Integrated Report 2020

Contents

Cover image: The cover is a tribute to our employees, whose continuous passion, dedication and perseverance in the face of adversity allowed our company to continue progressing towards its ambitions in 2020.

About Philip Morris International

Philip Morris International (PMI) is leading a transformation in the tobacco industry to create a smoke-free future and ultimately replace cigarettes with smoke-free products to the benefit of adults who would otherwise continue to smoke, society, the company, and its shareholders. PMI is a leading international tobacco company engaged in the manufacture and sale of cigarettes, as well as smoke-free products, associated electronic devices and accessories, and other nicotine-containing products in markets outside the U.S. In addition, PMI ships versions of its *IQOS* Platform 1 device and consumables to Altria Group, Inc. for sale under license in the U.S., where these products have received marketing authorizations from the U.S. Food and Drug Administration (FDA) under the premarket tobacco product application (PMTA) pathway; the FDA has also authorized the marketing of a version of *IQOS* and its consumables as a Modified Risk Tobacco Product (MRTP), finding that an exposure modification order for these products is appropriate to promote the public health. PMI is building a future on a new category of smoke-free products that, while not risk-free, are a much better choice than continuing to smoke. Through multidisciplinary capabilities in product development, state-of-the-art facilities and scientific substantiation, PMI aims to ensure that its smoke-free products meet adult consumer preferences and rigorous regulatory requirements. PMI's smoke-free product portfolio includes heat-not-burn and nicotine-containing vapor products. As of December 31, 2020, *IQOS* was available for sale in 64 markets in key cities or nationwide, and PMI estimates that approximately 12.7 million adults around the world have already switched to *IQOS* and stopped smoking.

(i) **For more information, please visit www.PMI.com and www.PMIscience.com**

Key milestones

1847
Mr. Philip Morris opens a shop on London's Bond Street, selling tobacco and ready-made cigarettes

1902
Philip Morris & Co., Ltd. is incorporated in New York

1908
Marlboro, which will become the company's most famous brand, is established and registered as a trademark

1919
A new company is incorporated in Virginia under the name Philip Morris & Co. Ltd., Inc. and starts to manufacture cigarettes in its factory in Richmond by the end of the next decade

1963
The entity purchases Fabriques de Tabac Réunies in Neuchâtel, Switzerland, a family business that already began to manufacture *Marlboro* cigarettes under license in 1957

1972
Marlboro becomes the world's best-selling cigarette brand

1985
Philip Morris Companies Inc. becomes a holding company and acquires General Foods. Other acquisitions in the food sector follow over the next decade, including Kraft Foods and Jacobs Suchard

1987
Philip Morris International Inc. (PMI) is incorporated as an operating company of Philip Morris Companies Inc.

2001
PMI's Operations Center is transferred from New York to Lausanne, Switzerland

2003
Philip Morris Companies Inc. is renamed Altria Group, Inc., and remains the parent company of Kraft Foods Inc., Philip Morris International, Philip Morris USA, and Philip Morris Capital Corporation

2008
PMI is spun off from Altria Group, Inc.

2009
PMI unveils its new research and development facility in Neuchâtel, Switzerland

2014
PMI pilots its heat-not-burn product, *IQOS*, in Italy and Japan

2016
PMI announces its ambition to deliver a smoke-free future, shifting its resources toward the development and responsible marketing of less harmful noncombustible alternatives that are scientifically substantiated

2020
PMI's Board of Directors adopts PMI's Statement of Purpose, reaffirming the company's commitment to deliver a smoke-free future

About this report

We are pleased to share our second Integrated Report, which follows our first Integrated Report published in June 2020 and constitutes our sixth consecutive annual disclosure. Evolving our reporting toward integrated reporting and aligning it with the International <IR> Framework enables us to better detail our business transformation and more fully capture our company's progress in delivering on its purpose.

The report content is shaped by a formal sustainability materiality assessment, refreshed in 2019, which incorporates diverse stakeholder perspectives and our impacts on sustainable development. We have structured our sustainability topics around four strategic pillars of action and two tiers, which form the basis of our reporting. This report provides information on context, relevance, management approach, targets, and performance for each tier 1 topic. Details about our management and performance on tier 2 topics, as well as case studies that shed light on our work at country level, are available on **PMI.com**.

Unless otherwise indicated, the scope of the data in this report covers our operations worldwide for the full calendar year 2020 or reflects the status as of December 31, 2020. Where not specified, data come from PMI estimates.

PricewaterhouseCoopers SA (PwC) has provided independent assurance on select Business Transformation Metrics, available on pages 15 and 130. For more details, see the Independent Assurance Report on page 146. External verification of our environmental and health and safety data can be found on **PMI.com**.

This report was completed with oversight from PMI's Board of Directors and reviewed by its Executive Chairman, as well as by members of PMI's Company Management, including our Chief Executive Officer, Chief Financial Officer, and Senior Vice President and General Counsel.

This report has been prepared in accordance with the Global Reporting Initiative (GRI) Standards: Core option. We also align our reporting with the principles and standards of the UN Global Compact (UNGC) and indicate our contribution to the UN Sustainable Development Goals (SDGs). The UNGC principles and SDGs are mapped against the indicators in our **GRI Index**. Furthermore, in our **SDG Index**, we discuss alignment of our work and ambitions with the SDGs and corresponding targets.

We also take into account guidance from the Sustainability Accounting Standards Board (SASB). Reflecting our business transformation, the **SASB Index** provides links to content within this report aligned with the Tobacco Standard, as well as with aspects of the Agricultural Products, Hardware, and Medical Equipment and Supplies Standards. This report also addresses some recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), with our **reporting to CDP** covering most of the remainder. We will continue to develop our climate change reporting to reflect the TCFD's guidance. For the first time, to further reflect the importance of stakeholders as per our **Statement of Purpose**, we also mapped our disclosures in a dedicated **Index** against the World Economic Forum's (WEF) Measuring Stakeholder Capitalism Towards Common Metrics and Consistent Reporting of Sustainable Value Creation White Paper, released in September 2020.

Additional information about our sustainability work, as well as previous reports, is available in the **Sustainability Resources** area of **PMI.com**.

We welcome your feedback and suggestions. Please contact us at **sustainability@pmi.com**.

An *IQOS* store in Athens, Greece

Overview

Innovating for
better products

Operating
with excellence

Caring for the
people we work with

Protecting the
environment

Performance
metrics

2020 highlights

Business transformation

$28.7 billion

Net revenues

23.8%

Of net revenues from smoke-free products

$4.80/share

Annualized dividend based on a quarterly dividend of USD 1.20/share, declared September 9, 2020; 13th consecutive year with a dividend increase since becoming a public company in 2008

$495 million

R&D expenditure, of which 99 percent was dedicated to smoke-free products

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Pillar 1: Innovating for better products

12.7 million
Adult users who have switched to *IQOS* and stopped smoking, out of 17.5 million total *IQOS* users

64
Markets where *IQOS* was available for purchase, of which 52 percent were in non-OECD countries

76%
Of PMI's total commercial expenditure dedicated to smoke-free products

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Pillar 2: Operating with excellence

2
Human rights impact assessments completed in high-risk countries

95%
Of critical non-tobacco supplier spend assessed against PMI's Responsible Sourcing Principles in our supplier due diligence platform

>94%
Of PMI's total shipment volume (including cigarettes, heated tobacco units, other tobacco products, and e-cigarettes) represented by markets with youth access prevention programs in place

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Pillar 3: Caring for the people we work with

100%
Of tobacco farmers and farmworkers provided with access to personal protective equipment

0.12
Total recordable incidents rate (TRIR) per 200,000 hours worked, covering PMI employees, contracted employees, and contractors

37.2%
Of management positions held by women, up from 36.1 percent in 2019

Pillar 4: Protecting the environment

Triple A
Score from CDP for our efforts in combating climate change, protecting forests, and promoting water security

-18%
Reduction in CO_2e emissions across our value chain (scope 1+2+3) versus our 2019 baseline

84%
Recycling rate of *IQOS* devices returned at our centralized recycling hubs (weighted-average percentage of each device that is recycled)

Leading with purpose

> "Clarity of purpose is essential for both external stakeholders and internal alignment. PMI's Statement of Purpose reaffirms our company's commitment to deliver a smoke-free future and lays out our unique business model and value proposition."

Letter from the Executive Chairman

The primary responsibility of the Board of Directors is to support the long-term success of the company, consistent with its statutory duty to shareholders. Last year, the PMI Board of Directors issued a statement of corporate purpose that recognized the importance of focusing on key stakeholders in the Company's transformation.

A company's purpose is much more than the reason it is in business. Clarity of purpose is essential for both external stakeholders and internal alignment. PMI's Statement of Purpose reaffirms our company's commitment to deliver a smoke-free future and lays out our unique business model and value proposition: To relentlessly focus our resources to replace cigarettes with better alternatives. The statement explains how we are disrupting our business from the inside, leading our industry toward a future without cigarettes, acknowledging our stakeholders, and ensuring the long-term success of our company.

More concretely, we intend to accelerate the decline of cigarette smoking beyond what could be achieved by traditional tobacco control measures alone. We believe that with the right regulatory encouragement and support for smoke-free products from governments and civil society, cigarette sales can end within 10 to 15 years in many countries.

We understand that maximizing shareholder value is no longer acceptable as a company's sole purpose. While our Board must exercise its fiduciary duties as they relate to the oversight of our company's financial performance, it also recognizes the importance of creating value for a diverse group of stakeholders, including employees, customers, suppliers, and communities. To find the right balance, our Board and Company Management work closely together to make informed decisions and evaluate how PMI manages risks and opportunities associated with our business in order to support long-term value creation. The devastating impact of COVID-19 on societies and economies in 2020 intensified the debate around the purpose of business.

Investors are also redefining how to integrate ESG and the impact of business on society and the environment. As U.S. Securities and Exchange Commission Acting Chair Allison Herren Lee recently said: "What started out many years ago as so-called 'impact' investing, that is investing specifically for the purpose of supporting positive outcomes on particular environmental, social or governance (ESG) goals, has grown. Today, in addition to impact investing, ESG risks and metrics are used to support a number of sustainable investment strategies, such as inclusionary and exclusionary strategies. But, significantly, ESG risks and metrics now often underpin traditional investment analyses designed to maximize risk-adjusted returns on investments of all types. They represent a core risk management strategy for portfolio construction."[1]

The surge in ESG reporting is only beginning. As the market continues to organize around risk analysis and disclosure standards and methods, the scope of our Board's oversight of these areas will continue to increase. The Board views sustainability as an integral part of our company's business strategy and sees the opportunities it offers.

In the area of governance, anchoring our sustainability priorities in executive accountabilities helps ensure that our strategy is embedded in our daily operations. Aligned with our purpose, we are working to seamlessly integrate numerous ESG issues into the corporate culture, business strategy, and executive-compensation plans. We aim to continuously improve our performance and drive material and measurable progress toward our targets and aspirations—all communicated through open and clear reporting and disclosure. We understand the essential need to continue building the necessary legitimacy and trust to achieve a smoke-free future.

PMI's key stakeholder constituencies are fundamental to our company's purpose and can accelerate the pace at which we achieve it. Our 2020 Integrated Report aims to address stakeholder demands for more transparent, comparable, and reliable information on our ESG risks and performance.

André Calantzopoulos
Executive Chairman

ⓘ **Read PMI's Statement of Purpose**

[1] https://www.sec.gov/news/speech/lee-playing-long-game-110520

Driving change together

Letter from the Chief Executive Officer

Sustainability is core to the transformation of our company, which is based on a deep sense of purpose to create value for our shareholders and other stakeholders. Our strategy is based on four pillars, which dictate what we produce, how we operate, and how we manage our social and environmental impacts.

I am enormously proud of our 2020 achievements, made all the more remarkable by the year's unprecedented circumstances. We witnessed what can be achieved when close to 71,000 employees worldwide apply their hard work, dedication, perspectives, skills, and passion every day to help us achieve our goals.

In 2020, we continued with relentless focus on our business transformation, dedicating 99 percent of our research and development and

76 percent of our commercial expenditure to smoke-free products. In July 2020, the U.S. Food and Drug Administration authorized the marketing of a version of *IQOS* as a modified risk tobacco product. It is the only electronic inhalable nicotine product to have received such authorization to date. This marks a historic milestone for our company and presents a powerful opportunity for improving public health.

Five years since PMI publicly announced its vision to replace cigarettes with less harmful alternatives, our efforts and investments are delivering strong results. In 2020, smoke-free products represented close to 24 percent of our total net revenues, and by year-end an estimated 12.7 million adults had already switched to *IQOS* and stopped smoking. The strong position of our smoke-free business has allowed us to increase our ambition. From a net revenue perspective, we now aim to become a predominantly smoke-free product company by 2025.

We also achieved significant headway across the other pillars of our strategy. With the introduction last year of the *IQOS VEEV* e-vapor product in New Zealand, we began the journey toward our target of having 100 percent of PMI's electronic smoke-free devices introduced on the market equipped with age-verification technology as of 2023. During the year, we also conducted human rights impact assessments in two countries—one in virtual format—and are on track to cover our 10 highest-risk markets by 2025.

Regarding our employees, our clear priority in 2020 was to continue protecting their health, safety, and well-being. As a company, we moved early and fast to respond to the COVID-19 crisis, taking measures in an array of areas to prevent the spread of infection, sustain our operations, and support not only our employees and their families, but also the communities in which we operate.

In November 2020, PMI's CEO signed The Valuable 500, an initiative that commits PMI to creating a welcoming space for employees facing physical and mental health challenges.

We continue to push hard toward a more diverse, equitable, and inclusive workplace, always mindful that more progress can be made.

In our tobacco supply chain, we achieved important targets of our Agricultural Labor Practices program, strengthened our monitoring, and established additional strategies to promote a living income for our contracted farmers. We see higher pay as a means of preventing labor abuses and other social issues.

We also continued to lead on environmental sustainability. In 2020, CDP awarded PMI a "triple A" score for our efforts to combat climate change and protect forests and water security. We continued to decarbonize our operations and value chain, guided by our revised science-based targets, and are well on track to achieve our carbon-neutrality goals.

Looking forward, we will continue to operate responsibly while striving to deliver value, not only for our shareholders, employees, and consumers but for society and the planet.

PMI is committed to serving as an agent of change and an advocate of positive values. We understand that our business must become a provider of effective solutions. Innovation and inclusiveness are key to solving our challenges, whether related to tobacco harm reduction, environmental sustainability, or equity. To accelerate our progress, we must position ourselves at the forefront of consumer-centricity, technology, science, and innovation. As part of that vision, we will build on PMI's unique scientific capabilities to develop products and services that go beyond nicotine. We aspire to achieve at least USD 1 billion in revenues from such sources by 2025.

We will always have critics and value their constructive challenges. We are committed to engaging with them in a frank and transparent two-way dialogue, pointing out the actions we are taking to address their concerns and soliciting feedback on how we can do better to achieve our goals. Data and facts are the foundation of constructive dialogue and engagement.

We will allow our actions to speak louder than our words. It is equally important that we address our stakeholders' legitimate concerns as we implement our transformation strategy. We cannot make cigarettes obsolete without building coalitions of support for a smoke-free future.

As PMI's new Chief Executive Officer, I present this report with pride in what we have already achieved, yet with a deep recognition of the immense work ahead. Transforming our value chain means venturing into uncharted territories, each bringing fresh challenges.

Five years ago, we set out to create a new future for PMI—a future in which cigarettes would be replaced by less harmful, science-based alternatives—with a focus on reducing the negative impacts of our products on the health of our consumers. Beyond this, we understand the necessity of addressing the environmental and social implications of our products, including through principles of circularity and eco-design, as well as a commitment to diversity, equity, and inclusion.

Sustainability strategy is corporate strategy. ESG issues are business issues. This is what we want to emphasize through our integrated report. We hope it provides a window into our present, as well as the better future that we envision. We hope, too, that it will spark a dialogue with those who can help to accelerate the pace of change.

I cordially invite you to share your feedback, to question, to challenge, and, above all, to engage with us as we remain focused on making our company one that is centered on sustainability and a higher purpose.

Jacek Olczak
Chief Executive Officer

An overview of PMI's response to COVID-19 in 2020

During 2020, our business navigated the financial and operational challenges of a global pandemic while working to protect the health and safety of our people and address the needs of consumers, business partners, and suppliers.

Given the impact COVID-19 has had on our lives, business, and value chain, we highlight throughout this report instances in which the pandemic directly affected our sustainability efforts and describe how we adjusted our work in response. For most of our sustainability priority topics, an "Impact of COVID-19 on our activities in 2020" subsection can be found under "Progress in 2020."

Overall, PMI moved early and fast to respond to the crisis, taking measures to prevent the spread of infection, protect our people, sustain our operations, and support the communities in which we operate. We established a centralized global team to coordinate our response, supported by local teams set up by our affiliates and global functions. This "team of teams" approach has ensured our response has been relevant locally and consistent globally.

Our approach has been guided by science and facts, and is underpinned by five principles:

- **People first:** Our people's safety is our primary concern.
- **Local decisions, consistent globally:** Decisions must be informed by a deep understanding of the local situation and applied consistently across our organization.
- **Physical distancing:** The most powerful lever we can pull to prevent transmission.
- **Promoting a new balance:** Supporting new ways of working and colleagues who are facing challenges.
- **Preparing for the long haul:** Ensuring we are ready for changes in circumstances.

Clear and frequent communications with employees and stakeholders throughout this period was essential.

Repurposing our value chain

An important value derived from our company's transformation is the ability to leverage our new capabilities to help combat the pandemic. In Switzerland, our scientific teams at our R&D center in Neuchâtel helped local hospitals analyze COVID-19 test samples when local resources were unable to keep up with the demand. We temporarily repurposed production lines in our factories in Brazil, Indonesia, the Netherlands, Poland, and Switzerland to produce thousands of liters of hand sanitizer, which we donated to local communities, our employees, and their families. Our affiliate in Brazil also made available 10 of our fleet vehicles (with drivers) to distribute COVID-19 hygiene kits provided by the municipality across São Paulo, the city with the largest number of infections.

CASE STUDY

Repurposing our scientific capabilities and fostering multistakeholder partnership in Switzerland

Our know-how on aerosol science and our testing capabilities have allowed our scientists in Switzerland to provide expertise related to mitigating the spread of COVID-19. In response to the critical shortages of protective masks at the start of the pandemic, the team convened a consortium of internal and partner experts in mid-March to develop a high-performance, reusable face mask.

Read the case study

Scientists in PMI's R&D center in Neuchâtel, Switzerland

Overview

Innovating for
better products

Operating
with excellence

Caring for the
people we work with

Protecting the
environment

Performance
metrics

Our global footprint

>175

Markets where our
cigarettes are sold

64

Markets where our heat-not-burn
product *IQOS* is available for sale

70,849

Employees worldwide, of whom
41.7 percent are women

39
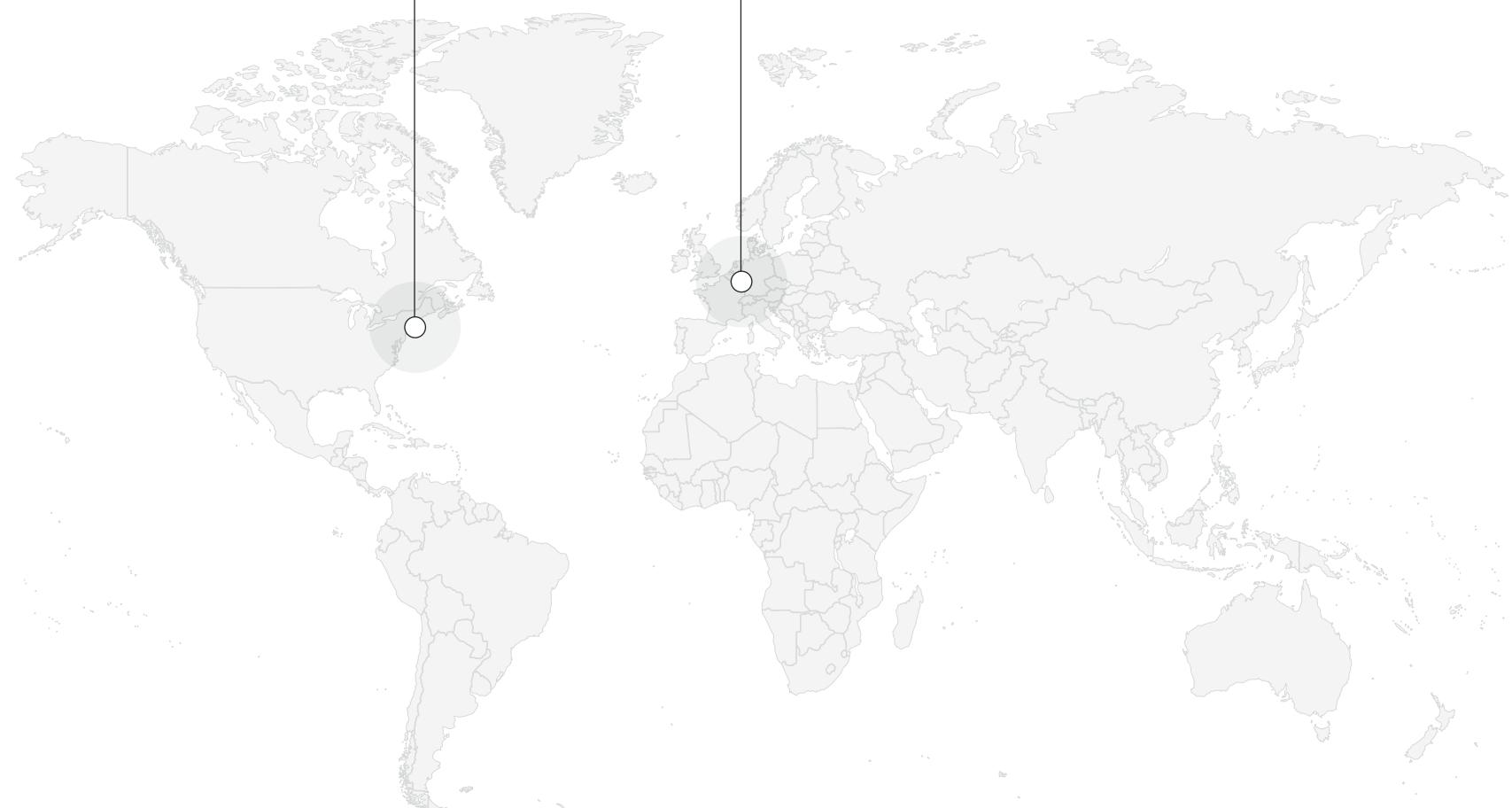
PMI-owned manufacturing facilities,
of which 8 are partially or fully
dedicated to the production
of smoke-free products

285,900

Contracted farmers supplying
tobacco to PMI, located in
23 countries

Headquarters
New York, U.S.

Operations Center
Lausanne, Switzerland

Transforming our business

In 2016, we set a new course for the company—staking our future on replacing cigarettes with scientifically substantiated, less harmful alternatives.
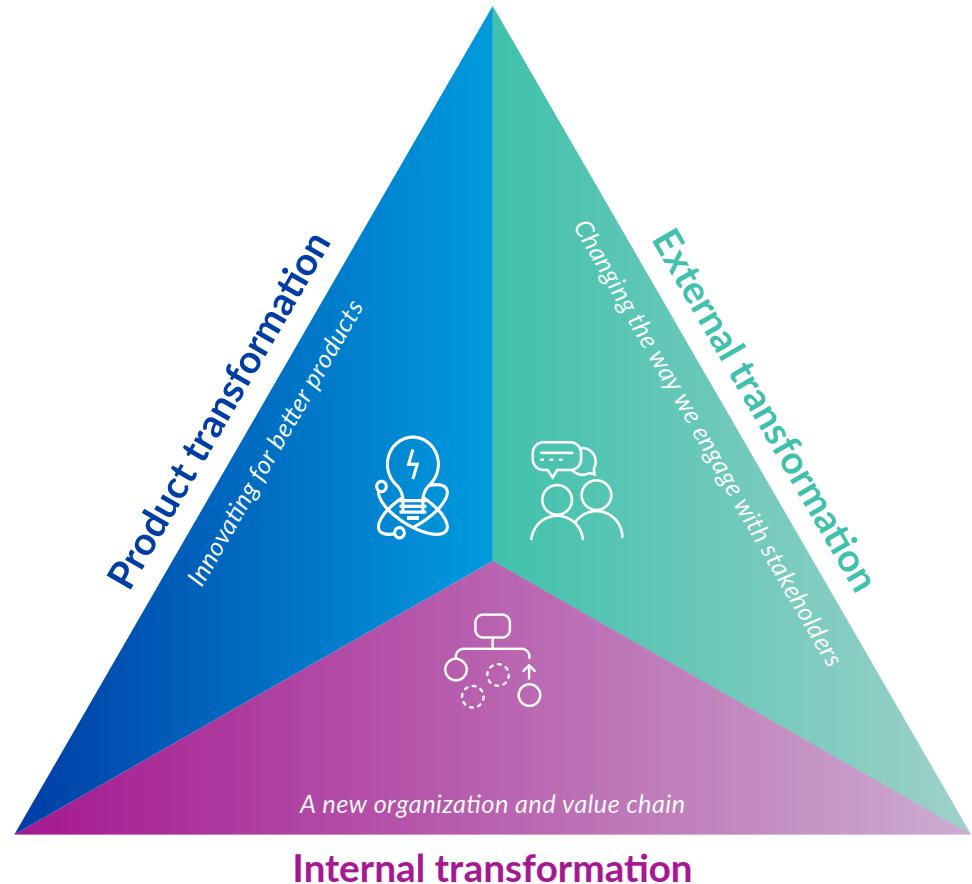
Five years since announcing our new vision, reaffirmed by our Board last year in our **Statement of Purpose**, we remain committed to accelerating the end of smoking. This means not only transforming our company to deliver on our purpose, but also inspiring our industry to follow our lead. We aim to create a sustainable positive impact that benefits our company, shareholders, consumers, and society.

More than one billion people worldwide smoked cigarettes or other combustible tobacco products in 2020, and, according to the World Health Organization (WHO), around the same number will smoke in 2025.[1] At PMI, we want to provide better, science-based alternatives for those adults who otherwise would continue to smoke. Our commitment is backed by a substantial R&D program and significant, sustained investments in the manufacturing, commercial and human capabilities, and infrastructure needed to bring these alternatives to market.

To date, we are the only company within the traditional international tobacco industry to have committed to going completely smoke-free by encouraging full switch of adult smokers to better alternatives than continued smoking. And we have already built a leading position in the smoke-free category globally.

Delivering on our purpose requires ambitious goals and targeted decision-making. Transforming from a cigarette company into a world-leading smoke-free business is about more than replacing one product with another. It requires a holistic review and overhaul of our entire business model and value proposition, including extensive changes within our operations and value chain and in the ways we interact with society.

PMI's business transformation

Product transformation
Innovating for better products

External transformation
Changing the way we engage with stakeholders

A new organization and value chain

Internal transformation

Transforming our business continued

Product transformation: Innovating for better products

People who do not smoke should not start. Those who do smoke should quit, and those adult smokers who otherwise would not quit should switch to one of the better alternatives to cigarettes now available. Our priority is to address the health impacts associated with smoking by offering science-based options that have been scientifically proven to be a far better choice than continued smoking.

At PMI we want to accelerate the end of smoking, and are therefore transforming our operations to purposefully phase out cigarettes as quickly as possible. We believe every company has an ethical and societal responsibility to address and mitigate the negative impacts of the products it manufactures and sells.

To be clear, we do not believe it is enough simply to offer more choice of combustible and smoke-free products to consumers. Instead, we believe the responsible approach is to guide and encourage consumers to make a fundamental change in behavior by switching from combustible products to smoke-free alternatives, while simultaneously working with policymakers to ensure these products ultimately replace cigarettes.

Science and technology are a vital engine of innovation and growth for our company, and they are also the key to tobacco harm reduction. We have harnessed the latest scientific advances to develop better alternatives to cigarettes, but that is not enough. Now we must ensure that those adult smokers who otherwise would not quit are aware of and have access to them, so that they can switch to them.

Our smoke-free products

To address a variety of adult consumer preferences, we have developed a portfolio approach that includes both heat-not-burn products and nicotine-containing vapor products. Our current smoke-free product portfolio incorporates four platforms—all centered on eliminating combustion—in various stages of development and commercialization. An overview of our product platforms is available on **PMIscience.com**. Furthermore, in 2021, we plan to expand our portfolio and enter the nicotine pouch category.

Our smoke-free product platforms

Currently, our main smoke-free product is a heat-not-burn product that was commercialized under the *IQOS* brand name in 64 markets by year-end 2020. In the second half of 2021, we plan to launch the next generation of *IQOS*, *IQOS ILUMA*, based on a new internal heating technology addressing consumer feedback and expected to ease the switch for adult smokers. In 2020, we also started commercializing an improved version of our *IQOS MESH* e-vapor product under the *IQOS VEEV* brand name. By the end of the year, we had launched *IQOS VEEV* in two markets: the Czech Republic and New Zealand.

ⓘ **Read more: Product health impacts and Access to smoke-free products**

Our combustible products

In support of our transformation, we have reallocated significant proportions of our commercial spending from cigarettes to smoke-free products and have streamlined our cigarette portfolio to focus on fewer brands and variants. Consequently, there is a natural trend toward reducing the number of our combustible product stock-keeping units (SKUs) globally and conversely increasing the number of smoke-free product SKUs. More concretely, our global number of combustible product SKUs decreased by over 20 percent between 2016 and 2020, while the number of smoke-free consumable SKUs increased by over 160 percent during the same period.

Nevertheless, maintaining our competitive position in the cigarette market while we transition to our smoke-free future is critical, as it best positions us to significantly accelerate our smoke-free journey. The extensive commercial and distribution infrastructure of our traditional tobacco business provides an effective platform from which to launch our smoke-free products at scale. Furthermore, maintaining leadership within the cigarette segment during the transition period enables us to engage more smokers regarding the benefits of switching, especially where we can communicate directly with our consumers.

While seeking to remain competitive in the cigarette segment, we carefully consider the commercial activities needed to do so. Our decisions are based on consumer insights and adherence to responsible commercialization practices guarding against youth access, and are guided by the following triplet: People who do not smoke should not start, those who smoke should quit, and those who won't quit should switch to less harmful alternatives.

Our cigarette brands are the choice of an estimated 130 million consumers worldwide. Our cigarettes are sold in more than 175 markets; in many markets, they hold the number one or number two market share position. Our portfolio includes a wide range of premium, mid-price, and low-price brands, including *Marlboro*, *L&M*, *Chesterfield*, *Philip Morris*, and *Parliament*, which are among the 15 most popular brands in the international cigarette market (excluding China and the U.S.). *Marlboro* is the world's best-selling international cigarette; in 2020, it accounted for approximately 37 percent of our total cigarette shipment volume and held a 9.5 percent share of the international cigarette market.

PMI's plant research facility in Switzerland

Transforming our business continued

Tobacco economics: Understanding the global tobacco and nicotine value chain

Internal transformation: A new organization and value chain

To deliver on our purpose, we are transforming our company and our value chain. The complexity of our strategy comes from simultaneously managing the impacts of two value chains: the one we are moving away from (our cigarette portfolio) and the one we are moving toward (our smoke-free portfolio).

Over the past years, we have undergone a meaningful reorganization, recruiting the talent and capabilities needed to drive a successful transformation while also seeking to allow our employees to build the skills they need to contribute to our business transition. We have incorporated new ways of working to become an increasingly digitalized, project-based organization focused on consumer-centricity, agility, and data-driven decision-making.
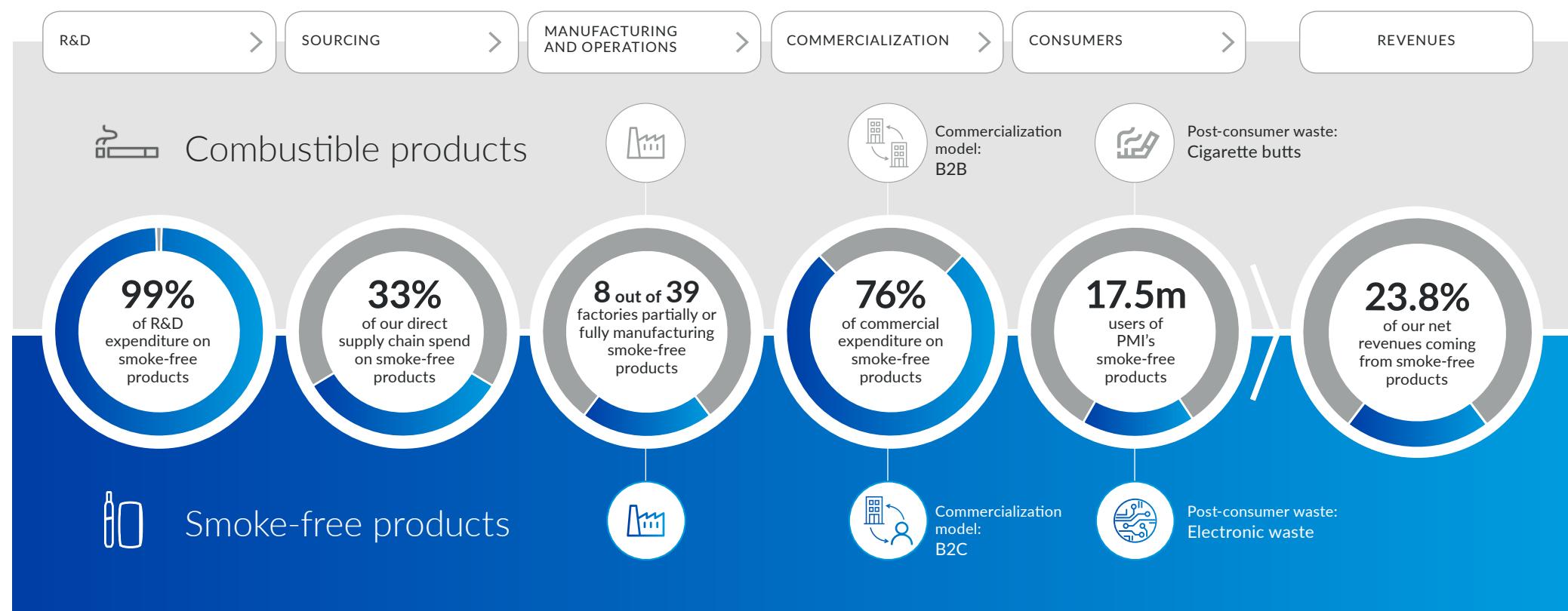
Since 2008, we have invested USD 8.1 billion to build state-of-the-art scientific research, development, and technology capabilities; launch a commercial engine fit for our new products; build manufacturing capacity; and conduct studies on adult smoker understanding. We are now leveraging those investments to accelerate our journey toward a smoke-free future.

Beyond our own operations, every step of our value chain is transitioning to serve our company purpose. For instance, our procurement now extends to new materials, such as electronic components (read more here). Smoke-free products differ from cigarettes and entail changes for some of our supply chain partners. We recognize the challenges these changes pose to some of them and we are actively helping them manage the transition.

In all aspects of our business, we are relentlessly shifting resources from cigarettes to smoke-free products. For instance, we have set up a post-consumer waste program to take back and recycle our electronic devices (read more here).

A transformation of such magnitude does not happen overnight and we must build on learnings as we progress. Still, we are committed to making it happen as fast as possible and to managing the impacts of our two parallel value chains, each with its own specificities.

R&D	SOURCING	MANUFACTURING AND OPERATIONS	COMMERCIALIZATION	CONSUMERS	REVENUES

Combustible products

Smoke-free products

99% of R&D expenditure on smoke-free products

33% of our direct supply chain spend on smoke-free products

8 out of 39 factories partially or fully manufacturing smoke-free products

76% of commercial expenditure on smoke-free products

17.5m users of PMI's smoke-free products

23.8% of our net revenues coming from smoke-free products

Commercialization model: **B2B**

Commercialization model: **B2C**

Post-consumer waste: Cigarette butts

Post-consumer waste: Electronic waste

Transforming our business continued

External transformation: Changing the way we engage with stakeholders

While PMI's commitment to a sustainable smoke-free future is unwavering, we cannot complete this journey alone.

Stakeholder engagement and collaboration are a crucial part of innovation, as they help inform product development. We also recognize that we cannot design new solutions effectively unless we first understand the issues we seek to address and stakeholder concerns.

As we continue to transform our business and our organization, we must rely on the cooperation of a host of stakeholders—from supply chain partners to regulators and public health authorities. This requires that we work continuously to build trust, confidence, and legitimacy and earn the license to operate. Multistakeholder engagement is the way to achieve systemic change; it will allow us to effectively transform and to lead an industry transition away from cigarettes. Engaging with stakeholders in an open and transparent way allows us to develop processes through a shared understanding of the context and the challenges related to our transformation.

PMI's key stakeholder constituencies will be impacted in different ways by our continued transformation. We will seek to engage and collaborate with all our stakeholders to speed the transformation while minimizing negative consequences.

ⓘ **Read our Statement of Purpose**

Consumers

Adult smokers and adult nicotine consumers

Why we engage

Adult consumers are at the heart of our business transformation. While we historically operated mostly under a business-to-business model, our new model is increasingly adding components of business-to-consumer. It is vital that we engage with adult smokers to raise awareness of smoke-free products and their benefits compared with cigarettes, and explain how they work. Engaging with consumers also helps us develop products that meet their preferences and needs and enhance our customer services.

How we engage

- Digital interfaces
- Surveys and questionnaires
- Hotlines and call centers
- Consumer events
- Ongoing conversations

Key issues discussed

- Quality and services
- Product innovation

ⓘ **Read more about our engagement efforts in 2020:**

Responsible marketing and sales practices

Access to smoke-free products

Employees

Employees, management, work councils, trade unions

Why we engage

Our employees are drivers of change and the ambassadors of our purpose. Their dedication is essential to making PMI's vision a reality. Engaging with our employees allows us to identify and resolve challenges together.

How we engage

- Regular surveys
- Group-wide intranet and internal platforms
- Performance and development reviews
- Internal events and conferences
- Training programs
- Recognition schemes
- Ongoing dialogue

Key issues discussed

- Company strategy and performance
- Diversity, equity, and inclusion
- Training and development
- Health, safety, and well-being

ⓘ **Read more about our engagement efforts in 2020:**

Fair working conditions

Talent attraction, retention, and employability

Diverse and inclusive working environment

Health, safety, and well-being at work

Supply chain

Farmers and farmworkers, farmers' associations, contractors, suppliers, retailers, wholesalers, business partners, third party-operated manufacturers

Why we engage

People working in our supply chain, including tobacco farmers, rely on PMI for a substantial portion of their income. PMI aims to deal fairly and ethically with its suppliers and is dedicated to acting as a good partner to other companies, large and small, that help us achieve our ambitions. Collaborating with others across our supply chain helps us address social and environmental challenges.

How we engage

- Compliance, audits, and risk assessments
- Strategic partnerships
- Supplier forums and events
- Meetings and workshops
- On-site visits
- Digital retailer interface

Key issues discussed

- Product innovation
- Health, safety, and fair working conditions
- Responsible supply chain management
- Environmental and social impacts
- Responsible commercialization practices

ⓘ **Read more about our engagement efforts in 2020:**

Sustainable supply chain management

Socioeconomic well-being of tobacco-farming communities

Responsible marketing and sales practices

Overview

Innovating for
better products

Operating
with excellence

Caring for the
people we work with

Protecting the
environment

Performance
metrics

Transforming our business continued

Investors and finance community

Equity and fixed income investors, lending institutions, insurance companies, financial analysts, rating agencies

Why we engage

Engaging with the finance community is key to promoting a comprehensive understanding of PMI's unique value proposition, strategy, and performance. Furthermore, investment decisions increasingly integrate environmental, social, and governance (ESG) criteria, and we are confident in the business opportunity our transformation brings.

How we engage

- Annual shareholder meeting
- Events and conferences
- Investor Days
- Earnings calls
- Presentations
- Reports and publications
- Roadshows
- Questionnaires and disclosure platforms for investors such as CDP
- Sustainability reporting frameworks (SASB, GRI, IIRC, TCFD)

Key issues discussed

- Business transformation strategy
- Financial and ESG performance
- Market and industry dynamics
- Capital allocation
- Sustainability priorities
- Governance and remuneration

ⓘ **Read more:**

   Investor Relations section of PMI.com

   Megatrends

   PMI's performance in ESG ratings, indices, and rankings

Regulators

Policy influencers, policymakers, intergovernmental organizations, regulatory bodies, standard setters, government authorities (including legislators), customs organizations

Why we engage

Dialogue with national and local governments and regulators allows us to understand their priorities and concerns, and share our views, objectives, and scientific findings. We engage with governments, regulators, and legislators—both directly and through business and trade associations—in the development of proposed legislation and regulations that may facilitate (or not) a smoke-free future. The right regulation can accelerate the end of smoking, foster innovation, and minimize unintended consequences.

How we engage

- Ongoing dialogue
- Forums and events
- Public consultations
- Reports and publications
- Trade associations
- Training and presentations

Key issues discussed

- Product health impacts
- Access to smoke-free products
- Regulatory compliance
- Differential fiscal and regulatory frameworks
- Sustainability priorities and performance

ⓘ **Read more about our engagement efforts in 2020:**

   Responsible engagement practices

   Access to smoke-free products

   Our business environment

Public health community

Scientific community, academia, researchers, public health agencies

Why we engage

Conducting our R&D with rigor is of utmost importance, as is engaging with the public health community. They are, unfortunately, polarized on the issue of tobacco harm reduction. By sharing our findings and asking them to scrutinize our products and the growing body of scientific evidence surrounding them, we aim to engage constructively on this topic and collectively seize the immense opportunity smoke-free products present for advancing public health within the current generation of adult smokers.

How we engage

- Conferences, forums, and events
- Reports and publications
- Articles and studies
- Dedicated scientific website (**PMIscience.com**)
- Online platforms for data transparency and reproducibility in science (**sbv IMPROVER** and **INTERVALS**)
- Applications and submissions

Key issues discussed

- Product innovation
- Product health impacts
- Scientific research

ⓘ **Read more about our engagement efforts in 2020:**

   Product health impacts

   Responsible and transparent R&D

   Access to smoke-free products

Civil society

Academia, local communities, civil society organizations, NGOs, multistakeholder organizations and initiatives, media

Why we engage

From best practices and information exchanges to close partnerships, engaging with civil society actors can help inform our strategy, define our priorities, and advance sustainable solutions to common challenges.

How we engage

- Sustainability materiality assessments
- Partnerships
- Communication campaigns
- Social contributions
- Open dialogue

Key issues discussed

- Sustainability priorities
- Business transformation
- Product innovation
- Environmental and social impacts
- Sustainability megatrends

ⓘ **Read more :**

   Innovating for better products

   Operating with excellence

   Caring for the people we work with

   Protecting the environment

Transforming beyond nicotine: Thinking net positive

Letter from the Chief Sustainability Officer

As we continue to transform our products, business model, and value proposition, stakeholder engagement and constructive dialogue remain paramount. This implies having frank conversations that embrace the concept of transformative change.

The positive impact that phasing out cigarettes, and thereby ending smoking, can have on public health (at both the individual and collective level) is undeniable. And yet, despite much progress, many of our stakeholders remain skeptical about our purpose, and question the impact of our transformation. They often inquire about our end goal, and whether the completion of our transformation concludes when the world is smoke-free. Moreover, and like many other companies, we are pressed regularly by certain stakeholders on the need for a long-term vision that involves a net-positive future.

Even though the beginning of our transformation journey started by articulating a vision centered on phasing out cigarettes and developing and commercializing better and less harmful alternatives to smoking, we realize that this cannot be our end goal. We understand that a complete and successful transformation is one that allows our company's business to move from a value proposition, centered on doing less harm, toward one where we can have a net positive impact on society.

Net positive strategies are built on the idea that a company must give back more than it takes from society and the environment. Can a business be net positive? How can this be measured or accounted for? What does a smoke-free future, beyond nicotine, look like? Sustainability offers us an opportunity for growth through investments in scientific research to continue innovating for better products, with the aim of becoming net positive.

Researching and developing less harmful non-combustible alternatives that are scientifically substantiated was the first step; broadening access for adult smokers, while simultaneously and deliberately working to phase out cigarette smoking, completed the equation of our smoke-free purpose. In the process, we have expanded our social, human, intellectual, and manufactured capital in ways that allow us to go a step further and develop products that seek to be better than merely less harmful.

In order to demonstrate the seriousness of our endeavor, we introduced a new aspiration to complement our Business Transformation Metrics and 2025 Roadmap: Net revenues of at least USD 1 billion derived from "beyond nicotine" products by 2025. This aspirational goal aims to further cement the confidence we have about the long term, as we evolve into a broader lifestyle and consumer wellness company, leveraging our ability to monetize the skills and assets we have accrued and developed in the process of our transformation. These include our commercial and digital abilities as well as our focus on consumer-centricity, which have enabled us to better inform adult smokers, allowing them to make fundamental behavior changes to improve their health and well-being.

Furthermore, we will continue to leverage on our life sciences capabilities, with the goal of having a net positive impact on the world. We will accomplish this by further expanding our value proposition to products that go beyond nicotine. The way to do that is fourfold.

> Expanding our value proposition to products that go beyond nicotine

As we prepare to refresh our sustainability materiality assessment during 2021, we will appropriately adapt and better reflect the changes of our business model and value proposition accurately, to recalibrate and reassess our strategy. We look forward to reporting on progress and elaborating in greater detail on this topic in our next report.

Jenny

Jennifer Motles
Chief Sustainability Officer

"Many products in the wellness and drug sector, although demonstrating good efficacy, still leave open unmet medical and consumer needs. Two of those unmet needs pertain to the time until someone can feel the effect and the side effects (safety profile) of a given product; both are linked (at least partially) to the route of administration. When a product is taken orally it takes time for the expected effect to set in. Also, due to the dose needed to achieve the expected effect, side effects may occur. Inhalation as an alternative form of application can offer advantages in both areas due to the faster uptake of the active compound, the potentially lower dose necessary (e.g., compared to an oral application), and higher bioavailability of the active compound achievable compared to when a product is taken orally in the same dose range. Our expertise in aerosol chemistry and physics as well as inhalation device technology can be effectively repurposed to help address these needs. Building upon PMI's unique scientific capabilities in smoke-free products, Life Sciences seeks to outline our company's scientific strategy for new products and services that go beyond tobacco and nicotine. We have the ability to combine scientific excellence with commercial rigor to continue elevating our business transformation."

Patrick Picavet, PMI Vice President Life Sciences, Program Delivery & Governance

Transparent reporting on progress: PMI's Business Transformation Metrics

To make our progress both measurable and verifiable, we developed a set of bespoke key performance indicators (KPIs) that we call Business Transformation Metrics. This set of metrics, which we report on periodically, allows our stakeholders to assess both the pace and the scale of our transformation. Over the years, based on our stakeholders' feedback we have expanded the number of metrics to increase transparency and clarity about our progress.

Our Business Transformation Metrics also showcase how we are allocating resources away from our traditional cigarette business, aiming to base our success on a future where we no longer make or sell cigarettes.

