for our consumers. And I think overall if we are successful, we will have a much more sustainable business. And if the regulators stop hesitating and start playing the game much more like the FDA does here, I think we can accelerate this 40 million to much, much higher and probably in 10 to 15 years in certain countries start talking about phasing out cigarettes. So that's all I had for you.

(Applause)

MS. BASAK: As a reminder for the people that are not in the room, you can deliver questions via Slido. We can start in the room. Back here it looks like we have a question.

FEMALE VOICE: Thank you. And thank you very much for the presentation. I do have a question around your marketing practice, global marketing practices. There was a Stanford study done recently where they presented evidence that you were marketing via social media and organized events that had youth as young as 16 years old. So you mentioned several times that you're trying to change your marketing practices to adult only. So what is your minimum age globally of target audience or target market. And then also what are you doing to ensure that those are met by all your marketing divisions?

MR. CALANTZOPOULOS: Okay. First of all internal alignment is fundamental and we do continue reviews. Materials are reviewed by a lower department, by external affairs department, by management. That's obvious. And I think we have enough experience in cigarettes and knowing what not to do for so many years, that it's kind of natural. Rather than startups that didn't know which industry they're in. I would say that regarding the new products, but also you know existing. But let's take the new products. I think we should be looking at measures of what effectively happens not saying that maybe this

visual or this execution may be attractive to young people. So, so far we have no red flags because we do post-market surveys. Okay? Recently there was a study sponsored by the Minister of Health of Japan that I mentioned in --. Only .1% of school age -- teenagers used IQOS. When the product is 18% market share. Okay? Now what you are referring to it was an influencer program. That we used in certain occasions at the beginning in Russia where we had put a threshold of 25 years old smokers to be qualified as influencers. And the agency didn't follow so we stopped the entire program of social media worldwide, okay? And we are reviewing the situation, so if somebody gives us feedback we can act. I cannot guarantee and nobody can guarantee that there will not be one or two problems somewhere. If we get feedback we can fix them. There is no systemic need to do that. And I think that's where our monitoring eventually is important. So we have conducted a very thorough review because it was at the shareholders' request. We found that in the vast majority it works well. There are things to improve, we have worked to improve them. And we will do the reviews and eventually we'll start introducing external verification as well to double lock it. But the most important thing is go back and we have a golden opportunity as I say, we need minimum age for purchase of products. That exists almost I'm going to say in every country in the world. Okay. Maybe somewhere I don't know it doesn't exist but practically in every country. We need the enforcement in retail. And in some places it's not easy. You have Indonesia with more than 2 million retailers, 1.4 million in the Philippines. It's not so easy to go and enforce this. Okay, you enforce it in the 300,000/400,000 outlets your sales force do. But it's not an excuse, I'm saying sometimes there are material issues. And as we know if teenagers try to find the product, they will. So in the electronic products we have the minimum age, we need to continue education of the trade, we need to educate teenagers differently. I told my children don't smoke and my daughter came vaping and she told me but I don't smoke, dad. And she's right, she's not smoking. So we have to tell them don't use nicotine products.

And finally with technology, lock the device and unlock it only, you know, once you're age verified, then I think we minimize the probability that we have access by youth. Can we eliminate it completely? Hopefully but I don't think this is reality. Okay. But not the problem we had here.

MS. BASAK: Are there any more questions from the room? Over here.

FEMALE VOICE: So I had a question about for any industry going through a transition there are often tradeoffs between environmental and social issues. And so could you shed a little bit of light on -- well we did social in your case, you know the lives of tobacco farmers and how to manage that transition as you go through this product re-envisioning.

MR. CALANTZOPOULOS: Well there are differences. They start with yes as you say upstream supply, it will be less tobacco over time. But we have to work and we are working with the different institutions and educating the farmers to switch crops. This is a slow process so it's works -- and still we use tobacco, okay, it's not -- these products use half of the tobacco because in a cigarette half of the tobacco you burnt in the air to use it as an energy source. Here you don't need it because you have electronics heating. So at the end of the day we also need to bring to the farmers other industries in a way that we guarantee them for three, four years that somebody will buy their crops when they make their transition to new crops. So we need to work from all sides. Of course we can help them from an agricultural point of view because we have technicians on the ground to do all the crops. That's not the issue. It's to convince them to do it because they want to have a guarantee that they're going to get some income in the initial years. And that's where we're open to partners from food and other industries if we can find a good solution for both. That would be great. If we look at electronics for example, we need to start recycling electronics. And also, we are looking at realizing the plastics and everything -- editions of the product. But I think -- from that perspective because it's all recycled materials. So that's a new area that we have to learn to do better because we did not operate.

So I guess overall, I don't think the transition is worse than before, but there are new areas that we need --. On the other side -- energy reduction. Certain processes --.

MS. BASAK: There's a question that's being quickly voted up from all our viewers, and it's that you mentioned the need to incentivize customers to switch to new platforms. How are you doing that?

MR. CALANTZOPOULOS: By essentially spending time with them, explaining what the product is, following them up, that they don't go back into cigarettes. So in general, it's a lot of effort from the commercial organization to find the people who smoke, explain to them the new products, and make them switch,

and follow them up.

And it's very different from traditional FMCG products - - where the consumer goes to the retail store, buys the product and leaves. There is no - - transaction at the point of sale. Here it's much more direct engagement with the people, at least until the product becomes known. And then people talk to each other. And consumer - - continues because they - -.

On the other side, I think it would be also helpful, and that's why I'm talking about incentivizing, if the governments had differentiated regulation, for example, different label, different health warning. The FDA recognized this when they authorized the product. They - - warning requirement but doesn't burn, for example.

And potentially, initially differentiated - - line with - -. Because we do the same when we incentivize people to buy electric cars, so that the efforts of demand side measures are going up. The key is that we recognize that - -.

MS. BASAK: So another question that you're getting a lot now is being in the big tobacco industry, how do you combat criticism and skepticism? How do you promote sustainable business practices while you're in a tobacco company?

MR. CALANTZOPOULOS: As I said, also - - intervention. Of course there is skepticism. Of course the industry has a past. But we have to start looking what's happening in the future. What happened 30 years ago and 20 years ago I cannot change it. None of us today can change it.

What we can change is the product itself, and we are doing this. And put all our focus behind these products. And that's what we are doing is putting our money where our mouth is, and then - -. All the science we've produced is something available for everyone. Anybody can go buy the products and test them.

Actually we submitted these products to multiple - - laboratories across the planet. They come to the same - - more or less that we have, including the FDA. So yes, it is-and I don't think the business cannot become sustainable because otherwise we will never incentivize businesses to do better things.

I think if we want to achieve something, in terms of sustainability, actually of humans and not the planet, because that's what we're talking about, we need to tell people what the

problems are, offer them alternatives, offer them incentives, government or company, and then have a machine that commercializes and convinces them. And that's what businesses need.

And then hope for the best still because convincing them to change behavior in any sector is not the easiest thing on earth. And if we don't combine all this we will never actually - -. And if the fight is how can Philip Morris be sustainable, well by changing its products and changing the way it is, and eventually demonstrating that this is feasible, and by having support because the more we fight each other, and we say, okay - - public health, Philip Morris cannot do good thing.

So we'll not expect anything coming from Philip Morris. I think that leaves the people who smoke completely out of the equation. And actually, they don't care about the - -, and even scientific debates. Scientific debates are great, but at the end of the day, people need clarity. And that's what we need to do in every sector of the economy, if we really want to change things.

MS. BASAK: Andre, thank you so much. We have more questions than we have time to do.

[Applause]