* The 2020 metrics marked with an asterisk (*) are subject to PwC's Assurance Report (see page 146).

1 Smoke-free products include heated tobacco units, devices, and e-cigarettes. Total products include smoke-free products, cigarettes, and other combustible products.

2 R&D positions include scientists, engineers, technicians, and support staff. Comparable data for years prior to 2018 are not available, as the scope of R&D positions changed following company organizational changes.

3 IP5 jurisdictions are Europe (patents granted by the European Patent Office), China, South Korea, Japan, and the U.S.

4 Data related to perception and behavior studies were restated to include both premarket and post-market studies.

5 Direct spend focuses on materials used in the manufacture of our products; it includes tobacco leaf, direct materials, and electronic devices and accessories.

6 Investments reflect research, product and commercial development, production capacity, scientific substantiation, and studies on adult smoker understanding. Figure does not include commercial deployment costs.

7 Production temporarily stopped at one of our factories in Germany in December 2019 and resumed early 2020.

8 "SKUs" stands for stock-keeping units. References to number of SKUs are based on the latest available data from a number of internal sources, and exclude People's Republic of China and the U.S.

9 Excluding PMI Duty Free. Data are based on 2020 OECD country list.

10 Includes flagship stores, and small, large, and temporary boutiques.

11 The smoke-free product shipment ratio is compiled based on millions of units.

12 Excluding PMI Duty Free; see **glossary**.

13 Net of excise taxes.

14 Excluding PMI Duty Free and the U.S.

Business Transformation Metrics	2016	2017	2018	2019	2020
R&D					
R&D expenditure (in millions USD)*	429	453	383	465	**495**
R&D expenditure (smoke-free/total)[1] *	72%	74%	92%	98%	**99%**
Number of R&D positions (FTEs)[2]	n/a	n/a	764	942	**934**
Patents granted in IP5 jurisdictions relating to smoke-free products (cumulative)[3]	170	300	480	740	**1,300**
Number of studies completed by PMI on smoke-free products (cumulative, since 2015)					
– Toxicological assessment	36	57	82	109	**146**
– Clinical assessment	11	12	19	19	**22**
– Perception and behavior (premarket and post-market)[4]	7 (7+0)	8 (7+1)	12 (9+3)	13 (9+4)	**30 (15+15)**
Sourcing					
Supply chain direct spend expenditure (smoke-free/total)[5]	n/a	n/a	n/a	35%	**33%**
Operations					
Cumulative investments behind smoke-free products (since 2008, in billions USD)[6]	3.2	4.6	6.2	7.2	**8.1**
Number of factories producing smoke-free products out of total number of factories[7] *	3 out of 48	4 out of 46	8 out of 44	8 out of 38	**8 out of 39**
Commercialization					
Year-on-year change in number of SKUs—combustible products[8]	-1.7%	-6.5%	-6.1%	-5.5%	**-4.1%**
Year-on-year change in number of SKUs—smoke-free products	78.2%	9.9%	37.1%	24.9%	**38.2%**
SKUs (smoke-free/total)	4.7%	5.5%	7.8%	10.1%	**13.9%**
Number of markets where IQOS is available for sale*	20	38	44	52	**64**
Proportion of markets where IQOS is available for sale that are outside the OECD[9] *	32%	41%	44%	45%	**52%**
Number of IQOS stores[10]	26	63	81	199	**259**
Number of retailers that sell PMI smoke-free product consumables (in thousands)	90	292	488	679	**749**
Commercial expenditure (marketing) (smoke-free/total)*	15%	39%	60%	71%	**76%**
Consumers					
Smoke-free product shipment volume (billion units)*	8	36	42	60	**76**
Combustible product shipment volume (billion units)*	845	791	767	732	**654**
Smoke-free product shipment ratio (smoke-free/total)[11] *	0.9%	4.4%	5.1%	7.6%	**10.4%**
Total IQOS users (in millions)[12] *	2.1	6.9	9.6	13.5	**17.5**
Estimated users who have switched to IQOS and stopped smoking (in millions)[12] *	1.5	4.7	6.6	9.6	**12.7**
Estimated users outside the OECD countries who have switched to IQOS and stopped smoking (in millions)[9] *	0.0	0.2	1.1	2.9	**4.3**
Revenues					
Net revenues (smoke-free/total)[13] *	2.7%	12.7%	13.8%	18.7%	**23.8%**
Number of markets where net revenues from smoke-free products exceed 10% of total net revenues[14] *	1	5	19	31	**38**
Number of markets where net revenues from smoke-free products exceed 50% of total net revenues[14] *	0	1	3	4	**6**

New metrics   Metrics linked to 2025 aspirations

Transforming our business continued

Our 2025 aspirations
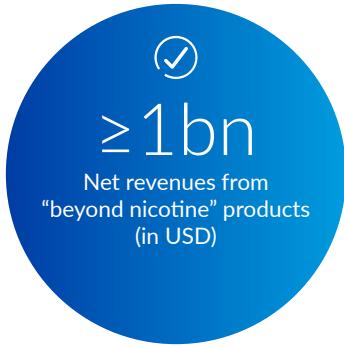
Aspirational goals linked to our Business Transformation Metrics give us a clear roadmap and offer our stakeholders visibility into the pace and scale of our achievements.

Our smoke-free products are realizing a strong business performance, which we intend to accelerate in the coming years. Previously, we had aimed for 38 to 42 percent of our total net revenues to come from smoke-free products by 2025. In early 2021, we increased that goal to at least 50 percent. This pioneering ambition to become a predominantly smoke-free company within the next five years demonstrates our commitment to deliver on our purpose and drive the end of cigarette smoking as fast as possible.

By 2025, we aspire to grow our smoke-free shipment volume above 250 billion units while simultaneously decreasing our combustible product shipment volume to below 550 billion units. This means we aspire for smoke-free products to represent more than 30 percent of our total shipment volume by that year.

We also aim for at least 40 million adults—half of them in non-OECD countries—to have switched to our smoke-free products and stopped smoking by 2025.

Furthermore, we aspire for our smoke-free products to be available for sale in 100 markets by 2025.

Finally, we are introducing this year a new aspiration of at least USD 1 billion in annual net revenues from "beyond nicotine" products by 2025, leveraging the capabilities we have built in life sciences, device technology, and consumer expertise (read more in the **Letter from our CSO**). We expect to further communicate on progress in this area in our next report.

>250
Smoke-free products shipment volume (in billion units)

<550
Combustible product shipment volume (in billion units)

>30%
Smoke-free product shipment ratio (smoke-free/total)

>40m
Estimated users who have switched to PMI smoke-free products and stopped smoking

>20m
Estimated users outside the OECD countries who have switched to PMI smoke-free products and stopped smoking

>50%
Net revenues (smoke-free/total)

100
Number of markets where PMI smoke-free products are available for sale

≥1bn
Net revenues from "beyond nicotine" products (in USD)

New aspirational targets linked to our Business Transformation Metrics

Note: Aspirational goals do not constitute financial projections

Our business environment

Key trends shaping our industry

Consumers

Today, an estimated 1.1 billion people worldwide smoke cigarettes or other combustible tobacco products. The latest statistics from the World Health Organization (WHO) project a decline in smoking prevalence (age 15+), from 21.5 percent in 2010 to an estimated 17.1 percent in 2025.[1] At the same time, the global adult population is growing by around 70 million people per year. The net effect of this population growth and declining smoking prevalence is a forecast of just under 1.1 billion smokers by 2025—essentially no change versus 2010.

WHO member states want faster change, targeting a 30 percent reduction in the prevalence of tobacco use by 2025 (versus the 2010 baseline) by encouraging cessation and discouraging initiation.[2] However, even if the WHO target is achieved, there will still be around 930 million smokers in 2025, according to PMI's calculations.

[1] WHO Global Report on Trends in Prevalence of Tobacco Use 2000–2025, third edition (December 2019).
[2] WHO Global Report on Trends in Prevalence of Tobacco Smoking 2015.

Our perspective

Our smoke-free vision complements WHO efforts by offering less harmful alternatives to adult smokers who wouldn't otherwise quit. It is our long-standing aspiration that by 2025 at least 40 million smokers switch to PMI's smoke-free products and stop smoking.

As of December 31, 2020, we estimate that there were close to 18 million *IQOS* users, of which 72 percent—or nearly 13 million—had switched to *IQOS* and stopped smoking, with the remainder in various stages of conversion.

PMI's Operations Center in Lausanne, Switzerland

Our business environment continued

Market dynamics

The global tobacco and nicotine market is characterized by a range of products, including combusted tobacco products (e.g., cigarettes, fine-cut tobacco, pipe tobacco, cigars, and cigarillos) and non-combusted products (also referred to as "smoke-free products" in this report). Those include heated tobacco, e-vapor, and hybrid products, as well as oral tobacco and nicotine products (such as snus and nicotine pouches).

While the number of consumers of tobacco and nicotine products has remained largely unchanged in recent years, the total retail value continues to grow over time. This largely reflects the impact of excise tax-driven retail price increases for combustible tobacco products, coupled with the growth of smoke-free products. This is partly offset by a lower volume of combustible tobacco products, reflecting an increasing number of adult smokers switching completely or partially to smoke-free products, and in addition, in some markets a lower average daily consumption induced by price elasticity.

In 2020, the total value of the international tobacco and nicotine market, excluding China and the U.S., reached an estimated USD 450 billion.[1] Mostly due to COVID-related disruption, the estimated total 2020 international industry volumes for cigarettes and heated tobacco units declined by almost 6 percent (compared with an average annual decline of 2 to 3 percent historically), with a disproportionate impact on Duty Free and markets with a high proportion of daily wage workers, such as Indonesia, the Philippines, and certain Latin American countries.

We estimate that the international market for heated tobacco and e-vapor products in 2020 reached an approximate value of USD 27 billion. The growth versus the estimated 2019 value reflects the increasing number of adult smokers who are moving to smoke-free products and was mainly driven by the heated tobacco category, which represented an estimated 74 percent of the combined retail value for heated tobacco and e-vapor products in 2020.

In recent years, some governments have legalized cannabis for medical and/or recreational purposes, and some tobacco companies have invested in the category. PMI does not produce or sell cannabis products. We do, however, intend to leverage our capabilities and expertise in aerosolization, scientific substantiation, assessment of safety and efficacy, and consumer insights to move beyond nicotine into areas such as botanicals and respiratory drug delivery.

Our perspective

Combustible market declines reflect growth of smoke-free products

Regulation and taxation

The risks of smoking have led legislators and regulators to impose rigorous restrictions and high excise taxes on cigarettes. Such restrictions are comprehensive, covering packaging and health warnings, ingredients, advertising, marketing, promotions and sponsorships, and public use.

Much of the regulation that shapes the tobacco industry operating environment is driven by the WHO's Framework Convention on Tobacco Control (FCTC), which took effect in 2005. The FCTC has established a global agenda for tobacco regulation, with the purpose of reducing the prevalence of tobacco use and exposure to tobacco smoke.

There is currently no global consensus among regulators on how best to regulate or tax smoke-free products. Some aim to encourage these products, seeing them as presenting less risk to adult smokers than continued smoking and an opportunity for public health; others severely restrict or ban not just communication about such products but in some cases the sales of the products themselves.

Our perspective

For many decades, public health strategies to reduce tobacco-related morbidity and mortality focused primarily on preventing smoking initiation by youth and encouraging smokers to quit. Novel, scientifically substantiated smoke-free products now provide regulators the opportunity to supplement and significantly strengthen the existing public health approach with a third pillar: tobacco harm reduction.

Government regulation of all nicotine-containing products, both combusted and non-combusted, is essential. We advocate for a comprehensive and risk-proportionate regulatory framework that recognizes that not all these products are the same. Regulation and taxation should subject the most harmful products to the most restrictive measures and should encourage those adults who would otherwise continue to smoke to switch to less harmful alternatives.

We don't agree with preemptive bans and unreasonable restrictions on scientifically substantiated smoke-free products, as such measures deprive those adult smokers who will not quit of alternatives that present less risk of harm than cigarettes. Smoke-free products contain nicotine, which is addictive, and they are not risk-free. Regulation should therefore provide minimum standards for all smoke-free product categories and specific rules for product assessment methodologies, ingredients, and labeling. Further, regulations should ensure that the public continues to be informed about the relative health risks of all combustible and noncombustible products. Regulation, as well as industry practices, should reflect the fact that youth should not consume nicotine in any form.

1 Includes the retail value of cigarettes and other tobacco products (including cigars, cigarillos, pipe tobacco and fine-cut), heated tobacco units and e-vapor products (including devices), snus, and nicotine pouches.

Our business environment continued

Illicit trade

The illicit tobacco trade provides a cheap and unregulated supply of tobacco products. It undermines efforts to reduce smoking prevalence, damages legitimate businesses, stimulates organized crime, increases corruption, and reduces government tax revenue. It is estimated that illicit trade accounts for as much as 10 to 12 percent of global cigarette consumption and that governments worldwide are losing USD 40 billion in tax revenues each year as a result.[1]

Many countries have introduced or are considering actions to prevent illicit trade. In November 2012, the FCTC adopted the Protocol to Eliminate Illicit Trade in Tobacco Products (the "Protocol"), which includes supply chain control measures such as the licensing, enforcement in free trade zones, and the implementation of tracking and tracing technologies. The Protocol came into force in September 2018, and parties to it have started implementing its measures via national legislation.

Our perspective

The illicit tobacco trade is large and demands integrated action. From our side, we focus on controlling our supply chains to prevent the diversion of our products. For 15 years, we have been operating a global tracking and tracing system for our products, covering all markets. We also work with governments and other partners in the public and private sectors to combat illicit trade. Read more about our efforts to tackle the illicit trade of tobacco and nicotine products on **PMI.com**.

1 Source: World Bank Group

Competition

The global tobacco sector includes four large international manufacturers—British American Tobacco (BAT), Japan Tobacco (JT), Imperial Brands (IMB), and PMI—along with two major manufacturers focused primarily on their respective domestic markets: The China National Tobacco Corporation (CNTC) in China and Altria Group, Inc. (the parent company of Philip Morris USA) in the U.S. Together, these six companies accounted for close to 86 percent of global cigarette and heated tobacco unit sales by volume in 2020. Regional and local companies, including state-owned enterprises, accounted for the remaining 14 percent.

As in other consumer goods sectors, manufacturers compete primarily on product quality, brand recognition, brand loyalty, taste, R&D, innovation, packaging, customer service, marketing, advertising, and retail price.

Increasingly, competition also focuses on the development and commercialization of smoke-free tobacco and nicotine products, with tobacco manufacturers shifting their resources, by varying degrees, toward the development of such products, particularly heated tobacco, e-vapor products, and nicotine pouches.

The main difference, however, rests on competition centering their value proposition on expanding their portfolios and offering more choice to their consumers. This drastically contrasts with PMI's, which aims to phase out cigarettes completely, not only offering choice but promoting full switching to better alternatives.

Various manufacturers, including PMI, launched the first heated tobacco products in the late 1990s, with limited commercial traction. Following the commercial breakthrough by *IQOS* after its initial two city launches in 2014, other manufacturers introduced their own heated tobacco products in certain markets. Some manufacturers have also launched hybrid products, which combine aspects of heated tobacco and e-vapor products. To date, competition in the heated tobacco category is primarily among manufacturers of combustible tobacco products.
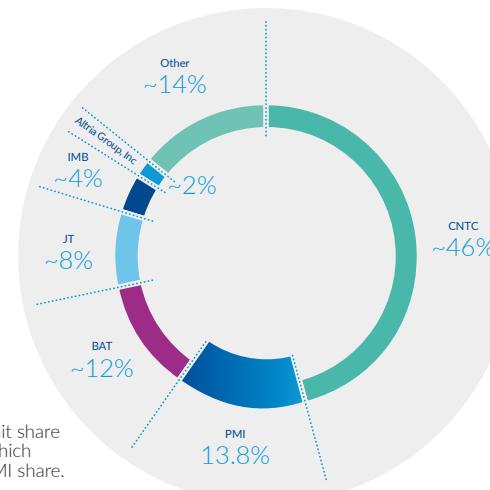
The e-cigarette was invented in 2003 in China, and—after more than a decade of relatively limited success—the broader e-vapor category has recorded significant growth in the past decade, particularly in the U.S., Canada, and certain European markets. Currently, the market for "open"[2] e-vapor products remains heavily fragmented. In contrast, the market for "closed"[3] e-vapor products is relatively consolidated among tobacco manufacturers and a certain number of e-vapor startups.

Nicotine pouches, an oral, usually tobacco-free product, have also emerged as credible smoke-free products over the past two to three years, most notably in markets with an existing oral tobacco segment, such as the U.S. and Scandinavia. Outside of these markets, the category remains small but is growing. Nicotine pouches are overwhelmingly produced by the major tobacco manufacturers and Swedish Match.

Our global market share 2020, including cigarettes and heated tobacco units

Other ~14%
Altria Group, Inc. ~2%
IMB ~4%
JT ~8%
BAT ~12%
PMI 13.8%
CNTC ~46%

Note: Total heated tobacco unit share was 1.8 percent in 2020, of which 1.5 percent represented by PMI share.

Source: PMI Financials or estimates

Our perspective

We have made significant progress in transforming our business. In 2020, smoke-free products accounted for over 10 percent of our total volume and almost one-quarter of our total net revenues. In fact, net revenues from smoke-free products already exceeded 50 percent of total net revenues in six markets, 25 percent or more in three of our six regions, and over 10 percent in 38 markets.

2 Open systems feature a chamber that can be refilled with e-liquid.
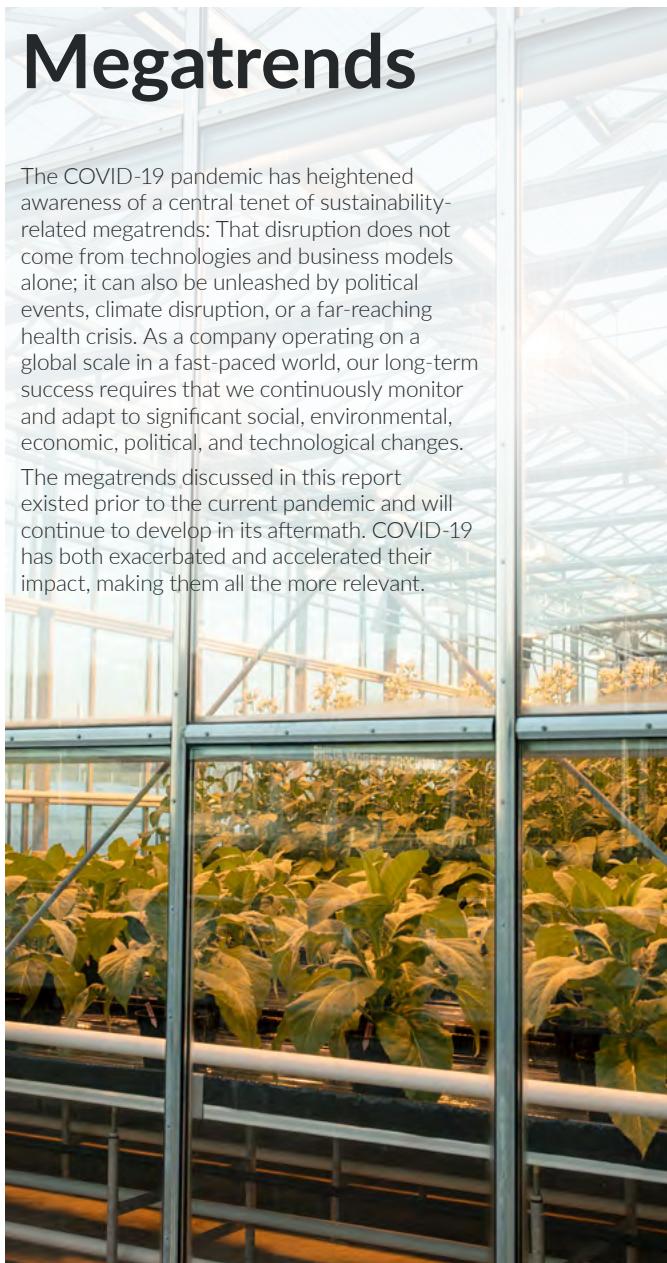
3 Closed systems are disposable or reloadable with prefilled cartridges.

Megatrends

The COVID-19 pandemic has heightened awareness of a central tenet of sustainability-related megatrends: That disruption does not come from technologies and business models alone; it can also be unleashed by political events, climate disruption, or a far-reaching health crisis. As a company operating on a global scale in a fast-paced world, our long-term success requires that we continuously monitor and adapt to significant social, environmental, economic, political, and technological changes.

The megatrends discussed in this report existed prior to the current pandemic and will continue to develop in its aftermath. COVID-19 has both exacerbated and accelerated their impact, making them all the more relevant.

PMI's plant research facility where the team explores avenues for selecting crops for more environmental resilience and reduced footprint, Switzerland

Technological progress

New technologies are emerging rapidly, including in robotics, artificial intelligence, and virtual reality. Consumer goods companies have been at the forefront of digital innovation in marketing and sales. Automation and digital solutions are also widely implemented in manufacturing and supply chains, introducing risks related to employment patterns, data privacy, and human rights. Taking a mindful and proactive approach to shaping the future of work will enable companies to respond to people's need and desire for income security, well-being, empowerment, and purpose, ensuring lives are enriched by advancing technology and that people across society can prosper from equal access to new opportunities.

COVID-19 impact

Digitalization has become an imperative, changing how businesses operate and consumers live. Companies have accelerated the digitalization of their customer and supply chain interactions and internal operations. During the pandemic, consumers have migrated to online channels, and companies have responded in turn. Businesses have seen similar accelerations in the digitalization of core internal operations, such as administration, production, R&D, and remote working.

How we are responding

Breakthrough developments in science and technology, including from outside our industry, are affecting our products, business model, and value chain. They have enabled us to develop and scientifically substantiate innovative smoke-free products. Adopting leading-edge technology systems and tools, and building new capabilities are speeding our transformation from a business-to-business (B2B) toward an increasingly business-to-consumer (B2C) commercial model—a model that requires direct consumer engagement, online sales, and aftersales support. In 2020, during a difficult year that did not permit much social interaction, technology allowed us to increasingly migrate from an offline to online model. This means that we have been able to successfully accelerate the deployment of our e-commerce platform, as well as remote coaching to accompany smokers on their conversion journey to smoke-free products. We also leverage on technology in support of our activities across our value chain, for instance by leveraging on satellite imagery to assess deforestation risks or on telematics to minimize road traffic accidents. As the world of work is changing, we are also expanding life-long learning programs that allow employees to enhance their career opportunities and boost their employability.

Consumer values and expectations

Consumers are increasingly interested in knowing the social and environmental impacts of the products they buy and are changing their consumption patterns accordingly. To mitigate the negative impacts of their consumption, they focus on sustainability; the capacity to reuse, repair, and recycle products; and product ingredients and attributes (e.g., organic, natural, locally produced). In addition, consumers expect a seamless experience across channels. They value the overall experience more than the channel and appreciate brands that take service from transactional to personal.

COVID-19 impact

As people worldwide adjust to the next normal, there is significant variance in consumer sentiment and behaviors. COVID-19 has brought an unprecedented shift in the priorities and channels of engagement of consumers and businesses. As the threat of infection swept across the world, consumer patterns shifted to essential goods and personal safety, seemingly deprioritizing sustainability. However, now that they are emerging from isolation, consumers are reassessing their values and rewarding brands that operate with a clear purpose beyond profits.

How we are responding

We are continuing our transition into a consumer-centric organization. Consumer feedback continually informs our product development and improvement. We are serving our consumers through a wider variety of channels, both offline—e.g., our *IQOS* stores and exclusive *IQOS* retail touchpoints—and increasingly online. Beyond offering adult smokers a less harmful alternative to cigarettes, we aim to reduce our products' environmental footprint by integrating eco-design and circularity considerations at the early stages of product development, as well as strengthening our capabilities to collect and recover used devices and consumables.

Environmental pressure

Business leaders should look at environmental risks in a new way. The impacts of climate change, biodiversity loss, and water insecurity—among others—threaten more than supply chains and physical infrastructure; they endanger progress and business growth by exacerbating systems-level disruption to customers, investors, employees, and communities. Averting catastrophic climate impacts will require drastic reductions in global greenhouse gas emissions to limit global warming to 1.5 degrees Celsius. Decarbonizing the global economy will be one of the biggest transformations ever undertaken.

COVID-19 impact

The COVID-19 pandemic has occurred against the backdrop of the climate crisis. There are hopeful signs that the global experience of the pandemic and the lessons learned will help to mobilize the climate response. As a global community, we have seen how interconnected and mutually dependent we are—to one another and to the natural world. The pandemic's spread and human toll put into sharp focus the need to act on global existential threats decisively and collectively.

How we are responding

Carbon neutrality remains a top priority for us. We support the Paris Agreement and have revised our targets, making them more ambitious in line with the recommendations of the Intergovernmental Panel on Climate Change (IPCC) aimed at stabilizing global temperature rise below the internationally agreed 1.5 degrees Celsius. Our efforts extend beyond our own business to our entire value chain, and our strategies account for the interdependencies between various environmental challenges. We seek to address our environmental impacts holistically, applying a landscape approach as we work to prevent cigarette butt littering, integrate eco-design principles in our smoke-free products, combat deforestation, protect biodiversity, manage water responsibly, and reduce waste.

Sustainable finance

An increasing number of stakeholders are demanding that capital markets shift from perceived short-term, siloed, and sometimes extractive behavior to a model of long-term, inclusive and sustainable capitalism. Investors are increasingly moving beyond a traditional risk-return model to ask how they can deploy capital as a lever for change. Investment decisions increasingly integrate environmental, social, and governance (ESG) criteria, which are growing in sophistication from initial undifferentiated approaches, and are expected to ramp up dramatically over the next decade. The standardization, measurement, and aggregation of nonfinancial data is needed to support the financial sector in making more sustainable investment decisions.

COVID-19 impact

The pandemic has underscored the complexity and interconnectedness of our world and how quickly these links and structural supports can collapse if not sustainable. The focus on ESG investing and sustainable finance and business intensified in the past year as the COVID-19 shock accelerated demand for sustainability-based solutions. From sustainable portfolio construction to specialized stock exchanges and green bond markets, many investors have worked to infuse purposefulness into their investment approaches.

How we are responding

Although at its beginning, we believe the way ESG investing is currently applied is not yet capturing the power of the process to make true change happen, as it mostly uses negative screening—which tends to exclude controversial industries such as tobacco. This does little to incentivize companies and industries to effect positive change, or more importantly to encourage change in consumer behavior. What a company makes is at least as important as how it makes it, and not all companies within an industry are the same. In October 2020, we announced that our Chief Sustainability Officer would report directly to PMI's Chief Financial Officer, as it is our firm belief that fully integrating ESG drivers into our business strategy can significantly enhance both our sustainability and our financial performance. This was the logical next step following our Board's adoption of the **PMI Statement of Purpose** in 2020 and our shift to integrated reporting in 2019. Those developments underscore that ESG is core to PMI's performance and success, and further demonstrate that, at PMI, sustainability and business performance do not follow separate paths; they are fully interrelated and mutually reinforcing and are organized and presented to all stakeholders, including investors, in an integrated way.

Social inequality

Social inequality can manifest in the labor market, the source of income, health care, and freedom of speech, education, political representation, and participation; it is an ethical and moral concern globally. Promoting equality is a common ideal across cultures, a principle that should be upheld and actively pursued. While global inequality has fallen in the past 30 years, it has risen sharply within some countries. Globalization has increased the supply of cheap labor by integrating emerging markets into the global economy, thereby displacing low-income jobs in advanced economies. Technological advances have increased demand for skilled labor at the expense of low-skilled workers everywhere, and migration has increased the labor supply in advanced economies.

COVID-19 impact

COVID-19 may end up being the most significant development setback of our lifetime. The pandemic is reversing decades of progress in poverty reduction, promotion of education, health improvements, and overall well-being as the livelihoods of billions of people are being negatively affected. There are indicators that the pandemic may have pushed an additional 100 million people or more into extreme poverty, with a devastating impact on equality. Women, alongside minorities and the poor, elderly, disabled, and migrant populations, have borne the worst of the fallout from the pandemic.

How we are responding

We pay our employees equally for equal work, and we aim to provide them with equal opportunities regardless of sex, gender identity, country of origin, age, or other personal characteristics. Our global EQUAL-SALARY certification verifies that PMI pays men and women equally for equal work everywhere we operate, and we are committed to fostering fairness in the workplace, rewarding employees based on their performance. We aim to close our gender pay gap through a range of initiatives focused on improving the gender balance of our leadership populations. We are also committed to maintaining at least a living wage for all our employees. Our efforts to address income inequality extend to our supply chain, as we aim for the farmers from whom we source tobacco to make a living income.

Sustainability at PMI

**Our purpose of achieving a smoke-free future must be conducted sustainably.**
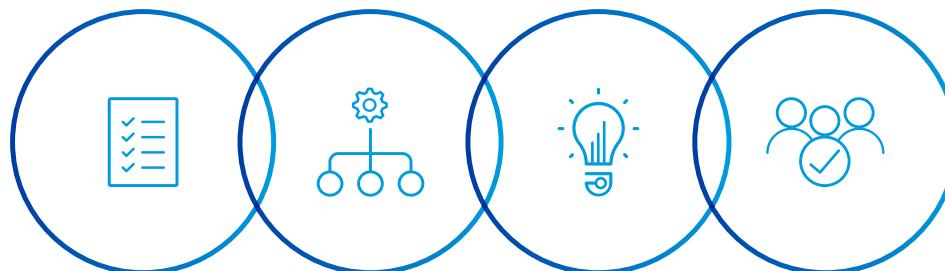
For PMI, sustainability is an opportunity for innovation, growth, and long-term value creation, and a means to minimize the negative externalities while maximizing operational efficiency and resource allocation. Sustainability stands at the core of PMI's transformation and helps address some of the challenges resulting from this transition, while spurring innovation and securing success over the long term.

Our message as we pursue a smoke-free future is clear: People who don't smoke should not start, those who do smoke should quit, and those

smokers who don't quit should switch to a better alternative. Our priority is to address the health impacts associated with smoking by encouraging adult smokers to switch to better, science-based alternatives, ultimately phasing out cigarettes.

Addressing the health impacts of smoking, therefore, requires a three-part approach:

1. Develop and commercialize better alternatives

2. Provide broad access to adult smokers who will not quit to ensure these products accelerate the decline of smoking prevalence

3. Work to ensure these products ultimately replace cigarettes. This is the most important contribution we can make to public health and is the cornerstone of PMI's purpose and business strategy

Mitigating risk & compliance

Operational & resource efficiency

Technology innovation & growth

Purpose, value & impact

IMD business case studies on PMI's transformation: A source for classroom debate and reflection

"One of the key issues that I see with companies—and not only tobacco companies—is how difficult it is to define what sustainability specifically means for them. If you're a company that makes chocolates, or cars, what aspects of sustainability are material to your core business? Do we define sustainability simply as 'mitigating harm'? Or do you need to demonstrate a positive impact? Do we define it in terms of the products or services you provide? These questions apply across all industries and can create an interesting debate in class for my students and the participants at IMD to have an original experience and debate something that is very controversial. Discussing the tobacco business's impact on society brings strong emotional reactions, which influence the willingness of various stakeholders to even consider the possibility of positive impact. Those same emotions are expressed in class—making this case a launchpad for rich analysis and reflective learning."

Professor Vanina Farber, PhD, IMD Director, elea Center for Social Innovation

The business case studies—available in The Case Center and the Harvard Business Review online store—are based on the idea that stakeholders have an essential role to play in PMI's transformation and that their agendas can ratchet up or slow down the process. They dig deeply into purpose, materiality, and integrated reporting. Do stakeholders trust PMI's transformation? Are they willing to engage in it? Or will they disengage and disinvest from the push for change? How important is the nonmarket environment to PMI's success in transforming its business model?

PMI's Vision of a Smoke-Free Future: Can a Tobacco Company Be Sustainable?
Farber, V.; Olynec, N.
Institute for Management Development (IMD)

A World Without Cigarettes? Actions Speak Louder Than Words
Farber, V.; Jaén, M.
Institute for Management Development (IMD)

A World Without Cigarettes? Building a Sustainability Materiality Matrix
Farber, V.; Jaén, M.
Institute for Management Development (IMD)

Disclaimer: The IMD business case studies were written independently, were not commissioned or paid for by PMI, and Professor Farber and her coauthors received no economic benefit or incentive from PMI for writing these cases.
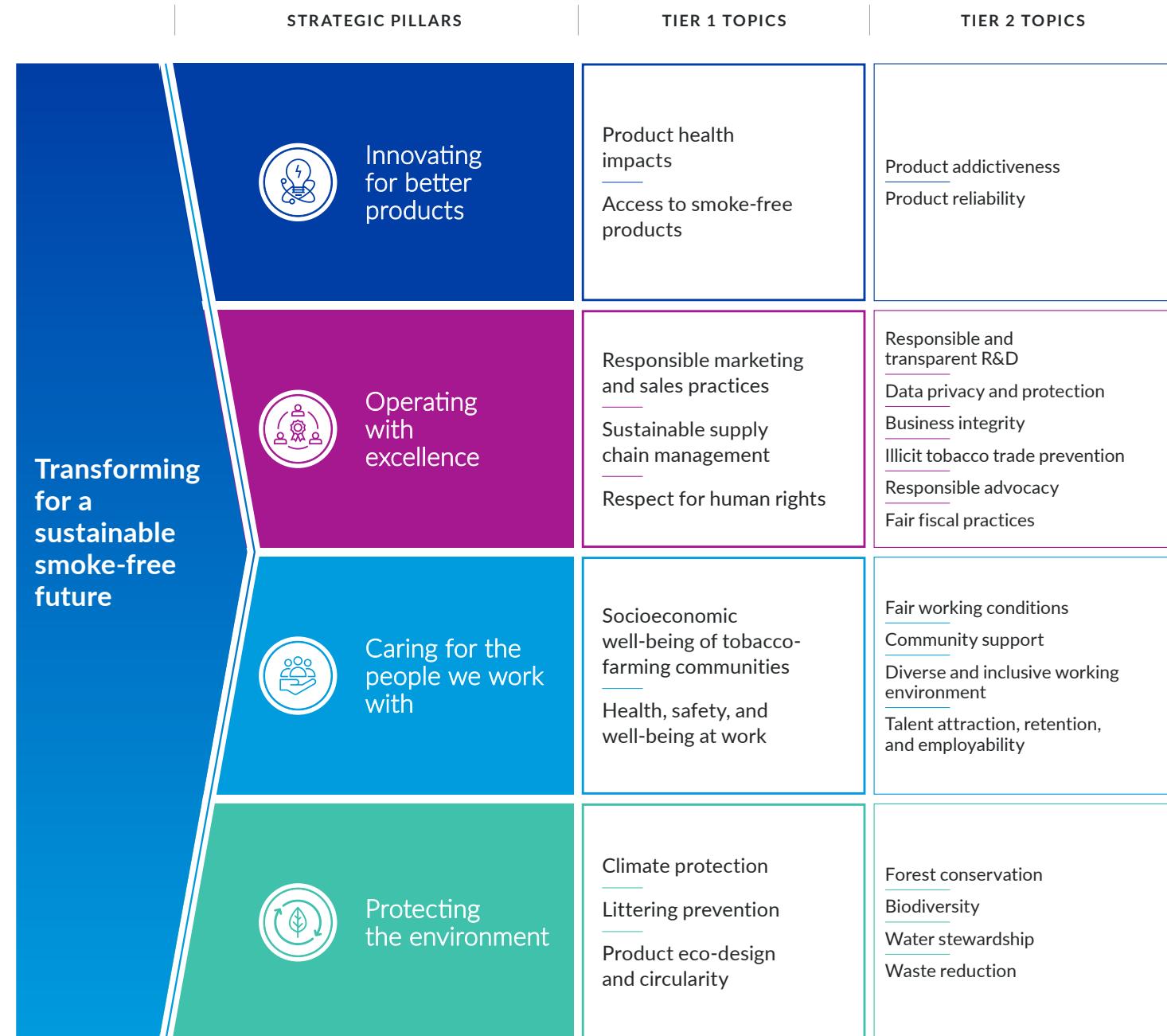
Strategic framework

Our approach to sustainability is structured around four pillars of action and two tiers of topics. It provides the framework through which we respond to sustainability challenges and opportunities.

To become a sustainable company, we must make every effort to replace cigarettes completely with better, smoke-free alternatives. Innovating for better products is therefore at the core of our strategy. Our other strategic pillars include effective management of operational topics, social issues, and environmental matters.

Our two-tiered grouping of topics is based on the sustainability materiality analysis we conducted in 2018 and refreshed in 2019. That analysis identified 10 areas of priority focus—or "tier 1 topics"—across our four pillars of action, which are discussed in detail in this report. Tier 2 topics are referred to in this report and further described on **PMI.com**.

In the **Governance and management** section of this report, we describe how sustainability is embedded throughout our business and how we delegate accountability to the heads of different functions within the company linked to the main impacts they can help address.

STRATEGIC PILLARS | **TIER 1 TOPICS** | **TIER 2 TOPICS**

Transforming for a sustainable smoke-free future

Innovating for better products
Product health impacts

Access to smoke-free products

Product addictiveness

Product reliability

Operating with excellence
Responsible marketing and sales practices

Sustainable supply chain management

Respect for human rights

Responsible and transparent R&D

Data privacy and protection

Business integrity

Illicit tobacco trade prevention

Responsible advocacy

Fair fiscal practices

Caring for the people we work with
Socioeconomic well-being of tobacco-farming communities

Health, safety, and well-being at work

Fair working conditions

Community support

Diverse and inclusive working environment

Talent attraction, retention, and employability

Protecting the environment
Climate protection

Littering prevention

Product eco-design and circularity

Forest conservation

Biodiversity

Water stewardship

Waste reduction

Sustainability materiality

Building on our 2018 exercise, we refreshed our materiality assessment at the end of 2019 to ensure we focus resources for the greatest impact. The assessment took into account the perspectives of more than 800 internal and external stakeholders. It also included an evaluation of impact on sustainable development and allowed us to identify emerging trends. Our 2019 sustainability materiality refresh (conducted in line with Global Reporting Initiative guidance) informed the development of our 2025 Roadmap.

Sustainability materiality is a process through which our company identifies, assesses, and prioritizes issues by collecting feedback from a range of sources. These sources vary in complexity and include both financial and nonfinancial quantitative and qualitative information. A rigorous materiality assessment ensures that our strategy, work, and reporting cover the right topics in the right way; this allows us to measure progress against our sustainability roadmap.

To ensure that our strategy remains current and is able to best fulfill our stakeholders' expectations, and that our initiatives continue to address those issues on which our business can have the greatest impact, we plan to conduct a new comprehensive sustainability materiality assessment in 2021. This will allow us to reassess, recalibrate, and reaffirm our goals. We will communicate the findings in our next report.

ⓘ Read PMI's Sustainability Materiality Report 2019

Materiality:
PMI's perspective

Impact valuation: Holding sustainability to account

Impact valuation is a method by which companies identify, understand, improve, and demonstrate the benefits and costs of their activities to society and the environment, translated into monetary terms.

To support the creation of a global impact measurement and valuation standard for monetizing and disclosing impacts of corporate activity, PMI joined other companies in 2019 to cofound the Value Balancing Alliance (VBA), a nonprofit organization.

In 2020, we piloted a first version of the VBA methodology with a set of nine environmental, social, and economic topics covering companies' operations and upstream supply chains. A cross-functional team of internal experts within PMI applied the methodology to evaluate our company's impacts, participated in peer-learning sessions, and provided feedback to inform the work of the VBA. The piloted methodology was made publicly available by VBA in early 2021; find it here.

"Measuring and valuing economic, social, and environmental impacts can enhance understanding of the materiality and interdependencies of companies' positive and negative impacts. It promotes a cross-functional approach to addressing impacts and is an essential step to inform a decision-making process resting on a holistic understanding of companies' value contributions and effects on society. However, for impact valuation to be broadly adopted and relevant to companies and all stakeholders, we believe it needs to rest on a common methodology."

Andreas Kurali, PMI Vice President and Controller

The exercise confirmed that a significant portion of our impacts lies within our supply chain and allowed us to define those impacts in monetary terms. It also shed light on the need to enhance the VBA methodology to consider additional emerging or existing sustainability best practices in the calculation models, including those related to sustainably managed forests or employee lifelong learning programs. Finally, piloting the methodology proved valuable in providing insights into the linkages between social impacts and macroeconomics. This allows us to account for such linkages in strategy-setting and scenario forecasting.
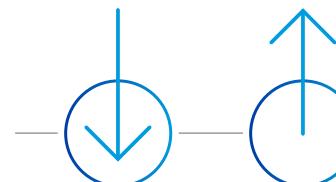
Over the next two years, PMI and the other corporate members of the VBA will continue expanding the methodology to cover additional topics and promoting integrated management practices. We plan to further communicate on the results of the impact valuation exercise as we progress on the topic. We will also explore further how to leverage findings from our valuation assessments to inform business decisions.

"We are glad that industry leaders such as PMI are members of the VBA driving the movement to integrate environmental, social, and human aspects in decision-making and disclosures towards a more sustainable economy."

Christian Heller, CEO Value Balancing Alliance

Impact valuation

Traditional reporting | Impact measurement & valuation

Input
What resources have been used for business activities?

Output
What activities have been done?

Outcome
What changed as a result of the business activities?

Impact
How does the outcome affect society?

Value of impacts
How do people value the change in well-being due to the impact?

Note: Visual adapted from Value Balancing Alliance, Methodology Impact Statement General Paper, Version 0.1 (February 2021)

Contribution to the UN Sustainable Development Goals (SDGs)

The 2030 Agenda for Sustainable Development is a universal call for action to address global challenges. At PMI, we are committed to doing our part to make the UN SDGs a reality.

Though none is unimportant, we impact and are impacted by different goals to differing degrees. In 2019, building on our refreshed sustainability materiality assessment, we reviewed our contribution to the SDGs to identify areas where we have an opportunity to make the greatest difference, in line with our sustainability priorities. As a result, for each of our tier 1 topics, we identified primary SDGs to which PMI can contribute, as well as secondary SDGs.

This year, we have taken it a step further. To add more visibility and granularity, we deepened our analysis and mapped in our **SDG Index** our efforts and ambitions with the targets of the UN SDGs for each of our sustainability topics.

The goals are interconnected and influence each other. We have developed initiatives to systematically address the most critical sustainability challenges affecting our business and stakeholders. Through our business transformation, we aspire to have a significant, positive impact on SDG 3 (Good Health and Well-Being) while contributing to several other SDGs and corresponding targets.

TIER 1 TOPICS	PRIMARY SDGs	SECONDARY SDGs
Product health impacts	3 GOOD HEALTH AND WELL-BEING	
Access to smoke-free products	3 GOOD HEALTH AND WELL-BEING	
Responsible marketing and sales practices	3 GOOD HEALTH AND WELL-BEING	
Sustainable supply chain management	12 RESPONSIBLE CONSUMPTION AND PRODUCTION	1 NO POVERTY; 2 ZERO HUNGER; 8 DECENT WORK AND ECONOMIC GROWTH; 13 CLIMATE ACTION; 15 LIFE ON LAND; 16 PEACE, JUSTICE AND STRONG INSTITUTIONS
Respect for human rights	(SDG wheel)	
Socioeconomic well-being of tobacco-farming communities	2 ZERO HUNGER; 8 DECENT WORK AND ECONOMIC GROWTH	1 NO POVERTY; 3 GOOD HEALTH AND WELL-BEING; 4 QUALITY EDUCATION; 5 GENDER EQUALITY; 6 CLEAN WATER AND SANITATION; 10 REDUCED INEQUALITIES; 11 SUSTAINABLE CITIES AND COMMUNITIES; 16 PEACE, JUSTICE AND STRONG INSTITUTIONS
Health, safety, and well-being at work	3 GOOD HEALTH AND WELL-BEING	8 DECENT WORK AND ECONOMIC GROWTH
Climate protection	13 CLIMATE ACTION	1 NO POVERTY; 2 ZERO HUNGER; 7 AFFORDABLE AND CLEAN ENERGY; 8 DECENT WORK AND ECONOMIC GROWTH; 9 INDUSTRY, INNOVATION AND INFRASTRUCTURE; 15 LIFE ON LAND
Littering prevention	14 LIFE BELOW WATER; 15 LIFE ON LAND	12 RESPONSIBLE CONSUMPTION AND PRODUCTION
Product eco-design and circularity	12 RESPONSIBLE CONSUMPTION AND PRODUCTION	8 DECENT WORK AND ECONOMIC GROWTH; 14 LIFE BELOW WATER; 15 LIFE ON LAND

17 PARTNERSHIPS FOR THE GOALS

Connectivity and trade-offs

Sustainability challenges do not exist in a vacuum. They are often linked to one another, and their interdependencies—including the direction of causality and magnitude—must be considered as we craft appropriate solutions.

These solutions can be mutually reinforcing. For example, sustainable supply chain management can be a catalyst for progress on climate protection or fair working conditions. As another example, forest protection is key to climate stability and biodiversity conservation, and is instrumental to the socioeconomic well-being of rural tobacco-farming communities.

However, in other instances, addressing a particular topic may limit the way we tackle another. For instance, a topic of utmost importance to us is "access to smoke-free products," an essential aspect of which is creating awareness that less harmful alternatives exist and are available (in jurisdictions that allow it). While doing our utmost to reach all adult smokers who will continue to smoke, we must carefully limit our awareness-raising initiatives in light of another, equally important topic, "responsible marketing and sales practices." We do this in order to minimize unintended consequences, including the risk of our messages (about smoke-free products) reaching unintended audiences like non-smokers and youth.

Given the multifaceted and complex nature of sustainable development, such trade-offs are inherent to decision-making. In some circumstances, we are compelled to make sacrifices in one sustainability area to obtain benefits in another. Beyond natural dependencies between sustainability topics, trade-offs can also stem from the competing interests of different stakeholders, conflicts between short-term and long-term priorities, and the impacts of external trends shaping the context in which we operate.

At PMI, necessary trade-offs also occur due to our business transformation. For example, our priority is to address our biggest externality by replacing cigarettes with less harmful alternatives. While our environmental footprint is small in comparison with other fast-moving consumer good companies, our transformation runs counter to our conservation efforts. For instance, the manufacturing process of the heated tobacco units uses more energy and water than cigarettes today. In this report, we explain how we are tackling this issue and increasing efficiency in order to mitigate this trend.

As another example, we know that with the growth of our smoke-free business there is a simultaneous decline of our cigarette business, which translates into a gradual decrease of demand for tobacco leaf. Such change has an undeniable impact on our contracted farmers. Read how we seek to minimize the negative effects of such trade-off **here**.

In designing our strategies and programs, it is vital that we accurately comprehend, analyze, and account for situations of forced compromise. We strive to minimize trade-offs, guided by our sustainability materiality assessment. If appropriately addressed, some trade-offs can also be a source of innovation, as such compromises press us to develop plans for tackling the tensions created. Embedding an integrated approach to sustainability within our business allows us to monitor and tackle multiple issues simultaneously, identifying effective solutions that leverage on interdependencies to make progress. Read for instance our **case study** describing the holistic strategies we have applied to tackle our environmental impacts in Malawi.

A cigarette manufacturing line (on the right) and heated tobacco unit manufacturing line (on the left) in our manufacturing facility in Neuchâtel, Switzerland

Our 2025 Roadmap

Besides reporting transparently on progress, it is crucial to have forward-looking goals that inform the route of our long-term plan. Accordingly, in 2020 we introduced a set of aspirational targets for each of our tier 1 topics. Known collectively as our 2025 Roadmap, they correspond to the areas in which we believe our company can have the most significant impact.

Despite the unprecedented challenges brought by the global pandemic, we have not deviated from our efforts to become a sustainable company. In 2020, we remained focused on achieving our ambitions and realized noteworthy progress in many of our priority topics.

In 2021, we plan to develop our processes further by structuring key performance indicators (KPIs) related to our aspirational targets. We will communicate our progress in this regard in our next report.

Product health impacts and access to smoke-free products

Broaden access for adult smokers to smoke-free products that are scientifically substantiated as less harmful alternatives to cigarettes

>40m — Number of adult smokers globally who switch to PMI smoke-free products and stop smoking

>20m — Number of adult smokers in non-OECD countries who switch to PMI smoke-free products and stop smoking

By the end of 2020, we estimate that, out of 17.5 million total *IQOS* users, 12.7 million had switched to *IQOS* and stopped smoking. Of them, 4.3 million live in non-OECD countries.

100 — Markets where PMI smoke-free products are available for sale

In 2020, we launched *IQOS* in 12 additional markets. This brought to 64 the total number of markets in which the product was commercialized at December 31, 2020. Among these markets, 33 were in non-OECD countries.

Legend

- Not started
- Progress, but with challenges
- Progress on track
- Progress, further than anticipated
- Completed

Responsible marketing and sales practices

Commercialize our products responsibly, preventing youth from accessing and using them

>90% — Youth access prevention (YAP) programs in place in markets representing over 90 percent of PMI's total shipment volume by 2020

By the end of 2020, markets representing over 94 percent of PMI's total shipment volume had developed and started implementing YAP plans—where allowed, considering COVID-19 restrictions imposed by local governments.

100% — Percentage of PMI smoke-free electronic devices introduced on the market as of 2023 equipped with age-verification technology

In August 2020, we launched our e-vapor product *IQOS VEEV* in New Zealand—our first electronic device equipped with age-verification technology.

Sustainable supply chain management

Further embed sustainability in our procurement practices, leveraging on opportunities to create long-lasting social and environmental impact

100% — Percentage of critical suppliers from whom PMI sources sustainably

In 2020, compliance with our Responsible Sourcing Principles has been assessed for 95 percent of PMI's critical nontobacco supplier spend. In our tobacco supply, we purchased 99 percent of our tobacco through direct contracts between the farmers and PMI or our tobacco suppliers, and field technicians were able to monitor the implementation of our Good Agricultural Practices (GAP) program on contracted farms. Overall, we estimate that 67 percent of our critical suppliers spend was sourced sustainably in 2020.

Respect for human rights

Safeguard the human rights of people impacted by our activities

10 — Highest risk countries covered by external human rights impact assessments

We conducted two human rights impact assessments in 2020, thereby reaching a total of four assessments completed in high-risk countries to date. We closely monitor the subsequent implementation of agreed action plans in those countries.

Our 2025 Roadmap continued

Socioeconomic well-being of tobacco-farming communities

Eliminate child labor and provide safe and fair working conditions on tobacco farms, and promote a living income for farmers

100% — Percentage of contracted farmers supplying tobacco to PMI who make a living income

In 2020, we started conducting living income studies with third-party experts, which will complement our internal analysis and help to guide our efforts toward reaching our goal. We also continued implementing various initiatives aimed at improving income levels in priority markets. In 2020, 48 percent of the contracted farmers supplying tobacco to PMI were earning at least a living income.

Zero — Zero child labor in PMI's tobacco supply chain

We maintained a relentless focus on preventing incidents of child labor in our tobacco supply chain, despite impacts on our initiatives due to COVID-19 and related restrictions. We introduced a new methodology to measure prevalence of all types of child labor incidents among our contracted farms, giving us increased visibility as we aim to eradicate cases that are repetitive and systemic, and tackle promptly isolated cases in our supply chain. In 2020, we continued working to eliminate the remaining 3.5 percent prevalence of child labor among our contracted farms.

Health, safety, and well-being at work

Promote a safe and healthy working environment that protects the physical and mental well-being of all while at work

<0.3 — Total recordable incidents rate for employees and contractors

In 2020, across our factories, offices, and fleet, our total recordable incidents rate (TRIR) was 0.12 per 200,000 hours worked, covering our employees, contracted employees, and contractors. We are proud of the progress made to date but remain cautious, as exceptional circumstances in 2020 driven by COVID-19 have positively impacted our performance.

Legend:
- Not started
- Progress, but with challenges
- Progress on track
- Progress, further than anticipated
- Completed

Climate protection

Mitigate climate change by decarbonizing our operations and value chain, while increasing our resilience

Net zero — Achievement of carbon neutrality of PMI's direct operations (scope 1+2) by 2030

We achieved significant absolute CO_2e emission reductions in 2020: Emissions across our value chain (scope 1+2+3) contracted by 18 percent, and those in our direct operations (scope 1+2) by 26 percent. These were partially driven by COVID-19 related impacts, but mainly due to accelerated efforts toward our carbon neutrality goals. Our progress in 2020, supported by our new science-based targets and revisited approach to carbon pricing, makes us confident we can achieve our carbon neutrality target in our operations (scope 1+2) before 2030.

Net zero — Achievement of carbon neutrality of PMI's value chain (scope 1+2+3) by 2050

Littering prevention

Prevent littering of our products by promoting appropriate behavior among adult smokers

-50% — Reduction of plastic litter from our products (versus 2021)

Since the core of our plastic reduction rests on cleanup activities and awareness-raising campaigns aimed at changing behavior, COVID-19 lockdowns and disruptions adopted worldwide to contain the pandemic have prevented us from making progress. During 2020, we focused on establishing partnerships and on developing a methodology to measure our global plastic litter footprint over time, and we plan to establish our baseline in 2021.

Product eco-design and circularity

Integrate circularity when developing our products, improving efficiency and recyclability, and strengthening our collection program

100% — Percentage of PMI smoke-free product users who have access to collection and recovery for devices and consumables

When *IQOS* users return broken or end-of-service devices, our reverse-logistics program CIRCLE helps to cycle materials back into the economy. In 2020, we continued the rollout of our CIRCLE program, achieving 48 percent market volume coverage (up from 39 percent in 2019), by adding two new markets to the program. For consumables, we progressed in the development of take-back schemes but a number of complexities in the setup of such an innovative program delayed the launch of our pilots.

100% — Percentage of PMI smoke-free electronic devices introduced on the market as of the end of 2025 that have eco-design certification

In 2020, we focused on establishing a robust roadmap and launched a program to identify relevant certification schemes for our smoke-free product devices, in partnership with third-party experts and informed by comprehensive benchmarking.

Creating value

We harness our purpose and strategy to create value for our shareholders and other stakeholders through the allocation of our human, intellectual, natural, manufactured, social, and financial capital.

Our mission

Accelerate the end of smoking

What we do

Replace cigarettes with less harmful tobacco and nicotine products for the benefit of adults who would otherwise continue to smoke.

Data refer to calendar year 2020 or reflect status at December 31, 2020.

Key resources and relationships

Human
Our success depends on the dedication, talent, and consumer-centric focus of our employees. As of year-end 2020, we directly employed 70,849 people. More than 130 nationalities are represented within our workforce, and 41.7 percent of our employees are women.

Intellectual
Innovation is the backbone of our business transformation. We invested USD 495 million in R&D expenditure in 2020, of which 99 percent related to smoke-free products. Innovation also guides improvements in our processes, from sourcing to manufacturing, logistics, and sales.

Natural
To produce our products, we use raw materials such as timber-based products, metals, water, and energy. In 2020, we sourced 281,000 tons of packed tobacco, a material vital to our products. We seek to use natural resources efficiently and to source them sustainably.

Manufactured
Our assets, such as our two main R&D centers, 39 factories, 23,000 vehicles, 24 consumer call centers, and 259 IQOS stores, allow us to develop, manufacture, and deliver our products to meet the demands of consumers.

Social
Building trust with our stakeholders is essential. We develop and sustain relationships with a network of over 28,000 suppliers, 285,900 contracted farmers, 130 million adult consumers of our cigarette brands, and close to 18 million IQOS users. Our relationships also extend to the retailers of our products, the communities in which we operate, government officials and regulators, nongovernmental organizations, and the multistakeholder initiatives in which we participate.

Financial
Our business activities require financial capital, which we strive to allocate efficiently to create value. The capital is provided by our equity and debt holders, as well as by the cash flow generated from our operations. Our company's market capitalization at December 31, 2020 was approximately USD 129 billion and PMI's long-term debt was USD 31 billion. At that time, PMI's long-term credit was rated A by Standard & Poor's and Fitch and A2 by Moody's.

Our strategic priorities

- Grow current smoke-free product platforms to scale by building a superior portfolio across segments, IQOS brand equity, a quality consumer experience across digital and physical touchpoints at scale, and geographic expansion
- Maintain leadership in our conventional business, through continued brand development and selective innovation while recognizing its volume will decline if we are successful
- Develop our long-term product and ecosystem portfolio for future growth and drive material and measurable progress in priority sustainability corridors, ensuring transparent and clear sustainability reporting and disclosure
- Build global societal support for smoke-free products and advocate for regulatory and fiscal measures that allow adult smokers to learn about, and convert exclusively to, our smoke-free products faster
- Achieve cost and cash leadership by improving productivity to reinvest in smoke-free product expansion
- Deliver launch and service agility

Our strategic enablers

- Consumer centricity
- Digitalized business model
- People, culture, ways of working, and organization
- Real-time communication with external stakeholders

PMI's R&D center in Neuchâtel, Switzerland

Key outputs and outcomes

Human
- **12.7 million** adults who have switched to IQOS and stopped smoking, of whom 4.3 million live in non-OECD countries
- **3.5%** prevalence of child labor among contracted farms supplying tobacco to PMI
- **0.12** total recordable incidents rate (TRIR) per 200,000 hours worked, covering PMI employees, contracted employees, and contractors
- **0.53** collision rate within our fleet (per million kilometers driven), down from 0.87 in 2019
- **4** countries covered by human rights impact assessments since 2018, corresponding action plans being implemented
- **+33** employee engagement score (employee Net Promoter Score), up from +16 in 2019
- **94%** markets representing over 94 percent of PMI's total shipment volume with youth access prevention (YAP) plans in place

Intellectual
- **1,300** patents granted in IP5 jurisdictions relating to smoke-free products
- **418** scientific papers published by PMI since 2008 to share our methods and findings
- **146** toxicological assessment studies, 22 clinical assessment studies, and 30 perception and behavior studies completed by PMI on smoke-free products since 2015

Natural
- **26%** reduction of CO_2e emissions in our direct operations (scope 1+2) versus 2019, and 18 percent reduction across our value chain (scope 1+2+3)
- **100%** of tobacco purchased at no risk of deforestation of old-growth forest
- **14%** reduction in water consumption in our factories versus 2019
- **85%** of total factory waste generated that was recycled

Manufactured
- **2** smoke-free product platforms commercialized, one centered on heated tobacco technology, the other in the e-vapor category
- **1st** smoke-free device introduced on the market equipped with age-verification technology
- **64** markets where IQOS was available for sale, of which 52 percent are non-OECD countries

Social
- **99%** of tobacco purchased through direct contracts by PMI and our tobacco suppliers
- **93%** of all contracted farms monitored against PMI's Agricultural Labor Practices Code
- **95%** of our critical nontobacco suppliers spend assessed against PMI's Responsible Sourcing Principles in our due diligence platform

Financial
- **28.7 billion** in net revenues
- **23.8%** of total net revenues from smoke-free products
- **2.4 billion** in corporate income taxes
- **72.4 billion** total amount of excise tax paid by consumers on PMI products

Governance and management

PMI's governance structure underlies our daily activities to ensure that we conduct our business in compliance with high standards and with integrity.

Board of Directors

The primary responsibility of the Board of Directors is to support the long-term success of the company. The Board is responsible for establishing broad corporate policies, setting strategic direction, and overseeing Company Management, the individuals responsible for the day-to-day operations of the company.

The Board has established various standing committees to assist with the performance of its responsibilities. The Board adopted corporate governance guidelines, which—along with the company's charter, bylaws, charters of Board committees, code of ethics, code of business conduct and ethics for directors, and related-person transactions policy—provide the framework for the governance of the company. All of these documents are available on **PMI.com**.

PMI's annual Proxy Statement contains detailed information on our Board and committee structure, the independence and diversity of its members, and the responsibilities and meeting frequency of each committee.

Company Management

PMI's Company Management encompasses those employees who are executive officers under Section 16 of the Securities Exchange Act of 1934. As of March 12, 2021, our Company Management was made up of 25 members, of whom four were women. A biography of each member of PMI's Company Management can be found on **PMI.com**.

Executive compensation

Our compensation and benefits program supports our business and financial objectives. Each component is designed to achieve one or more of the following objectives:

- Support our ability to attract, develop, and retain world-class leaders in a controversial industry
- Align the interests of executives and shareholders
- Reward performance against pre-established objectives
- Support long-term business growth, superior financial results, sustainability efforts, societal alignment, and integrity of conduct
- Promote internal fairness and a disciplined assessment of performance
- Align executive incentives with our risk management objectives

These objectives provide the framework for the various components of compensation and benefits and take into account the specific nature of our business. Together, these elements form an aggregate package that is intended to be appropriately competitive. Our executive compensation program reflects our commitment to put sustainability at the core of our corporate strategy, and our diversity and inclusion goals form a part of this strategy. The Compensation and Leadership Development Committee of the Board determined not to make any substantial modifications to the program in 2021, other than to more clearly reflect the Company's commitment to having sustainability at the core of its corporate strategy.

We continue to incorporate key measures pertaining to our transformation into both our annual and three-year management incentives. In 2020, annual incentive awards were assessed on six measures, including a 20 percent weight for RRP/non-combustible shipment volume, and 15 percent on strategic priorities and enablers (which are heavily focused on our transformation to smoke-free products). The remainder is split between measures of market share, net revenue growth, adjusted operating income growth and operating cash flow—all of which are highly contingent on the success of our smoke-free products. For more information and definitions of these measures, please refer to **PMI's Proxy Statement 2021**.

2021–2023 Performance Share Units (PSU) Performance Cycle

Our three-year management incentives are structured in the form of Performance Share Units (PSUs). As set out in **PMI's 2021 Proxy Statement**, for the 2021–2023 PSUs granted in February 2021, the Compensation Committee established performance metrics at what it believes are appropriately ambitious levels that reflect the Board-approved three-year plan. It retained the previously used metrics of Total Shareholder Return (TSR), weighted 40 percent, which measures TSR relative to our peer group; and organic adjusted compound annual diluted EPS growth, weighted 30 percent. The final metric is **Transformation, defined as net revenues from our smoke-free products as a percentage of the company's total net revenues, in the last year of the performance cycle**.

(40%) PMI TSR as a percentile of peer group

	Result	Performance Factor
Below Threshold	Below 25th percentile	0%
Threshold	25th percentile	50%
Target	50th percentile	100%
Maximum	80th percentile and above	200%

(30%) Organic compound annual adjusted diluted EPS growth rate

	Result	Performance Factor
Below Threshold	<5%	0%
Threshold	5%	50%
Target	8%	100%
Maximum	≥10.5%	200%

(30%) Transformation (net revenues from smoke-free products, out of total net revenues)

	Result	Performance Factor
Below Threshold	<31%	0%
Threshold	31%	50%
Target	37%	100%
Maximum	≥42%	200%

Executive compensation linked to ESG performance

In addition, the Committee preserved its discretion to use the following modifiers in its certification of **the Transformation performance metric**, including:

- The quality of the net revenue achievement, which may have a positive or negative 15-percentage-point impact, and is assessed based on the heated tobacco products excise tax differential compared to cigarettes as well as the conversion rate to PMI's smoke-free products (converted and predominant usage); and
- **ESG performance**, which may have a positive or negative 30-percentage-point impact, and consists of progress on:

Governance and management continued

- **Carbon footprint reduction:** We aim to continue reducing carbon emissions in line with our carbon neutrality ambition and science-based targets. By 2023, our target is to reduce carbon emissions by 135 tons CO_2e in our direct operations (scope 1+2) versus a 2020 baseline. Read more about our efforts to reduce our carbon footprint in the **Climate protection** chapter of this report.

- **Environmental leadership:** We aim to maintain our Triple A CDP rating for climate change, forests, and water.

- **Electronics circularity:** We target an effective recycling rate for our smoke-free *IQOS* devices (i.e., proportion of *IQOS* device sales volume covered by the CIRCLE program multiplied by the weighted average recycling rate of *IQOS* devices at the CIRCLE hubs) of 70% by 2023. Read more about our efforts in the **Product eco-design and circularity** chapter of this report.

- **Diversity, equity & inclusion:** Our target is to increase the representation of women in senior roles to 32 percent by 2023. Read more about our efforts to promote a diverse and inclusive working environment on **PMI.com**.

Sustainability governance and management

Integrating sustainability into our company relies on a formal structure with clear accountabilities at different levels of the organization.

Several committees of the Board of Directors are tasked with oversight responsibility for the topics covered in this report. The Nominating and Corporate Governance Committee (NCGC) oversees the company's sustainability strategies and performance and advises the Board on sustainability matters. The Product Innovation and Regulatory Affairs Committee oversees the long-term portfolio strategy of the company with a particular focus on smoke-free products, and monitors and reviews key legislative, regulatory, and public policy issues and trends related to the research and development of smoke-free products. In 2020, the Board established the Consumer Relationships and Regulation Committee; this committee oversees the company's commercialization of smoke-free products and monitors key legislative, regulatory, and public policy issues and trends related to the post-market regulatory environment that may limit consumer access to RRPs, as well as the risks associated with

changes in consumer preferences regarding smoke-free products. The Audit Committee oversees, among other matters, the risk management of climate change, of manufacturing and supply chain disruption, and the cybersecurity risk assessment.

Anchoring our sustainability priorities with executive responsibilities and accountabilities helps embed our strategy into our daily operations. Within our Company Management, members are responsible for driving progress and delivering on our sustainability targets within their respective functions. In addition, as previously stated, the Compensation and Leadership Development Committee of the Board has tied a significant portion of our senior management's compensation to Transformation and ESG metrics.

Fully integrating environmental, social, and governance (ESG) drivers into business strategy can significantly enhance both sustainability agendas and financial performance. Accordingly, our Chief Sustainability Officer (CSO) reports to the company's Chief Financial Officer, a member of the Company Management. The CSO leads the integration of sustainability across our business. She updates the Sustainability Committee quarterly and hosts the Sustainability Coordination Working Group, which meets every month.

The CSO heads PMI's Sustainability Team, which coordinates the implementation of our strategy across the different business functions and markets. The Sustainability Team also leads PMI's sustainability materiality analysis, defines strategy, and manages reporting on performance.

Our approach to sustainability programs

Our approach to designing and managing our sustainability material topics is harmonized across areas. It relies on common foundational elements:

Deep understanding of the topic, context, materiality, external expectations, and interdependencies with other issues

Governance structures and policies to formally guide our actions and ambitions

Targets to drive improvement and provide clarity on our desired outcomes

Performance indicators to measure progress and evaluate our efforts

Concrete activities to achieve progress against targets

Transparent reporting on progress, allowing stakeholders to scrutinize our actions and encouraging dialogue

The sustainability landscape is dynamic and evolving. We continuously update and strengthen our programs as knowledge improves or the relative importance of specific topics changes.

"At PMI, we support and seek to align with guidance and recommendations from different reporting frameworks and standards, such as those from the GRI, SASB, TCFD, <IR>, and UN SDGs, as well as the recently published WEF Stakeholder Capitalism Metrics, which we see as complementary. **Applying all of these simultaneously while tailoring our disclosures to properly reflect our company's unique value proposition is a complex exercise, but it is also an enriching one as it brings sophistication and perspective to our work.**"

Marie Corger, PMI Head of Sustainability Materiality & Reporting

Risk management

We designed our risk management and internal control practices to address all significant and/or emerging strategic, external, inherent process, and project deployment risks that could undermine the ability to achieve our business objectives.

We identify and prioritize key enterprise risks based on four dimensions: the impact of a risk on PMI if it were to occur, its likelihood, its velocity, and its interconnectivity with other risks.

Risk management is overseen by the committees of the Board as well as by the full Board. As part of the risk management process, the company has established a Corporate Risk Governance Committee (CRGC) comprising senior executive officers, including the Chief Operating Officer (COO), Chief Financial Officer (CFO), Chief Strategy Officer (CSO), Chief Digital & Information Officer, VP & PMI Controller, Global Head of Risk & Controls, Chief Information Security Officer (CISO), VP Chief Ethics & Compliance Officer, and VP Corporate Audit. As of 2021, the new General Counsel joined the CRGC. Ownership of each prioritized key risk area is assigned to a member of senior management; its oversight is assigned to a particular Board committee or to the full Board. Management reports regularly on these risks to the appropriate committees and to the full Board throughout the year.

Our governance and technical procedures for relevant controls align with the Sarbanes-Oxley (SOX) Act. We manage corporate strategy and operations to account for functional, market, and product risks, and our Chief Strategy Officer reports to our CEO directly on strategic group risks.

Integrated risk assessment

At the request of the CRGC, the Risk & Controls function defines and coordinates an integrated enterprise risk assessment, which brings together "first line" business, "second line" risk management, and "third line" internal audit functions. This framework includes, beyond the primary business functions, Risk & Controls, Corporate Audit, Ethics & Compliance, Information Security, and Data Privacy. Taking a holistic approach, these functions collaborate to identify, assess, and respond to emerging strategic, external, inherent process, and project deployment risks. Sustainability risks and opportunities such as those related to safety, leaf supply, climate change, electronic waste, and labor conditions, for instance, are considered as part of the integrated enterprise risk assessment.

In 2020, "second line" risk management and "third line" internal audit functions held monthly meetings to allow for a continuous evaluation of the company's risk environment, aligning and consolidating risk management and action plans. The CRGC and the Audit Committee of the Board of Directors received updates on the company's risk management and internal controls practices and observations at least once per quarter.

We discuss the company's risk factors in our 10-K and 10-Q submissions to the U.S. Securities and Exchange Commission (SEC). Click **here** to access our latest submissions.

Our risk management framework

Managing risks during the COVID-19 pandemic

Following the outbreak of the COVID-19 pandemic in 2020, specific risk management activities were established by our Risk & Controls function to allow for continuous alignment between business process owners, business continuity planning (BCP) stakeholders, and the risk management functions. These activities were established with the objective to provide senior management with a biweekly status update of the company's rapidly evolving risk landscape.

The established COVID-19 risk management activities focused on specific and concrete BCP risks, including:

- The risk of (partial) unavailability of our personnel (e.g., due to regulatory enforced measures, illness, hospitalization)
- The risk of (partial) unavailability of our physical locations (e.g., due to voluntary and/or regulatory enforced "shutdown" of PMI sites)
- The risk of (partial) unavailability or vulnerability of our IT infrastructure (e.g., due to "peak" stress on technology infrastructure)
- The risk of (partial) unavailability of our external parties/dependencies, including suppliers, third parties, governmental authorities, and other external parties/dependencies

Ultimately, these efforts provided our senior management an aggregated view of the company's risk landscape and the effectiveness of the invoked BCP measures. As such, our risk management response to the pandemic contributed to the successful management of the challenges our company faced. Furthermore, it allowed the company to continue its operations without significant interruption by addressing risk timely as it arose in the midst of the initial dynamics caused by the pandemic outbreak.

The outbreak of the pandemic and the company's risk management response demonstrated the added value of focusing on the early identification of rapidly emerging and evolving risks during special situations. Following our risk response to the outbreak of COVID-19 in 2020, we decided that certain risk management activities (for instance, the mobilization of local risk functions in the rapid testing and validation of centrally issued guidance in response to risk) will be structurally embedded in our regular approach toward risk management going forward.

Overview

Innovating for
better products

Operating
with excellence

Caring for the
people we work with

Protecting the
environment

Performance
metrics

A laboratory analyst in PMI's manufacturing facility in Izhora, Russia

WE ARE

Innovating for better products

Cigarette smoking causes serious disease and the best way to avoid the harm of smoking is never to start or, if one does start, to quit. However, we also recognize that millions of adult smokers will not stop smoking unless presented with a better alternative. We believe that product innovation has the potential to benefit smokers and consequently have a positive impact on public health.

In order to achieve this potential, we must accomplish two things: First, we must develop products that have a significantly reduced health impact compared with combustible cigarettes. We have accomplished this by researching and developing smoke-free products, whose reduced-risk profile is scientifically substantiated, employing a step-by-step program derived from practices followed by the pharmaceutical industry.

Second, in order to successfully reduce harm at the individual and population level, adult smokers must be motivated to switch to these better products rather than continuing to smoke. Here, we must continue innovating, transforming our organization, and engaging with policymakers and regulators to ensure that adults who would otherwise continue to smoke have access to smoke-free alternatives.

In this section

Further reading

Product health impacts

Public health authorities, the scientific community, and many regulatory bodies, such as the U.S. Food and Drug Administration (FDA), agree that the primary cause of smoking-related disease is not nicotine but the inhalation of harmful and potentially harmful constituents, the vast majority of which are emitted as a result of burning (combusting) tobacco.[1] We have therefore developed, and continue to refine, a portfolio of products that deliver nicotine without combustion—smoke-free products. While not risk-free, these products are a far better choice than continuing to smoke.

A scientist in PMI's R&D center in Neuchâtel, Switzerland

The right thing to do

Cigarette smoking is the most dangerous form of tobacco use. It is the leading cause of preventable diseases, including cardiovascular disease, lung cancer, and chronic obstructive pulmonary disease. The best way to avoid the harm of smoking is never to start, but for those who do smoke, to quit. However, many smokers do not quit. According to World Health Organization (WHO) forecasts, there will still be more than one billion smokers by the year 2025. For these people, access to alternative products that significantly reduce the risk of disease compared with continued smoking is critical. When appropriately regulated, these products can complement and help accelerate existing efforts to reduce smoking prevalence.

The business case

The future of the nicotine industry is unarguably in smoke-free products, which are experiencing rapid growth. Through our early and sustained investment in R&D, and consequent leadership in technology and innovation, we have built a very strong position. As of year-end 2020, our R&D work and its associated innovations have resulted in 1,300 patents granted for smoke-free technologies by the five largest intellectual property offices in the world (IP5); moreover, in 2020 we held over 80 percent of the international heated tobacco category and over half of the overall smoke-free category (as compared with our cigarette volume share of 25.7 percent), excluding China and the U.S. Heated tobacco consumables also have higher revenues and gross unit margins per pack compared with cigarettes, and as scale increases we are also driving significant operating income margin expansion as we generate operational leverage on our ongoing development, device, and commercial infrastructure costs, and realize digital efficiencies. Through growing this business as fast as possible, and adult smokers fully switching to our smoke-free products, we aim to capture more overall market share at superior margins and deliver strong organic growth in net revenues and adjusted diluted earnings per share (EPS). This provides attractive returns on our significant upfront and ongoing investments in developing the category, with USD 8.1 billion invested since 2008 in the development of scientifically substantiated, commercially viable smoke-free products such as *IQOS*.

1 Source: https://www.fda.gov/tobacco-products/health-information/nicotine-addictive-chemical-tobacco-products

Product health impacts continued

Achieving our aims

The principal source of smoking-related diseases is known: The burning of tobacco emits the vast majority of the harmful chemicals that are found in cigarette smoke. By avoiding combustion, we reduce or eliminate the formation of harmful and potentially harmful constituents (HPHCs). Through substantial investment in R&D, we have developed products that provide the enjoyable experience of consuming nicotine and flavors without burning tobacco.

(i) **Read more on PMIscience.com**

Two fundamental principles guide the scientific assessment of smoke-free products:

Epidemiological

Smoking-related harm and disease are caused by long-term exposure to the toxicants found in cigarette smoke. The best way to avoid these harms is never to start smoking. For men and women who do smoke, cessation is the best way to reduce harm and the risk of tobacco-related disease by eliminating exposure to the toxicants in cigarette smoke. Complete, long-term cessation offers the maximum risk reduction a smoker can achieve and hence is the "optimum standard" for the assessment of smoke-free products.

Toxicological

The level and duration of exposure to toxicants determines the nature and extent of adverse health effects. For exposure to take place, toxicants must be present—meaning that they are emitted by the product or process of use. A product with significantly lower toxic emissions compared with cigarettes has the potential to significantly reduce exposure to toxicants, which in turn leads to a reduction in adverse health effects.

In line with those two principles, our assessment program aims to compare health outcomes of switching to smoke-free products with both ongoing smoking and cessation.

We implement a rigorous scientific assessment program aligned with the U.S. FDA's draft guidance on modified risk tobacco products (learn more about how we conduct our R&D on **PMI.com** and **PMIscience.com**). In addition to aerosol chemistry, non-clinical, and clinical studies, our assessment program includes consumer behavior studies in order to minimize the use of our smoke-free products by unintended audiences, such as former smokers, never smokers, and youth. In addition, following market launch, we continuously monitor the safety profile of our smoke-free products to ensure that any new or different health risks associated with their use can be identified in a timely fashion, if they occur, and can be managed appropriately. We do this by improving our products and updating user information. We also produce and share with regulators—including the U.S. FDA—annual safety update reports, which include notifications received directly from consumers.

Our two main R&D centers, located in Switzerland and Singapore, employ hundreds of scientists, engineers, and other experts working to develop and assess smoke-free products. This work is headed by our Chief Life Sciences Officer, Chief Product Officer, and Chief Consumer Officer, who are members of PMI's Company Management.

In 2020, PMI allocated 99 percent of its R&D budget of USD 495 million to its portfolio of smoke-free products. This includes costs related to clinical studies, the development of machinery and prototypes, and product acceptability testing. The remaining 1 percent of our expenditure is largely related to regulatory compliance requirements for our combustible tobacco products.

A laboratory analyst in PMI's manufacturing facility in St Petersburg, Russia

"Science and technology can help society make significant strides in our collective efforts to address the world's most pressing problems. Giving facts and evidence greater prominence in policymaking—over ideology, politics, and unsubstantiated beliefs—will help match the public's expectations for science to sit at the heart of decisions impacting them and their future."

Dr. Moira Gilchrist, PMI Vice President for Strategic & Scientific Communications

Product health impacts *continued*

Progress in 2020
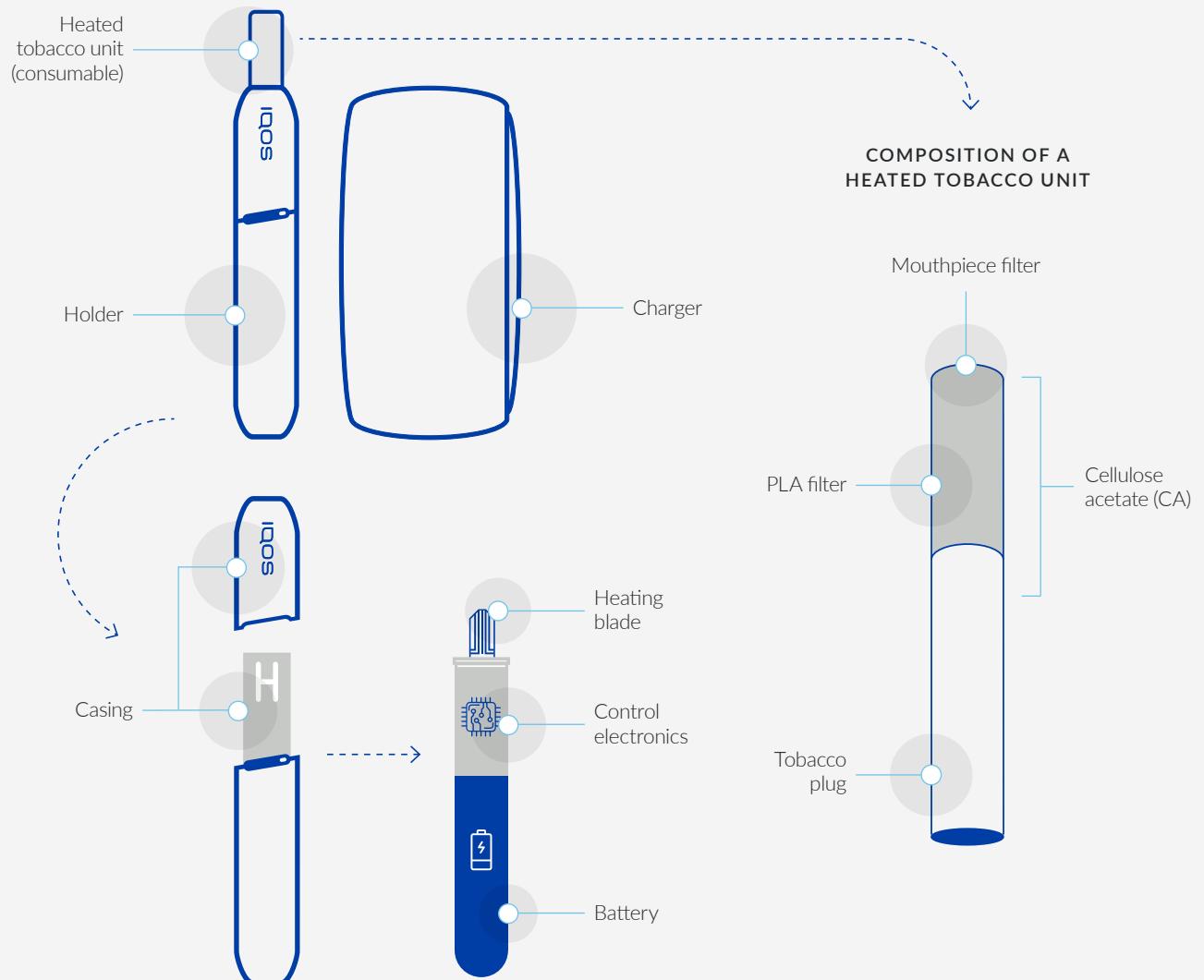
Smoking and COVID-19

Our heat-not-burn product, *IQOS*

What is it, and how does it work?

Our main smoke-free product, *IQOS*, is a battery-powered, heat-not-burn product that heats tobacco to produce a nicotine-containing aerosol that the user inhales. There is no combustion of the tobacco. Our base model comprises three main components: A tobacco unit, a holder, and a charger. The tobacco unit is a novel product designed specifically and exclusively for use with the holder (the heating device). It contains two filter sections and specially processed tobacco designed to be heated but not burned. Tobacco leaves are ground and reconstituted into tobacco sheets, called "cast-leaf." These sheets are then crimped and made into a tobacco plug. The user inserts the tobacco unit into the holder. Once activated, the holder heats the tobacco via an electronically controlled heating blade. Each tobacco unit provides a maximum of 14 puffs or around six minutes of consumption, whichever comes first. The holder contains a small battery, which can be recharged by inserting it into the charger; the charger, in turn, can be recharged using a household power socket. We continue to enhance our *IQOS* product portfolio, driven by consumer insights and supported by scientific substantiation, and currently sell a variety of models in each market.

The different parts of an *IQOS 3* device

- Heated tobacco unit (consumable)
- Holder
- Casing
- Charger
- Heating blade
- Control electronics
- Battery

COMPOSITION OF A HEATED TOBACCO UNIT
- Mouthpiece filter
- PLA filter
- Cellulose acetate (CA)
- Tobacco plug

Product health impacts continued

A laboratory analyst in PMI's manufacturing facility in Bergen op Zoom, the Netherlands

What scientific evidence have we gathered to date?

IQOS is the most thoroughly assessed of our smoke-free platforms. We have accumulated extensive clinical and nonclinical data to support its potential to reduce the risk of developing smoking-related diseases compared with continued cigarette smoking.

In our assessment program, we compared the chemical composition of the aerosol produced by *IQOS* with the smoke from a reference cigarette, using standardized and validated analytical methods to quantify the most extensive established list of HPHCs (the FDA-93) which includes carcinogens, respiratory, and cardiovascular toxicants. We found that these HPHCs are reduced on average by 90 to 95 percent compared with the reference cigarette's smoke. In addition, we conducted extensive chemical characterization of the *IQOS* aerosol. Our untargeted screening was used to identify all constituents above 100 ng/stick and resulted in the characterization of 99.8 percent of the aerosol mass. These analyses have shown that there are approximately 10 times fewer constituents in *IQOS* aerosol than reference cigarette smoke. As the U.S. FDA put it when it authorized a version of *IQOS* for sale in the US, "these chemicals are present in very low levels and potential effects are outweighed by the substantial decrease in the number and levels of HPHCs found in combusted cigarettes."[1] We also conducted indoor air chemistry and quality studies, which demonstrated that the use of *IQOS* does not negatively impact indoor air quality.

We conducted toxicological studies for *IQOS*, both in vitro and in vivo, to determine whether the reduced formation of HPHCs in the aerosol leads to reduced toxicity. Results from the in vitro studies show that the *IQOS* aerosol is significantly less cytotoxic and genotoxic than the smoke from cigarettes. The in vivo studies found that, compared with cigarette smoke, the reduced exposure to toxicants results in significantly reduced lung inflammation and respiratory toxicity.

"In the case of our heated tobacco products, we have conducted numerous non-clinical and clinical studies. The risk reduction potential of those products is backed up by volumes of high-quality research data."

Prof. Manuel C. Peitsch, PMI
Chief Scientific Officer

[1] Source: https://www.fda.gov/media/124247/download (p. 41). The FDA does not endorse or approve tobacco products.

Product health impacts continued

In the following stage, we conducted several systems toxicology studies to assess the disease-relevant biological mechanisms affected by exposure to toxicants, using human-derived in vitro cell cultures and organotypic tissue cultures. These studies showed that, compared with the reference cigarette smoke, the *IQOS* aerosol has a significantly reduced impact on key mechanisms involved in the development of respiratory and cardiovascular diseases. In a systems toxicology study conducted in an animal disease model (Apoe-/–), we observed that switching to the *IQOS* aerosol following two months of cigarette smoke exposure reduces the development of both atherosclerosis and emphysema in a manner similar to smoking cessation. We also completed an in vivo study to assess the potential of the *IQOS* aerosol to reduce the risk of lung inflammation, emphysema, and lung cancer compared with cigarette smoke. The results of this study show that, in contrast to cigarette smoke, the aerosol of *IQOS* does not increase the incidence and number of lung tumors. The study also confirmed the significantly reduced effect of *IQOS* aerosol on lung inflammation and emphysema observed in the study mentioned above.[1]

Our 14 clinical studies on *IQOS* have involved thousands of participants and up to 12 months of exposure. For example, we conducted four clinical studies—each involving 160 participants and an exposure period lasting five days to three months—to assess subjects' relative exposure to toxicants when using *IQOS* compared with continuing to smoke cigarettes. The first two

Our 14 clinical studies on *IQOS* have involved thousands of participants and up to 12 months of exposure

studies—incorporating a five-day exposure, in confinement—were conducted in Europe and Japan. The subsequent two studies extended over three months—a five-day confined exposure period followed by an ambulatory period of 85 days—and were conducted using a menthol version of heated tobacco units in Japan and the U.S. The ambulatory study period was intended to assess whether reductions in exposure observed in a confined setting were sustained under "real world" conditions, where factors such as environment, diet, or passive smoking could influence exposure to HPHCs. All four studies showed a significant reduction (ranging from 47 to 96 percent relative to continued cigarette smoking) in the 15 biomarkers of exposure in adult smokers who switched to *IQOS*. Complete switching to *IQOS* achieved a 95 percent reduction in exposure from smoking abstinence.

We also conducted an exposure-response study to measure clinical risk markers when adult smokers switch to *IQOS* for six months. The results of this study show that six months after switching to *IQOS* all eight co-primary biomarkers of potential harm displayed favorable changes (i.e., changes in the same direction as cessation) and that for five of the eight markers the favorable changes were statistically significant compared with continued smoking. We completed a six-month extension of the six-month exposure response study to understand what the same markers look like 12 months after switching. The study showed that in smokers who switched to *IQOS* the favorable changes observed at six months were maintained.

To complement our research, in 2020 we also initiated ecological studies. These studies are used to measure prevalence and incidence of disease, by observing data at the population or group level, rather than individual level.

The launched program of ecological studies explores risk-modifying factors on health outcomes at the population level. Independent evidence already links the launch of *IQOS* to an accelerated decline in cigarette smoking in Japan, the first country in which *IQOS* was launched nationwide (2015).[2] We are now studying time series of Japanese hospital data and health insurance claims for two smoking-related diseases (chronic obstructive pulmonary

disease and ischemic heart disease) to detect a possible health impact of the introduction of *IQOS* at the population level. The first results show a decline in observed hospitalization rates for chronic obstructive pulmonary disease (COPD) exacerbations coinciding with the national rollout of *IQOS* in Japan. More research is needed to confirm this first ecological observation. We aim to publish results of our research in peer-reviewed journals as soon as possible.

1 References: **32780830** and **32780831**.

2 "Effect of *IQOS* introduction on cigarette sales: evidence of decline and replacement," June 2019, Tobacco Control, Michal Stoklosa, American Cancer Society.

IQOS status of scientific substantiation

Product health benefits	Access to smoke-free products	Innovating for better products
Individual **risk reduction**	Consumer **switching**	Population **harm reduction**

Data gathered so far

Average 95 percent reduction in harmful chemicals measured in laboratory studies	72 percent of smokers who switch to *IQOS* stop smoking cigarettes	12.7 million smokers have stopped smoking and switched to *IQOS*
Analyses of aerosol identify few to no new risks compared with cigarette smoking	Very low levels of use of *IQOS* among youth and nonsmokers	*IQOS* significantly accelerates decline in cigarette smoking
Clinical studies find favorable changes in risk markers among smokers who switch		

Data being gathered

A substantial reduction in morbidity or mortality among individual tobacco users is likely to be established in future studies		Ecological studies are being undertaken to establish public health impact of *IQOS* on smoking-related diseases (COPD and IHD) at population level

Product health impacts continued

What are the external findings to date?

Our scientific results are supported by a growing body of independent research. Several government agencies have already reviewed the available evidence or conducted research of their own. In addition to studies on aerosol chemistry and toxicology, the first independent clinical and post-market studies have started to emerge. In general, these studies confirm PMI's results, although some have contradictory interpretations of the data (e.g., using fresh air as the comparator instead of cigarette smoke), methodological differences (e.g., enrolled populations, studies that do not follow OECD guidelines), or overstated conclusions.

The list of independent studies (over 160 in total) published around PMI's smoke-free products and/or our methods and results as of April 29, 2021 is available on **PMIscience.com**.

In 2019, a version of our heat-not-burn product *IQOS* became the first innovative electronic alternative to cigarettes to be authorized by the FDA for sale in the U.S. (read the decision summary **here**). On July 7, 2020, the FDA went one step further, authorizing *IQOS* to be marketed as a modified risk tobacco product with the following "reduced exposure" information:
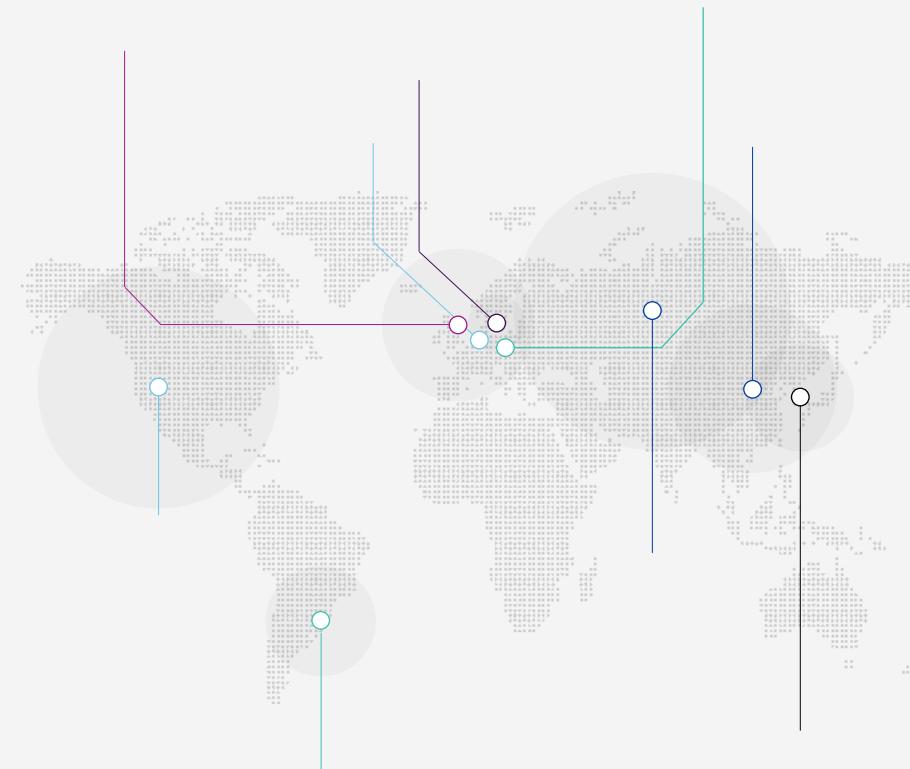
- The *IQOS* system heats tobacco but does not burn it.

- This significantly reduces the production of harmful and potentially harmful chemicals.
- Scientific studies have shown that switching completely from conventional cigarettes to the *IQOS* system significantly reduces your body's exposure to harmful or potentially harmful chemicals.

This decision followed a multi-year review of the scientific evidence PMI submitted to the FDA in December 2016. The agency found that the use of reduced-exposure claims would be "appropriate to promote the public health and is expected to benefit the health of the population as a whole."[1] The FDA also concluded that the totality of evidence presented suggests that a measurable and substantial reduction in morbidity or mortality among individual tobacco users is reasonably likely to be established in subsequent studies. The order letter as well as the decision summary are available on **the FDA's website**.

On December 7, 2020, the FDA authorized for sale in the U.S. the *IQOS 3* device, which contains a number of technological advances compared with a previously authorized version of the *IQOS* device, including longer battery life and a quicker recharge between uses. In its **decision**, the FDA noted that international survey data reviewed by the agency found no evidence of increased uptake of *IQOS* by youth or young adults, while use patterns available for a previously authorized version of *IQOS* within the U.S. have not raised new concerns regarding product use in youth and young adults.[2]

Growing scientific and regulatory consensus

1 Source: https://www.fda.gov/news-events/press-announcements/fda-authorizes-marketing-iqos-tobacco-heating-system-reduced-exposure-information

2 Source: https://www.pmi.com/media-center/press-releases/press-details?newsId=22996

Product health impacts continued

Our e-vapor product, *IQOS VEEV*

Our second smoke-free product, *IQOS VEEV*, is an e-vapor product (or e-cigarette). The battery-powered device uses a liquid solution containing nicotine and flavoring to produce an inhalable vapor. The product is composed of a device and disposable cartridge. The device houses the battery and the puff sensor, while the cartridge holds the heating element and the e-liquid.

IQOS VEEV represents a new heating technology within the e-vapor product category. Until recently, most e-vapor products used a coil-and-wick system to heat a nicotine-containing solution. The wick draws the liquid onto a coil heating element to create an aerosol. In these systems, the temperature of the heater can vary significantly depending, for example, on the amount of liquid in the system, or how strongly the user puffs on the e-cigarette. Several studies have shown that puffing on an e-cigarette when the liquid level is low results in "dry puffs," which can significantly increase exposure to certain toxicants—especially formaldehyde.

In *IQOS VEEV*, the wick is eliminated, and the coil is replaced by a metal mesh. When the liquid is introduced to the heater, the increased surface area provided by the mesh design helps heat the liquid in a more consistent way compared with current-generation coil-and-wick systems. The software ensures that the heater's temperature is stable and does not vary based on puff strength or from puff to puff. The low-liquid detection system cuts off power to the mesh heater once the liquid has dropped below a certain level, eliminating dry puffs.

Unlike typical e-vapor product cartridges, *IQOS VEEV* cartridges are manufactured, assembled, pre-filled, and pre-sealed in a fully automated process to ensure product consistency. This occurs within our European production facilities. We launched the product in 2020 in New Zealand and the Czech Republic and are compiling consumer insights before proceeding with an international rollout planned in 2021. Moreover, *IQOS VEEV* is the first of our smoke-free products to be trialed in New Zealand with technology to prevent underage use, whereby the device can only be unlocked by registered, age-verified users (read more **here**).

Next steps

We continue to invest in research to develop and scientifically substantiate a portfolio of ever-better, affordable, and acceptable smoke-free products for existing adult smokers—in both OECD and non-OECD countries. As of year-end 2020, our R&D work and its associated innovations have resulted in 1,300 patents granted for smoke-free technologies by the five largest intellectual property offices in the world (IP5).

To further strengthen the already robust *IQOS* evidence package, we are starting to complement laboratory and clinical studies with real-world evidence regarding the public health impact of the introduction of *IQOS* at the population level.

Finally, we will start leveraging our technical and scientific capabilities beyond the field of nicotine and reduced risk products by using our knowledge and expertise in the delivery of aerosols to humans in both wellness and medical applications such as respiratory drug delivery.

Laboratory analysts in the manufacturing facility of Papastratos, PMI's Greek affiliate

2020 performance highlights

See our performance metrics ›

99%
of our R&D expenditure dedicated to smoke-free products

934
R&D positions, including scientists, engineers, technicians, and support staff (FTEs)
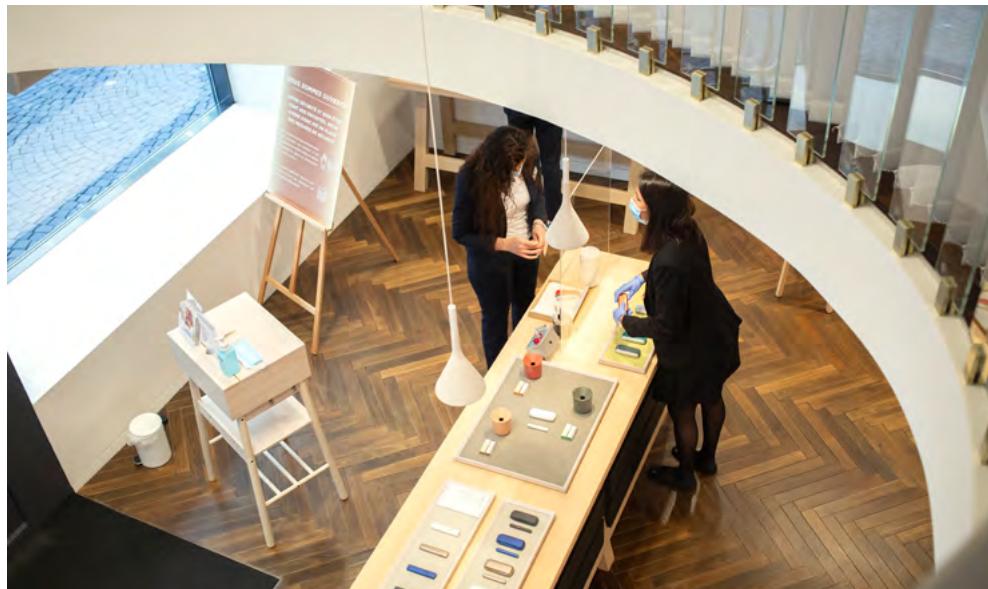
1,300
Patents granted to date in IP5 jurisdictions relating to smoke-free products

TIER 1

Access to smoke-free products

The public health benefit of smoke-free products depends not only on their potential to reduce the risk of smoking-related disease, but also on their actual use as alternatives to cigarettes by adult smokers. For smokers to switch to them, these alternatives must be accessible. Increasing accessibility means improving consumer awareness as well as the acceptability, availability, and affordability of our smoke-free products.

The right thing to do

Reducing the harm caused by smoking is a desire for most smokers and a long-held goal of NGOs, the scientific community, public health experts, and regulators. Investing in R&D to understand the causes of harm and work toward reducing them significantly was an important first step in creating better alternatives to cigarettes. PMI chose to go beyond that by adopting the broader purpose of accelerating the decline of smoking prevalence and phasing out cigarettes. At PMI, we believe that our value proposition should not rest on expanding our portfolio to offer choice in addition to cigarettes. Much to the contrary, our purpose is to make cigarettes obsolete, encouraging adult smokers to switch to better alternatives.

The business case

Our sustained investments in R&D, commercial capabilities, and the *IQOS* brand have created a competitive advantage, allowing our smoke-free products to lead the new category of better alternatives to cigarettes. By focusing the vast majority of our commercial deployment efforts on making sure that smokers who do not quit fully switch to better alternatives, we aim to reach as many adult smokers as possible in as many markets as possible; this includes the estimated 130 million PMI cigarette smokers as well as the over 800 million smokers who buy competitor brands. This is not only the right thing to do, but the business case is clear: Our smoke-free product consumables drive higher net revenues and profitability per pack than cigarettes, with significant operating income margin benefits from increased scale as we start to generate attractive returns on our significant upfront and ongoing investments in developing the category. We are also gaining share of the total tobacco market, thereby increasing our current and future revenue base from which to generate income. Any delay in providing cigarette smokers access to smoke-free products means lower revenues and earnings per share for PMI.

IQOS coaches in an *IQOS* store in Lausanne, Switzerland

Our aims

>40 million

Number of adult smokers globally who switch to PMI smoke-free products and stop smoking by 2025

>20 million

Number of adult smokers in non-OECD countries who switch to PMI smoke-free products and stop smoking by 2025

100

Number of markets globally where PMI smoke-free products are available for sale by 2025

Access to smoke-free products continued

Achieving our aims

It is our long-standing ambition that by 2025 at least 40 million smokers will have switched to PMI's smoke-free products and stopped smoking, including at least 20 million smokers in non-OECD countries. This number can be much higher if more regulators make tobacco harm reduction an integral part of their tobacco control strategies, in addition to preventing initiation and encouraging cessation.

We have made good progress toward our targets. We estimate that by the end of 2020, a total of 12.7 million smokers—including 4.3 million smokers in non-OECD countries—had switched to *IQOS* and stopped smoking cigarettes.

In the four years following our 2016 announcement of our smoke-free vision, PMI's smoke-free product shipment volume increased from 8 to 76 billion units. Simultaneously, the shipment volume of our combustible tobacco products contracted from 845 to 654 billion units over that period and smoke-free products played a very important role.

To succeed in making the world smoke-free, we need all adult smokers to have access to PMI's smoke-free products. By access, we mean that:

- Smokers are **aware** of the benefits of smoke-free products
- The products are **accepted** by smokers as a viable alternative to cigarettes
- The products are conveniently **available** for sale to smokers
- Smoke-free products are **affordable** to smokers
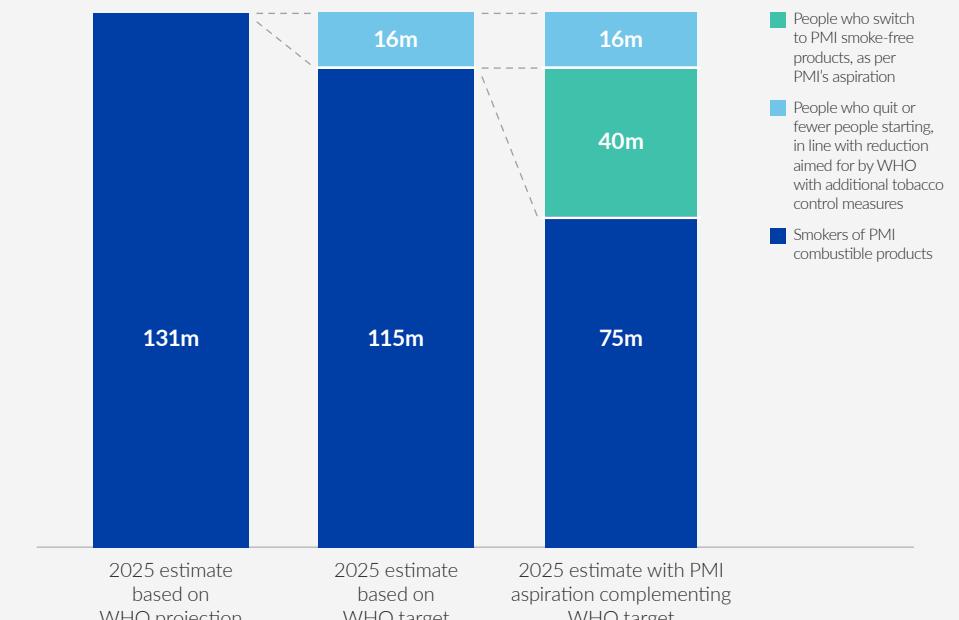
In this context, a regulatory framework allowing the products to be sold and adult smokers to know that these products exist and are available is essential.

To achieve our objectives, we are leveraging our resources to, where we can, enhance the awareness, acceptability, availability, and affordability of our smoke-free products. Our commercial expenditure ratio is a good overall indicator of our efforts in this regard, showing how much of our total global spend on marketing, consumer engagement, and trade activities is dedicated to smoke-free products. In 2020, 76 percent of PMI's commercial expenditures related to smoke-free products (up from 71 percent in 2019), far exceeding their share of total net revenues (23.8 percent). While PMI is doing everything under its control by shifting resources, government, policy, and regulations should play a key role in enabling and facilitating access.

Access

Awareness × Acceptability × Availability × Affordability

Consumers of PMI products—projection 2025

(Illustration based on WHO projections, assuming constant PMI market share)

131m	115m	75m
	16m	16m
		40m

Legend:
- People who switch to PMI smoke-free products, as per PMI's aspiration
- People who quit or fewer people starting, in line with reduction aimed for by WHO with additional tobacco control measures
- Smokers of PMI combustible products

2025 estimate based on WHO projection | 2025 estimate based on WHO target | 2025 estimate with PMI aspiration complementing WHO target

Access to smoke-free products continued

Our Chief Executive Officer heads our efforts to roll out smoke-free products across our markets globally. The team led by PMI's Chief Consumer Officer brings together all consumer-facing experiences across the consumer journey, from trends and insights on acquisition channel strategy, to programs to deter relapse to cigarettes. In conjunction, our Commercial team, headed by PMI's Senior Vice President, Commercial, develops, tests, and deploys the routes to market for smoke-free products. Meanwhile, the team led by our Chief Product Officer continuously develops and enhances PMI's smoke-free products, drawing on consumer feedback. Importantly, our Operations team, led by our Senior Vice President, Operations, works to ensure our manufacturing capabilities meet the demand for smoke-free products.

"Providing adult smokers access to our smoke-free products is the top priority at PMI. In addition to substantial resources, we dedicate the vast majority of management time to the topic, from our entire Company Management team to the management teams in every market in which we are commercializing or plan to commercialize *IQOS*."

Jacek Olczak, PMI Chief Executive Officer

CASE STUDY

Can innovative products like *IQOS* accelerate the decline of smoking?
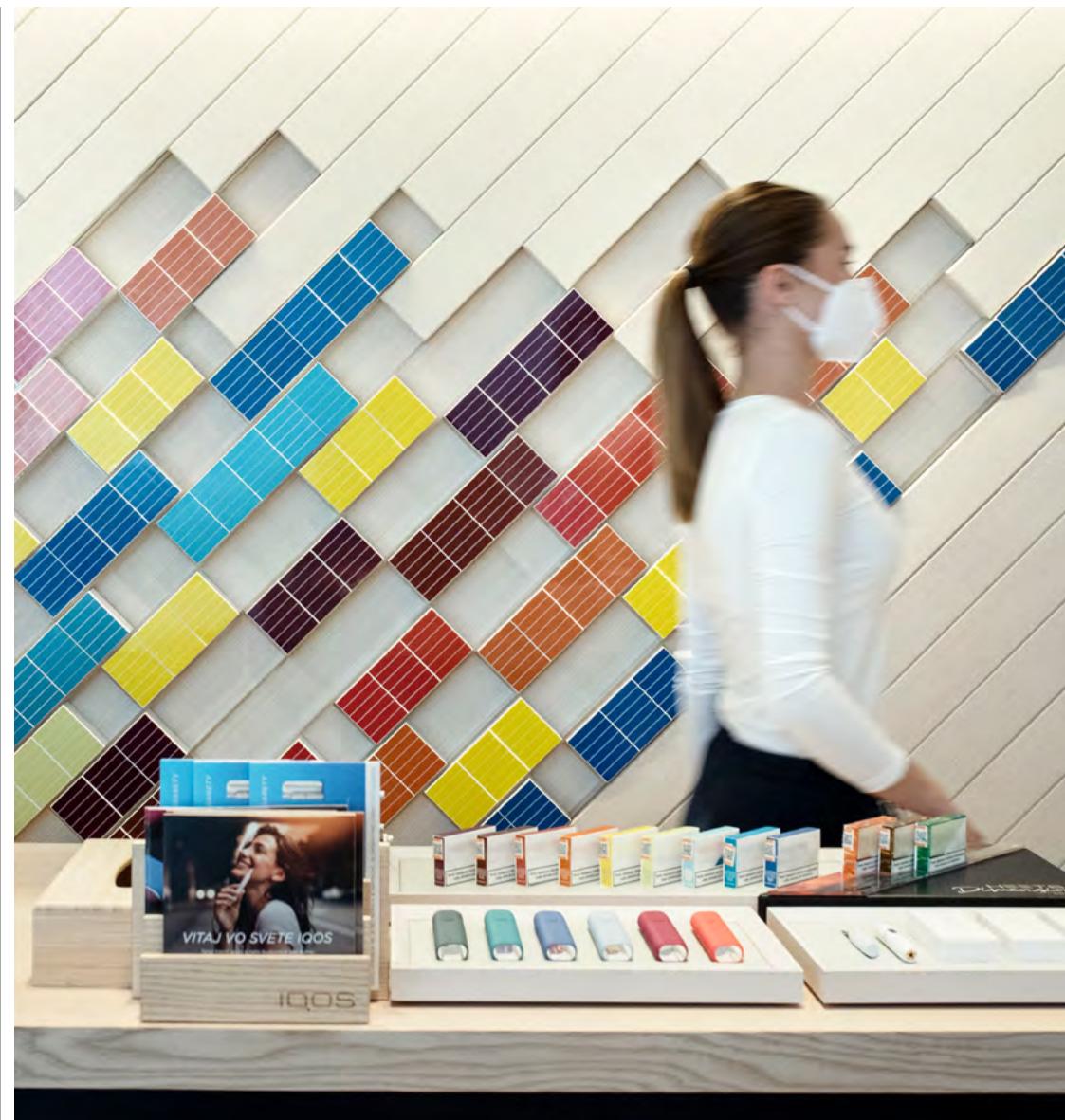
Minimizing tobacco-related harm at the population level depends not only on the degree of risk reduction of the smoke-free products, but also on their adoption by adults who would otherwise continue to smoke. It is important that these people switch completely in large numbers, while product initiation by nonsmokers—including youth and ex-smokers—must be minimized.

This case study responds to calls from researchers and public health policy experts for better understanding of the population level impact of the increasing availability and uptake of *IQOS*, our heat-not-burn product.

Read the case study ⤢

A sales representative and a customer in an *IQOS* store in Ginza, Japan

A sales representative in an *IQOS* store in Bratislava, Slovakia

Access to smoke-free products continued

Progress in 2020

Product awareness

The first component of our access strategy is raising awareness. This means understanding by consumers of what causes morbidity and mortality, and raising awareness of smoke-free products among adults who smoke and will continue smoking. We want these smokers to understand the differences and benefits of our smoke-free products in comparison with combustible cigarettes, while also ensuring they understand that smoke-free products are addictive and not risk-free. In our awareness-raising efforts, we are cautious to guard against use by unintended audiences such as never smokers, former smokers, and youth (read more: **Responsible marketing and sales practices**).

Tobacco product marketing is subject to extensive restrictions worldwide, including outright bans in some countries. The regulatory environment varies substantially across markets, making it difficult—or almost impossible—in some countries to make people who smoke aware of available alternatives to cigarettes and how and why they should use them instead.

As of the end of 2020, we estimate that only 36 percent of adult smokers in the markets in which PMI commercialized *IQOS* were aware of the product's features and benefits compared with smoking cigarettes.[1] This lack of information arguably presents the single biggest hurdle to achieving tobacco harm reduction. It is also potentially the easiest to overcome if and when

1 The estimate is based on studies in 54 markets where *IQOS* was commercialized in 2020.

2 Changing Perceptions of Harm of e-Cigarette vs Cigarette Use Among Adults in 2 US National Surveys From 2012 to 2017, March 2019 (https://www.ncbi.nlm.nih.gov/pmc/articles/PMC6450305/).

3 Perception of the relative harm of electronic cigarettes compared to cigarettes amongst US adults from 2013 to 2016: analysis of the Population Assessment of Tobacco and Health (PATH) study data, 2020 (https://harmreductionjournal.biomedcentral.com/articles/10.1186/s12954-020-00410-2).

public health organizations decide to inform adult smokers—or allow them to be informed—about the benefits of smoke-free products.

Product information

At PMI, we seek to provide adult consumers with accurate and non-misleading information about our smoke-free products so that people who would otherwise continue to smoke can choose to switch. We have internal processes in place to ensure that our consumer messages meet this standard. We have also developed a program of perception and behavior assessment studies to understand how our smoke-free products are perceived and how users will behave with the products.

A cross-functional team of scientists, market researchers, lawyers, communication experts, and marketers review consumer messages about our product features and benefits. To establish whether a statement is accurate (substantiated), the team verifies it against available information on product design and characteristics or scientific evidence available either from the literature or directly from our scientific studies or consumer research. To confirm a message is clear and non-misleading, particularly for reduced risk messages, we conduct comprehension research in various markets and carefully analyze the results before allowing the message to be released.

The team also works directly with markets to ensure proper deployment of centrally developed consumer communication and that locally developed marketing materials meet our standards and local law requirements.

Perception and behavior assessment studies help us evaluate risk perceptions of smoke-free products among various adult consumer groups. The results of our studies to date show that the adult consumer groups tested have a very good understanding that *IQOS* presents less risk than cigarettes but is not risk-free and that it is riskier than smoking cessation. Additionally, when assessed in the context of specific communication materials, more than 90 percent

of participants in consumer studies understood that *IQOS* is not intended for nonsmokers, and more than 80 percent comprehended that quitting the use of all tobacco is the best way to reduce the risk of tobacco-related disease.

We do not conduct studies on individuals under the legal age to purchase tobacco. We have conducted studies of our heat-not-burn product *IQOS* among young adult never smokers (age 18-25) and these tests indicate a very low or no intention to use or try *IQOS* among these young adult never smokers. However, our FDA MRTP exposure modification order required that we submit a post-market surveillance and studies plan, which had to be approved by the Agency. As part of that plan, our commercialization partner in the United States, Altria, will conduct a secondary analysis of Altria's existing Underage Tobacco Use Survey (UTUS), which is nationally representative survey of U.S. household-dwelling individuals 13-20 years of age. *IQOS* specific questions were added to the UTUS and will be used to estimate awareness and use of *IQOS* among underage individuals. This information is part of FDA's ongoing post-market surveillance efforts related to *IQOS*, which were deemed necessary to grant the MRTP exposure modification order.

Our premarket and post-market studies guide all our consumer-facing activities and communication, including the internal assessment of consumer messages.

The opinions expressed about smoke-free products by public health organizations, regulatory bodies, and NGOs have a big impact on individual smokers' decisions, so it is critical that these organizations avoid contributing to category confusion or misinformation. To illustrate existing misconceptions: A study found that "the proportion of U.S. adults who perceived e-cigarettes as less harmful [than cigarettes] declined from 39.4 percent in 2012 to 33.9 percent in 2017" and that "during the same period, the proportion of adults who perceived e-cigarettes as equally harmful as cigarettes more than tripled from

11.5 percent in 2012 to 36.4 percent in 2017."[2] Another study also found that "the proportion of U.S. adults who correctly perceived e-cigarettes as less harmful than cigarettes decreased each year from 41.1% in 2013–2014, 31.5% 2014–2015 and 25.3% in 2015–2016."[3] It is of paramount importance that science and facts prevail for the 1.1 billion smokers worldwide.

> ## Unsmoke: Our global corporate campaign

An *IQOS* store in Stockholm, Sweden

Access to smoke-free products continued

Consumer engagement at retail

To help smokers transition to smoke-free products, we are shifting from a business-to-business to consumer-centric model. This is a highly complex and resource-intensive undertaking. In the table below, we illustrate some of the dimensions of this change in our business model, showcasing the complexity and scale of the change. This transformation requires significant changes to our internal processes, skill set, and mindset. It also requires a substantial and long-term investment in infrastructure, systems, and capability building. Therefore, we have to maintain a careful pace while scaling things up.

Purchasing and trying a smoke-free product is only one step along the conversion journey of an adult smoker who switches to a less harmful alternative. It is essential that we set in place the right infrastructure to support smokers along every leg of this journey.

We currently have 24 consumer call centers, where adult users can contact us if they have a question about the product or its use. Insights we receive are fed back into our product development.

At the end of 2020, PMI had a footprint of 259 stores dedicated to *IQOS* and over 2,200 exclusive *IQOS* retail touchpoints worldwide.[1] These retail outlets offer personalized support to adult consumers, starting with explaining how the product should be used and how to clean it. In our boutiques, interested adult smokers can learn about heated tobacco technology and its benefits, communicate with our staff, and try the product. Our *IQOS* coaches are trained on our **Good Conversion Practices** and are required to interact with adult smokers exclusively.

In addition to the *IQOS* stores, there are premium resellers—select stores in which we provide information about our smoke-free products to adult smokers, offering them an opportunity to have a session with trained staff to learn about the product, its benefits, and how to use it within the environment they regularly visit to purchase tobacco products. Additionally, these locations offer *IQOS* users with access to related services such as device cleaning and replacement (in the case of defects). These sites also permit current users to experience and access new device ranges and accessories with which to personalize their *IQOS* products.

Digital capabilities help us become more efficient in serving consumers. In 2020, we shifted our focus in this direction as COVID-19-related lockdown measures inhibited other means of connecting with consumers. In countries where this is permitted, adult smokers who express an interest in *IQOS* are offered an online session with a remote *IQOS* coach. Consumers can also benefit from additional services via other digital touchpoints. With the consumer's consent, we use customer relationship management (CRM) to offer tailored communication and promotions to consumers, according to their specific interests and the stage they have reached in their conversion journey. CRM also allows us to process, analyze, and respond swiftly to consumer feedback collected across all touchpoints.

1 In 2020, we refined our classification of different retail channels.

	From	To
Product	Single product	Multiple products with multiple components (devices, consumables, accessories)
Consumer journey	Simple: From one cigarette brand to another	Complex: Changing behavior[2] by adopting a smoke-free product and stopping smoking
Touchpoints	One type: Retailer	Multiple types: Own retail, independent retail, e-commerce, call centers, coaches

2 For the smokers who would otherwise continue to smoke.

A sales representative and a customer in an *IQOS* store in Ginza, Japan

Access to smoke-free products continued

Product acceptability
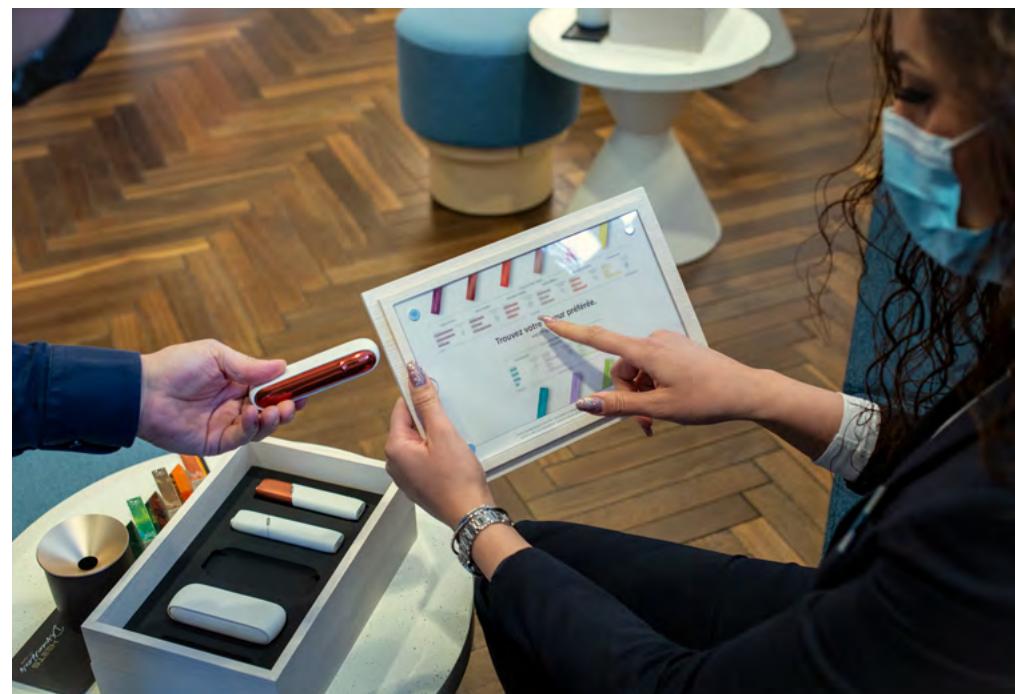
Smokers will only stop smoking and switch to better alternatives if they prefer these products over cigarettes.

An important indicator of whether our heat-not-burn product meets consumer preferences is the so-called full-switching rate: The percentage of *IQOS* users who stopped smoking versus total *IQOS* users. In 2020, the average full-switching rate for *IQOS* was 72 percent, which significantly exceeds the performance of competing products, for which dual use (i.e., using both smoke-free products and cigarettes) is the norm. The perfect full-switching rate is 100 percent, and this is our goal as we continue to develop and improve our products and make cigarettes truly obsolete. *IQOS* is a new product with different characteristics to cigarettes. During the switching journey, users go through an adaption process where dual use may occur. Our goal is to support consumers to make this adaptation process as short as possible. It is only by switching completely, and eliminating cigarettes, that the full benefits of smoke-free products like *IQOS* can be realized.

Product design

We designed our smoke-free products to reduce disease risk compared with smoking while replicating as much as possible the taste, nicotine delivery, and ritual characteristics of cigarettes so that adults who will not quit are willing to switch to these alternative products.

The likelihood that adult smokers will consider a smoke-free product a viable alternative to cigarettes is dependent on the overall sensory experience and nicotine delivery and clarity on potential health benefits. With regard to nicotine, the FDA stated in its 2019 premarket tobacco application decision: "*IQOS* delivers nicotine in levels close to combustible cigarettes suggesting a likelihood that *IQOS* users may be able to completely transition away from combustible cigarettes and use *IQOS* exclusively."[1] We discuss in more detail the role of nicotine in our smoke-free products on **PMIscience.com** and **PMI.com**.

As of December 31, 2020, *IQOS* heated tobacco units were available in over 30 taste variants to cater to a variety of tastes and maximize the probability that a smoker will switch. In 2020, we launched a flavor adviser tool, both at retail and online, to guide consumers in selecting the variant that best matches their preferences. Flavors are essential to encourage adult smokers to switch, and their use should be preserved; however, certain flavors, such as candy- or dessert-like, could be particularly appealing to youth and should not be used. In all circumstances, heated tobacco units, as any tobacco or nicotine products, should be regulated, including the way they are marketed, to ensure they do not particularly appeal to youth. At PMI, we have implemented a central governance system, under which new flavored heated tobacco products and e-vapor products are assessed and by which those product variants are subject to a specific assessment framework that requires data and checkpoints in the process to demonstrate premarket that a new flavored product proposition is not particularly appealing to minors or other unintended audiences. As part of the assessment, we review literature and market data and we also conduct behavior research assessment by "online" consumer testing on a case-by-case basis. Only once this review and validation process is done, new flavored heated tobacco or e-vapor products are commercialized. To confirm premarket findings, we also conduct post-market studies to verify that flavored tobacco and nicotine products commercialized by PMI are not particularly appealing to unintended audiences, including youth.

From concept design to commercialization at scale, our efforts to continuously enhance the experience of our smoke-free products are guided by consumer insights. We regularly incorporate product updates and new features designed to address consumer pain points to help adult smokers switch from cigarettes more seamlessly. In recent years, we have broadened our portfolio of *IQOS* heat-not-burn devices, and we are currently commercializing four models. In 2020, we focused on finalizing a major product update: A new heating technology that addresses consumer pain points related to the need for regular device cleaning and the risk of breaking the heating blade. We will launch this new technology in 2021.

An *IQOS* coach and a customer in an *IQOS* store in Lausanne, Switzerland

1 Source: https://www.fda.gov/news-events/press-announcements/fda-permits-sale-iqos-tobacco-heating-system-through-premarket-tobacco-product-application-pathway. The FDA does not endorse or approve tobacco products.

Our efforts to continuously enhance the experience of our smoke-free products are guided by consumer insights

Overview

Innovating for
better products

Operating
with excellence

Caring for the
people we work with

Protecting the
environment

Performance
metrics

Access to smoke-free products continued

Post-market studies and surveillance

We conduct post-market studies to understand how the product is used and by whom. These studies are necessary to confirm the results of our premarket perception and behavior assessments, to measure the extent to which current adult smokers switch to the product, and to ensure never and former smokers are not using it.

We have established repeated studies in 45 countries among adult *IQOS* users. These studies involve in total about 100,000 participants and allow to measure the use patterns of *IQOS* adult owners over time.

In Japan, we are conducting cross-sectional surveys to measure trends in prevalence and patterns of *IQOS* use over time and to assess the impact of the product on public health. The results thus far have highlighted a very low proportion of tobacco-use initiation with *IQOS* (2.0 percent of *IQOS* users in 2017, 1.3 percent in 2018, and 0.6 percent in 2019) and very low use by former smokers (only 0.1 percent of adult former smokers reinitiated tobacco use with *IQOS*). Additionally, results from an independent study commissioned by the Japanese Ministry of Health among middle and high school students found that the use of heated tobacco products among this group is extremely low—and lower than smoking cigarettes.[1]

We are also conducting similar cross-sectional surveys in Italy and Germany. The results of these studies have shown comparable dynamics to the ones observed in Japan. Between 2018 and 2019, the highest proportion of tobacco use initiation with *IQOS* among the *IQOS* users was 0.7 percent and it was observed in Italy, while the lowest proportion was 0.2 percent and it was detected in Germany. With respect to former

smokers reinitiating tobacco use with *IQOS*, the highest value was equal to 1.5 percent in Germany and the lowest was 0.1 percent in Italy.

Overall, the data from our studies, as well as independent studies, confirm that *IQOS* is reaching the intended audience, adult smokers, and is of very limited interest to adults who have never used nicotine products before or who had already stopped using tobacco.

We welcome and encourage rigorous monitoring of the overall tobacco and nicotine market by governmental bodies in a way to comprehend the dynamics of this new market and enhance a constructive dialogue on regulation that can accelerate switching of smokers, who do not quit, to better alternatives.

Product availability

Whether we can make our smoke-free products available to adult smokers depends on several factors, including some beyond our control. The country's regulatory conditions must be favorable to allow the launch of the product there in a commercially viable way. If they are, we must build sufficient production capacity, which depends in part on trade zones and tariff barriers. Lastly, we need to establish the right market organization to commercialize the product and implement the necessary consumer interaction described earlier in this section.

As of December 2020, our smoke-free products were available in 64 markets, either in key cities or nationwide. Based on this geographic footprint, we estimate that around 150 million adult smokers (i.e., 64 percent of the total number of adult smokers in the markets where we have launched) have physical access to purchase *IQOS* devices and consumables.

Production capacity

Expanding the sale of smoke-free products requires significant investment in our production capacity. In particular, the manufacturing of smoke-free product consumables requires that we

build new factories or convert existing cigarette factories and increase our capital expenditure—for example, to purchase new machinery. In 2020, eight of our 39 factories were dedicated—either partially or fully—to the manufacture of our smoke-free product consumables.

Market launches

In 2020, we launched *IQOS* in 12 additional markets, including Lebanon and the Philippines. This brought to 64 the total number of markets in which the product is commercialized. Of these markets, 52 percent are in non-OECD countries.

Several countries, including Australia, India, and Singapore, do not permit the sale of heated tobacco products. We nonetheless continue to engage with stakeholders to advocate for

regulations that would allow under a well-defined framework the sale of *IQOS* and other scientifically substantiated smoke-free products in these countries. We do not believe that banning such products is a rational policy, especially considering that these countries permit the sale of the most harmful tobacco product: cigarettes.

In addition to external factors, internal constraints affect the rate at which we can roll out smoke-free products globally. PMI is present in over 175 markets, but the size and capacity of our local organizations vary. Not every market has the resources and capacity to launch smoke-free products immediately. We evaluate the commercial viability of launching smoke-free products in each market to decide how to prioritize internal resources internationally.

A customer and a sales representative in an *IQOS* pop-up store in Cape Town, South Africa

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1 Kumamaru H & Osaki Y (2019). Update of Current Status in Japan on Tobacco Harm Reduction. Global Nicotine Forum (GNF) 2019 presentation. Available at :https://gfn.net.co/downloads/2019/presentations/Hiroya_Kumamaru.pdf

Access to smoke-free products continued

Distribution channels

By the end of 2020, there were 27 markets in which our heat-not-burn product, *IQOS*, and its consumables were available for purchase nationwide in physical channels or e-commerce, where allowed.

> ## The *IQOS* consumer journey

An *IQOS* store in Bratislava, Slovakia

In the other markets in which we have launched *IQOS*, the product initially is offered in key cities, allowing us to gain experience and build capacity before we proceed with a nationwide rollout.

Expanding the geographic availability of our smoke-free products requires that we leverage a variety of retail channels. In 2015, we started opening and running our own retail stores in markets where *IQOS* was present. These consumer touchpoints allow us to communicate and engage directly with adult smokers. They enable adult smokers to see, touch, and test the product where allowed. We rely on both stationary and temporary sales areas, with established flagship stores and pop-ups. As of the end of 2020, we had 259 permanent *IQOS* boutiques and stores worldwide, mainly in key cities and areas of high consumer traffic. Where legally permitted, we also run e-commerce sites for *IQOS*, allowing adult consumers to purchase the product online and have it delivered to their homes (51 markets in 2020).

The indirect retail environment consists of our traditional trade partners (e.g., tobacco retailers) and key account chains (e.g., convenience stores and petrol/gas stations). Based on the product portfolio handled and the services provided to consumers, we classify the general trade and key accounts universe into three groups: Consumable sellers, service points, and premium resellers. At consumable sellers, the main focus is to provide *IQOS* users with a convenient option for everyday purchases of the heated tobacco units. At service points, consumers can also access services related to *IQOS*, such as device replacement in case of defect. Premium resellers offer consumers the full spectrum of services, including device cleaning and learning sessions, along with a full brand experience.

At the end of 2020, there were over 2,200 exclusive *IQOS* retail touchpoints and 3,800 indirect retail brand experience touchpoints worldwide, and around 749,000 points of sale at which *IQOS* heated tobacco units were sold.

Product affordability

We will only achieve a smoke-free future if all those adult smokers who do not quit tobacco and nicotine but would like to switch to smoke-free products can afford to do so.

Economics of innovative smoke-free products are massively different than those of a century-old product like cigarettes.

Unlike with cigarettes, adult smokers who want to switch to *IQOS* must first buy a device. The retail price of these devices ranges from around USD 29 to 136, depending on the model and country, with a geographic average price for the lowest-cost *IQOS* device being USD 50. These high-quality devices require significant production costs to ensure they consistently function within the well-defined specifications of the scientific substantiation package.

To address the potential cost barrier for adult smokers who would like to switch, we have implemented various solutions, including initial lending of the device or payment over time, and we have lowered the price of existing *IQOS* device versions following the launch of newer versions. We also enhanced battery performance, thus improving the longevity of the devices. Beyond lowering the average annual costs for the user, this improves the ecological footprint of *IQOS* devices. In 2020, we also introduced the licensed *LIL SOLID* device, for use with *Fiit* consumables, at a price below the cheapest *IQOS* device in Russia and Ukraine.

A second aspect of affordability is the price of the consumable. Currently, the production costs of the heated tobacco units used with *IQOS* devices are, on average, somewhat higher than those of cigarettes. Heated tobacco units undergo a special manufacturing process that is vastly different from the manufacturing of cigarettes, and the products require an increased level of quality assurance in factories. We also incur other costs that are not applicable to cigarettes, such as the costs of scientifically substantiating the reduced-risk profile of these products.

Importantly, *IQOS* has much higher commercialization costs compared with cigarettes due to the need to properly introduce consumers to this new product and explain its functionalities. These costs include our customer care call centers and follow-up to ensure users do not fall back into smoking during their conversion journey.

Beyond production and commercialization costs, a key factor driving tobacco product retail prices is the excise tax. Excise taxes on cigarettes are generally higher than those on smoke-free products. Within the smoke-free category, electronic cigarettes tend to be taxed at a lower rate than heat-not-burn tobacco products.

Differential taxation is an appropriate fiscal policy considering the fundamentally different risk profiles of combusted tobacco products and non-combusted alternatives.

Access to smoke-free products continued

This approach plays an important role in incentivizing adult smokers, who would otherwise continue smoking, to switch away from cigarettes and other combusted tobacco products, and encourages manufacturers to channel their future investments and R&D toward better alternatives.

The combined effect of cost and tax differences is such that the price to the consumer of *IQOS* heated tobacco units is typically below that of premium cigarettes and is sometimes, as in New Zealand and the U.K., at the low end of cigarette pricing. We estimate that heated tobacco units are priced the same as or lower than a smoker's current cigarette brand for 58.6 percent of smokers in the geographies where we currently commercialize *IQOS*.[1]
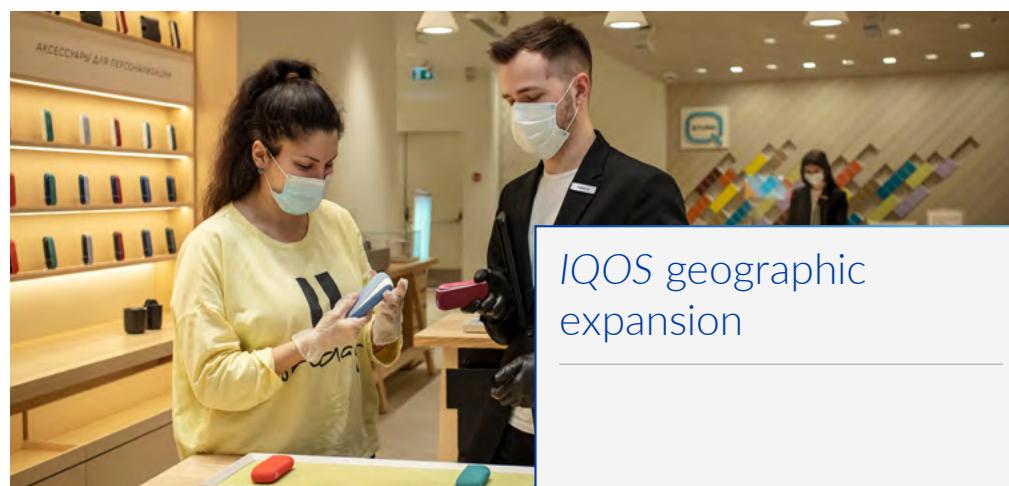
To help address potential affordability barriers, we are also expanding our heated tobacco unit consumables range by offering brands at multiple price points in certain markets. The most notable example is in Japan, where we introduced a mainstream-priced brand in 2019, and we view this as a necessary strategy for a broader range of markets over time. We have also leveraged our agreement with KT&G in this regard, by offering

heated tobacco units (HTU) brands at price points below our *HEETS* consumables in both Russia and Ukraine, as part of our strategy to grow the heated tobacco category by offering a wider range of product choices, including based on price.

Clearly, to achieve our vision of a smoke-free future, our smoke-free products must be affordable to all adult smokers within each market.

The same reasoning applies across countries. Our efforts aim to reach all adult smokers in all countries, both in the OECD and outside the OECD.

We are only at the beginning of commercializing a full-fledged portfolio of smoke-free products at a global scale and are actively seeking partnerships to accelerate a smoke-free future. In addition to our cooperation with Altria Group, Inc. on the commercialization of *IQOS* in the U.S., we secured an agreement with KT&G in January 2020 to commercialize its portfolio of smoke-free products outside its home country of South Korea. In 2020, we successfully commercialized KT&G's heat-not-burn product, *LIL SOLID*, in Russia and Ukraine alongside our *IQOS* product, offering consumers a wider range of taste, price, and technology choices.

IQOS geographic expansion

A sales representative and a customer in an *IQOS* store in St. Petersburg, Russia

Next steps

Our long-standing aspiration is that by 2025 at least 40 million people will have switched to our smoke-free products and stopped smoking. To achieve this ambitious goal, we will need to work on all four access drivers: Awareness, acceptability, availability, and affordability. This, in turn, requires that we continue to focus resources on smoke-free products.

Consumer feedback received during the launch of *IQOS VEEV* in New Zealand and the Czech Republic in 2020 will inform our launch in additional countries in 2021. We also plan to enter the nicotine pouch category in 2021.
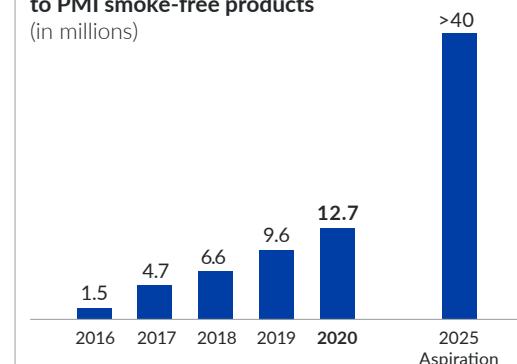
We expect that the launch of the new induction heating version of the *IQOS* heat-not-burn product in 2021 will effectively address consumer pain points related to our current heating technology and enable easier conversion due to increased intuitiveness. We anticipate that this will boost consumer acceptance of *IQOS*, thereby accelerating a full switching away from cigarettes.

We will continue to do all we can to give full access to our smoke-free products to those adults who otherwise would continue to smoke. However, several factors are outside our control. Governments, in particular, can accelerate the end of smoking. They can ensure through regulation that adult smokers have accurate information about smoke-free products. They can introduce product standards to ensure that only scientifically substantiated smoke-free products are commercialized. And, through risk-proportionate regulation and taxation, they can provide the right incentives to encourage smokers and manufacturers to switch from cigarettes to better, scientifically substantiated alternatives.

[1] Against 53.4% in 2019 (figure restated). Main drivers of year-on-year increase are pricing differentials between cigarettes and HTUs, as well as launch of *IQOS* consumables at lower price points.
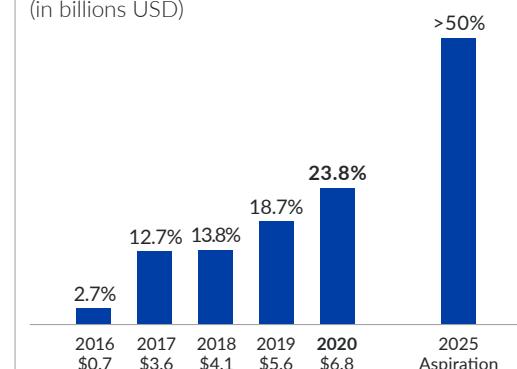
2020 performance highlights

See our performance metrics   >

Number of consumers who have stopped smoking and switched to PMI smoke-free products (in millions)

2016	2017	2018	2019	2020	2025 Aspiration
1.5	4.7	6.6	9.6	12.7	>40

Net revenues (smoke-free/total) and smoke-free product net revenues (in billions USD)

2016 $0.7	2017 $3.6	2018 $4.1	2019 $5.6	2020 $6.8	2025 Aspiration
2.7%	12.7%	13.8%	18.7%	23.8%	>50%

Overview

Innovating for
better products

Operating
with excellence

Caring for the
people we work with

Protecting the
environment

Performance
metrics

TIER 2

Product addictiveness

To PMI, this topic is about better understanding nicotine and its role in addiction, separate from the risks to health associated with the use of our products, in particular those that combust tobacco. The public health and scientific community continues to explore ways in which nicotine, when isolated and used as a potential therapeutic compound, could confer certain health benefits.

Read more online

Product reliability

Product reliability means securing the quality and integrity of our products, their components, and ingredients, in line with appropriate design and manufacturing standards.

Read more online

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WE ARE

Operating with excellence

We strive for excellence in all we do. This includes ensuring our products are commercialized responsibly, in line with regulation and societal expectations. The programs and rules we have established help us meet the high standards we have set for our marketing and sales activities.

Our supply chain accounts for a significant portion of our social and environmental footprint. As we embed sustainability in our supply chain management, we continue to work closely with our suppliers to create sustainable value. In all this, our guiding principle remains to protect and promote the human rights of those impacted by our operations.

An employee in PMI's manufacturing facility in Guadalajara, Mexico

TIER 1

Responsible marketing and sales practices

Globally, the commercialization of tobacco products is subject to extensive rules and regulations. At PMI, we support regulation that supports tobacco harm reduction, as well as measures to discourage initiation, encourage cessation, and encourage smokers who do not intend to quit to switch to less harmful non-combusted alternatives to cigarettes.

The right thing to do

The responsible commercialization of tobacco and nicotine-containing products is of profound interest to society. Cigarette smoking is one of the leading causes of preventable mortality and morbidity in the world. While smoking rates, including among youth, have declined in most countries, smoking continues to be a public health issue. There are also legitimate concerns on youth uptake of nicotine-containing smoke-free products, notably exacerbated by youth use of e-vapor products in the U.S. We take this risk extremely seriously, and while our smoke-free portfolio has no evidence of any significant use by youth, we must place strong focus on continuing to minimize use by unintended audiences as we expand to more categories and geographies.

There are still an estimated one billion plus people who smoke in the world, and hundreds of millions of people who would otherwise continue to smoke are looking for better alternatives to cigarettes. The availability of innovative smoke-free products offers significant opportunity for adult smokers to move away from cigarettes, as well as benefit public health.

The business case

Consumer-centric product design, development, marketing, sales, and engagement drive our commercial success and can propel our mission. Responsible marketing and sales practices are fundamental to minimizing unintended use of our products and reputational damage to our brand equity. Driving sustainable organic growth in net revenues and earnings per share relies on a continued license to operate with regulations which allow us to communicate with and market to adult smokers. Maintaining and growing strong brand equity for our smoke-free products is also critical to growing our market share and delivering an attractive financial performance. Concerns that our products, marketing, and sales could discourage cessation, encourage initiation, or particularly appeal to minors can undermine our credibility, harm our reputation, and even trigger adverse regulation, threatening our ability to engage or jeopardizing product categories. How we market and sell our products can either enhance or undermine our credibility and trust, especially for smoke-free products, where meaningful dialogue is indispensable for achieving our purpose of accelerating the end of smoking. Enforcing the most responsible marketing practices allows us to lead by example.

An *IQOS* store in Stockholm, Sweden

Our aims

>90%
Youth access prevention (YAP) programs in place in markets representing more than 90 percent of PMI's total shipment volume by 2020

100%
Percentage of PMI smoke-free electronic devices introduced on the market as of 2023 equipped with age-verification technology

Responsible marketing and sales practices continued

Achieving our aims

We aim to market and sell our products responsibly to adult consumers of tobacco and nicotine-containing products. Fundamental to achieving this objective is providing clear and meaningful information about our products, including about the risks of consumption, through our marketing and sales activities.

All our commercialization activities across the world are guided by a set of core principles:

- PMI products are only for adults who smoke or use other nicotine-containing consumer products.
- We warn consumers about the health effects of our products.
- We communicate about our products to enable adult consumers to make choices.

- We market truthfully and transparently. We design, develop, and commercialize our products in ways that are consistent with our smoke-free mission.

Our marketing and sales principles and practices are codified in separate Marketing Codes for combusted tobacco products and non-combusted alternatives (smoke-free products). Until 2021, PMI's (only) Marketing Code focused exclusively on combusted tobacco products—which, together with national laws, set the standards for the marketing and sale of our combusted tobacco products. In parallel, our Good Conversion Practices (GCP) articulated the rules governing the marketing and sale of our smoke-free products.

Early 2021, PMI released internally an updated Marketing Code for combusted tobacco products and a new, separate Marketing Code for non-combusted alternatives that codifies and elaborates on the principles contained in the GCP.

"In order to maximize the potential of smoke-free products while simultaneously minimizing unintended consequences, we are aiming for digital age-verification processes that are both effective in preventing youth access and seamless for legal-age consumers, to facilitate their switching away from cigarettes."

Stefano Volpetti, PMI Chief Consumer Officer

The new Marketing Codes establish a robust governance process to ensure that all commercial programs, campaigns, and initiatives comply with all relevant laws and the principles in the Codes.

Everyone involved in PMI's commercialization activities—including employees and third parties acting on our behalf—must be trained on the Codes and follow them.

We also have policies that set standards and requirements for conducting market research regarding combusted tobacco products and non-combusted alternatives. Research is restricted to adults who smoke or use other nicotine-containing products, and all employees and third parties involved in market research activities must be formally trained and are contractually bound to comply with the policies.

Three functions—Ethics & Compliance, Risk & Controls, and Corporate Audit—support and monitor compliance with the **Guidebook for Success** (our code of conduct) and our Principles and Practices through training, communication, controls, investigations, and audits.

Most of our marketing expenditure is geared toward our smoke-free products. In 2020, 76 percent of our total commercial expenditure related to the marketing and sale of smoke-free products, while only 24 percent pertained to our combusted tobacco products.

In addition, we seek to leverage technology and closely monitor emerging solutions with potential to increase the accuracy of age verification and minimize the scope for human error. Preventing unintended use of smoke-free products is fundamental to building a sustainable business. Cooperation with external stakeholders, especially technology companies, is key in that regard to accelerate the pace of progress and help us meet our goals.

A retailer in Tokyo, Japan

Responsible marketing and sales practices continued

Progress in 2020

Consumer communication and labeling

We apply strict rules to how we communicate about our products with our adult consumers.

We warn consumers about the health effects of all our products. All advertising and consumer packaging for combusted tobacco products and non-combusted alternatives must contain clear and visible health warnings, even in markets where not required by law.

As of 2015, we do not use social media to market our combusted tobacco products. This applies to all advertising, direct communication, campaigns, and activities, whether branded or unbranded. The same rule applies to our contracted parties, including event organizers, third-party agencies, and brand ambassadors.

Unlike combusted tobacco products, non-combusted alternatives are a new category and still relatively unfamiliar to most people. Our priority is to create awareness among adults who smoke (and will not quit) about these better alternatives to continued cigarette smoking. Our commercial activities for non-combusted alternatives must strike the right balance between encouraging those adult smokers to switch fully to these better alternatives and minimizing access, initiation, and use by youth and nonsmokers. As the consumption of smoke-free products may not be as intuitive as cigarette smoking, we also need to inform consumers of their proper use. In addition, even when not required by law, because these products are not risk-free, we include a health warning on the consumables packaging that the product is not risk-free, contains nicotine, and is addictive.

Our **Good Conversion Practices** must be displayed for staff and consumers at stores and other direct-retail locations we own or control.

As a leading manufacturer of tobacco and nicotine products, we have a key role to play in guarding against youth access to tobacco and nicotine products and to our marketing communications. This is a role we take seriously. There are various channels through which an adult consumer can obtain access to PMI smoke-free products. They range from PMI-owned and operated e-commerce platforms, to third-party online marketplaces; and from PMI owned and operated boutiques, to third-party retailers. While the level of control we have over these different channels varies, it is critically important that, even in those channels where our influence is limited, we use our best efforts to guard against youth access to PMI non-combusted alternatives. We take a similar approach when we reach out to adults with our marketing communications related to PMI non-combusted alternatives and/or allow access to such marketing content.

For example, we open commercial social media accounts for PMI non-combusted alternatives in countries where we obtain reliable audience data which show that the audience of the social media platform in the relevant country is at least 75 percent adult. In addition, we use all native age gates made available on such social media platforms. As of October 2019, we do not engage with anyone for the purpose of generating social media posts to market our smoke-free products. We do not hire social media influencers to advertise our smoke-free products. Moreover, we do not encourage adult consumers to share commercial content related to PMI non-combusted alternatives on their personal social media accounts and pages in order to limit the reach of our marketing communications to the unintended audience, including minors.

Employee and third-party training

Our responsible commercialization efforts rely on the adherence and dedication of our employees and the third parties with whom we work.

In 2020, 28,569 training sessions on our Marketing Code were delivered through various channels. Around 64 percent of these training sessions were to employees and 36 percent to third parties, including suppliers, retailers, and hosts (2019: 14,500 sessions). This also includes over 15,000 people trained on our GCP in the markets in which we sell smoke-free products (2019: 33,000).

Training plays a crucial role in ensuring employees and third parties understand our principles and practices and embed them in their work. In parallel to the release of our Marketing Codes, we will deploy new training in 2021 to reach all PMI employees directly involved in developing or commercializing our products as well as third parties contracted or engaged by PMI to do so.

Our Marketing Codes are discussed during the recruitment of prospective employees and third parties who will interact with adult smokers and consumers of smoke-free products. We hire employees and engage third parties only if they agree to follow them.

Leveraging the power of our brands to drive positive behavior change

Our brands and marketing activities allow us to connect with adult consumers and can raise awareness and encourage them to switch to better alternatives to combusted tobacco products.

We seek to use our brands' power to encourage adult smokers who otherwise would continue smoking to try our smoke-free products. Since 2019, we have been utilizing an innovative mobile digital platform called Scanpack, which can be accessed by adult smokers by scanning a QR code or using a weblink featured on the insert inside the cigarette pack. It combines image-recognition and age-verification technology to trigger unique and targeted communication campaigns through which we can engage with legal age adult smokers. This new channel provides the opportunity to increase awareness about smoke-free products by digitally communicating their benefits while driving trial within the target audience—adult smokers. Scanpack is highly engaging, encompassing interactive features such as quizzes or augmented reality. So far, we have leveraged Scanpack across 30 markets, which have enabled us to engage with more than 850,000 adult smokers in 2020 alone. Engagement has been powerful, with over 15 percent of the adult smokers exposed to smoke-free content signing up for a free trial. In 2021, we plan to further roll out this technology, covering additional markets, and we expect to reach an additional one million adult smokers.

Where allowed, our brands can also serve as a means to increase environmental considerations. For instance, they can encourage adult smokers not to litter their cigarette butts. Since 2019, we have been deploying a limited pack edition for our *Marlboro* brand that communicates anti-littering messages to adult smokers, complementing our broader awareness-raising efforts.

ⓘ Read more: Littering prevention

Responsible marketing and sales practices continued

Monitoring and remediation

PMI has a robust and tested infrastructure aimed at ensuring compliance with its policies and processes. Our Ethics and Compliance function monitors adherence to our policies on the ground.

We monitor incidents of noncompliance with laws and PMI's Marketing Codes in marketing communications, including advertising, promotion, and sponsorship.

In 2020, there were 29 substantiated violations of our Marketing Code or GCP (2019: 42). As a consequence of these violations, we terminated the employment of eight employees. Furthermore, six employees were suspended and received a written warning, eight employees received a written warning or pay cut, and seven employees received a verbal warning or counseling.

The number of cases of noncompliance is low, considering that over 35,000 PMI employees and third parties working on our behalf are directly involved in the commercialization of our products. There is also no pattern that would suggest systemic problems.

Our commitment to youth access prevention

We support regulation that ensures that only adults can buy tobacco and nicotine-containing products, as well as the strict enforcement of minimum age laws and penalties for those who provide tobacco products to minors.

We apply global guidelines, even when not required by local laws, to all our commercial activities to reduce the likelihood that our products will appeal to minors. For example, our creative materials must not contain any of the following: (i) images of models who are, or appear to be, under age 25; (ii) images of youth-oriented celebrities; (iii) characters from children's TV, cartoons, films, online video or audio programs, books, or nursery rhymes; or (iv) brands, toys, or other content or merchandise primarily intended for, or used by, minors. We do not pay for product placement in entertainment programs, films, or theatrical productions in or on the internet, cinema, television, radio, video games, or any other program intended for or disseminated to the general public.

While flavors are essential to encourage adult smokers to switch to smoke-free products, some flavors such as those with candy- or dessert-like descriptions could be particularly appealing to youth and should not be used. At PMI, we have implemented a central governance system, under which new flavored heated tobacco products, e-vapor products, and combusted products are assessed and by which those product variants are subject to a specific assessment framework that requires data and checkpoints in the process to demonstrate premarket that a new flavored product proposition is not particularly appealing to minors or other unintended audiences (read more: **Access to smoke-free products**).

"While PMI alone cannot prevent youth from smoking or using nicotine-containing products, there is a lot we can do, and are doing, to minimize the extent to which our marketing and products reach youth and other unintended users. We engage with various stakeholders on this issue, including retailers and governments."

Werner Barth, PMI Senior Vice President, Commercial

An *IQOS* store in Moscow, Russia

Responsible marketing and sales practices continued

Monitoring our efforts on youth access prevention

The risk of marketing and selling to youth is covered in our annual integrated risk assessment and in our risk-based audit program.

Reviews by our Corporate Audit department in 2020 found that only a few affiliates had issues related to responsible marketing compliance, and these issues were mainly procedural.

During 2020, Corporate Audit conducted seven audits covering 10 markets as well as the governance of the youth access prevention (YAP) program by our central Commercial function in our Operations Center in Switzerland.

Processes and controls were reviewed in all these markets, and members of the Corporate Audit team visited a limited number of points of sale in most locations (in a few of them, COVID-19 restrictions did not permit field visits) to assess compliance with the Marketing Code provisions and our GCP. No significant issues related to youth access were identified in any of the locations visited. The audit of the central YAP program led to further enhancements embedded in our new Marketing Codes.

We also run a mystery shopping program in a sample of our smoke-free product stores, contact centers, and website operations. An independent third party uses mystery shoppers to assess the consumer experience delivery, the quality of service offered, and compliance with our GCP.

We encourage any member of the public who spots PMI marketing materials or sales practices that they believe are inappropriate to contact us so we can review the situation and take action, as necessary.

Last but not least, we support establishment by the regulators of post-market monitoring and surveillance, which can help address concerns related to the use of novel smoke-free products by measuring whether such products are in fact reaching the intended audience of adult smokers, as well as by collecting data and evidence on the safety of these products and their impact on the health of users. Such post-market surveillance should be conducted independently but paid for by the manufacturers.

Engaging with our trade partners

We do not own or control the vast majority of retail outlets in which people buy our products. However, we set robust standards for our direct trade partners and work with them to guard against sales to youth.

In 2020, we implemented a set of YAP guidelines and tools to help our affiliates work more effectively with their trade partners to guard against sales of our combusted and smoke-free products to underage purchasers.

The tools include templates for contract clauses that, for example, require retailers to ensure strict compliance with minimum age laws or, in the absence of such laws, to refuse sales of nicotine-containing products to anyone below 18 years old. The tools also include YAP educational modules on the digital communication platform we use with our retail trade partners in various countries (76 countries, approximately 955,000 registered points of sale). The modules include educational materials on YAP for both combusted and smoke-free products, as well as knowledge checks. Trade partners who currently use the platform were required to complete the educational modules by the end of 2020.

Other tools we provide include point-of-sale signage, communication templates to be used by our affiliates, and talking points to guide in-person conversations with trade partners.

By the end of 2020, markets representing over 94 percent of PMI's total shipment volume had developed and started implementing YAP plans where allowed, considering COVID-19 restrictions imposed by local governments. In 2021, we will launch a new toolkit with updated communication and educational materials to align with the new Marketing Codes and further strengthen the local practices to prevent youth access to our products. Markets will continue to deploy the initiatives aimed at maintaining YAP implementation in markets accounting for over 90 percent of PMI's total shipment volume.

What is a youth access prevention (YAP) program?

A retailer in Istanbul, Turkey

Responsible marketing and sales practices continued

Age-verification technology

We have established and follow internal guidelines informing processes requiring that a consumer's age is verified before providing them with access to our products in owned and third-party-operated retailers, including e-commerce and marketplaces.
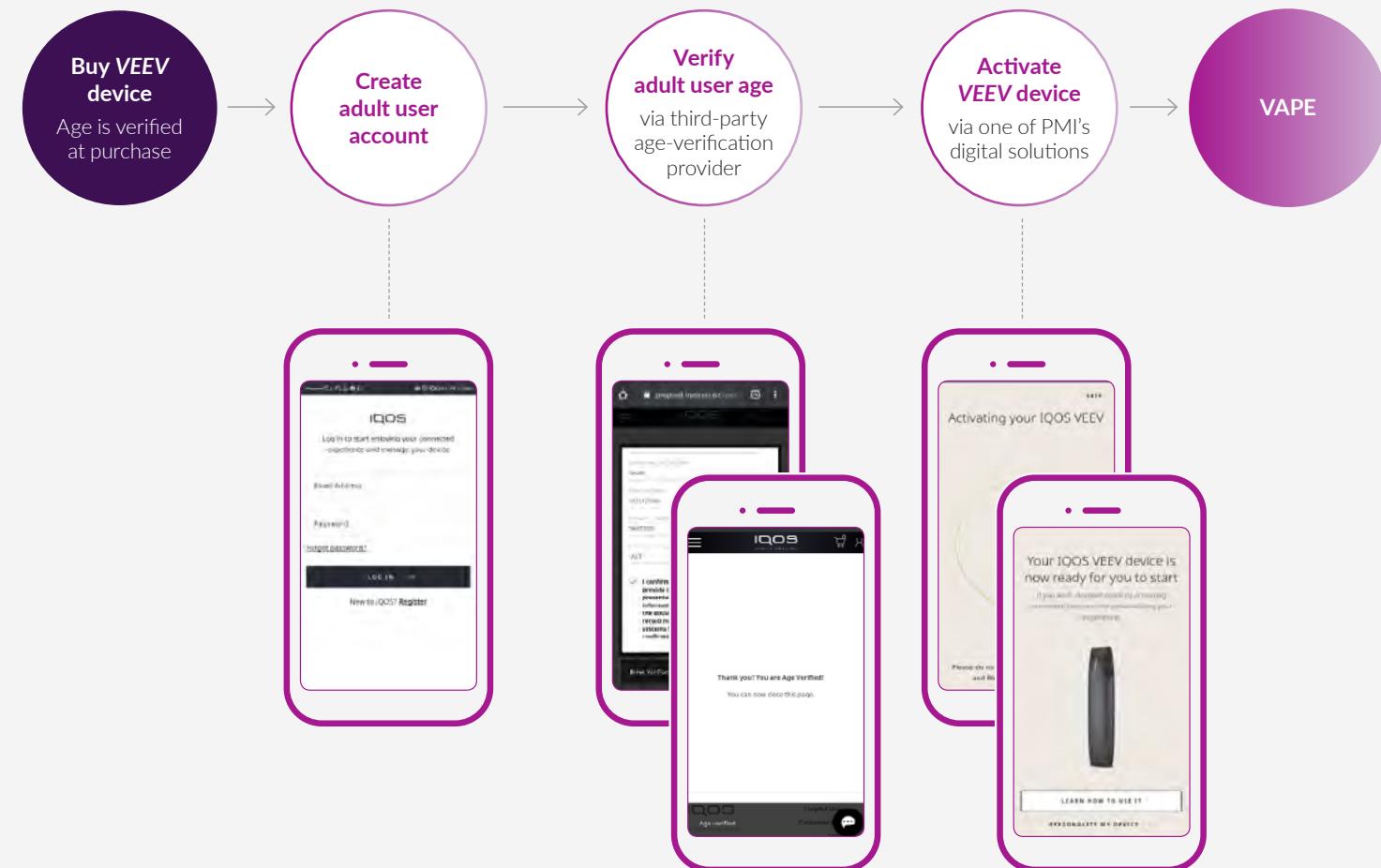
When performing online age verification, we leverage data from authoritative sources, such as government organizations, telephone network operators, and banks in order to use reliable sources to perform age verification prior to selling electronic smoke-free devices. In 2020, we worked with third-party age-verification providers in 16 markets to online-verify adult consumers seeking to purchase our products on one of our websites.

Online age-verification technology corresponds to the ability to corroborate that a purchaser is of the minimum legal age authorized to purchase nicotine-containing products in a particular market, without the need for a face-to-face interaction with a retailer. We are aiming to equip all markets in which we sell smoke-free products through owned e-commerce platforms with online age-verification solutions.

In addition, we are developing technology to help guard against minors from using our smoke-free devices via compulsory age verification prior to first usage and allowing users to lock and unlock their device—when they choose—to prevent unintended use. In the second half of 2020, we launched our *IQOS VEEV* product equipped with age-verification technology pilot in New Zealand. Our aim is to have our portfolio of electronic smoke-free devices designed by PMI and introduced on the market as of 2023 equipped with age-verification technology.

Secure and user-friendly age-verification technology is a novel advance in the smoke-free product category and requires strong collaboration with information technology service providers and owners of various software applications. Our teams are reaching out to the main hardware and software players in these industries to ensure that best-in-class technology is available for PMI's smoke-free products and the category in general.

Piloting age-verification technology in New Zealand: How does it work?

Buy *VEEV* device
Age is verified at purchase

→ **Create adult user account**

→ **Verify adult user age** via third-party age-verification provider

→ **Activate *VEEV* device** via one of PMI's digital solutions

→ **VAPE**

Note: This is one process for age-verification technology; a range of options may be considered in the future.

Responsible marketing and sales practices continued

An *IQOS* "shop-in-shop" store in Tokyo, Japan

Next steps

As described, PMI has a robust infrastructure for monitoring compliance with our Principles and Practices.

In May 2021, we introduced two new Marketing Codes and implementation guidelines and will implement with a full training program for all PMI employees directly involved in developing or deploying consumer-focused product, packaging, marketing, and sales initiatives, as well as all third parties engaged by PMI to conduct those activities. We will roll out the Marketing Codes and implementation guidelines during 2021 to allow the organization to embed the principles in the Codes into PMI's sales and marketing practices. We are planning to publish the two Codes externally in 2022.

As a leading manufacturer of tobacco and nicotine products, we have a critical role to play in guarding against youth access to our products. This is a role we take seriously. We will continue to deploy measures to age-verify consumers through channels ranging from PMI owned and operated e-commerce platforms and boutiques to third-party online marketplaces and retailers. While the level of control we have over these channels varies, it is critically important that, even where our influence is limited, we use our best efforts to guard against youth access to our products.

We remain committed to implementing our YAP programs, including new communication and education materials, with trade partners.

We will continue to investigate ways to further enhance our age-verification technology, aiming to equip all the electronic smoke-free devices we introduce on the market as of 2023 with such technology.

2020 performance highlights

See our performance metrics ❯

28,569
training sessions conducted on PMI's Marketing Code

■ 36% third parties
■ 64% employees

>94%
Of our total shipment volume represented by markets with youth access prevention programs in place in 2020

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TIER 1

Sustainable supply chain management

With increasingly integrated and globalized value chains, balancing the security of our supplies with cost-efficiency and ambitious environmental, social, and quality standards is a major priority. Our supply chain accounts for a significant portion of our potential social and environmental risks and impacts, which we are committed to managing and addressing responsibly. It is also a challenging aspect to tackle, as we need to engage and influence a large number of suppliers—companies with different strategies, priorities, and cultures—to onboard them on our sustainability journey and to jointly commit and deliver on our ambitions.

A tobacco farmworker in Salta, Argentina

The right thing to do

Our supply chain is central to our business, and sustainability is essential to protecting and developing our supply chain. Our operations rely on securing high-quality, cost-effective, and fit-for-use materials and services from suppliers that are selected and managed by PMI to also adhere to our environmental, social, and governance (ESG) requirements.

We strongly believe that PMI has an important role in engaging with our suppliers to minimize our social and environmental footprint and in bringing positive social, environmental, and economic value to those with whom we collaborate.

Sustainable supply chain management plays a vital role in safeguarding human rights, and labor rights, as well as protecting the health and safety of workers. Optimally, it also serves to resolve gender-related inequalities and inequities, and alleviate poverty. Moreover, it represents a key lever in mitigating the adverse impacts of climate change, reducing greenhouse gas emissions, protecting forests and biodiversity, and promoting energy efficiency, water stewardship, and waste management.

The business case

The increasing environmental, social, and economic impacts of global supply chains and the growing consumer expectations for greater sustainability and transparency led PMI to integrate sustainability in our end-to-end supply chain management. This shift is reflected by an understanding that a sustainable supply chain brings new and significant value creation opportunities while at the same time contributing to the greater good. Besides that, traditional objectives, including cost optimization, ensuring continuity of our operations, and reducing time required for preparing the materials for transportation, allow better reaction to business challenges. In addition to strengthening regulatory compliance and preventing reputational risks, responsible supply chain management supports our ability to secure the resources needed to deliver on our company purpose and make tangible positive contributions to environmental and social issues. Agile, reliable, and high-quality suppliers are also critical to our ability to innovate and deploy our smoke-free products rapidly at scale, and respond to consumer feedback, which in turn allows us to acquire more adult nicotine users, grow market share, and benefit from the growth in top- and bottom-line performance that this implies. Further, improving collaboration with our suppliers and our knowledge of their operations enables us to strengthen and broaden partnerships. Such partnerships are key to sustainability, innovation, and growth, allowing us to accelerate progress toward achieving our company targets.

Our aim

100%
Percentage of critical suppliers from whom PMI sources sustainably by 2025

Sustainable supply chain management continued

Achieving our aims

We aim to purchase goods and services from suppliers at best value, commensurate with business requirements, while appropriately managing supply, financial, legal, quality, and sustainability requirements. We seek to continuously identify and address potential and current risks while also seizing opportunities to create a positive impact in the communities in which we and our suppliers operate, thereby increasing the sustainability performance of our supply chain. We work with our suppliers and contracted farmers to achieve a solid economic performance and tangible environmental and social improvements.

Our approach to sustainable supply chain management is built on the following principles and values:

- *Proactive engagement:* Engagement is at the core of responsible sourcing at PMI. Successful partnerships require an open and transparent relationship and ongoing communication in which expertise is shared and built together, both in one-to-one activities and through participation in relevant multistakeholder and industry initiatives.

- *Risk mitigation*: We take a risk-based approach, focusing our efforts on where they can have the greatest impact. Establishing risk-based criteria enables us to identify critical suppliers, tailor our due diligence tools and actions, and target interventions to address inherent risks, with a special focus on strategic supply chains, such as electronics and tobacco leaf.

- *Continuous improvement:* By proactively strengthening collaboration and engagement with our suppliers, we clearly achieve greater commitment and support from our suppliers to continuously improve their sustainability performance and achieve the highest standards of compliance.

- *Programs with impact:* We leverage our reach and increasing understanding of our supply base to implement impactful programs in our key sustainability focus areas, such as those pertaining to our carbon neutrality, zero deforestation, and zero child labor ambitions.
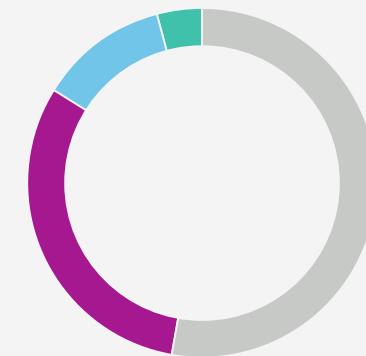
Tobacco bales being loaded at a tobacco buying station in Misiones, Argentina

Overview of our supply chain in 2020

With over 28,000 tier 1 suppliers across more than 175 markets, our supply chain spend amounted to approximately USD 10.1 billion in 2020.

Our global supply chain is supporting our two main finished product streams and it is organized in seven categories managed by our Leaf (for tobacco) and Procurement (for the other six categories) organizations.

Supply chain spend in 2020

⬜	Indirect materials and services (including R&D)	53%
🟪	Direct materials and smoke-free product devices	31%
🟦	Tobacco leaf	12%
🟩	Manufacturing equipment	4%

Manufacturing facility of Papastratos, PMI's Greek affiliate

Sustainable supply chain management continued

We aim to source sustainably from all our critical suppliers by 2025. Critical suppliers are those that manufacture or sell components used in the manufacture of PMI finished products.

To meet our ambition of sourcing sustainably by 2025, we will require all our critical non-tobacco tier 1 suppliers to undergo an evaluation of their sustainability performance through an assessment in our due diligence STEP (Sustainable Transformation Enables Performance) platform. Those that achieve a satisfactory score demonstrating compliance with PMI's **Responsible Sourcing Principles** (RSP) will be considered sustainable. In addition, we consider all tobacco farmers contracted by PMI or by our tobacco suppliers critical. Sourcing sustainably means continued contractual commitment to PMI's RSP and **Good Agricultural Practices** (GAP) by all our tobacco suppliers and monitoring of their adherence to GAP through yearly self-assessments—complemented with on-site audits and on-the-ground reviews. At the farm level, sustainable sourcing requires monitoring by field technicians of GAP implementation, through both planned and unannounced visits to all contracted farms several times a year, and addressing any issue raised. Noncompliance can lead to contract termination for **Agricultural Labor Practices** (ALP) violation, or supplier lot rejection if exceeding maximum limits for tobacco lot integrity.

PMI's supplier due diligence platform: STEP

STEP is the due diligence and performance program we use to ensure suppliers comply with our RSP. It serves as the backbone for sustainably managing our critical tier 1 suppliers and selectively extends to tier 2 suppliers as well. Through STEP, our suppliers' potential ESG risks are evaluated based on the type of material or service supplied and the country in which it is produced or delivered.

Within the frame of STEP, we segment suppliers on a range of risks using indicators from international bodies such as the World Bank, United Nations Development Programme, and Inequality-adjusted Human Development Index.

This inherent-risk profile tailors the subsequent evaluation of suppliers' performance. Suppliers identified as low risk are required to complete a basic self-assessment questionnaire, while those characterized as medium or high risk complete a

more detailed questionnaire. In addition, high-risk suppliers undergo a desktop audit. Depending on the results of the questionnaire—and, as applicable, of the desktop audit—the suppliers may be required to undergo an on-site audit.

The STEP platform is underpinned by an external responsible-sourcing audit protocol developed by Achilles, a key player in sustainability supplier evaluation.

Screen risk → Assess suppliers → Supplier performance / Supply chain risks → Corrective action plan / Supplier audits

Sustainable supply chain management continued

Our supply chain sustainability strategy is grounded in our **Responsible Sourcing Principles** (RSP), which align with the UN Guiding Principles on Business and Human Rights, the Ten Principles of the UN Global Compact, and the International Labour Organization (ILO) Conventions. The RSP, together with its corresponding **Implementation Guidance**, set process and performance standards for our suppliers of materials and services, from the direct materials used in the manufacturing of our products, to the goods and services required to run our business.

Sustainability work in our tobacco supply chain is managed by our Leaf department and governed by our **Good Agricultural Practices** (GAP) and our **Agricultural Labor Practices** (ALP) Code.

The operationalization of GAP and ALP occurs at farm level via the 2,675 field technicians, who work year-round with the farmers contracted by PMI and our suppliers.

Adherence to our RSP—and GAP for our tobacco supply chain—is part of our contractual agreements with suppliers. On an ongoing basis, we monitor the activities of our critical suppliers through a suite of tools, including third-party assessments, on-site audits, and field visits.

Sustainable sourcing of goods and services goes beyond the work of our Procurement and Leaf teams and involves strong cross-functional collaboration within PMI.

Globally, our supply chain categories exposed to the highest sustainability risk are:

- Tobacco production across Asia, Africa, and South America, with main risks pertaining to working conditions, child labor, climate change, and access to water
- Electronics manufacturing, with the main risks relating to the working conditions of workers
- Wood and paper materials, with main risks linked to deforestation

Our supply chain sustainability strategy is grounded in our Responsible Sourcing Principles

A tobacco buying station in Misiones, Argentina

Sustainable supply chain management continued

Progress in 2020

Impact of COVID-19 on our activities in 2020

Monitoring the sustainability performance of our critical suppliers

We started onboarding our critical non-tobacco suppliers to our due diligence STEP platform in 2019, focusing first on our direct materials and electronics supply chains. In 2020, we exceeded our target of assessing suppliers representing 90 percent of our spend in those categories.

By the end of the year, 113 critical tier 1 suppliers, representing 95 percent of our critical supplier spend on the direct materials and electronics categories, completed self-assessments. Of them, 45 percent were shown to be compliant with PMI's RSP, while for 17 percent, the self-assessment triggered targeted follow-up actions. The assessments revealed significant gaps for the remaining 38 percent of suppliers, mainly related to resource consumption and waste minimization, freedom of association, and risk of child labor. In a number of cases, desktop audits were undertaken—as on-site audits were not possible due to the COVID-19 pandemic.

In 2020, we completed 29 desktop audits: 93 percent of suppliers increased their performance compared with the results of their self-assessment. This indicates that the guidance provided by auditors at the time of the desktop audits improves the quality and completeness of the answers provided by respondents to our STEP questionnaire. Overall, 86 percent of the suppliers that underwent the desktop audit demonstrated compliance with our RSP, while 14 percent reported significant gaps.

In parallel, we started onboarding non-tobacco suppliers in other supply chain categories. In total, suppliers representing more than 15 percent of our spend on technical procurement, R&D expenditure, and indirect materials and services completed our due diligence process by the end of the year. In 2020, we also onboarded to our STEP program tier 2 suppliers with whom PMI manages a commercial relationship and holds an agreement. We covered 100 percent of the tier 2 suppliers of our board and paper direct suppliers and 92 percent of the tier 2 suppliers of electronic components (such as batteries and blades) of our electronic manufacturing suppliers.

During the year, to address our evolving needs and reflect market developments, we embarked on a reassessment of our STEP platform. We benchmarked our solution with the broader due diligence market, with the aim of leveraging state-of-the-art digital solutions aligned with best practices and standards and allowing for advanced reporting capabilities. Further, we considered how to optimize efforts for both our company and our suppliers through a collaboration-promoting tool that enables us to share assessments across companies and industries. We concluded that our current platform did not provide the functionalities and capabilities required to advance our due diligence program to the next level, and plan to start the implementation of a new solution in 2021. Our analysis also highlighted the opportunity to enhance our approach by focusing the management of online evaluations and on-site audits through different service providers. With regard to on-site audits, we plan to select and partner with several specialized providers in 2021.

Fostering collaboration with our network of suppliers

We dedicated **a section of PMI.com** to describing our company, goals, and purpose with regard to our current and potential suppliers. It also details how Procurement is organized within PMI, reinforces the expectations we have toward our suppliers regarding our RSP, and discloses some of the guidelines and general terms and conditions we build our partnerships on.

To increase awareness of sustainability in our supply chain, we held virtual events, webcasts, and training sessions with strategic suppliers globally in 2020. These events covered both general and specific topics, from supplier onboarding to STEP to partnering on our **Zero Deforestation Manifesto** and carbon footprint reduction targets. For instance, we organized two CDP training sessions for our electronics suppliers, one in English and one in Mandarin, with over 100 participants. Such activities reinforce our expectations and commitments, promote the exchange of expertise and best practices, and identify potential areas for closer collaboration.

Our suppliers play a major role in our transformation journey. Therefore, we consider it fundamental to recognize our suppliers' excellent performance and contribution to PMI's business goals, fostering long-term partnerships and value creation. To this end, in 2020 we launched our Global Supplier Recognition program. We recognized selected suppliers for their sustainability commitment and performance, active contribution to PMI's value creation, and engagement in innovation. In a virtual ceremony attended by around 400 participants, five of our suppliers were awarded in the areas of sustainability, innovation, and value creation.

For the fourth consecutive year, in 2020 CDP placed PMI on the CDP Supplier Engagement Leaderboard in recognition of our efforts and progress on our supplier engagement on climate change. PMI's Supplier Engagement Rating (SER) positions us in the top 7 percent of companies that disclosed for CDP's full climate questionnaire. By engaging our suppliers on climate change, we aim to contribute to their transition toward the net-zero sustainable economy.

"Developing long-term effective relationships across our supply chains is most critical to success, as close collaboration and ongoing engagement with our suppliers are essential to realize the ambitious sustainability objectives we set forth."

Cesare Guarini, PMI Director, Sustainability Procurement

Sustainable supply chain management continued

Focus on our electronics supply chain

As our company continues to transform and build new capabilities, we simultaneously look at risks inherent in specific supply chains; a key area of focus is our relatively new and expanding electronic manufacturing supply base in Asia.

As our supply base widens, we strengthen our selection and onboarding process of electronic suppliers involved in the manufacture of our smoke-free devices. For new suppliers, we collect information on their practices, ask them to complete a self-assessment questionnaire, and provide a third-party audit report and an update on any corrective actions taken as a result. We then hold an on-site management review before entering into a contractual agreement in which we include sustainability clauses and required adherence and compliance with our RSP. We then integrate the supplier into our STEP platform and due diligence program.

Our tier 1 electronics suppliers were assessed through our STEP platform in 2020 and demonstrated excellent performance by reporting practices in line with PMI standards. No follow-up action in any sustainability area was necessary from this assessment. On top of our due diligence through STEP, we monitored manufacturers' performance via sustainability scorecards and key performance indicators. We revamped our criteria in 2020 to focus on inherent risks such as working hours and labor rights, environmental performance, supply chain management, and overall sustainability and business integrity.

To ensure our upstream supply chain fulfills our RSP, we also onboarded and completed the STEP assessment of a total of 35 tier 2 electronics suppliers, representing over 92 percent of the spend managed by PMI with such suppliers. We conducted desktop audits on those suppliers for which the STEP assessment had revealed gaps.

The audits showed improvements related to main gaps identified, such as in the provision of personal protective equipment or emergency preparedness.

In our engagement and communication with electronics suppliers, PMI maintains a clear focus on our RSP. Beyond checking systems and monitoring progress, we aim to build capability and promote progress in the areas of human and labor rights, environmental impact, and business integrity.

Participation in multistakeholder initiatives

The electronics supply chain is complex and very dynamic, and it faces specific challenges.

Therefore, we engage with different stakeholders to better understand inherent risks, increase traceability of the materials used in our products, and assess how we can enhance responsible sourcing practices through collaboration. To this end, we participate in several initiatives, including the Responsible Business Alliance (RBA) Foundation's Responsible Minerals Initiative (RMI), and continued our work on the RBA Foundation's Responsible Workplace Program.

In addition, during 2020 we further enhanced our collaboration with industry initiatives and notably the RBA, the world's largest industry coalition dedicated to corporate social responsibility in the electronics global supply chains. We were pleased to join the RBA as an Affiliate Member in early 2021, underscoring our ongoing commitment to sustainable sourcing in electronics, as this membership will help PMI to step-change the quality and impact of our supplier sustainability program in our electronics supply base.

In 2020, we also worked with the CDP to promote the Science-Based Target initiative (SBTi) to our electronic suppliers. Furthermore, we continued to involve additional workers in the women's empowerment program we launched in 2019 in partnership with Inno, a Chinese nongovernmental organization (NGO), supported by external funding.

Conflict minerals

Companies are expected to demonstrate how they respect human rights and avoid contributing to conflict in their mineral-purchasing decisions and practices. This applies particularly to the potential adverse impacts associated with sourcing tin, tantalum, tungsten, and gold ("3TGs") from conflict-affected and high-risk areas of the world. Our **2020 conflict minerals submission** to the U.S. Securities and Exchange Commission, covering the year ended December 31, 2019, showed that the smelters from which our suppliers source 3TGs for our Covered Products (as defined in the submission) are either compliant with the Responsible Minerals Initiative audit program (265 smelters) or were going through the assessment process (two smelters).

Cobalt

Cobalt is a critical raw material in the production of the batteries used in our smoke-free products. While the quantities of cobalt required for our products are minor compared with the total global market size, since 2019 we have been deploying a due diligence program based on the RMI approach and tools to identify and address potential human rights risks in the supply chains of our suppliers. In 2020, all our battery suppliers fulfilled specific reporting requirements, including information on the smelters from which they source. On that basis, subsequent due diligence deploying additional RMI tools indicated that, as of December 31, 2020, all the smelters from which PMI battery suppliers source cobalt were on either RMI's conformant (seven smelters) or active list (eight smelters).

IQOS device manufacturing in Asia (pre COVID-19 photography)

Sustainable supply chain management continued

PMI's Good Agricultural Practices program

PMI defines sustainable tobacco production as the efficient and competitive production of quality tobacco in conditions that limit as much as possible the impact on the natural environment and improve the socioeconomic condition of the people and communities involved in its production.

In our tobacco supply chain, production is managed in accordance with our **Good Agricultural Practices** (GAP). GAP was first introduced in 2002. Since then, it has been updated and improved to reflect feedback received from farmers, suppliers, and stakeholders and to keep up with ever more demanding expectations and technological developments. PMI has initiated major revisions of GAP, introducing the **Agricultural Labor Practices (ALP) Code** in 2011 and **ALP Step Change** in 2018.

GAP defines the principles and measurable standards to be met by all those who grow and supply tobacco to PMI. The principles guide suppliers and farmers toward sustainable production. We use measurable standards to measure how well the practices on the farms or at the suppliers are aligned with our principles. These principles and standards are organized around four focus areas:

- **Governance:** PMI expects suppliers to have in place the necessary governance, procedures, and processes to manage contracts, field technicians, visits, and training.

- **Crop:** The crop must meet specific criteria on quality, style, integrity, and regulatory compliance. GAP also demands that the crop is grown with the appropriate seed variety, with the correct plant nutrition, and using effective integrated pest management practices to minimize the use of crop protection agents while improving yield. Mechanization practices are also promoted.

- **Environment:** Tobacco farmers are encouraged to preserve, reuse, and recycle the natural resources used in tobacco production, including wood, water and fuel.
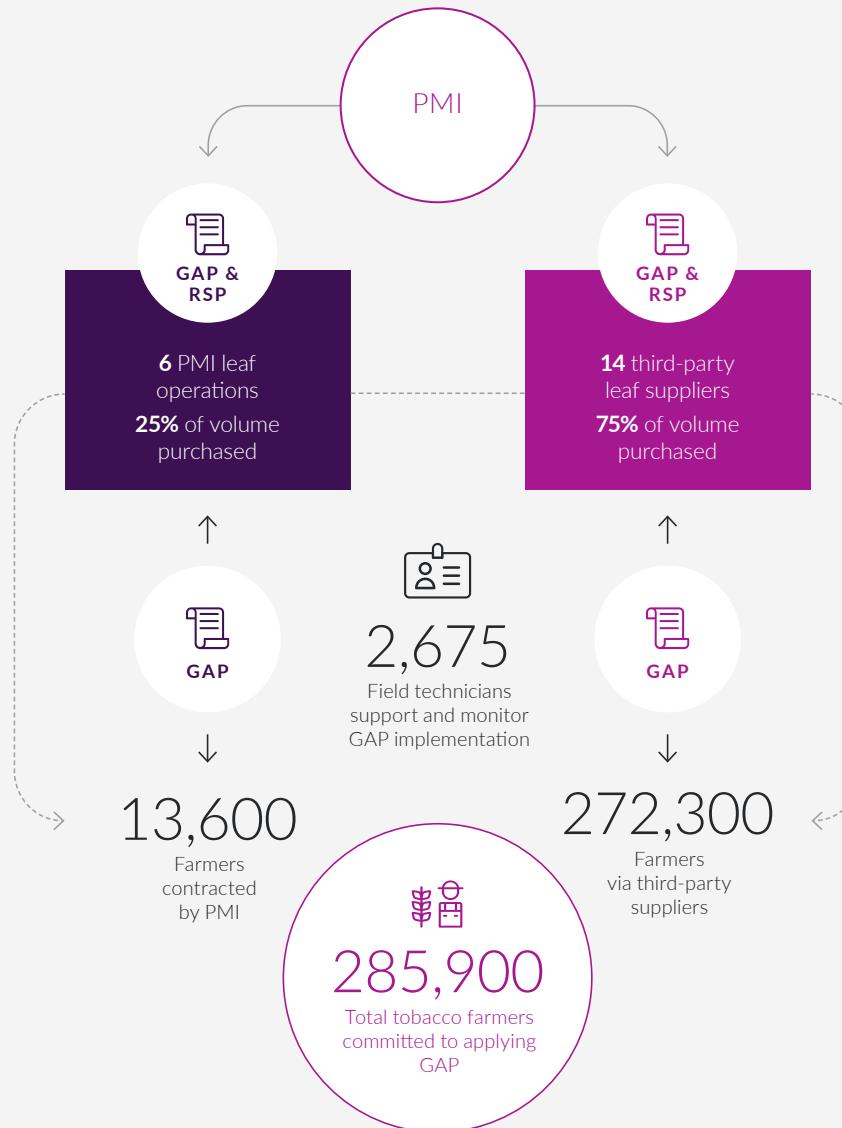
Overview of our tobacco supply chain in 2020

In 2020, we sourced tobacco from 285,900 farmers we either directly contracted through our Leaf operations in six countries or who were contracted by our 14 third-party suppliers. In both instances, our GAP standards and related monitoring and remediation system apply at farm level. Our third-party leaf suppliers are required to adhere to PMI's RSP and GAP.

During the year, we sourced 281,000 tons of packed tobacco grown across 23 countries, with most of our volume coming from Argentina, Brazil, and Indonesia.

While the profile of each contracted farmer varies significantly between geographies, most of our supply base consists of smallholder farmers cultivating less than two hectares of tobacco in rural areas with limited access to basic infrastructure. Under our program to ensure contracted farmers earn a living income, we aim to help them improve productivity, which can imply increasing the average surface of tobacco grown per farmer.

ⓘ Read more: Socioeconomic well-being of tobacco-farming communities

PMI

GAP & RSP

6 PMI leaf operations
25% of volume purchased

GAP & RSP

14 third-party leaf suppliers
75% of volume purchased

GAP

GAP

2,675
Field technicians support and monitor GAP implementation

13,600
Farmers contracted by PMI

272,300
Farmers via third-party suppliers

285,900
Total tobacco farmers committed to applying GAP

Sustainable supply chain management continued

- **People:** PMI is committed to eliminating child labor and other labor abuses on all farms from which we source tobacco. Our **ALP Code** guides our work in this regard.

GAP is mandatory for all suppliers of tobacco to PMI, as is reflected in the supply contracts of PMI and its affiliates. PMI expects all its suppliers to continuously improve the implementation of GAP principles and standards in coordination with the farmers from whom they purchase. The absence of a clear commitment to act on issues identified, or a persistent lack of action and improvement, can lead to contractual implications for both farmers and suppliers. PMI also reserves the right to terminate contracts immediately in cases of severe violations impacting people, the crop, or the environment.

A field technician and a tobacco farmworker in Indonesia

Monitoring GAP implementation

To a large extent, responsible sourcing is achieved when relationships on the ground are strong. PMI's Integrated Production System (IPS) connects leaf suppliers and farmers beyond the customary boundaries of a commercial relationship and enables direct technical support, agronomic advice, financial loans, and various other services. This direct contractual relationship between PMI and our leaf suppliers and farmers without intermediaries is especially important when conditions are uncertain, as was demonstrated in 2020 during the COVID-19 pandemic. IPS—which covered 99 percent of our tobacco purchases in 2020—brought financial security to our farmers by ensuring them a guarantee of purchase for the contracted volume.

IPS is vital in providing traceability and visibility in our supply base; it enables the deployment of our GAP monitoring system down to the farm level. At the center of our system are field technicians.

Field technicians are men and women who support GAP implementation and monitor how well sustainability requirements are applied and commercial processes are working. Some 2,675 field technicians—132 employed by PMI and 2,543 by our third-party suppliers—implement GAP among the 285,900 farmers from whom we source tobacco, across 23 countries worldwide. Concurrently, they provide agronomical assistance, deliver training to farmers, identify and address labor issues, and ensure implementation of improvement plans. Field technicians facilitate progress on the ground by building relationships with the farmers and usually visiting each farm on average five to ten times during the growing season. The trust they garner is crucial to the effective implementation and monitoring of GAP and ALP; it is often their pragmatic and sensitive interventions that overcome the barriers facing a program of responsible sourcing.

In 2020, despite the COVID-19 pandemic, field technicians allowed us to monitor the implementation of GAP on all contracted farms. In a few countries facing stringent confinement measures during the crop season, farm visits were adapted and remote support was offered when needed, always respecting the governmental measures and restrictions.

For instance, in Pakistan the local team collaborated with an external IT partner to create an automated platform communicating messages to over 6,000 farmers and workers. These messages, focused on both the ALP Code and COVID-19 prevention, have been distributed despite existing infrastructural constraints due to, sometimes, poor internet connection. In addition, this platform also spread awareness to the workers about independent grievance mechanism channels where they can confidentially report potential complaints.

Overview

Innovating for
better products

Operating
with excellence

Caring for the
people we work with

Protecting the
environment

Performance
metrics

Sustainable supply chain management continued

Industry-wide Sustainable Tobacco Program

In parallel to our GAP program, and as an additional way to evaluate supplier performance, we have been participating since 2016 in the industry-wide Sustainable Tobacco Program (STP). The program is administered by a third-party service provider and has been adopted by all major global tobacco manufacturers and their leaf suppliers. The objective of STP is to assess suppliers' performance more consistently to drive continuous improvement in addressing systemic issues across the global tobacco leaf supply chain. At PMI, STP applies to our tier 1 suppliers, including our third-party leaf suppliers, as well as our own leaf operations. All of our sourcing origins were formally reviewed and visited between 2016 and 2018 (including on-the-ground visits to a sample of tobacco farms and a comprehensive review of suppliers'

policies, procedures, and practices by a third-party specialist in supply chain management).

In 2019 and 2020, the industry—with seven major manufacturers involved—focused on the development of a new STP standard. Following an in-depth review, the due diligence process was revised to center on five steps (identify, prioritize, respond, measure, and report) applied to eight themes and 25 topics. The development team referred for the guidance to the most relevant reference frameworks such as the UN Guiding Principles on Business and Human Rights, ILO conventions, OECD-FAO Guidance on Sustainable Agricultural Supply Chains, 1.5 Playbook, Setting Site Water Targets, and CORESTA guidance documents to name a few.

The revamped program aims to foster a risk-based, impact-focused approach promoting continuous improvement and multistakeholder cooperation.

A field technician during a tobacco farm visit in Malawi

The eight themes of the Sustainable Tobacco Program 2.0

LIVELIHOODS
Basic needs
Living income

GOVERNANCE
General information

CLIMATE CHANGE
Targets
Adaptation
Resilience

CROP
CPA residues
Highly hazardous pesticides (HHPs)
Integrated pest management (IPM)
Integrity
Traceability

HUMAN AND LABOR RIGHTS
Child labor
Fair treatment
Modern slavery
Freedom of association
Income, working hours and benefits
Safe working environment
Other impacts

WATER STEWARDSHIP
Quantity
Water, sanitation, and hygiene (WASH)
Quality

SOIL HEALTH
Productivity
Degradation

NATURAL HABITAT
Biodiversity
Forestation

Sustainable supply chain management continued

At PMI, we also support efforts of the STP program to promote transparent communication of responsible practices across the tobacco supply chain.

2020 marked the first year of implementation of the revamped STP self-assessment questionnaires. During the year, our suppliers demonstrated high levels of engagement and all except one completed the questionnaires. In total, those covered 98 percent of our tobacco supply chain (i.e., 49 questionnaires completed, defined by supplier, origin, and tobacco type).

Under this STP 2.0, suppliers' self-assessments will be guided by a risk assessment and trigger an adapted action plan centered on the eight themes listed above. A secretariat has just been selected in 2021 and will be responsible for reviewing the action plans and monitoring the implementation of the agreed improvements. Independent third-party assessors will review progress by means of an in-depth, on-the-ground assessment in the priority markets determined by the risk-based approach. We plan to pilot this new in-depth assessment concept in 2021 and target a full rollout of the new program by the end of 2021. We will communicate on progress in our next report.

Next steps

In 2021, we plan to further enhance our sustainability programs in the supply chain.

We plan to transition our STEP due diligence platform, partnering with a leading service provider. Through this, we will be able to access and leverage the provider's state-of-the-art digital platform and tools, and existing very large supplier base, while continuing to expand our STEP program across different spend categories in our supply chain.

We also expect to onboard PMI and our electronics suppliers to the RBA initiatives through the deployment of the coalition's approaches, tools, and capability-building activities.

We will extend the deployment of the PMI RSP sustainability clause in suppliers' commercial agreements, while also continuing to organize and deliver capability-building activities, both internally and with our suppliers.

We will explore opportunities to extend grievance mechanisms for workers in our supply chain, focusing first on electronics suppliers, while continuing to strengthen our programs in cobalt and conflict minerals.

In our tobacco supply chain, we will roll out the STP 2.0 program with the first in-depth assessments on the ground and will evaluate inviting global tobacco leaf suppliers to our STEP program.

2020 performance highlights

See our performance metrics ＞

33%
Proportion of direct supply chain spend related to smoke-free products

95%
Of our non-tobacco critical suppliers spend assessed in PMI's supplier due diligence platform

99%
Of tobacco purchased through direct contracts by PMI and PMI tobacco suppliers

Pilot with Produzindo Certo in Brazil

In 2020, our affiliate in Brazil (PMB) partnered with Produzindo Certo, a local company specialized in agribusiness socio-environmental management, to pilot a project aimed at improving farming efficiency and promoting effective use of natural and human resources. We felt the need to specialize further our PMB field technicians in sustainability to better support our integrated farmers to make more impact and to reach ambitious sustainability targets in Brazil. The pilot was carried out with the participation of 123 farmers.

To execute the program, PMB divided the field technicians into two groups: "production field technicians," who continued to support all aspects related to GAP implementation, improvements in productivity, quality, and product integrity; and the "sustainability field technicians," who focused exclusively on the environmental and social aspects.

The sustainability technicians were trained by Produzindo Certo to evaluate the farmer practices, with regard to water quality, soil erosion, native vegetation, and work safety, among other aspects. To do this, they relied on the Produzindo Certo platform, which offers all the resources and indicators necessary for diagnosing and improving farming practices from a socio-environmental standpoint. Each farm assessment highlighted both areas of strengths and areas for improvement and resulted in an individual "sustainability scorecard" broken down for social, environmental, and production aspects. Action plans were then established, tailored to each farm.

Farmers could commit on a voluntary basis to implement the action plan designed specifically for their farm and see their score improving over time as they progress.

The pilot proved valuable to gain insights into improvement areas and generated a very high acceptance level among farmers. The strength of the program comes from the independent third-party assessment conducted by specialized teams, defining action plans in agreement with the growers and monitoring progress over time. PMB already plans to extend this program to all its contracted farmers (around 5,300 in total) by 2022 and considers opening the initiative to tobacco suppliers and to service providers in the supply chain.

Respect for human rights

Respect for human rights must be embedded in the corporate culture, allowing human rights principles to shape the way we work and guide interactions with employees, suppliers, business partners, consumers, and the communities in which we operate.

The right thing to do

The United Nations Guiding Principles on Business and Human Rights (UNGPs), as well as academia, recognize that businesses now operate under an expanding web of liability that results from the rise of cross-border human rights legislation.

From a societal standpoint, human rights are inherent in the dignity of human life and are a prerequisite for any society to prosper. As a global company, we can have a significant impact on protecting and promoting the rights of our stakeholders, and we expect and require the same behavior of our business partners, including our suppliers.

The business case

At PMI, respecting human rights is fundamental to sound risk management and value creation. It is not only the right thing to do—there is also a strong business case: Fostering and promoting the continuous integration of human rights considerations in our strategy and operations allows us to minimize legal and financial risks, as well as prevent the risk of supply chain disruption. A company's overall reputation is based on its acts and the trust it garners around how those acts are perceived by stakeholders. Moreover, potential exclusion from public procurement, as well as exposure to human rights related litigation, may affect us negatively. The risk is particularly important for multinational companies like ours, operating across the world. Safeguarding and promoting human rights within our value chain creates the basic environment and conditions for our stakeholders, including our employees, to thrive and create value. Combined with a positive, inclusive culture and sound management, this provides the space and opportunity to fulfill our key business enablers of innovation, collaboration, continuous improvement, and execution.

Employees in PMI's manufacturing facility in St. Petersburg, Russia

Our aim

10

Highest-risk countries covered by external human rights impact assessments and findings addressed by 2025

Respect for human rights continued

Achieving our aims

We aim to address our adverse impacts and maximize our opportunities to drive positive change for people across our value chain. While this can be challenging given the scope and complexity of the issues and the breadth of our operations, we believe that human rights are an absolute and universal requirement—a requirement we are committed to upholding.

We aim to continuously improve our practices with respect to identifying and addressing risks and impacts to "rights-holders" across our operations and supply chain, including by securing our supply of raw materials responsibly.

"As we progress toward our vision of a smoke-free future, the realm of our human rights work is expanding into new sectors and activities. The broadened scope of our work— within the electronics industry, for instance—represents an opportunity to identify and tackle human rights issues from the start. We continually refine our approach to ensure real, positive impact for rights-holders."

Anna Kletsidou, PMI Head of Social Sustainability & Human Rights

Our work, which is governed by **PMI's Commitment to Human Rights**, is managed by a cross-functional team and delivered through extensive internal engagement and training, externally conducted human rights impact assessments (HRIAs), consultation with experts, and partnership projects with peers. Tackling human rights abuses requires a collaborative effort involving suppliers, governments, NGOs, and other stakeholders.

PMI's efforts—and the underlying methods—have been highlighted in a **case study** published early 2021 by Shift, the leading center of expertise on the UN Guiding Principles on Business and Human Rights. According to Shift, building good relationships with affected stakeholders, communities, and consumers is a prerequisite for doing business with respect for human rights. Over the past three years, Shift has engaged with companies and organizations that have been piloting ways to measure the quality of their relationships with stakeholders. As a result, the center developed a case study on PMI's work to prevent child labor and other labor issues in its tobacco supply chain by applying a series of participatory methodologies.

In addition, PMI's ongoing efforts to eliminate child labor on tobacco farming have been recognized by the World Business Council for Sustainable Development (WBCSD), which included the company as a "sector leader" **case study** in its toolkit on advancing human rights policy and practice in the agribusiness sector issued in November 2020.

In 2020, our efforts to respect and promote human rights were recognized by the Dow Jones Sustainability Index (DJSI), as we achieved the industry-best score for this criterion of its corporate sustainability assessment.

The **Human Rights Roadmap** we developed in 2018 guided us in establishing strong foundations and further integrating the promotion and protection of human rights into our policies, processes, and practices as we committed to a set of actions to be completed by the end of 2020. This report describes the progress made in the past year across our key areas of focus.

Our approach to respecting human rights

Employees in the manufacturing facility of Papastratos, PMI's Greek affiliate

Respect for human rights continued

Progress in 2020

Impact of COVID-19 on our activities in 2020

Implementing our Human Rights Commitment

PMI's **Human Rights Commitment** (HRC) is the cornerstone of our human rights strategy and commits us to managing our work in accordance with the United Nations Guiding Principles on Business and Human Rights (UNGPs). Our HRC requires us to avoid, mitigate, and remediate any human rights risks and impacts that may arise across our operations and value chain.

The implementation of our HRC is focused on establishing the right controls throughout our processes and practices. Human rights

considerations are included in our code of conduct (our **Guidebook for Success**) and its accompanying set of Principles and Practices (P&P), which apply to all PMI employees and reflect our core values of a culture of honesty, respect, and fairness. Those policies govern our day-to-day operations and enable us to implement and safeguard our HRC. Our P&P cover risk areas such as environment, health, safety and security, supply chain management, responsible marketing and sales, workplace and labor practices, privacy protection, and anti-bribery.

Early 2021, PMI also released internally an updated Marketing Code for combusted tobacco products, as well as a new, separate Marketing Code for non-combusted alternatives that codifies and elaborates the principles related to preventing youth access.

A complex global supply chain brings potential human rights risks that we need to understand, manage, and continuously address. Our RSP and GAP guide our work to safeguard human rights throughout our supply chain.

Raising awareness among employees

Embedding an ethos of respect for human rights in our corporate culture starts with awareness-raising and training.

In November last year, we launched a revamped e-learning to give our employees a practical understanding of human rights risks and the expectation for PMI's HRC to be embedded throughout our operations and value chain. We developed the training in collaboration with an external expert organization, and its various modules align with our most salient risks by covering child labor, forced labor, freedom of association, and environmental stewardship. The e-learning seeks to explain what human rights are, how they relate to both PMI and each employee, and the role of employees in helping safeguard them.

We made the e-learning available to all employees and have integrated it into existing learning frameworks of certain business functions, such as Operations and External Affairs. In some cases, it was rolled out as a mandatory requirement for priority teams, such as Security. By year-end, all Security employees had completed the e-learning.

"Respect for Human Rights is integral to our approach to security worldwide. We work to ensure our business practices reflect the values and principles adopted by PMI and the international community. Training and awareness among our own team is an ongoing priority in this journey, in addition to holding our key security provider partners accountable."

Richard Gould, PMI Head of Security and Market Safety

We also continued to provide targeted human rights training tailored to the regional and market teams within our Security function. We partner with the International Code of Conduct Association (ICoCA), a multistakeholder initiative formed in 2013 to ensure that providers of private security services respect human rights and humanitarian law. ICoCA delivered focused training sessions on human rights to all security regional and country heads. With this, in 2020 we covered 100 percent of our global security personnel (over 160 employees in total).

An employee in PMI's manufacturing facility in Guadalajara, Mexico

Respect for human rights continued

Human rights topics are also covered by other compliance training related to our **Guidebook for Success** and its accompanying set of P&P, such as our employment policy and our health, safety, and environment policies. They are also a key component of various corporate training programs, such as those to equip supervisors with appropriate management skills or to sensitize talent acquisition teams to discrimination.

With regard to our tobacco supply chain, we reviewed training materials and delivery methods of our ALP program in 2020. We began revamping our materials and developing a learning framework for ALP professionals and field technicians around the world, with guidance from our strategic partner Verité.

Identifying human rights risks and issues

Our due diligence process is embedded in our approach to risk management across our value chain. Human rights risks are incorporated into our overall integrated risk assessment, our compliance program, our supplier due diligence and evaluation processes, and our ALP monitoring and remediation system deployed on the tobacco farms contracted by PMI and our suppliers.

In complement, we periodically conduct human rights risk assessments to proactively identify and mitigate potential adverse human rights impacts across our value chain.

In 2020, we updated our global human rights risk assessment (saliency mapping) to account for the rapid pace of our business transformation and our evolving supply chain, as well as for external trends such as the COVID-19 pandemic and heightened concerns around diversity, equity, inclusion, equality, and racial justice. These updates focused on key groups of rights-holders who may be impacted by our activities: Consumers, employees and contractors, suppliers and supply chain workers, and communities. Our review broadly confirmed PMI's salient risks (before mitigation).

Salient risks include the reduction of products' health risk and, in the markets where our products are sold, risks related to the use of our products by youth. The review also highlighted risks related to health and safety, working hours and wages, and diversity, equality, and inclusion in our operations. Risks of child labor, forced labor, and freedom of association were mentioned as more relevant for our supply chain. Environmental risks resulting from our activities and supply chain footprint, as well as risks related to conflict minerals, were mentioned as potential risks for the communities where we operate. The visual on the right shows these risks and directs to the relevant sections within this report that explain how PMI mitigates the identified risks.

Human rights saliency mapping: Putting rights-holders at the center

Consumer

Reduction of products' health risk

ⓘ Read more here

Responsible marketing and commercialization

ⓘ Read more here

Employees and contractors

Workplace health and safety

ⓘ Read more here

Working hours and wages

ⓘ Read more here

Diversity, equality, and inclusion

ⓘ Read more here

Suppliers and supply chain workers

Child labor

ⓘ Read more here

Forced labor and modern slavery

ⓘ Read more here and here

Freedom of association and collective bargaining

ⓘ Read more here

Communities

Environmental stewardship

ⓘ Read more here

Conflict minerals

ⓘ Read more here

Access to grievance mechanisms

Respect for human rights continued

Conducting a human rights impact assessment in Russia remotely

Due to the extraordinary circumstances of the COVID-19 pandemic, we decided to conduct our assessment in Russia in a fully virtual format. We selected Russia for our significant manufacturing and *IQOS* retail operations in the country; corporate culture and digital expertise; and expected level of social risks. We collected lessons learned in Russia to improve virtual engagement in the future, if needed.

Read more online ⇗

An employee in PMI's manufacturing facility in St. Petersburg, Russia

Assessing human rights impacts

To strengthen our due diligence framework and proactively identify risks and mitigate potential adverse impacts in our operations and value chain, we aim to conduct human rights impact assessments (HRIAs) in the 10 highest-risk countries in which we operate by 2025. Our HRIAs are carried out by independent expert organizations. The list of high-risk countries is determined—and periodically reviewed—based on PMI's footprint (e.g., presence of manufacturing operations and type of supply chain) and the country's human rights risk profile, as determined by internationally recognized indicators such as the Heidelberg Conflict Barometer, the Freedom House Freedom of the World Index, and U.S. Trafficking in Persons Report and Transparency International.

These assessments follow a formal process and are conducted in accordance with the UNGPs. After each HRIA, the external expert organization presents its findings and suggests ways to address issues identified. The report is shared with the corresponding market leadership team, which develops a time-bound action plan in collaboration with the relevant corporate functions. The action plan assigns responsibilities for implementation and progress measurement at the local level. Learnings from an individual market HRIA are shared globally, where applicable.

We apply substantial focus to the depth and scope of each assessment and leverage learnings from each exercise to further strengthen our procedures. Following our pilot project in Mexico in 2018 and the 2019 exercise in the Philippines, we conducted HRIAs in Mozambique and in Russia in 2020, with different approaches. Findings reflect the unique range of human rights issues that arise in the context of any individual market.

Action plans: Monitoring implementation

We monitor action plans that have been developed following our previous HRIAs. The first layer of monitoring takes place at market level where cross-functional teams are responsible for the implementation of the established action plans. In addition to local checks, biannual status updates sessions with representatives from relevant central functions (mainly sustainability, operations, people & culture, and legal) are also taking place. Progress as well as delays and potential challenges are also discussed. Success is measured against the implementation of action plans. Actions can also lead to additional positive impacts beyond what was originally intended. One representative example is our work in Mexico where, within two years and as a result of our 2018 HRIA, we transformed our distribution model from being exclusively dependent on drivers, to mostly transporting our products by train. This change did not only manage to successfully address security concerns and the related safety issue raised due to excessive overtime but is also expected to contribute to significant financial and environmental benefits. Concretely, it is estimated to represent a reduction of 75 percent of security spend and 66 percent reduction of carbon emissions. More information on the 2018 pilot assessment in Mexico is available on **PMI.com.**

Following our HRIA in the Philippines in 2019, various actions have been undertaken to address concerns among sales teams—especially women—about risks to their personal safety, working hours, lack of compliance with legal age limits at small neighborhood stores, the wages of security and janitorial contractors, and the use of protective equipment by tobacco farmers and workers. Read more about it on **PMI.com**.

Assessing human rights impacts in our tobacco supply chain in Mozambique

Mozambique is an important tobacco sourcing market for our company, and a country that faces systemic social issues. In 2020, we collaborated with a peer company and our common suppliers to conduct a human rights impact assessment, focusing on impacts within the tobacco supply chain.

A farmworker in Mozambique

Read more online ⇗

Respect for human rights continued

Key learnings from our HRIAs

Each HRIA we have conducted to date has proven highly valuable. The structured methodology provides an important evaluation of how our Commitment to Human Rights and other policy instruments are implemented on the ground. The HRIAs have raised awareness among our organization on human rights at the country level and further developed employee competencies and skills to identify and address potential issues. They have shed light on local challenges and triggered targeted remediation interventions. In parallel, local learnings have allowed us to enhance our global understanding and tailor our management of human rights impacts accordingly. For instance, they informed the content of the e-learning we launched globally in 2020. The findings and learnings from the HRIAs were also considered in our global human rights saliency

mapping, which led to the establishment of PMI's 11 salient human rights risks (described above).

Human rights considerations are embedded in key business decision-making at PMI. For instance, findings from HRIAs in Mexico and the Philippines were key inputs into the decision to consolidate security service providers and develop standard human rights expectations for these providers, in partnership with ICoCA.

We acknowledge that we cannot analyze the complexities of human rights issues in every corner of our operations straightaway, but we use our learning to continually deepen our understanding and strengthen our processes. The journey to turn inherent risks into managed risks is ongoing, and we are encouraged by the progress made so far—for instance, in working toward alignment of working hours with ILO standards, providing above-average salaries, and maintaining our strong compliance and speaking-up culture.

"At the International Code of Conduct Association (ICoCA) we value the leadership role PMI are taking to institutionalize human rights due diligence throughout their private security supply chain. By partnering with ICoCA and requiring their private security providers be Members or Affiliates of the Association, PMI are paving the way for others to follow, showing how responsible private security procurement practices that respect human rights are good for business because it's good for the communities in which they operate."

Jamie Williamson, Executive Director, ICoCA

Assessing impacts in medium- and low-risk countries

To strengthen our due diligence framework, we worked with our consultant Article One in 2020 to develop a "self-service" HRIA process and toolkit that will enable our medium- and low-risk country affiliates to identify and address salient human rights risks in their markets. The toolkit will be available to these affiliates and will feature a set of self-service tools, embedded instructions, and additional resources that will allow local experts to conduct an HRIA for their market with external expert review and support.

Specifically, the HRIA toolkit will include:

- A human rights saliency mapping tool to identify and prioritize risks
- A gap analysis tool to assess existing mitigation measures
- A stakeholder mapping and prioritization tool
- Sample interview guides for internal and external engagement
- Potential sources for additional desktop research
- Assessment report templates
- Embedded instructions for each tool and process step

The toolkit aligns with the UNGPs and other key international human rights standards such as relevant ILO conventions. We plan to pilot it in three countries in 2021, incorporate and address insights and feedback from the pilot markets, and roll it out globally in 2022. In parallel, we will build the relevant governance to ensure support and appropriate consolidation of the countries' results.

An employee in PMI's office in Rome, Italy

Respect for human rights continued

Grievance mechanisms

Providing access to effective grievance mechanisms in our operations and across our supply chain is a key requirement of the UNGPs and a core element of our due diligence approach.

Internally, we maintain clear policies, run regular training, and work to ensure that robust processes are in place to encourage employees to speak up if things don't seem right or can be improved.

ⓘ Read more: **Business integrity**

The same applies to our supply chain, where we believe everyone should have a voice and be able to seek help. In our RSP, we specifically ask suppliers to provide their workers with easily accessible ways to raise concerns, free from risk of retaliation.

ⓘ Read more: **Sustainable supply chain management**

In our tobacco supply chain, our ALP Code states that "Workers should have access to a fair, transparent, and anonymous grievance mechanism." Such mechanisms are available in some countries where we source tobacco; and concerns can also be raised with field technicians at any time.

ⓘ Read more: **Socioeconomic well-being of tobacco-farming communities**

Next steps

The rollout of our key diagnostic tool—the HRIA—will continue in 2021. Depending on the restrictions due to COVID-19, we are assessing and will re-evaluate our options. We plan to conduct at least one HRIA in a select high-risk country, which should deliver in-depth analysis and robust action plan.

We will leverage learnings from our virtual assessment conducted in Russia in 2020 to potentially replicate the format should conditions require it.

We plan to pilot our HRIA self-assessment toolkit in three medium- or low-risk geographies in 2021 and gather insights to further inform our tools and processes before global rollout in 2022.

Our **Human Rights Roadmap** helped us establish strong foundations and a more structured approach in our work related to human rights. The maturity acquired so far helped us establish ambitious targets across all functions to be delivered by 2025. Although the focus will be to achieve these targets, we will continue listening to our stakeholders, learning from our current control mechanisms, reinforcing our due diligence and remediation processes, and staying up to speed with external and internal developments.

In this respect, we are currently conducting a human rights saliency mapping for our electronics supply chain to identify potential risks and address them proactively. We will share findings and actions in our next integrated report.

In addition to this focused assessment, we acknowledge that the climate crisis threatens livelihoods, in particular of the most vulnerable people around the world. Recognizing the importance of identifying synergies and integrating efforts to mitigate climate change and human rights impacts throughout our business activities, we decided to explore how the climate crisis and human rights relate to each other, and the role a company can play in addressing the interconnected challenges they present. We will publish this year a white paper analyzing this topic.
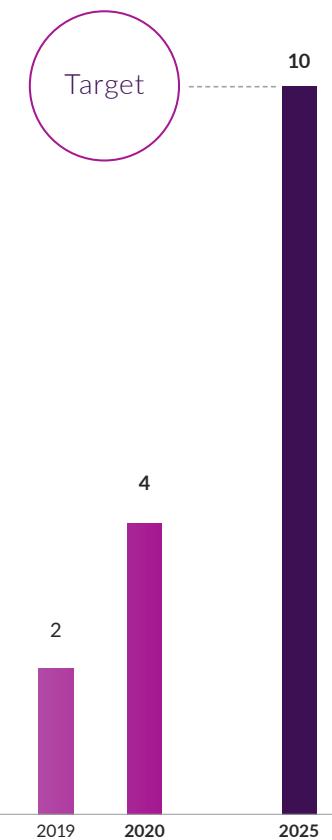
We will also continue raising awareness on the topic of human rights and further rolling out our e-learning across our organization.

Moreover, during 2021, we will continue to review and look for opportunities to further strengthen the grievance mechanisms that exist in our operations and value chain.

A field technician and a tobacco farmer in Pakistan

2020 performance highlights

See our performance metrics ›

Cumulative number of human rights impact assessments conducted

Target

2018	2019	2020	2025
1	2	4	10

Overview

Innovating for
better products

Operating
with excellence

Caring for the
people we work with

Protecting the
environment

Performance
metrics

TIER 2

Responsible and transparent R&D

For PMI, responsible R&D means ensuring the credibility, integrity, and robustness of our scientific research through alignment with international standards, as well as transparency in our methods and results.

Read more online

Data privacy and protection

In recent years, there has been increasing public awareness of privacy issues and greater scrutiny by stakeholders of how companies approach data privacy. We have developed and maintain programs designed to protect our company's and stakeholders' data privacy from attacks and improper use.

Read more online

Business integrity

For PMI, conducting business with integrity means complying with the law, our **Guidebook for Success** (PMI's Code of Conduct), and other company commitments. Our Guidebook for Success defines the rules we follow and describes the values that form the foundation of good ethical judgment.

Read more online

Fair fiscal practices

PMI aspires to be a good corporate citizen in every country where we operate. Paying taxes commensurate with our activities in each country is not only our duty but the responsible thing to do and a key part of our social contract in every country where we operate.

Read more online

Illicit tobacco trade prevention
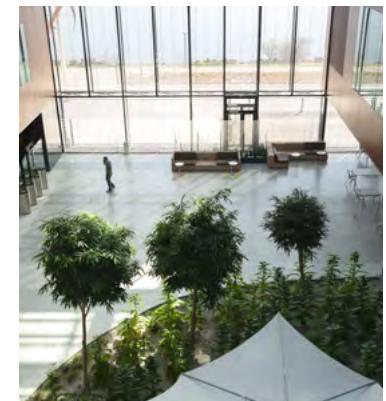
Eliminating illicit tobacco trade is a long-standing priority for PMI. Addressing this issue is about applying strict supply chain control measures and, whenever possible, cooperating with law enforcement agencies and other partners in the public and private sectors to prevent and reduce the illicit trade of PMI products, including combustible tobacco products as well as smoke-free consumables and devices.

Read more online

Responsible engagement

For PMI, responsible advocacy is about conducting engagement in a way that respects the law, observes professional standards and ethical principles, and is consistent with the company's vision and internal policies. This means acting in a fair, honest, and respectful manner when advocating our position with external stakeholders.

Read more online

An employee in PMI's Plant Research facility in Switzerland

WE ARE

Caring for the people we work with

Continuously improving our social impact within and beyond our operations is essential to PMI's long-term success.

Promoting a safe and healthy working environment is vital. In our factories, offices, laboratories, retail outlets, and for our sales teams in the field, we aim for a safe and secure work environment populated by a healthy and motivated workforce.

Our efforts extend to the labor standards we expect of our suppliers and farmers. In our tobacco supply chain, our aim is to provide a decent livelihood to all contracted farmers, promote safe working conditions, and prevent child labor and other labor abuses.

TIER 1

Socioeconomic well-being of tobacco-farming communities

The tobacco we source is cultivated in many regions of the world, including low- and medium-income countries, where it is typically grown on smallholder farms of less than two hectares. The socioeconomic well-being of tobacco-farming communities depends on many factors, including the nation's socioeconomic development, health and educational services, political stability, resilience to climate shocks, access to markets, and public infrastructure, as well as regulatory frameworks and their enforcement. If these factors are insufficiently developed, the population risks being locked in a cycle of systemic poverty, which, consequently, leads to poor working and living conditions, including the use of child labor.

The right thing to do

Child labor and other labor abuses are unacceptable to PMI. They raise ethical, social, and legal issues, including potential human rights violations, as well as reputational risk. As a global business sourcing tobacco from 23 countries, we have a role to play in addressing systemic issues such as poverty and other social issues such as child labor, forced labor, and human trafficking that are resulting from it.

Poverty prevents farming communities from achieving acceptable levels of socioeconomic well-being and hinders their economic development. It leads to labor abuses and exacerbates the risk of child labor on tobacco farms because farmers may be unable to hire workers or afford school costs for their children, resulting in them keeping their children home to work on the farm. Child labor affects an estimated 150 million children worldwide,[1] with the vast majority found in agriculture. It prevents children from getting a proper education, participating in the development of their communities, and fulfilling their potential.

Agricultural development can stimulate economic development outside of the agricultural sector, and lead to alleviating poverty, thereby preventing human rights issues and contributing to higher job and growth creation. Increased productivity of agriculture raises farm incomes, increases food supply, reduces food prices, and provides greater employment opportunities in both rural and urban areas.

The business case

Our business can have a significant socioeconomic impact on people, which is a major predictor of success, especially in the long term. By creating jobs, training workers, building physical infrastructure, procuring raw materials, transferring technology, paying taxes, and expanding access to products and services ranging from food and healthcare to energy and information technology, our company affects people's assets, capabilities, opportunities, and standards of living—their growth and well-being matter to the bottom line. If done right, agriculture can contribute to poverty reduction beyond a direct effect on farmers' incomes. We have found that farmers who make a decent living from growing tobacco among other crops or other income-generating activities are more likely to think long term, apply good agricultural practices, and send their children to school. These are the farmers that PMI prefers to work with, because they ensure the continuity of a high-quality tobacco supply at reasonable cost. A successful farmer base also helps to prevent child labor and other labor abuses, minimizing the risk of import bans and reputational risk. By implementing targeted initiatives and by developing strong working relationships with farmers, suppliers, civil society, governments, industry, and other stakeholders, PMI can create net benefits for the economies and societies in which we operate—and mitigate reputational and operational risks.

[1] International Labour Office—Global Estimates of Child Labour, Results and trends 2012-2016 (wcms_575499.pdf (ilo.org))

Our aims

100%
Percentage of contracted farmers supplying tobacco to PMI who make a living income by 2025

Zero
Child labor in our tobacco supply chain by 2025

A tobacco farmworker stringing tobacco leaves in Nayarit, Mexico

Socioeconomic well-being of tobacco-farming communities continued

Achieving our aims

A principal aim of PMI is to provide a decent livelihood to all contracted farmers in its tobacco supply chain. This has been a focus since we introduced our Agricultural Labor Practices (ALP) program in 2011, supplemented by the **ALP Step Change** in 2018.

We are committed to the following set of targets to improve the socioeconomic well-being of tobacco-farming communities:

- 100 percent of tobacco farmworkers to be paid at least the minimum legal wage by 2022
- 100 percent of contracted farmers supplying tobacco to PMI to make a living income by 2025
- Zero child labor in our tobacco supply chain by 2025
- 100 percent of contracted farmers supplying tobacco to PMI to have access to water by 2025
- 100 percent of contracted farmers supplying tobacco to PMI to have access to basic sanitation and hygiene by 2030

We had also committed to achieve by the end of 2020:

- 100 percent of tobacco farmworkers to be provided safe and adequate accommodation
- 100 percent of farmers and workers to have access to personal protective equipment (PPE) for the application of crop protection agents (CPA) and prevention of green tobacco sickness (GTS)

Our **ALP Code**, based on International Labour Organization (ILO) conventions and aligned with the United Nations Guiding Principles on Business and Human Rights, sets the principles and measurable standards applicable to all the contracted farmers from whom we source tobacco: No child labor, fair income and work hours, no forced labor and human trafficking, a safe work environment, fair treatment, freedom of association, and terms of employment. Our Sustainable Agriculture teams, suppliers, contracted farmers, and workers are regularly trained on the ALP Code. The ALP program is supported by related policies, such as our **Good Agricultural Practices** (GAP), **Human Rights Commitment** (HRC), and **Responsible Sourcing Principles** (RSP).

We have a robust due diligence framework in place to evaluate the implementation of our ALP Code; this is enabled by the traceability at farm-level provided by our integrated production system.

ⓘ Read more: **Sustainable supply chain management**

Our approach comprises internal monitoring by field technicians, external comprehensive and focused assessments conducted by Control Union, and external verification by specialized third parties.

A tobacco farmer in Nayarit, Mexico

Monitoring of ALP implementation

Internal monitoring

Field technicians collect and update individual farm profile data at the start of each growing season and visit the farms throughout the season to evaluate, among other things, how well labor practices align with the principles of the **ALP Code**. Field technicians raise "prompt actions" to flag and trigger an immediate response to any serious ALP violation. They work with the farmer to develop a remediation plan to address these and any other non-conformities identified, which they then follow up on and monitor. If the matter is not resolved within the agreed timeline, it is further escalated and may lead to sanctions, which can include contract termination.

In 2020, we reinforced our risk-based approach in our farm-by-farm monitoring in order to strengthen the monitoring procedures and techniques to better identify risks and address them before they evolve into issues. The "non-conformities" are identified through interviews with multiple stakeholders or observations and are raised with the farmers. Their reporting helps us flag risks and proactively take action to mitigate them.

External assessments

Control Union (CU) conducts assessments to evaluate the management system in place for ALP implementation, reviewing prompt-action protocols and procedures to identify, record, and address issues, while also examining the internal capacity to implement the ALP program. CU also evaluates labor practices at farm level, assessing compliance with the ALP measurable standards. Reports from CU are available on **PMI.com**. Under our **Step Change** approach, we are also implementing specific focused assessments to evaluate the management systems in place relating to the step-change priority areas, in addition to the farm-level assessment.

External verification

Specialized third parties verify our understanding of progress being made on the ground, challenge our monitoring data, evaluate the effectiveness of our initiatives, and, ultimately, better assess our impact. We work with local expert partners in each geography.

Socioeconomic well-being of tobacco-farming communities continued

We use a risk-based approach to identify, prevent, and mitigate incidents related to human rights and labor rights in our tobacco supply chain. For this undertaking, we collaborate with key stakeholders—such as suppliers, farmers and farmer associations, civil society organizations, academics, governments, and the private sector—to tackle more effectively persistent and systemic issues in the agricultural sector.

In 2018, we started a **Step Change** approach to our ALP program, focusing on four priority areas: Eliminating child labor, ensuring payment of at least a minimum legal wage or agricultural benchmark

standards, ensuring the availability and appropriate use of PPE, and ensuring adequate accommodation for all farmworkers. Step Change focuses on resolving the root causes of these persistent issues in priority countries—which we assess periodically—and is run in collaboration with our long-term strategic partner on the ALP program, Verité. In 2020, the program focused on Argentina, India, Indonesia, Malawi, Mexico, Mozambique, Pakistan, and Turkey due to the persistent nature of issues there. India was added in 2020 to the list of priority markets due to the complexities of challenges pertaining to gender inequality and the payment

of minimum wages. Also in 2020, South Africa was removed after intensive work to address the issues identified there—particularly the accommodation provided to farmworkers—was externally validated to have been successful. A key component of the Step Change approach has been to enhance external assessments and verification to support our progress toward meeting our ambitious targets.

Our governance arrangements guide and facilitate this work. PMI's Senior Vice President of Operations, a member of our Company Management, is accountable for our success in this area, while the operational responsibility lies with the head of our Leaf department. In each sourcing region, a management team oversees the implementation of ALP. A steering committee works closely with the dedicated local teams across our affiliates and suppliers.

Stakeholder engagement

Poverty and inadequate enforcement of labor legislation are some of the causes of child labor in agriculture. Stakeholders in the agricultural sector can play an important role to end this. In that regard, we realize that partnerships and multistakeholder engagement is paramount to advance our goals—during 2020, we participated in various events, such as seminars and conferences on the topic. For instance, we participated in the Sustainable Landscapes and Commodities Forum organized by the Innovation Forum and sponsored by the Global Agribusiness Alliance, discussing how agribusiness drives rural social and economic development. We also participated in the panel on leaf and sustainability during the virtual Global Tobacco and Nicotine Forum.

Moreover, PMI's ongoing efforts to eliminate child labor on all farms that supply us with tobacco have been recognized by the World Business Council for Sustainable Development (WBCSD). The organization has included PMI as a "sector leader" case study in its new **toolkit** on advancing human rights policy and practice in the agribusiness sector.

> "Since the start of Step Change, we have solidified the approach and identified critical enablers to address the root causes of social issues in our tobacco supply chain. **Improving the livelihoods of our contracted tobacco farmers is instrumental in preventing labor abuses. Accordingly, we deploy initiatives to improve income levels for our contracted farmers, support women in taking an active role in their households and communities, and ensure access to clean water, sanitation, and hygiene."**
>
> **Pedro Braga**, PMI Vice President, Leaf

A tobacco farmworker sorting dried tobacco leaves in Salta, Argentina

Socioeconomic well-being of tobacco-farming communities continued

Since 2016, we have also participated in the industry-wide Sustainable Tobacco Program.

ⓘ Read more: Sustainable supply chain management

In 2019, we decided to consolidate a number of initiatives, developed through GAP, ALP, and the industry-wide STP to support contracted farmers in improving their income levels and thus the livelihoods of their households. As we continue to expand and grow our Living Income program, our strategy will remain to focus on implementing more targeted, integrated, and localized initiatives which will best address the needs of our tobacco supply chain.

PMI has been a Board member of the ECLT Foundation, a multistakeholder partnership that works to find collaborative solutions to address the root causes of child labor issues in tobacco growing. After 20 years of fruitful partnership, in 2020 we decided to end our ECLT Foundation Board membership, as of 2022. This was by no means an easy decision, yet the status and maturity of our programs invited us to reflect on more impactful ways to continue making progress. In that regard, we will allocate our resources and efforts toward further implementing our Living Income program, which we consider a key enabler to address labor abuses and particularly child labor issues.

> **"We would like to thank the ECLT Foundation, their Board of Directors, as well as all ECLT Secretariat members for a tremendously successful and rewarding two-decade partnership. We expect and look forward to continuing to support the Foundation's mission at the local level in its continued efforts to eliminate child labor from tobacco-growing supply chains."**
>
> **Mauro Gonzalez**
> PMI Director, Sustainable Agriculture

> **"We are proud of the maturity and sophistication of PMI's ALP program. To share our learning and solicit recommendations for improvement, we publish on our website quarterly ALP Progress Updates detailing our experiences throughout the year."**
>
> **Massimo Andolina**
> PMI Senior Vice President, Operations

A gradual decrease in tobacco demand

One of the defining characteristics of sustainability is that it provides an opportunity for the explicit consideration of the trade-offs that are inherent in complex decision-making processes. As we often refer to our transformation and sustainability strategy indistinctively, trade-offs in this regard become more evident as our business transformation progresses. We know that with the growth of our smoke-free business there is a simultaneous decline in our cigarette business, which translates into a gradual decrease of demand for tobacco leaf.

This means that, in some markets, we are reducing the volume of tobacco we purchase, or we are stopping our sourcing activities altogether. Such change has an undeniable impact on our contracted farmers, especially those whose main source of income would traditionally derive from tobacco growing.

We are committed to addressing and, to the extent we can, minimizing the negative effects of these trade-offs. We do this through a dedicated assessment of the unique realities and contingencies that define each country or region where we source tobacco, building an understanding of the local ecosystem to tailor and implement sustainable solutions that can help farmers transition to sustainable alternative livelihoods where needed.

In some cases, farmers are not heavily relying on tobacco production for their livelihoods or have the means to fairly easily switch to other crops, or they will continue growing tobacco as suppliers will continue purchasing their crops to fulfill other customers' requirements. In other geographies, we provide additional support to help mitigate the negative impact of the reduction in our purchases.

For instance, as of 2021 we are stopping our tobacco purchases in Colombia. The impact of such a decision was assessed well in advance, and, since 2018, we have been developing and deploying a corresponding plan to help farmers bridge to viable economic models. More concretely, in 2018 and 2019, we funded diversification initiatives that provided farmers with corn seed packages and advice on the production of vegetable crops in home gardens, banana plantations, poultry production, and water tanks for fish production. Furthermore, in 2019 we rolled out two other initiatives, consisting of financial support as well as capacity building for the farmers. On the latter, we partnered with the local NGO, Proterritorio, which organized 50 workshops in the different farming communities. Around 1,370 farmers participated (i.e., all the farmers we contracted in the country to source tobacco from that year) and were provided with technical training sessions and financial education to help them design agricultural production projects.

More broadly, in the past years, we've introduced together with our suppliers a range of initiatives aimed at helping our contracted farmers make a living income by 2025. Under this program, we support the tobacco growers in eliminating farming inefficiencies. We also promote practices—such as mechanization and irrigation technologies—that not only allow them to improve productivity of the tobacco crop, but also help them diversify their production to other crops. In the coming years, we expect these efforts to play an important role in minimizing the potential negative economic impacts our transformation, and consequential reduction in demand of tobacco, may have on our current contracted farmers.

> **"Thanks to our partnership with Coltabaco, we completed a project aimed to develop and increase commercial and product related capabilities with 1,380 farming families, who were fully dedicated to tobacco growing. Through these trainings, we identified 10 sustainable alternative crops that would allow the beneficiaries of the training to count with a solid base of income and, at the same time, continue their development in order to increase both their productivity and their ability to compete in the agribusiness sector. Thanks to this project, as well as our partnership with other institutions, these farmers will be able to continue developing to transition on to alternative sources of livelihood."**
>
> **Fundación Proterritorio**

Socioeconomic well-being of tobacco-farming communities continued

Progress in 2020

Impact of COVID-19 on our activities in 2020

Contributing to alleviating poverty

PMI is committed to improving the livelihoods of the contracted farmers supplying tobacco to the company and, consequently, the communities in which they live. We see this as a fundamental way to address social inequality, as well as other issues in our supply chain.

Assessing income levels in our tobacco sourcing markets

To be able to achieve our ambitious goal of 100 percent of contracted farmers supplying tobacco to PMI to make a living income by 2025, we started

A tobacco farmworker stringing tobacco leaves in Malawi

by performing our own analysis to help us identify those markets where there is a gap between the farmers' current income levels and the living income benchmark. Our priority is to focus our efforts on those markets with the greatest gaps.

In order to validate the initial outcome of our internal analysis, we approached various organizations with expertise in the living income calculation field, such as the Global Living Wage Coalition and the Living Income Community of Practice. As a result of this engagement, we decided to adopt the Anker methodology, which is widely recognized to estimate living income benchmarks worldwide.

Moreover, in 2020 we started our partnership with Social Accountability International and the Living Income Anker Research Network to conduct living income studies, comprising both living income benchmarks and reference values.[1]

During the year, we ran two living income benchmark studies in Malawi and Pakistan. Due to the COVID-19 pandemic, we could only secure partial results (i.e., based on secondary data only) and, in 2021, we expect to have access to the primary data needed for the completion of the studies. In addition to this, we completed three living income reference values in Argentina, Mozambique, and Turkey, which were used in the design of comprehensive action plans that will help address the income gaps over time.

In parallel, we conducted farmer income studies in Malawi, Mozambique, Pakistan, the Philippines, and Turkey to assess the current income levels of our contracted farmers. We are using local and international partners in these countries. We had planned to conduct a farmer income study in Argentina; however, due to COVID-19 and the travel restrictions, this was delayed to 2021.

"PMI has taken an important step by using the Anker methodology, which is recognized around the world as the gold standard of living wage and income estimates. Using such rigorous, independent studies of the income levels required for a decent standard of living is a critical component for PMI if they are to credibly achieve their target by 2025. To date, Anker studies have been performed in 60 locations in over 40 countries. The new studies commissioned by PMI will not only support PMI's ambitious goal for their contracted farmers, they will be made publicly available and add to global efforts on living wages and income."

Jane Hwang, President and CEO, Social Accountability International

Calculating the living income benchmark

1 See glossary.

Socioeconomic well-being of tobacco-farming communities continued

When designing comprehensive action plans in our markets, we aim to exceed the living income benchmark targets that are required to achieve a decent standard of living, to make a provision for potential fluctuations in farmer incomes due to climatic shocks or volatility due to market dynamics. We will periodically review the living income benchmarks to account for annual inflationary increases, and revise farmer income studies to consider market dynamics that may impact farmers' overall income.

The results of the third-party studies are encouraging as they do not highlight major deviations from our initial assumptions. This provides us with the confidence in the prioritization of our markets as we work toward our 2025 target.

It also showed that our contracted farmers already make a living income in some markets, such as Pakistan, or that a significant portion of them already make it in other countries, such as Argentina, Malawi, Turkey, and the Philippines. Globally, in 2020 48 percent of the contracted farmers supplying tobacco to PMI were making a living income.

We expect to further examine and act on insights from these studies in 2021. The results will complement our internal analysis and help to guide our efforts and target initiatives toward reaching our target of 100 percent of our contracted farmers making a living income by 2025.

"PMI has set an ambitious target of 100% of their contracted farmers achieving a living income by 2025. To be able to achieve this objective, our Anker Living Wage and Income Research Network, together with Social Accountability International (SAI), have worked with PMI to conduct living income benchmarks and reference value studies in their tobacco-sourcing countries. The living income studies will use the research methodology we developed, which is widely used by many leading companies and sustainability standards. As a start, in 2020 PMI commissioned us to estimate the living income for tobacco farming areas in five countries. This will allow them the visibility on the required income levels for their contracted farmers to be able to achieve a decent standard of living and develop strategies in those markets where income gaps have been identified."

Living wage experts Dr. Richard and Ms. Martha Anker, Global Living Wage Coalition

Initiatives to improve livelihoods

In 2020, we continued implementing various initiatives aimed at improving income levels. Based on our internal analysis, we focused primarily on Argentina, Malawi, and Mozambique. While activities are tailored to local realities, our overall strategy is twofold: Firstly, on the tobacco crop to improve productivity and competitiveness and secondly, as needed, on supporting households to diversify their sources of income.

Improving productivity

We focus on enhancing tobacco production and encouraging farm efficiency. To improve household income, many farmers routinely seek out efficiencies in their operations—for example, by hiring only the labor required, making careful use of inputs such as fertilizer, and finding ways to increase yields per hectare. PMI supports these efforts. Additional efficiencies include supporting the mechanization of field preparation, which can provide labor savings and elevate yields.

CASE STUDY

Advancing income levels of farmers and farmworkers in Argentina

A fundamental step toward achieving a living income for our contracted tobacco farmers in the region of Misiones, Argentina was to conduct a study assessing what the appropriate living income should be, helping us refine our activities and further inform our strategy moving forward. In parallel, we promoted multistakeholder dialogue and achieved an agreement defining a minimum wage for tobacco farmworkers in this region, applicable as of September 2020.

Read more online ⧉

A tobacco farmworker in Salta, Argentina

Socioeconomic well-being of tobacco-farming communities continued

For instance, in 2020 mechanization for field preparation covered a total of 2,115 hectares in Malawi while, in Argentina, the main focus of activity was on mechanized harvesting, with a total of 3,566 hectares covered in 2020. Additionally, we continued with improved crop storage to reduce the potential financial loss from crops spoiling and the need for insecticides after harvest.

Supporting households to diversify their income sources

We also look at opportunities to implement other income-generating activities, such as the cultivation of complementary crops. Growing and marketing a range of crops can improve farm income while enhancing resilience against climate change and economic uncertainty. In 2020, we estimate that approximately 75 percent of our contracted farmers grew crops other than tobacco. Of these, 53 percent were intended for self-consumption, 10 percent were aimed at providing additional income, while 37 percent were grown for both self-consumption and additional income.

A tobacco farmer tending air dried tobacco leaves in Nayarit, Mexico

[1] The annual GDP per capita (USD) in Mozambique was USD 504 in 2019 (source: https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=MZ).

[2] The annual GDP per capita (USD) in India was USD 2,100 in 2019 (source: https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=IN).

Our Living Income program at work

Malawi

In Malawi, 2020 saw the expansion of our mechanization initiative, which aims to improve farmer yields by mechanizing the land preparation, which promotes better root development, increasing water retention and allowing timely planting. Additional benefits include a reduction in labor hours related to land preparation, which in turn can enable farmers to consider increasing their total cultivated area. During 2020, 844 farmers received mechanization services (covering 2,115 hectares covered) and we plan to expand this coverage year on year.

Together with our suppliers, we continued to encourage the production of complementary crops and other income-generating activities. 2020 saw a significant increase in the coverage of groundnut contracting, with 30 percent of the farmers within the PMI footprint contracted for groundnut production. The quality of available groundnut seed has historically proved to be a challenge in the successful cultivation of the crop; however, during 2020 our suppliers produced significant volumes of superior quality seed on their own commercial farms, which will be provided to smallholder farmers who should in turn realize improved germination rates and yields during the 2021 season.

Beekeeping was highlighted as an initiative that could provide farmers with an additional income, with minimal labor and land requirements. In 2020, we expanded the project by an additional 300 hives, taking the total hives to 910. One of our local suppliers has received Malawi Bureau of Standards approval to start processing the harvested honey and marketing the product both locally and internationally.

Mozambique

In Mozambique, a key focus area during 2020 was the development of a cotton supply chain in collaboration with an international retailer. Around 80 farmers were contracted for cotton production in 2020, and the quality results conducted during buying exceeded the initial project expectations. The 2020 production has been ginned and will be shipped to spinners early 2021. We plan to expand this program to 275 farmers for the 2021 season.

We started in 2019 an initiative to install treadle-pumps, aimed originally at reducing the risk of having children involved in the watering of seedbeds. However, we identified that this initiative proved valuable in assisting farmers in the production of winter crops as well, resulting in an improvement in their incomes. During 2020, an additional 1,760 farmers were provided with treadle-pumps, winter-crop inputs, and a six-module winter-crop training program. An impact assessment conducted during the year indicated that these treadle-pumps contributed to an additional USD 300 to 400 profit per farmer per year on average by allowing them to grow two cycles of winter crops during the dry season.[1]

Beekeeping, part of diversification efforts in Mozambique

India

Most farmers in Vinukonda, Andhra Pradesh, India are smallholders with an average tobacco cultivated land area of below 1.5 hectares. The weather patterns (drought and rainfall seasonality) have in the past prevented these farmers from implementing a sustainable crop rotation cycle. Without intervention, they only have one crop window per year, which leaves the community struggling to alleviate poverty. This, in turn, aggravates potential social issues such as child labor and poor living conditions.

We are working with our tobacco leaf supplier in the country and local organizations to implement improvements, targeting root causes and factors that impact farmers' livelihoods.

For instance, it is essential for farmers to have access to a reliable water source for irrigation to face droughts and mitigate rainfall seasonality, and to allow them to grow an additional crop during the year. Between 2016 and 2018, 86 reservoirs, to provide water for 600 hectares of land, were built. Farmers now harvest additional crops during tobacco off-season (in March and April), generating an additional annual income ranging from USD 825 to 2,000 per farmer.[2]

We also supported farmers' expansion to complementary crops. Among a set of crops trialed, guar, a legume, was introduced to 11 farmers in 2020. PMI provided free seeds and crop inputs, as well as technical training. So far, farmers have benefited from an additional annual revenue of over USD 1,600 per farmer on average. Building on the success of the trial, in 2021 we plan to expand the guar project and are looking at other potential crops to cover an additional 140 farmers.

Socioeconomic well-being of tobacco-farming communities continued

Enhancing access to water, sanitation, and hygiene

While substantial progress has been made in increasing access to clean drinking water and sanitation, billions of people worldwide—mostly in rural areas—still lack these basic services. The link between poverty and limited access to water, sanitation, and hygiene (WASH) is well established, and enhancing WASH infrastructure can provide substantial improvements to both the well-being and livelihoods of community members. The COVID-19 pandemic has also further demonstrated the critical importance of sanitation, hygiene, and adequate access to clean water to prevent and contain disease.

In 2020, we strengthened our approach and committed to ambitious targets: We aim for 100 percent of our contracted farmers to have basic water access by 2025 and sanitation and hygiene by 2030.

To set those targets and develop our framework, we aligned with the Joint Monitoring Programme for Water Supply, Sanitation, and Hygiene (JMP) established by the World Health Organization (WHO) and UNICEF.[1] Our WASH program is following JMP's service ladder, which starts with basic water access defined as from an improved source and less than 30 minutes away. Currently many of our farmers are using unimproved sources, often more than 30 minutes from their home, which means that the next few years will be focused on monitoring WASH access, mapping water source locations, and building new infrastructure (or improving existing infrastructure) where needed. In 2020, we also developed global WASH Monitoring Guidelines to standardize our approach (again connecting with JMP) and have shared these with our suppliers. In 2021, we will collect WASH data through farm-by-farm monitoring in the field, applying JMP's universal indicators to determine our final WASH priority markets, setting a baseline for each of them.

During the year, together with our suppliers, we continued the work started in 2019 in our two preliminary priority countries, building 47 hand-pump boreholes in Malawi and 50 in Mozambique—with each borehole estimated to benefit approximately 500 people in Malawi and 1,000 people in Mozambique —while continuing to raise awareness around WASH among community members. The economic benefits of improved sanitation can include increased productivity, reduced healthcare costs, and the prevention of illness, disability, and early death. People who have access to clean, safe, and convenient sanitation services also experience greater dignity, privacy, and security. This is especially important for women and girls, who may miss work or school when they are menstruating and do not have access to safe sanitation facilities. It also reduces the risk of sexual assault by reducing the walking distance to water sources.

ⓘ Read more in our **Q3 2020 ALP Progress Update**

Empowering women in tobacco farming

Around the world, women participate in agriculture both as members of family farming households and as hired wage labor on farms owned and operated by other households or companies. Agriculture remains the primary source of livelihood for both men and women living in rural areas in developing countries. Globally, only 13 percent of agricultural land is owned by women.[2] Many of the gender inequalities faced by women are exacerbated for women in agriculture. More concretely, women involved in tobacco farming often face structural and cultural barriers such as employment segmentation and gender gaps in earnings, financial inclusion and access to credit, ownership of land and property, and opportunities to receive training or technical support. Women typically also have to balance their financial contribution to the household with domestic responsibilities, which puts additional constraints on their time, and too often they still lack the authority to manage the income generated from the crops they produce. Additionally, girls tend to have higher school dropout rates, reinforced by gender norms that limit their possibilities. To break this cycle and overcome the dropout problem, policies need to be put in place and enforced, improving educational access and retention while simultaneously reducing gender inequality.

Since the inception of our ALP program, gender equality and fair treatment have been included as key principles in all the countries where we source tobacco. Gender equality is not only a fundamental human right but a necessary foundation for a peaceful, prosperous, and sustainable world. When we evolved our ALP program to include a Step Change approach in 2018, our objective was to address the root causes of the most prevalent and persistent issues in our tobacco supply chain. We saw an opportunity

A field technician in Nayarit, Mexico

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1 WHO/UNICEF Joint Monitoring Programme for Water Supply, Sanitation and Hygiene (JMP).

2 Report Of The UN Secretary-General's High-Level Panel On Women's Economic Empowerment.

Socioeconomic well-being of tobacco-farming communities continued

to strengthen our approach, considering the instrumental role women play in improving household economic conditions, while also addressing child labor and other social challenges.

We included women's empowerment as one of the 10 principles of our **Step Change** approach. Based on local needs, we are developing targeted initiatives in several priority countries.

Our activities include conducting focused women's training, hiring female field technicians to perform farm-by-farm monitoring, financial literacy training, and empowering women through entrepreneurial opportunities to bring positive change to their households and communities.

A representative example of our work on women's empowerment is found in India. Alongside the local NGO, ASSIST, we support Self Help Groups (SHGs) developed by local government. In 2020, we rolled out a project with the aim of building entrepreneurial capabilities of 200 women, members of the SHGs, by training them on financial and organizational skills. ASSIST uses a "train the trainer" approach equipping selected women with knowledge to empower and train others after them. Some 100 women from 11 SHGs, after having received training, have been selected to set up their own microbusinesses; these include dairy farms and grocery stores. In turn, they will support the funding of microbusinesses for 100 new beneficiaries, creating a positive domino effect. The approach is that all women participating in the project are committed to support other women within the community by donating a portion of their profit to ensure continuity, reach, and greater impact. In 2021, we plan to train an additional 200 women who can in turn further cascade their knowledge and provide funding for 100 additional women.

ⓘ Read more in our **Q1 2020 ALP Progress Update**

1 In Lebanon, we source through the state-run tobacco monopoly and do not receive granular information at farm level. In Switzerland, where we sourced from around 120 farmers in 2020, we aligned requirements with peer companies to apply deeper ALP monitoring to be included in our 2021 reporting.

Promoting PMI's Agricultural Labor Practices

In 2020, field technicians contracted either by PMI or by our leaf suppliers systematically monitored the implementation of ALP on 93 percent of all contracted farms (2019: 92 percent). We are committed to continually strengthening our monitoring to improve our visibility of existing issues, to taking a more risk-based approach, and to more effectively address identified issues. Our farm-level data cover 21 out of the 23 countries from which we source. It excludes Lebanon and Switzerland[1] but accounts for increased coverage of our ALP program in China.

Across the countries from which we source tobacco, the most recurrent and difficult problems are as follows:

- Work performed by children
- Inadequate and unsafe accommodation for farmworkers
- Payment to workers below the minimum legal wage or formalized agricultural benchmark
- Inadequate access to PPE that can prevent harm from exposure to CPA and GTS

We have developed and are implementing action plans to address these recurrent issues in collaboration with key stakeholders, including our strategic partner Verité, local NGOs, and governments. While Control Union was able to finalize its assessment in Argentina (covering two suppliers) early 2020, due to COVID-19 no additional external assessments were conducted during the year. However, local expert organizations were able to complete external verification in some priority countries. External verification allows us to evaluate the effectiveness of our initiatives and the accuracy of our internal monitoring. In 2020, we completed external verifications in seven markets: Three where we conducted an external verification for the first time (India, Malawi, and Mozambique), and four where we did it for the second time, in order to assess progress (Argentina, Indonesia, Mexico, and Turkey).

Furthermore, in 2020 we conducted a human rights impact assessment in Mozambique, the first one targeted on our tobacco supply chain, in collaboration with a peer company and our common tobacco leaf supplier. This assessment focused on identifying and addressing human rights risks and impacts resulting from our production and supply chain activities there.
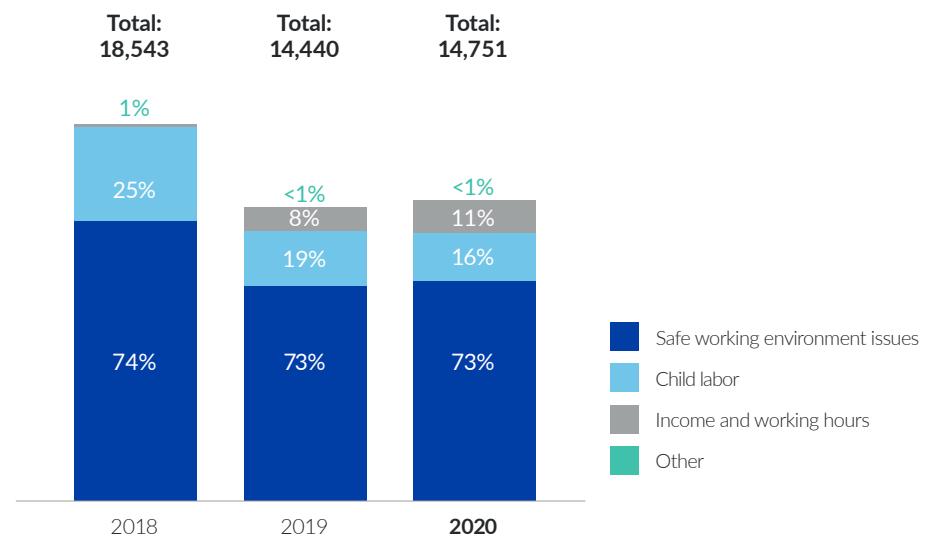
ⓘ Read **the case study**

The overwhelming majority of our relationships with contracted farmers feature a shared commitment to continuous improvement in addressing social issues. In the event of a contracted farmer's noncompliance and a continued failure to address gaps identified, we may end our business relationship with that farmer. In 2020, 1,794 contracts were terminated

due to ALP violations (up from 641 in 2019). Some 83 percent of the increased number of contract terminations in 2020 was due to child labor violations, predominately coming from Mozambique and Turkey. The increase can be attributed to the introduction (in 2019) of standardized guidelines related to due diligence, consequence management, and rewards.

To further support compliance, in 2020 we reviewed our ALP training materials (including some developed locally) and delivery methods. In terms of content, our objective is to update the training materials to align with changes on the ALP code, reflect changes driven by our Step Change approach, and bring consistency across sourcing markets. When it comes to delivery methods, we are exploring options and potential solutions accessible to all people working within our ALP structure, including suppliers' relevant personnel and field technicians.

Total prompt actions recorded by field technicians (2018–2020)

	Total: 18,543	Total: 14,440	Total: 14,751
	2018	2019	2020
Other	1%	<1%	<1%
Income and working hours	25%	8%	11%
Child labor	25%	19%	16%
Safe working environment issues	74%	73%	73%

Legend:
- Safe working environment issues
- Child labor
- Income and working hours
- Other

Socioeconomic well-being of tobacco-farming communities continued

Eliminating child labor

In 2020, we maintained a relentless focus on preventing incidents of child labor. Our robust due diligence system allowed us to identify risks and incidences of child labor and take immediate action.

Our ambitious goal is to eliminate child labor by 2025. Our objective is to eradicate cases that are repetitive and systemic in our tobacco supply chain. We also acknowledge that isolated cases (even when systemic occurrences are fully addressed) might continue occurring, due to farmer base turnover or unintentional misbehaving incidences. We will, in all cases, remain alert and tackle them promptly when identified.

The COVID-19 pandemic and the restrictions introduced in several sourcing countries unfortunately impacted our initiatives and relevant child labor remediation actions. Nonetheless, a key focus was to ensure that there would be no increase in child labor prevalence due to school closures and economic slowdown.

First of all, our field technicians, where possible, continued performing farm-by-farm monitoring and supporting farmers to address and remedy child labor incidences. Such support included awareness-raising and training (often redesigned to be delivered virtually); efforts to promote school access and attendance through scholarships, school feeding programs, after-school activities, and improvements in school infrastructure; vocational training for older children; and initiatives to improve household income levels such as women's self-help groups.
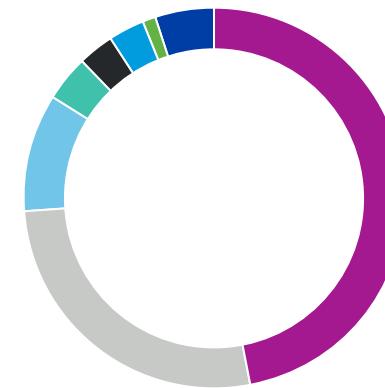
In markets where community initiatives, key to preventing child labor, could not be implemented due to restrictions, programs have been redesigned and funds reallocated to ensure continuous

support to children and their families. For example, in Mexico, PMI-funded migrant childcare centers were closed due to the pandemic. In response, and in partnership with our supplier and a local implementing partner, we delivered food baskets to more than 180 migrant families reaching over 370 children that could not attend the centers. A similar approach was taken by our team in India, where food baskets were provided to over 800 families who were under full lockdown.

Our progress toward our target of zero child labor is measured based on internationally defined ILO standards. It includes the following three categories: Children performing hazardous tasks, children under 15 hired, and children under 13 doing any tobacco related tasks. In this respect, in 2020 we enhanced our reporting on child labor issues by expanding its scope to include the latter two categories. During the year, field technicians monitored 99 percent of farms for child labor related issues and recorded a total of 2,352 prompt actions. Out of that, 2,285 cases involved children performing hazardous tasks (versus 2,712 recorded in 2019), three cases of children under 15 hired, and 64 cases of children under 13 working. In total, these prompt actions involved 2,502 children, with 95 percent of them being the farmers' children. A significant proportion of child labor incidents (1,560 prompt actions) were recorded in Turkey across a farmer base of around 23,600 farms. These involved 1,692 children, of which over 99 percent were family members. The predominant activities performed by these children were harvesting or handling green tobacco and stringing.
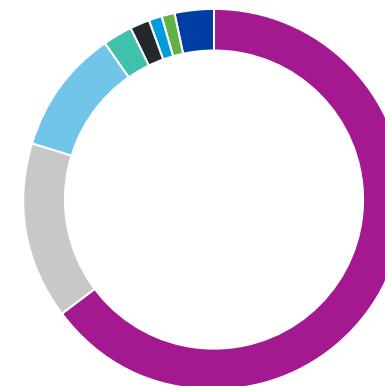
Regarding prompt actions raised for children performing hazardous tasks, there is a reduction from 2019 figures mainly driven by farm base consolidation efforts conducted in Mozambique and Malawi. Of the 2,352 prompt actions recorded in 2020, 75 percent were resolved and

Types of prompt actions recorded in 2020 relating to hazardous work performed by children

Harvesting or handling green tobacco	49%
Stringing	26%
Working with sharp tools	9%
Carrying heavy loads	4%
Driving a tractor or operating machinery	3%
Working in extreme temperature	3%
Handling or applying fertilizer	1%
Other	5%

Total number of child labor prompt actions recorded, by geography

Turkey	1,560
Mozambique	336
Malawi	238
Macedonia	57
Greece	37
Pakistan	29
Indonesia	26
Other	69

Socioeconomic well-being of tobacco-farming communities continued

the remaining 25 percent were being followed up against the action plans developed with concerned farmers. This is a decline from the previous year, mainly due to local initiatives impacted by COVID-19 restrictions. The most common hazardous tasks our technicians found children doing were harvesting or handling green tobacco (49 percent), followed by stringing (26 percent) and working with sharp tools (9 percent).

Despite this decreasing trend, we remain cautious and acknowledge the limitations of our monitoring system. For example, field technicians are only present on the farms for a limited time during the growing season, and the COVID-19 pandemic restricted their ability to conduct regular visits in some countries (read more: **Sustainable supply chain management**). Moreover, the issues we face are complex and often persistent.

In many geographies, external assessments related to child labor are reasonably well aligned with our internal monitoring data, which show that we are enhancing the visibility on the ground and the accuracy of our data. However, in two countries, Mozambique and Turkey, significant discrepancies were revealed. In those instances, we focused on engaging with our suppliers, understanding the causes of discrepancies, and

developing and implementing action plans to strengthen the internal monitoring. More concretely, we increased the number of unannounced visits performed by ALP supervisors, strengthened the due diligence and consequence management process, and reinforced internal capacity on ALP monitoring and reporting while introducing in-depth data analytics. Both countries will reconduct external verification in 2021.

Zero child labor

Our target to eliminate child labor by 2025 is ambitious. We have put all the foundations in place to be able to achieve it on time: A robust farm-by-farm monitoring system, a network of field technicians and ALP experts, external assessments verifying our data accuracy, and a range of stakeholders supporting us in this journey. We are dealing, however, with a very complex societal issue, especially present in some of our sourcing markets. In order to increase the accuracy of the instances of child labor prevalence in our reporting, we developed a new methodology integrating results from third-party verification as well as external sources (e.g., country human rights records). This supports our risk-based approach and provides us with country-level granularity on this specific topic. Based on this exercise, we feel confident that in most of our sourcing countries, child labor is not a systemic issue and we are continuously working to eliminate the remaining prevalence of 3.5 percent. We will maintain a relentless focus on further strengthening the reliability of our monitoring data, as well as the remediation steps to support farmers and workers to address child labor incidents in a sustainable way.

A school in Misiones, Argentina

Socioeconomic well-being of tobacco-farming communities continued

Promoting a safe working environment

In line with PMI's **ALP Code**, we require farmers to provide a safe workplace to prevent accidents and injury and minimize health risks.

In 2020, field technicians recorded a total of 10,816 prompt actions relating to unsafe working environments (2019: 10,519). Around 52 percent related to handling green tobacco and applying CPA without the proper PPE (34 and 18 percent, respectively), followed by 23 percent related to unsafe or insufficient accommodation for farmworkers.

Our internal monitoring data over the past few years revealed that a significant proportion of the prompt actions raised by field technicians pertained to exposure to green tobacco sickness GTS or to CPA due to the farmers and workers not wearing the proper PPE. To address this issue, we committed that 100 percent of our contracted farmers and their workers would have access to PPE for the application of CPA and prevention of GTS by 2020. During the year, our monitoring on PPE availability confirmed the achievement of the 2020 target.

Having achieved our target, we will continue ensuring full availability of PPE across the markets and raising awareness on the importance of appropriate PPE usage. Acquiring the fundamental understanding of the hazards of certain tobacco tasks and driving behavior change toward appropriate PPE usage is key to safeguard the health and safety of those involved. In 2020, our targeted training reached 99 percent of contracted farmers (and their workers).

In 2021, we will establish our baseline in terms of PPE usage and, based on the outcome, we will define our target—as our goal is to ensure that PPE is not only available but also appropriately used by farmers and farmworkers.

We also continued our work regarding accommodation. In 2020, around 8 percent of the total farmer base provided accommodation to their workers. In line with the ALP Code, when a farmer provides a worker with accommodation, we require it to be clean and safe and meet basic standards. We developed our accommodation standards in line with local legislation, with guidance from Verité and local partners. Field technicians monitor against these lists and when issues are identified, for example the window is broken or waste is improperly thrown out, action is taken. Specific action plans are agreed directly with the farmer and, when needed, together with our suppliers, we support with the provision of construction materials, refurbishments, and repairs. By the end of 2020, 100 percent of farmworkers receiving accommodation had been provided safe and adequate accommodation that met the above-described standards.

Thinking ahead, we already reinforced our requirements by issuing a set of global minimum accommodation standards to be implemented across all sourcing markets. This was the result of an extensive mapping exercise between local practices in all sourcing markets and relevant international standards. Additionally, following the commitment related to our Water Access, Sanitation and Hygiene (WASH) program, relevant requirements have been included in these guidelines. This approach brings not only better standardization and consistency but will further enhance the living and working conditions for farmers and workers. In 2021, we will roll out these new standards to our tobacco leaf suppliers.

Minimum wages for workers

Income earned during a pay period, or growing season, should be enough to meet workers' basic needs. Our **ALP Code** requires that the wages of all workers (including temporary, piece-rate, seasonal, and migrant workers) meet—at a minimum—the national legal standard or formalized agricultural benchmark standard. In a typical crop year, less than a third of contracted farmers supplying PMI or its suppliers (over 100,000 farmers) hire workers throughout the season.

In 2020, our monitoring on wages covered 92 percent of contracted farmers in our tobacco supply chain. In 2020, 65 percent of farmworkers were paid at least the minimum wage. Field technicians recorded a total of 1,541 prompt actions related to farmers paying less than the minimum wage to their workers (2019: 1,158). The increase in prompt actions is mainly due to more accurate monitoring and reporting of cases. The issues are most commonly found in India, Indonesia, Mozambique, the Philippines, Turkey, and the Misiones province in Argentina.
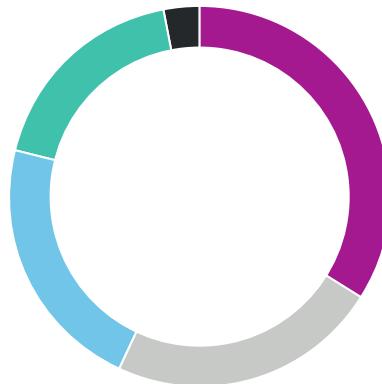
The challenges relate to not only substandard payment amounts but also informal terms of employment, inconsistency between supply and demand of labor, and workers' lack of knowledge on their rights. Another challenge we face in some countries is the lack of applicable legal minimum wage or formalized agricultural benchmarks. Read the example of Argentina in our **case study**.

Improved visibility on workers' wages via our monitoring system enables us to take steps to tackle the issue and ensure farmers pay the required minimum wage. We reiterated our expectations to farmers on this matter, in line with local laws. We also equipped farmers and workers with tools—such as time-recording templates and payment records—to help them track work hours and calculate payments in line with the minimum wage, a task that can be challenging when piece-rate payments or partial in-kind payments are the norm.

In countries where the pay gap is significant, we provided financial literacy training to farmers and supported them in improving their farm productivity and efficiency—and, thus, their overall incomes—to better position them to pay the minimum wage to their workers. A key component of this effort is helping farmers manage their costs responsibly by only hiring workers when necessary and according to their land size. In Mozambique, for example, our supplier ran an awareness campaign on over-hiring that discouraged farms

Types of prompt action recorded in 2020 relating to safe working environment issues

Exposure to GTS due to not wearing PPE	34%
Unsafe or insufficient work accommodation	23%
CPA stored in a way that could cause a health and safety accident	22%
Exposure to CPA due to not wearing proper PPE	18%
Other	3%

Socioeconomic well-being of tobacco-farming communities continued

of 0.67 hectares and below from hiring full-time workers, which resulted in a 60 percent reduction in farms hiring full-time workers in this category.

In certain geographies, there are important challenges to formalizing minimum wages. For instance, in India, where a national minimum wage is a challenging issue, our third-party assessment showed that several farmers were paying below the minimum wage and that women workers often were paid less than men for the same type of work, in clear violation of the ALP Code. Informality of labor employment has been one of the biggest challenges in enforcing compliance with the national legal minimum wage. Workers are commonly hired for certain tasks and they are paid through different payment terms such as daily payment, volume based, and piece rate. And it is common that farmers and workers agree on a fee, which, although in line with prevailing community rates, is often lower than the legal minimum wage. To understand better the complexity of this issue, in 2020 we conducted a desk research with the support of twentyfifty, a human rights and business consultancy. The objective of this research was to understand the factors influencing the wage-setting mechanism in the agricultural sector through stakeholder engagement of different companies and organizations. The key finding from this benchmarking exercise is that awareness, lack of documentation of wages, and enforcement of national minimum wage are still weak. Furthermore, we expect that our efforts to promote a living income for our contracted farmers will in turn help advance income levels for their workers. Our main focus in that regard will be to increase farmers' efficiency and productivity. We will also explore the introduction of mechanization for different tobacco stages. On top of that, given the vulnerability of women in the rural economy, we also developed projects on capacity building and financial training, as well as self-help groups that work with existing governmental programs and microbusiness initiatives.

Next steps

In 2020, we reached important milestones, achieving two ALP Step Change targets:

- 100 percent of contracted farmers and workers having access to PPE
- 100 percent of tobacco farmworkers provided safe and adequate accommodation

We will continue to work toward achieving our 2022 and 2025 targets.

2021 marks the 10th year anniversary of PMI's ALP program. We plan to celebrate the progress and achievements of our ALP program, publishing a dedicated report. We will continue publishing quarterly **Progress Updates** on specific topics or countries.

We will continue to strengthen our monitoring of the implementation of our **ALP Code** and improve our effectiveness and consistency in responding to identified issues. We will pilot our newly developed learning framework to further build capabilities and understanding of our requirements among field technicians and within the ALP community. In addition, we will conduct external verifications in Argentina, Mexico, Mozambique, Pakistan, the Philippines, and Turkey. We also expect Control Union to conduct assessments in China and Indonesia in 2021—if pandemic-related conditions allow.

Most importantly, as we continue to expand our monitoring of child labor incidents beyond hazardous work, we will aim to also analyze the impact of our initiatives using indicators developed with our expert partner Verité. This will allow us to further refine our work on child labor, safe working environments, and minimum wages.

We expect to issue a revised version of our monitoring guidelines on Step Change priority areas, as well as new guidance on WASH. These will be shared with our suppliers and will bring further consistency, clarity, and standardization. In 2021, we will also develop a WASH training video to raise awareness among our field technicians and farmers about what "WASH" stands for, how it impacts their health and well-being, and why PMI will be continuously monitoring water access, sanitation, and hygiene. This video will be shown on a tablet to farmers in the field and will be available in multiple languages for easiest understanding. We will continue strengthening our WASH program on the ground, and specifically in Malawi and Mozambique, where we will start focusing on rehabilitating unusable boreholes.

A key focus for 2021 will be to continue implementing our strategy to ensure that contracted farmers achieve a living income, drawing on insights from the living income studies and farmer income surveys conducted in 2020. In 2021, we will continue to expand the geographies to perform living income studies, by covering the Philippines, India, Greece, Mexico, and Brazil. In addition to this, we will initiate third-party farmer income studies in Argentina and Mexico while continuing to strengthen and monitor our internal analysis of farmers' incomes.

2020 performance highlights

See our performance metrics ›

48%
Of contracted farmers who make a living income

100%
Of farmers and farmworkers having access to personal protective equipment for CPA application and GTS prevention

3.5%
Prevalence of child labor among farms contracted by PMI directly or by PMI's tobacco suppliers

100%
Of tobacco farmworkers provided with safe and adequate accommodation (when applicable)

Overview

Innovating for better products

Operating with excellence

Caring for the people we work with

Protecting the environment

Performance metrics

TIER 1

Health, safety, and well-being at work

An environment that keeps everyone safe and protects the well-being of all is a prerequisite for productive work. We are committed to providing a safe and secure working environment for all employees, contractors, and visitors. Our responsibility doesn't stop at the factory gate; we expect our suppliers and tobacco growers to keep their workers safe, too.

The right thing to do

By ensuring that all people who work with us enjoy a safe and healthy work environment, and by paying attention to their physical and mental well-being, we can positively impact their lives beyond their time spent at work. In addition to the benefits that provides to our company and our people, it helps to lessen demands on national healthcare systems.

The business case

Maintaining a happy, safe, and healthy workplace isn't just good for employees, it is also good for our business; happy workers are more engaged, more productive, and more likely to stay at the company. Promoting a safe and healthy working environment is therefore key for PMI and our business. Making sure that our employees are mentally well, socially stimulated, and physically safe is every bit as important as looking after their financial security. It helps manage operational costs and foster a culture that attracts and retains great people. In short, implementing strong health, safety, and well-being management creates and protects value. It boosts morale, fosters teamwork, increases productivity, reduces absenteeism, increases job satisfaction, and strengthens engagement. A highly motivated, dedicated, and productive workforce is the key enabler of PMI's business transformation.

Employees in the manufacturing facility of Papastratos, PMI's Greek affiliate

Our aim

<0.3

Total recordable incident rate for employees and contractors by 2025

Health, safety, and well-being at work continued

Achieving our aims

We aim for a workplace that promotes the health, safety, and well-being of our workforce. We have embedded clear methodologies, procedures, and robust controls in our factories, offices, and fleet aimed at ensuring our employees and others who are on PMI sites stay safe.

Working conditions at PMI are governed by our **Guidebook for Success** (our code of conduct) and our health, safety, and security principles and practices. PMI's Global Head, People & Culture and Senior Vice President, Operations oversee the company's strategy and performance in this area.

The health and safety of employees and contractors is covered by our management systems, which are based on recognized guidelines and standards, including ISO 45001, and assessed and audited internally and externally. These systems enable us to monitor health and safety performance across all our manufacturing facilities, offices, and in our fleet. We routinely update our standards and train our staff to ensure teams understand and align with the requirements.

We conduct risk assessments to identify hazards and implement necessary controls. Our corporate targets on incidents help us evaluate the effectiveness of our safety policies and programs. Our health and safety metrics are externally verified by SGS.

ⓘ See the External Verification Statement of our environmental and health and safety data

Our training programs, delivered in a range of formats, cover all aspects of health and safety, including risk assessment, safety management, incident investigation, and standards and procedures.

Health and safety in our factories is coordinated centrally by our Global Manufacturing team. At site level, each facility has a dedicated team that ensures the standards are met on the ground. Team members constructively challenge their peers and benefit from cross-auditing by colleagues at other sites. All incidents in our manufacturing operations are subject to in-depth root cause analysis, and we apply the same thorough approach to all contractors in our manufacturing facilities. We use behavioral observation systems (BOS) in our factories to instill a culture in which everyone involves themselves in openness, care, observation, and behavior reinforcement. We advance this culture change through communication with employees and safety alerts or notice boards. Every person's contribution counts—a fact we recognize through awards and other means of acknowledgment. Through BOS, we are further embedding safety into the DNA of the organization in a planned, structured, and standardized way. It will make a significant contribution to delivering on our safety ambition. Yearly, we conduct assessments to evaluate our sites' safety culture level and we survey employees to identify improvement opportunities.

We allocate a total of over 160 people to manage security and market safety, including safety for our fleet of around 23,000 vehicles, led by our global Head of Security and Market Safety in coordination with local fleet safety committees. These personnel run safety programs, training, and engagement at the country level, using fleet diagnostics and performance indicators to continually evaluate

progress. PMI's fleet safety management system covers risk assessment, driver training, vehicle safety, and driver behavior; our procurement policy ensures maximum safety features in fleet contracts. In our fleet operations, our target is to reduce high-severity collisions, with an ongoing goal of eliminating fatal accidents completely.

We are committed to a holistic approach to supporting employee well-being that addresses physical, emotional, and mental health. We provide employees with a range of healthcare options tailored to local needs and contexts.

Many teams across PMI manage and contribute to employees' health and well-being at the local country or site level, including occupational health and safety and human resources specialists. While this approach allows the design of well-being support by and for local needs, it is somewhat fragmented and inconsistent. In 2020, we began moving to a more centralized approach, for example introducing a global approach to Employee Assistance Programs, flexible work options, and parental leave. In 2021, we will bring accountability for a global holistic well-being roadmap made under a newly appointed Global Head, Health & Resilience role, reporting to the Chief Diversity Officer.

An employee in PMI's manufacturing facility in Izmir, Turkey

Health, safety, and well-being at work continued

Progress in 2020

Impact of COVID-19 on our activities in 2020

0.12

Total recordable incidents rate in 2020 (employees, contracted employees, and contractors)

An employee in PMI's manufacturing facility in Guadalajara, Mexico

Health and safety performance

Our health and safety performance monitoring covers both PMI employees and contracted workers who are under the direct supervision of PMI but employed by a temporary employment agency (we had around 7,000 contracted employees per month in 2020). We also seek to continuously improve our monitoring of contractors when present on PMI premises.

In 2020, across our factories, offices, and fleet, our lost time incident rate (LTIR) for employees, contracted employees, and contractors was 0.08 (2019: 0.14). More specifically, it was 0.07 (2019: 0.12) for employees and contracted employees and 0.12 (2019: 0.23) for contractors. We do not set targets on lost time incidents, because we want to handle every single accident with the same level of importance, analysis quality, and mitigating actions regardless of whether or not the accidents involve lost time. We address equally all types of injury happening to all people in our premises—employees, contracted employees, and contractors.
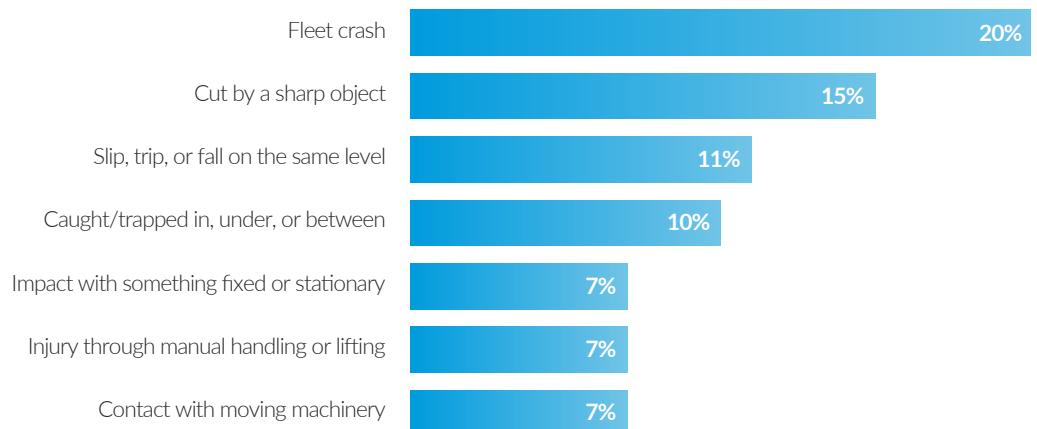
Our total recordable incidents rate (TRIR) was 0.12 (2019: 0.22)—which breaks down into 0.11 (2019: 0.20) for employees and contracted employees and 0.16 (2019: 0.32) for contractors.

Our LTIR and TRIR rates improved versus 2019, thanks to the strong commitment of our senior management, continued training and capacity-building, and a heightened safety awareness across the organization.

We are proud of the progress made to date but remain cautious, as exceptional circumstances in 2020 driven by COVID-19 have positively impacted figures. We will keep strengthening our monitoring and remain committed to achieving a TRIR below 0.3 by 2025 in a sustainable manner.

Top seven direct causes of injury in 2020

Cause	%
Fleet crash	20%
Cut by a sharp object	15%
Slip, trip, or fall on the same level	11%
Caught/trapped in, under, or between	10%
Impact with something fixed or stationary	7%
Injury through manual handling or lifting	7%
Contact with moving machinery	7%

Health, safety, and well-being at work continued

Working with contractors

Contractors are workers who are employed by or work on behalf of a third-party company contracted by PMI but who remain under the direct supervision of their employer. Typically, such workers are involved in project-specific or outsourcing arrangements.

The contractors with whom we work are employed by companies with varying approaches and requirements related to health and safety.

We had on average around 17,000 contractors per month in 2020, across our global organization. Their work typically includes specific projects (such as machine installation or construction), facility management (such as building maintenance), logistics (such as transportation and administration), or services such as canteens and medical centers available on PMI premises.

In 2020, our Health & Safety and Procurement teams reviewed our standards to further define health and safety requirements and performance measurement for contractors working on PMI premises. Moving forward, these more detailed measures will strengthen our reporting as we remain committed to achieving a TRIR of less than 0.30 for employees, contracted employees, and contractors by 2025 in a sustainable manner.

Although in previous years we had a zero-trend related to market fatalities, it is to our deep regret that we endured one market fatality in 2020, involving one of our contractors. The accident occurred during market field activities in Indonesia, involving challenging circumstances related to non-compliance with basic work-at-height safety standards. Detailed investigations have been carried out to understand root causes and identify ways to prevent such occurrences in the future. The lessons learned include process improvement in contractor management specifically for raising risk awareness regarding work at height and safe usage of ladders.

Safety in manufacturing

External certification helps us continuously improve and drive efficiency. In 2020, all our factories producing the equivalent of more than three billion cigarettes annually achieved certification to ISO 14001 and ISO 45001. The global multisite certification process included third-party audits of a sample of our sites, demonstrating that best practices are embedded across all our factories.

In our manufacturing facilities in 2020, our LTIR for employees and contracted employees was 0.07 (2019: 0.06). Our TRIR was 0.13 (2019: 0.17). Including contractors in the scope, our TRIR was 0.14, a decrease from 0.2 in 2019. No employee, contracted employee, or contractor fatalities occurred in our factories in 2020.

Following the deployment of behavioral observation systems (BOS) in 2019, we continued in 2020 to reinforce an "active caring" approach aimed at focusing employees' attention on daily safety behaviors—their own and those of colleagues. Drawing on peer-to-peer observations, BOS allows for data-driven decision-making and helps us evaluate and improve our health and safety strategy. We continued engaging employees and delivering training on BOS to shop floor teams, supervisors, and high-level management across all our factories. Globally, we engaged over 90 percent of employees in our manufacturing sites in BOS in 2020, and they conducted an average of nine observations per employee every month, contributing directly to improvements in our TRIR.

Learning and data from BOS help us adjust our initiatives and inform our strategy. We plan to digitalize the system in 2021, which will allow us to better understand the causes of unsafe behaviors and better tailor our prevention programs.

Focus on fleet safety

Driving presents a risk to employees at PMI. We have around 23,000 cars on the road, covering around 370 million kilometers a year. The safety risks faced by our sales and distribution personnel, especially those at the wheel, are exacerbated in regions where road conditions can be hazardous. Road traffic accidents affect not only PMI staff but also the public, so fleet safety management is a top priority. During the year, we reinforced our fleet safety management system, strengthening our procedures and standardizing our incident reporting. We continued to engage fleet safety committee teams at each of our affiliates, composed of the head of local management and representatives of relevant business units.

The challenges we face in delivering safe working conditions relate to road conditions, law enforcement, and driving culture. Drivers almost always work alone, and we recognize that they may be under stress at times. Technology can help manage these risks, and we use telematics to monitor driver behavior to improve safety and efficiency. By the end of 2020, around 35 percent of our vehicles were equipped with telematics, and we plan to have all working tool cars equipped by the end of 2023.

An employee in PMI's Indonesian affiliate, Sampoerna, conducting a fleet safety assessment in Sukorejo, Indonesia

Health, safety, and well-being at work continued

In 2020, globally, we reduced collisions per million kilometers driven, achieving 0.53 (2019: 0.87), continuing the positive trend of the past seven years (2014: 1.8). We must consider the COVID-19 impact in 2020 as a contributing factor, which additionally mitigated collision exposure risk, and we have improved our target, aiming to maintain our collision rate below <0.65 by 2022.

Although we continue to reduce collisions, it is to our deep regret that we endured road traffic fatalities in 2020, involving one PMI employee and five members of the public. The accidents occurred in two countries in Asia, involving challenging circumstances related to negligence of basic defensive-driving techniques, such as advance traffic anticipation and maintaining safe speeds for the road conditions or some elements of distracted driving. Robust investigations have been carried out to understand what happened and identify ways to prevent such occurrences in the future. The lessons learned include the necessity for a proactive risky driving detection platform, relying on a robust fleet safety management program and balance among behavioral programs, technology implementation, and a PMI fleet safety policy.

Employees in PMI's Indonesian affiliate, Sampoerna, office in Sukorejo, Indonesia

Employee well-being

Along with the many challenges, some positives have come from the need to adapt to COVID-19. One of these is the acceptance that remote work can be effective, productive, and, for some, a more satisfactory way of working compared with a full-time on-site presence. That said, sustained remote work presents its own challenges, and in-person interaction remains valuable. With this in mind, we have developed a global plan and adopted the concept of "Smart Work"—a hybrid of remote and office-based work—over the summer as the new standard way of working for PMI.

Our Smart Work philosophy enables employees to define more effective and efficient ways to achieve their objectives through greater flexibility in how and where they choose to work, facilitating increased productivity, flexibility, enjoyment, and ultimately balance in our everyday lives. A detailed suite of resources has been developed to guide markets in the implementation. The program is a post COVID-19 initiative. Due to the COVID-19 resurgence in many countries during the second half of the year, to date we have launched Smart Work in three markets (India, Thailand, and Vietnam). In the markets not yet covered by Smart Work, our FlexAbility program allowing for remote work, a compressed workweek, part-time employment, and unpaid leave remain available, subject to local COVID-19 restrictions and guidance.

During the year, we launched a global Employee Assistance Program which provides employees and their families with psychological and emotional counseling support as well as legal and financial support. This program was initially launched in 52 countries where the service did not exist previously and, by the end of 2020, 75 countries were part of the global program, covering over 80 percent of our employees and their immediate family members. Initial feedback on the program was positive, with utilization in line with global norms for such a program.

During the early stages of the pandemic, communications from senior management emphasized understanding of and empathy for personal situations and the extra pressure that pandemic restrictions were putting on individuals and families. They set the expectation that people managers be flexible with work priorities, and employees prioritize care for themselves and their families. We hosted several panel discussions with senior leaders, employees, and outside experts and facilitated conversations on our internal social media channel to raise awareness of mental healthcare and destigmatize struggles and asking for help. We also have an online learning platform with external expert resources for mental healthcare. We ran holistic resilience capability building workshops for our top 200 leaders. Those workshops define resilience as dealing with everyday stress without compromising well-being, coping with setbacks, and adapting to change and preparing proactively for future challenges.

As part of our regular employee listening, we ask employees once a year to answer the following question: How would you rate your current psychological or emotional well-being at present? This gets measured on a five-point scale from very bad to very good. In 2020, 58 percent of employees responded "good" or "very good." We will track progress on this indicator and aim to achieve a 5 percent increase in 2021.

Health, safety, and well-being at work continued

Building a smoke-free future starts with us: Leading by example

Across the organization, from our offices to our factories, we are doing our part to make our vision of a smoke-free future a reality.

For any individual, and in turn an employee of our company, a smoke-free future means quitting cigarettes for good. The next best option for those who would otherwise continue to smoke is to switch completely to a smoke-free alternative such as an e-vapor or heated tobacco product. Our Smoke-Free Employer Program brings this belief to life, with concrete action and information to educate and transform our workforce and workplaces. Being a large organization, it is imperative that we are as clear and as straightforward with our own teams on what the smoke-free future is, as we are with the rest of the world.

The basis of the program starts with reinforcing the message to employees that smoking is harmful and encouraging them to quit all nicotine and tobacco products altogether. The program also informs those who would otherwise continue to smoke that better alternatives to cigarettes are available. Coupled with education and awareness building, we have created sessions on both understanding those alternatives as well as the science behind them, for employees to make more informed choices. The final piece of the Smoke-Free Employer Program is taking all available actions to ban indoor smoking of cigarettes, remove indoor cigarette smoking rooms, and for employers to offer the use of smoke-free alternatives in accordance with local laws and regulations.

PMI affiliates around the world have been implementing this program. Once locations have successfully implemented the Smoke-Free Employer Program, they can apply to become "Smoke-Free Culture" certified by a third-party independent body. The protocol for the "Smoke-Free Culture" certification was developed by TÜV AUSTRIA. It is available to organizations such as events, corporations, and public authorities (e.g., municipalities), recognizing their commitment to reduce smoking and cigarette consumption through tangible actions and measurable objectives. "Smoke-Free Culture" certified organizations plan, support, implement, monitor, and continuously improve a set of actions with the aim of ensuring this vision.

PMI's Greek affiliate Papastratos was the first affiliate to implement the Smoke-Free Employer Program and to become "Smoke-Free Culture" certified in 2018. To date, in addition to Greece, PMI affiliate offices in Canada, Japan, Lithuania, the Czech Republic, the Slovak Republic, and the U.K. have been "Smoke-Free Culture" certified. Additional affiliates are currently in preparation for the certification process, and our goal is for PMI to become the first globally "Smoke-Free Culture" certified company.

Our goal is for PMI to become the first globally "Smoke-Free Culture" certified company

Next steps

At the end of 2020, many countries were facing a second wave of COVID-19, with governments issuing new requirements to try to slow the spread of the virus. To contribute to mitigation efforts, we remain committed to promoting the behaviors and measures recommended by authorities and public health experts. We will stay diligent and ready to react as the situation evolves.

In our manufacturing facilities and fleet, we will continue to deliver initiatives to improve safety and meet country-level and global targets.

Specific priorities for 2021 are to establish an integrated data-driven roadmap of priority action to support holistic well-being of employees across the company. This will include accelerated promotion of mental health support worldwide. We will continue to actively encourage talking about mental health and sharing stories to reduce stigma, as well as providing training to employees and line managers to understand the impact of mental health issues, recognize signs of struggle, and know how to support themselves and their teams.

2020 performance highlights

See our performance metrics >

0.12
Total recordable incident rate (TRIR) per 200,000 hours worked for PMI employees, contracted employees, and contractors
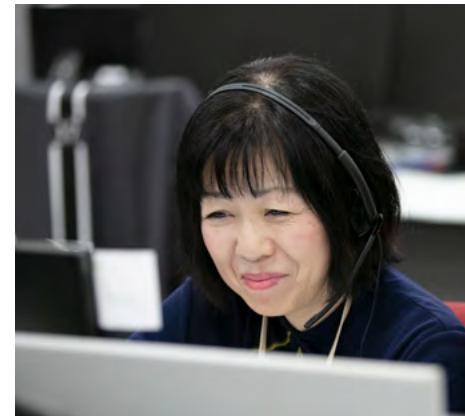
100%
Of our manufacturing facilities certified OHSAS 18001 and ISO 14001

Overview

Innovating for
better products

Operating
with excellence

Caring for the
people we work with

Protecting the
environment

Performance
metrics

TIER 2

Diverse and inclusive working environment

We believe diverse and inclusive workforces make businesses and society stronger, boosting innovation, creativity, responsiveness to change, performance, employee motivation, engagement, and well-being. PMI's goal is to uphold an inclusive environment in which all employees feel respected, supported, and engaged—and thus able to perform at their best. We are committed to improving the workplace by fostering an inclusive culture and enhancing our diversity.

Read more online

Community support

Supporting the communities in which we operate primarily means contributing to local development through community investments, charitable donations, and employee volunteerism.

Read more online

Fair working conditions

For PMI, fair working conditions are defined as conducting effective labor relations through ongoing engagement and social dialogue, promoting freedom of association and the right to collective bargaining.

Read more online

Talent attraction, retention, and employability

For PMI, talent management includes two primary areas of focus: Providing a workplace that is attractive to prospective employees and in which current employees can grow personally and professionally, and develop careers that satisfy and engage them; and responsibly addressing the future of work by considering the potential impacts of automation, digitalization, and business transformation.

Read more online

A field technician next to a renewable and sustainable forest in Pakistan

Protecting the environment

Effective environmental management across our operations and value chain goes beyond compliance with applicable laws and regulations. We are committed to continually improving our business activities to achieve the highest standards of sustainability, in line with our Environmental Commitment.

While improving the environmental performance of our manufacturing operations is vital, most of our ecological impacts arise elsewhere in our value chain—in particular, in tobacco growing and curing, and consumer waste. Working collaboratively with tobacco growers, suppliers, retailers, NGOs, and governments is critical to achieving our environmental targets.

In this section

Further reading

TIER 1

Climate protection

Climate change is among the greatest threats society faces. There is scientific consensus on necessary greenhouse gas (GHG) emission reduction targets; what is needed now is action from all parts of society to achieve them. PMI has been recognized as a climate leader and we continue working closely with our suppliers to achieve our science-based targets.

Tobacco seedling in Salta, Argentina

The right thing to do

The climate crisis, as acknowledged by the international community, threatens livelihoods, particularly those of the world's most vulnerable people. It impacts human rights, biodiversity, water access, global health, and food security, and exacerbates environmental changes such as ecosystem degradation, drought, flooding, and desertification. While science tells us that climate change is irrefutable and unavoidable, it also tells us that it is not too late to limit the warming to the 1.5 degrees Celsius that is considered the limit beyond which impacts will be catastrophic. This will require fundamental transformations in all aspects of society—how we grow food crops, use land, transport goods, and power our economies. The great challenge of our times is to find a way to effectively align the public and private sectors to take critical action and to put aside existing separate approaches and objectives. As a business with a multinational environmental footprint, PMI will continue to play a role in contributing to addressing this crisis.

The business case

We recognize climate change as both a risk and an opportunity. It changes weather patterns, which is particularly important for businesses like ours with an agricultural supply chain. Climate change also threatens facilities and operations, supply and distribution chains, as well as access to power networks and water. At PMI, we are taking steps to strengthen our resilience to climate impacts, reduce our GHG emissions, apply innovative low-carbon technologies, and support policies enabling a smooth transition to a low-carbon economy. Consistently, we voice support for national and global climate policies that help us plan for business growth, as we believe that effective climate policies give us more certainty for short- and long-term planning and investments, as well as help us better anticipate regulatory risks and seize economic opportunities. Moreover, we have reviewed our approach to carbon pricing, which we see as a powerful tool to consider the potential impact of external carbon taxes. But beyond helping mitigate risk related to investments that could become stranded with carbon-constrained regulation, shadow carbon pricing and carbon levy allow us to be more efficient and communicate to stakeholders, including investors, how we are making decisions, efficiently managing the shift from high-carbon to low-carbon activities.

Our aims

Net zero
Achievement of carbon neutrality of PMI's direct operations (scope 1+2) by 2030

Net zero
Achievement of carbon neutrality of PMI's value chain (scope 1+2+3) by 2050

Climate protection continued

Achieving our aims

Our climate strategy aims to address pertinent climate change risks and build resilience while seizing opportunities presented by a low-carbon future. To deliver on our climate ambition, we rely on robust carbon footprint accounting, sound analysis of climate change-related risks and opportunities, ambitious targets, clear management and governance structures, and key enablers such as our internal carbon pricing.

The past year marked a milestone in our sustainability journey, as many of our targets had been set against 2020. We achieved or exceeded most of them. As anticipated in our previous report, we scaled up our ambition and further strengthened our climate strategy in 2020, leveraging the progress made so far.

Based on our performance, we believe we can achieve our aim of carbon neutrality in our direct operations by 2030 significantly sooner. Likewise, we remain committed to achieving net zero emissions across our value chain by 2050.[1]

To achieve our carbon-neutrality targets, we focus primarily on reducing absolute carbon emissions. To guide our work in the years to come, we revised our absolute CO_2e emission reduction targets in 2020 to align with a scenario of an increase in global temperatures of no more than 1.5 degrees Celsius above pre-industrial levels. In doing so, we aligned with the recommendations of the Intergovernmental Panel on Climate Change (IPCC) 2018 report. We also updated our baseline, moving it from 2010 to 2019, to account for changes in our footprint and business model.

Our new targets, assessed and approved by the Science-Based Targets initiative (SBTi) in 2020, commit us to:

- Reducing our absolute scope 1+2 GHG emissions by 50 percent by 2030 from a 2019 base year
- Reducing our absolute scope 3 GHG emissions by 50 percent within the same timeframe[2]

To deliver on our targets, we take a holistic, three-part approach to emissions reduction: First, we seek to reduce consumption and optimize efficiency. Second, we minimize the use of fossil fuels and promote the switch to renewable energy. Third, once we have maximized our emissions reduction, we compensate for the remaining unavoidable emissions. When possible, we prioritize in-setting projects in our supply chain; alternatively, we purchase certified carbon credits.

Our carbon-neutrality work covers our entire value chain, which extends from the supply of tobacco and other materials to the production, packaging, commercialization, use, and end-of-life of our products. Guided by our footprint model, we have targets and tailored strategies in place that take into consideration the most significant climate impacts across our value chain.
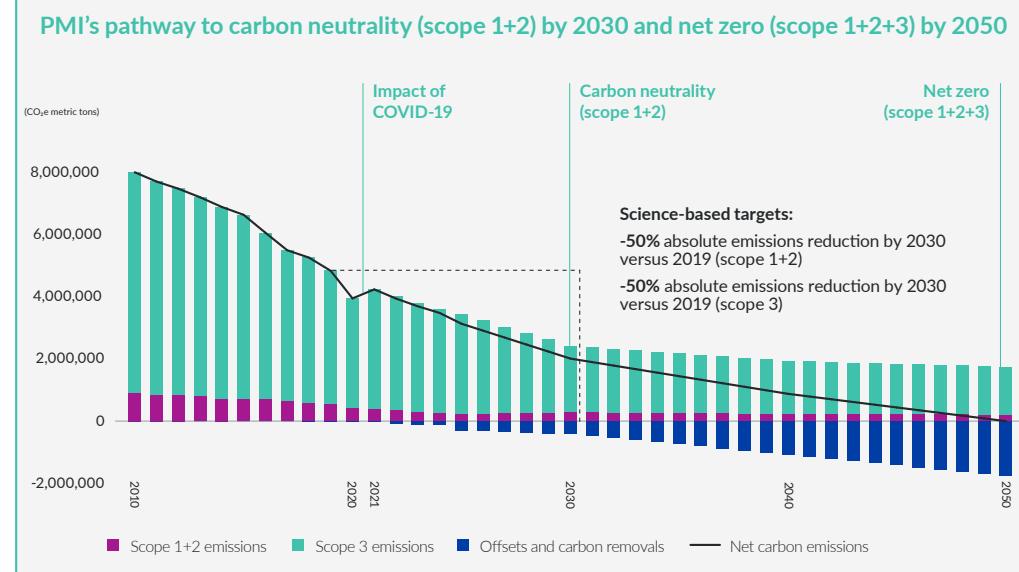
Our approach to decarbonizing our operations and value chain is guided by several corporate policies. Reducing energy consumption and carbon emissions is embedded in our **Environmental Commitment**, our **Guidebook for Success** (PMI's Code of Conduct), our **Responsible Sourcing Principles**, and our **Good Agricultural Practices** program; our efforts to protect forests, as a fundamental climate-regulation mechanism, are in accordance with our **Zero Deforestation Manifesto**. Our well-established environmental management system, based on international standards such as ISO 14001, supports the implementation of our environmental policies across our operations.

Stakeholder engagement

We know that partnership is critical to successfully addressing climate change and achieving UN SDG 13 ("take urgent action to combat climate change and its impacts"). PMI partners, supports, participates, and is a member of sustainability-related initiatives and organizations such as the World Business Council for Sustainable Development (WBCSD), Business for Social Responsibility (BSR), CSR Europe, and the We Mean Business coalition, which harness the power of collaboration to implement solutions at scale. In 2020, our CEO joined in **an open letter** from CEOs from over 170 businesses, investors, and business and investor networks, in a letter to call on EU policymakers to support an EU 2030 GHG emissions reduction target of at least 55 percent. Moreover, following the establishment of our new science-based emissions reduction

targets consistent with keeping global warming to 1.5 degrees Celsius above pre-industrial levels, we signed the Business Ambition for 1.5°C commitment—responding to the call-to-actions for companies to step up their ambition for the best chance of tackling the climate crisis. Our affiliates also belong to national business associations that are engaging with governments to advance progress on climate protection at the local level.

We have received external recognition for our efforts, achieving the highest possible score of 100 in the climate strategy, environmental reporting, and environmental policy and management systems categories of the 2020 Dow Jones Sustainability Index. We disclose our efforts to the CDP annually, and in 2020 we achieved a **"triple A" score** for sustainability leadership and maintained our position on the A List for Climate Change for the seventh year in a row.

PMI's pathway to carbon neutrality (scope 1+2) by 2030 and net zero (scope 1+2+3) by 2050

(CO_2e metric tons)

Impact of COVID-19

Carbon neutrality (scope 1+2)

Net zero (scope 1+2+3)

Science-based targets:
-50% absolute emissions reduction by 2030 versus 2019 (scope 1+2)
-50% absolute emissions reduction by 2030 versus 2019 (scope 3)

Legend: Scope 1+2 emissions · Scope 3 emissions · Offsets and carbon removals · Net carbon emissions

This chart aims to be indicative; underlying data are based on simulation and actual assumptions until 2030 (based on our science-based targets), and on simplified assumptions as of 2030.

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1 Net zero GHG emissions are achieved when anthropogenic emissions are balanced globally by anthropogenic removals over a specified period (source: World Resources Institute).

2 The boundary of our targets includes biogenic emissions and removals from bioenergy feedstocks.

Climate protection continued

Assessing climate change risks and opportunities

In conjunction with our integrated risk management process, we periodically conduct a climate change risks and opportunities assessment to fully understand PMI's impact across our entire value chain. This work aligns with international expectations such as those of the Paris Agreement to mitigate and adapt to climate impacts, as well as the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).

Our most recent risk assessment was conducted in 2019 and reported on in our last report as well as in **our submission to the CDP**.

"Strong action must be taken to reduce the risks of climate change impacts and stop the destruction of nature. At PMI, we are investing in innovative programs and taking a multidisciplinary approach to reduce the environmental impact of our products, operations, and value chain."

André Calantzopoulos
Executive Chairman of PMI's Board of Directors

Employees in PMI's manufacturing facility in Guadalajara, Mexico

Governance and management

PMI's governance and management systems aim to ensure that climate-related risks and opportunities are considered in relevant decision-making processes. The Nominating and Corporate Governance Committee of PMI's Board of Directors (BoD) oversees the company's sustainability strategies and performance, including climate change-related issues and initiatives aimed at eliminating negative impacts of our business on the environment. The Audit Committee of the BoD oversees the assessment and management of company risks, including those related to climate change such as natural disasters, water scarcity, and agricultural supply chain instability.

A member of PMI's Company Management, the Senior Vice President (SVP), Operations is tasked with addressing climate change risks, including physical and water-related risks, across all company activities. In 2020, this person reported to PMI's Chief Operating Officer, who himself reported directly to the CEO. He monitored and reviewed progress against objectives, strategies, and action plans related to climate change, and reported findings to the Nominating and Corporate Governance Committee and Audit Committee of the BoD.

As of May 2021, the SVP, Operations reports directly to and regularly updates PMI's CEO on climate issues and has operational responsibility, including for maintaining robust business resilience, risk assessment processes, and strategies to support business continuity. He examines and monitors issues related to climate change, ensuring that risk assessment and management are integrated into long-range plans, objectives, budgets, and performance review processes.

From an operational perspective, our Operations, Product, Consumer, Commercial, and Finance functions coordinate the company's climate change-related activities. Most of the coordination is done by the Sustainability team and takes place in the context of sustainability-related working groups and with local market coordinators.

"We strongly believe that PMI must play its part in protecting our planet by reducing our environmental impact across our value chain and by defining and executing strategies and initiatives to achieve our long-term targets. Our business and sustainability strategies are advancing hand in hand with increasing momentum. As we transform our company, we are also accelerating our sustainability efforts to achieve a smoke-free and more sustainable world."

Massimo Andolina
PMI Senior Vice President, Operations

This helps ensure that our global strategies and programs can be implemented at the market level and that local realities are reflected in our global efforts.

We incentivize our tobacco leaf buyers, procurement managers, environmental managers, and other relevant employees through monetary rewards or other forms of recognition for the successful implementation of GHG emission reduction projects, climate change mitigation activities, and behavioral change toward climate protection. We also seek to sensitize our entire workforce to the issue of climate change through regular internal communication and training.

Climate protection continued

Progress in 2020
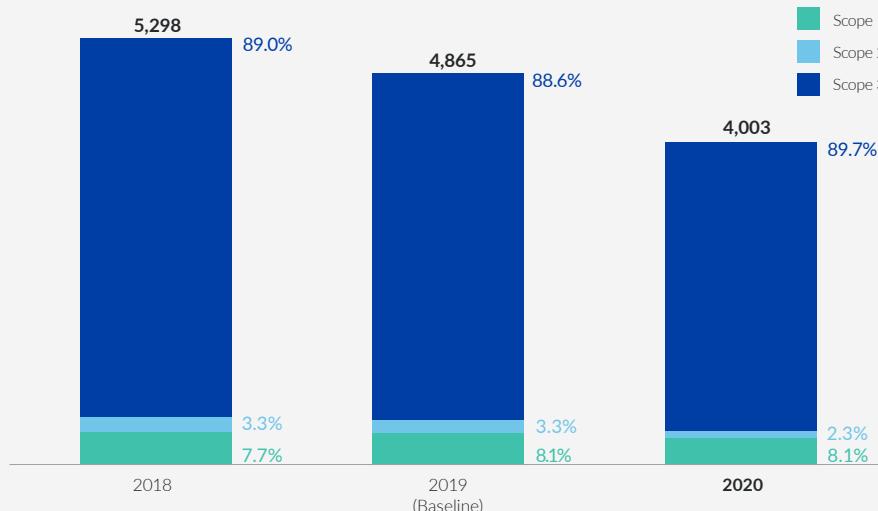
Impact of COVID-19 on our activities in 2020

Overview of our 2020 carbon footprint

Accurate measurement and transparent reporting of our footprint enables us to shape our strategy, set targets, and measure progress. We calculate our GHG footprint annually, following guidance from the Greenhouse Gas Protocol and accounting for all emissions generated across our value chain.

The emissions generated by our direct operations—including our factories, offices, and fleet—are a key focus, but they amount to around 10 percent of our total GHG footprint. One critical producer of GHG emissions we seek to address is the energy required to produce the consumables for our smoke-free products, which is approximately four times greater than for cigarettes. This is mainly due to the additional steam required in the manufacturing process. This leads to an increase in GHG emissions, which we address with multiple energy-saving measures.

Representing 85 percent of our total GHG footprint, our upstream emissions include those generated by curing fuels and fertilizers in our tobacco supply chain, acquiring and transporting direct materials such as paper and cellulose acetate tow, procuring indirect materials and services such as marketing, sales, and other professional services, third-party disposal and treatment of waste, and business travel and employee commuting.

Our upstream emissions reduced by 17 percent versus 2019, as a result of the reductions that we drove in our tobacco supply chain, our efforts in reducing the materials for our packaging, and the progress made by our direct materials suppliers to reduce their emissions. Furthermore, this year a small amount of the GHG reduction in our upstream emissions was due to the pandemic-related decrease in our employees' business travels and commuting.

Downstream, emissions generated by the transport and distribution, use, and end-of-life management of our products represent 5 percent of our total footprint. The emissions related to use and end-of-life management of our products are slowly but steadily decreasing mainly due to improvements in our heated tobacco units as well as the devices design that impact its use and end-of-life emissions. Eco-design principles inform how we use life-cycle analysis (LCA) to assess the carbon footprint of our products, from tobacco sourcing to end-of-life impacts.

ⓘ Read more: **Product eco-design and circularity**
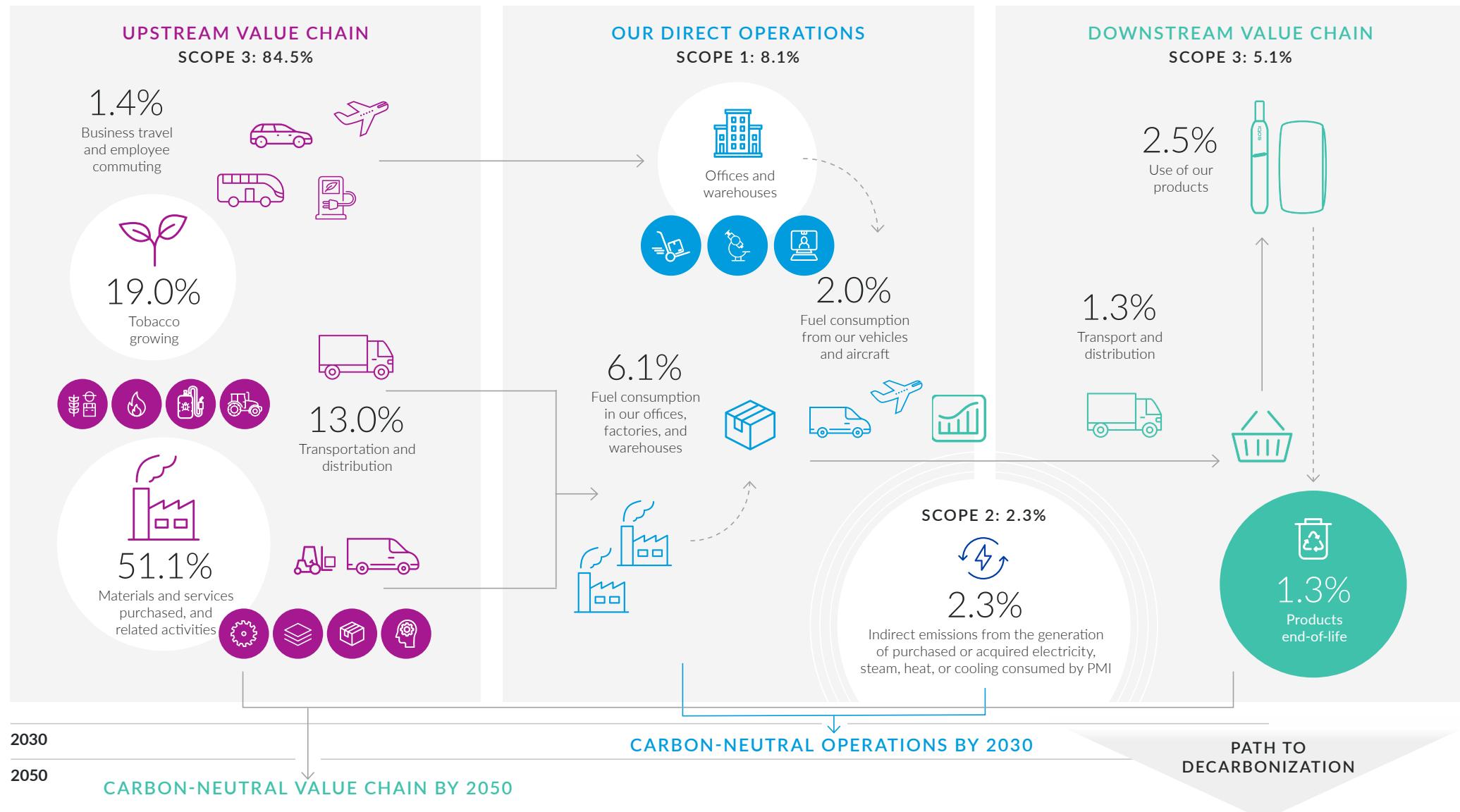
Overall, in 2020 our emissions decreased in absolute terms by 18 percent across our value chain versus 2019, amounting to a reduction of 862,699 tons of CO_2e. More specifically, we achieved a year-on-year absolute reduction in scope 1 emissions of 19 percent, in scope 2 of 43 percent, and in scope 3 of 17 percent.

Global greenhouse gas emissions scope 1+2+3 ('000 tons CO_2e)

	Scope 1	Scope 2	Scope 3
2018 total 5,298	7.7%	3.3%	89.0%
2019 (Baseline) total 4,865	8.1%	3.3%	88.6%
2020 total 4,003	8.1%	2.3%	89.7%

An employee at PMI's Indonesian affiliate, Sampoerna, solar panel farm in Karawang, Indonesia

Climate protection continued

Carbon emissions along our value chain in 2020

UPSTREAM VALUE CHAIN
SCOPE 3: 84.5%

1.4%
Business travel and employee commuting

19.0%
Tobacco growing

13.0%
Transportation and distribution

51.1%
Materials and services purchased, and related activities

OUR DIRECT OPERATIONS
SCOPE 1: 8.1%

Offices and warehouses

2.0%
Fuel consumption from our vehicles and aircraft

6.1%
Fuel consumption in our offices, factories, and warehouses

SCOPE 2: 2.3%

2.3%
Indirect emissions from the generation of purchased or acquired electricity, steam, heat, or cooling consumed by PMI

DOWNSTREAM VALUE CHAIN
SCOPE 3: 5.1%

2.5%
Use of our products

1.3%
Transport and distribution

1.3%
Products end-of-life

2030

2050

CARBON-NEUTRAL OPERATIONS BY 2030

CARBON-NEUTRAL VALUE CHAIN BY 2050

PATH TO DECARBONIZATION

Climate protection continued

A new approach to carbon pricing at PMI

An increasing number of organizations and sustainability leaders are using internal carbon pricing to structurally drive a reduction in CO_2 emissions. Assigning a price—and hence a theoretical cost—to the emissions generated makes an intangible more concrete and further incentivizes actions to reduce the emissions contributing to global warming.

In 2020, we took a new approach to internal carbon pricing at PMI, developing two complementary internal carbon prices: A shadow price and a carbon levy.

- **A shadow price** of USD 65 per ton of CO_2e: Our shadow price is an internal lever designed to accelerate carbon emissions reduction by ensuring that the company's investment decisions reflect all costs, including environmental ones. We use this price to better understand the potential impact of external carbon pricing (e.g., carbon taxes) on the profitability of a project, a new business model, or an investment, and hence drive and prioritize investments that accelerate CO_2 emissions reduction to a level that is considered as unavoidable (i.e., technically or economically not further abatable). We modeled what an adequate shadow price should be for PMI following a robust methodology, best international practices (such as guidance from the World Bank and the Stiglitz and Stern price corridor concept), a worst-case scenario analysis of transition risks projected by 2040, and specificities of our emission profile and geographic footprint. PMI's shadow carbon price is integrated into the financial evaluation and preparation of business cases that will impact our carbon emissions (favorably or unfavorably); in 2020, it was instrumental in the approval of 13 additional carbon emission reduction projects as part of our energy saving initiatives program in our manufacturing sites.

- **A carbon levy** of USD 8 per ton of CO_2e: The carbon levy internalizes external costs and supports behavioral change. It is an internal tax that is virtually charged to selected business units for their emissions, with the aim to use the calculated virtual revenue to size and fund investments that contribute to the decarbonization of the business. While the shadow price helps in the prioritization of business cases for investment in activities aimed at structurally reducing our carbon emissions, the carbon levy helps size the investments required today to abate our emissions through offsetting (e.g., acquisition of green certificates) or in-setting initiatives (e.g., agroforestry projects, and carbon sequestration programs). We have modeled what the carbon levy should be for PMI basing our calculation on data on the forecasted voluntary carbon market prices, our CO_2 compensation profile (i.e., the number of tons of CO_2 to be compensated through offsetting/in-setting investments), our carbon neutrality time horizon, and the compensation strategy we want to adopt. We started implementing our carbon levy in 2020 within the business functions accounting for the bulk of our direct emissions, such as our manufacturing sites, offices, and fleet, to form a budget that will be conducive to set up a portfolio of climate investments to compensate remaining unavoidable CO_2 emissions and achieve carbon neutrality.

We will revise our shadow price and carbon levy annually to allow the integration of changes in our risk or emissions profiles.

How we calculate GHG emissions

PMI has collected CO_2 emissions data over many years as part of our efforts to improve performance and achieve targets. We need robust data to inform our science-based targets, carbon footprint calculations, product life-cycle analysis, and decisions on investment in low-carbon technologies.

In line with good practices and the GHG Protocol of the World Resources Institute (WRI), we source emission factors from the U.K. government's GHG Conversion Factors for Company Reporting (2020) and the International Energy Agency's Emissions Factors (2020). We source global warming potential rates from the IPCC Fifth Assessment Report, 2014 (AR5). The scope of the data encompasses assets under our operational control, including PMI's fleet and offices (scope 1+2) and our overall upstream and downstream supply chain (scope 3). Scope 2 emissions are primarily market-based. Our value chain carbon footprint model aligns with WRI's Corporate Value Chain (Scope 3) Accounting and Reporting Standard, the accepted international standard.

We undertake third-party verification of scope 1, 2, and 3 emissions to ISO 14064-3 standards (please see the verification statements: **scope 1+2** and **scope 3**).

We use real data when possible; when primary data are not available, we extrapolate emissions from international databases such as ecoinvent. Transport relating to the end-consumer traveling to the retailer is not included under value chain or product footprint standards. Gases included in calculations are CO_2, CH_4, and N_2O (not HFCs, PFCs, SF_4, or NF_3). Biogenic CO_2 emissions are included in our SBTi targets both in direct operation and in our value chain. The climate neutrality at our factories in Lithuania and Switzerland in 2020 encompassed all validated scope 1 and 2 GHG emissions; the remaining emissions were offset by high-quality carbon offset projects from myclimate, using certification from Plan Vivo.

An employee in PMI's manufacturing facility in Izmir, Turkey

Climate protection continued
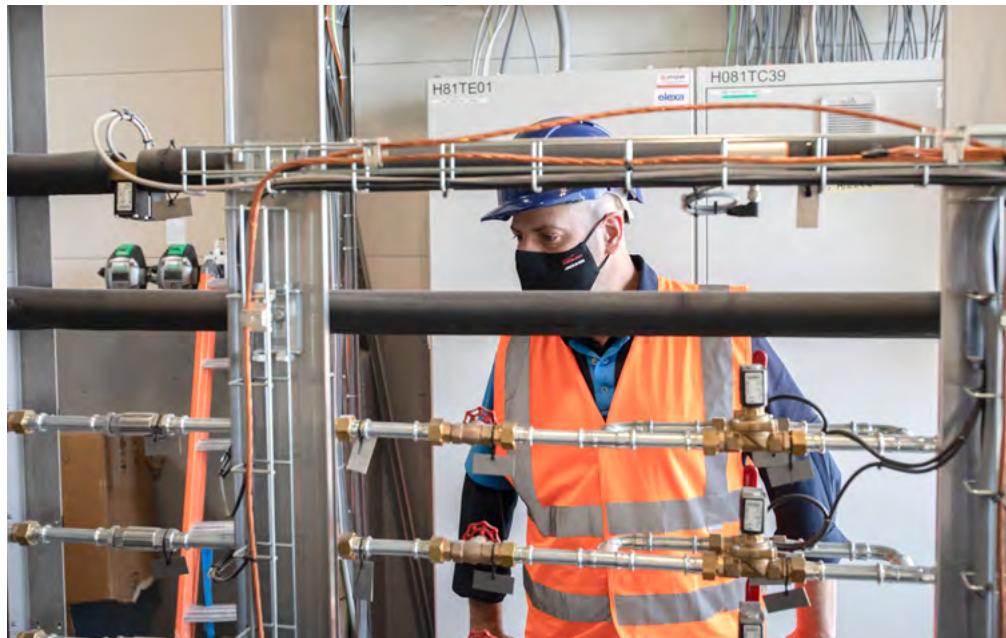
Decarbonizing our operations

Our sites and fleet are the parts of our value chain over which we have the greatest control. We have committed to becoming carbon neutral in our direct operations by 2030, and this commitment applies to our manufacturing facilities, our offices and warehouses, and our fleet. To achieve our ambition, we combine good management practices with strategic energy-related investments across our operations. We invest in optimizing energy and process efficiencies and replacing fossil fuel-based energy with renewable sources. We compensate our absolute carbon emissions only as a last resort—once we have maximized our emissions reduction via energy efficiencies and renewable energy. Our aim is to compensate unavoidable emissions via credits generated through in-setting projects, including nature-based solutions and other carbon removal technologies. Based on our new carbon levy, we are setting up a portfolio of climate investments (resulting in carbon credits generation or acquisition) for carbon compensation.

Our factories

A key component of the program is encouraging behavioral change and an ownership mentality. To reduce carbon emissions in our manufacturing sites, we promote efficient energy use through our Drive 4 Zero program, which establishes a common way of working across our factories. To promote a zero-loss mindset, we designed our systems to facilitate new ideas aimed at eliminating process losses (e.g., energy, materials and water). This seeks to empower every worker to look for losses and recommend and implement solutions. We apply improvements not only across the factories but also throughout the company.

Through this program, we implemented energy-saving projects across all our factories in 2020. Throughout the year, the program triggered more than 140 projects worldwide, ranging from chilled water optimization, heat-recovery projects, and LED lighting to heating, ventilation, and air conditioning system upgrades. Overall, our efficiency initiatives helped drive around 10 percent reduction in carbon emissions across our manufacturing facilities in 2020 versus 2019.
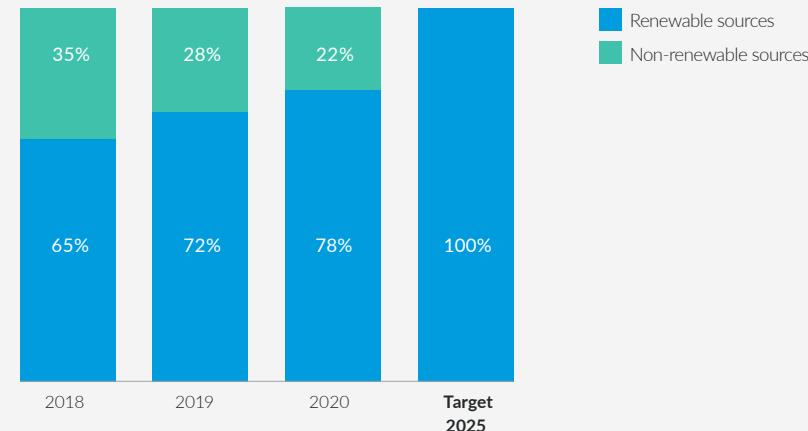
In parallel to our efforts to drive energy efficiency, we focus on switching to renewable energy sources. We implement technologies to generate renewable energy across our manufacturing sites, such as photovoltaic panels, biomass boilers and heat pumps, and tri-generation processes (combining cooling, heat, and power). For instance, in 2020 we installed pyrolysis technology in our factory in Neuchâtel, which uses operational waste instead of fossil energies to produce steam and hot water. It will be operational in 2021, and we will communicate results in our next report. This factory became our second carbon-neutral facility, receiving certification from the Swiss nonprofit organization myclimate. As another example, in 2020 our photovoltaic installation at our Bologna factory in Italy reached its full capacity, generating around 4 percent of the total energy used on the site in a year. In 2020, 34 percent of our total energy consumption came from renewable sources.

We are also on track to achieve our target of 100 percent electricity used in our factories to be from renewable sources by 2025. In total, 78 percent of the electricity used in our manufacturing facilities in 2020 came from renewable sources.

Overall, our efforts led to a reduction of 89,112 tons of CO_2e in our manufacturing facilities in 2020 versus the previous year, with the increased energy required to produce smoke-free products offset by our efficiency efforts and our switch to renewable energy.

An employee standing next to a pyrolysis machine in our manufacturing facility in Neuchâtel, Switzerland

Electricity purchased and produced in PMI factories

	2018	2019	2020	Target 2025
Non-renewable sources	35%	28%	22%	
Renewable sources	65%	72%	78%	100%

■ Renewable sources
■ Non-renewable sources

Climate protection continued

Our fleet

In 2020, our fleet of around 23,000 vehicles covered around 370 million kilometers. Our fleet comprises working tool cars (75 percent) and benefit cars (25 percent).

During the year, we developed a carbon-neutrality strategy for our fleet, along with supporting targets, and built organizational capability within the company.

From an environmental perspective, the first focus for our fleet is to optimize fuel consumption and improve operational efficiency. We do so through eco-driving training and the use of telematics. In 2020, we established a dedicated fleet safety e-learning platform with eco-driving modules. We started rolling it out early 2021, and we intend to reach a participation rate of over 70 percent in 2021. Telematics were installed in 35 percent of our vehicles by the end of 2020. This technology provides the driver and the company with data on driving behaviors and helps improve road safety, reduces occurrence of fatalities and injuries, and—as an outcome—leads to a decrease in carbon emissions. We aim to equip 75 percent of our total fleet (i.e., all working tools cars) with such technology by the end of 2023.

Telematics were installed in 35 percent of our vehicles by the end of 2020
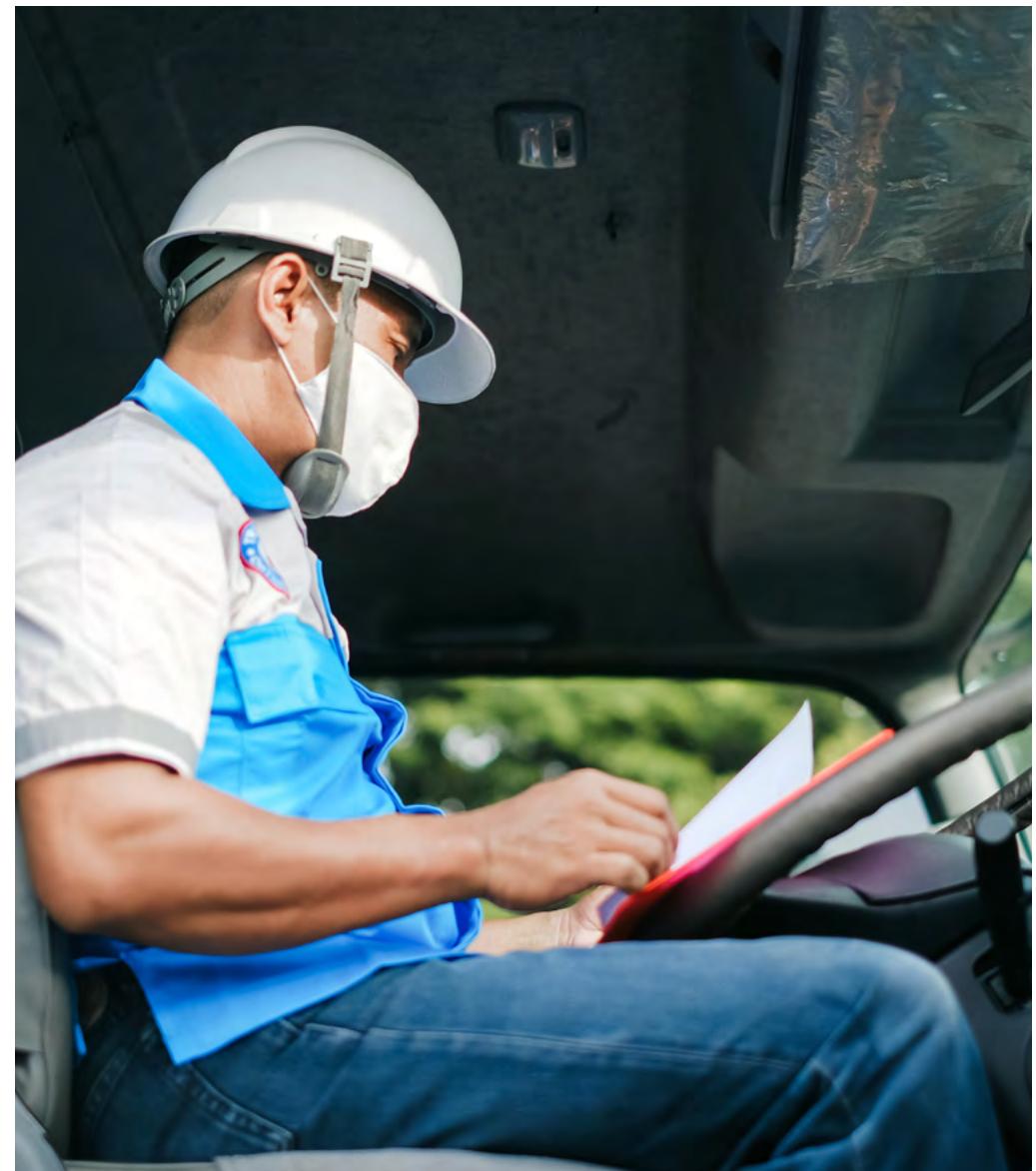
As an important step toward the reduction of our carbon emissions, we are also making changes to our fleet of cars and vehicles, minimizing the use of combustible fossil fuels and switching to alternative eco-powertrains—such as hybrid and electric vehicles. This shift has already begun, with green vehicles representing 4.7 percent of our fleet in 2020, but we plan to further accelerate it following the introduction of our global Fleet Policy in January 2021.

We estimate that our efforts translated into more than 2 percent GHG emissions reduction in 2020 versus 2019 in our fleet. Additionally, due to less mileage (COVID-19 impact) GHG emissions were reduced by more than 20 percent.

Our offices

We have offices and warehouses in over 80 markets worldwide, most of which we lease rather than own. In 2020, we focused on gaining visibility into energy use at those sites and preparing action plans to optimize energy consumption and promote the switch to renewable sources. In 2021, we will pilot these action plans in markets identified as the biggest contributors to our carbon footprint. Those include Indonesia, the Philippines, Poland, Russia, and Singapore.

In 2020, with 28,161 tons of CO_2e produced, our offices and warehouses represented 7 percent of our carbon emissions in our direct operations (scope 1+2), but only 0.7 percent of our total carbon footprint. Our offices in Switzerland were again certified carbon neutral and we purchased 100 percent green electricity in our offices in Portugal, New Zealand, and Sweden, as well as in our tobacco warehouse in Greece.

An employee in PMI's Indonesian affiliate, Sampoerna, conducting a fleet safety assessment in Sukorejo, Indonesia

Climate protection continued

## Driving carbon reduction in our tobacco supply chain

Our tobacco supply chain represented 23 percent of our total carbon footprint in 2020. It amounted to a total of 911,160 tons of CO_2e, a decrease of 28 percent versus 2019. This significant reduction was driven largely by our efforts to tackle our main source of carbon emissions—the process of curing tobacco—but also due to a gradual decrease in our overall tobacco demand.

Now that we have achieved significant progress in reducing GHG emissions from tobacco curing, we are exploring other contributors to our footprint, such as the use of fertilizers and mechanization. We are already exploring opportunities on the reduction of emissions through technological innovations that are rapidly becoming more

available in farming. In parallel to our reduction strategy, we are assessing nature-based solutions, which present an important opportunity due to the high potential for carbon removal and the linkages with our tobacco operations both on the farm and next to the farm at landscape level.

In line with PMI's carbon-neutrality ambitions, we developed new targets for our tobacco supply chain: We aim to achieve an absolute carbon emissions reduction of 35 percent by 2025 and of 50 percent by 2030 versus the 2019 baseline. We will continue our efforts to decarbonize tobacco curing while implementing additional reduction initiatives focused on the use of fertilizer and mechanization.

The main contributors to carbon emissions in our tobacco supply chain: Year-on-year reductions

Category	2019 / 2020	Reduction
Fertilizers	2019 / 2020	-11%
Curing fuels	2019 / 2020	-50%
Mechanized activities	2019 / 2020	-13%

'000 tCO_2e

Our tobacco supply chain emissions have decreased significantly in 2020, against our 2019 baseline. In particular, the emissions from the curing of flue-cured Virginia tobacco have dropped by half as we reached our targets related to fuel sustainability, barn improvements, and overall efficiency of the curing process.

An integrated approach to our environmental impacts in Malawi

Read our case study on environmental practices in Malawi, which describes how we apply a landscape approach accounting for the relationships between different environmental drivers—such as climate, water, forest, and biodiversity—to develop and implement programs with positive impacts not only for the planet but also for the local communities.

Read more online ↗

Tobacco curing

We mainly source three types of tobacco: Virginia, Burley, and Oriental. Virginia tobacco (approximately 47 percent of our purchased volume) is cultivated around the world and, once harvested, is generally cured by using an external heat source to dry out the leaves—a process called "flue-curing." Curing barns may be heated with coal, diesel, natural gas, firewood, or biofuels containing agricultural and wood-sawing by-products. The GHG emissions of flue-cured tobacco represent 6 percent of our total carbon footprint and over a quarter of the total GHG emissions related to our tobacco supply chain.

Our Monitoring and Verification Framework for Sustainable Leaf Curing Fuels allows us to systematically monitor the sustainability of all fuel types used in our tobacco supply chain. We apply it in all flue-cured sourcing markets to verify results on the ground and foster improvement. During 2020, we completed

23 audits—performed remotely due to the COVID-19 pandemic—covering all flue-cured origins to verify carbon reduction activities and data on fuel use per kilogram of tobacco cured.

In 2020, we achieved a 77 percent reduction in GHG emissions per kilogram of flue-cured tobacco versus our 2010 baseline, exceeding our target of 70 percent. One-third of this decrease was driven by efforts to make curing barns more efficient, while the remaining two-thirds resulted from the switch to renewable fuels.

We have set new targets related to decarbonizing the tobacco curing process, which will guide our efforts in the years to come. By 2025, we aim for a 75 percent reduction in emissions generated by curing one kilogram of tobacco, against our 2019 baseline. We will focus on increasing the use of renewable fuels in markets that still use a mix that includes fossil fuels.

Climate protection continued

Curing barns efficiency

A primary reason for the low energy efficiency of tobacco curing barns is the lack of insulation and the thermal conductivity of the construction materials. As most farmers own their curing barns, we collaborate with our suppliers to provide guidance and support to make the barns more thermal-efficient. Typically, our efforts aim to improve combustion efficiency, ventilation, and heating control, together with insulation. While delivering improvement projects worldwide, it is important also to train farmers on fuel efficiency, barn maintenance, and fuel sustainability.

The improvement projects we carried out in 2020 increased the efficiency of 2,146 barns in China, Malawi, the Philippines, Pakistan, and Brazil for a cumulative total of around 82,500 barns upgraded since 2014 and covering farmers in more than 10 countries. The reduction of carbon emissions in the curing process have also benefited from the increased efficiency of the barns that have been improved year on year with interventions mostly related to the thermal cycle and the insulation of the barn structures against fugitive heat.

Renewable fuels

To reduce GHG emissions, we are gradually phasing out fossil fuels such as coal and diesel in favor of renewable fuels. In 2020, 67 percent of the flue-cured tobacco we purchased was cured with renewable fuels, mainly sustainable firewood, but also biomass, such as wood sources, agro-pellets, and other agricultural waste products. We aim for 70 percent of our purchased flue-cured tobacco to be cured with renewables by 2021.
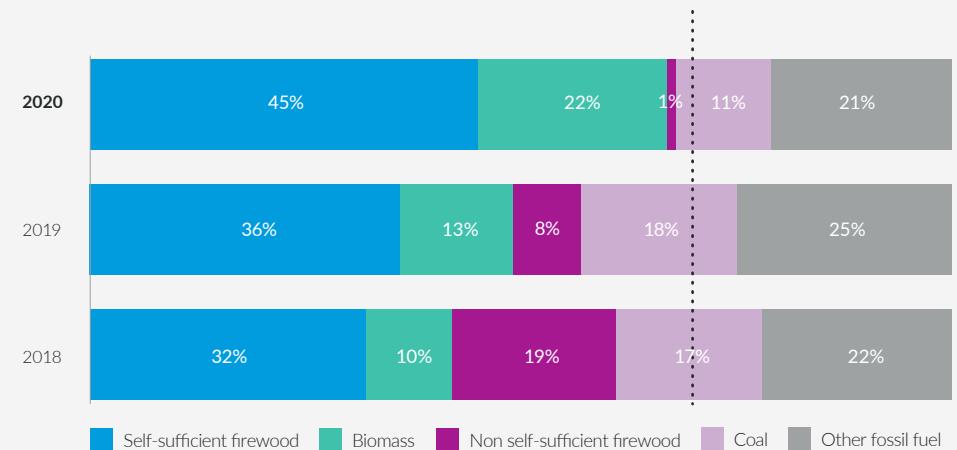
Sustainable firewood

Protecting natural ecosystems and sustainably managing forests, which are important carbon sinks, are key drivers in reducing greenhouse gas emissions. Critical to our work on curing fuels is ensuring that the firewood and other wood-based materials used to cure the tobacco we purchase do not contribute to deforestation. We are committed to sourcing wood fuels from traceable, sustainable, and legal sources and have set targets for our tobacco supply chain as part of our **Zero Deforestation Manifesto.**

An employee of our local third-party tobacco supplier and a field technician next to sustainable firewood in Pakistan

Switching to renewable fuels to cure flue-cured tobacco in our supply chain

70%

We aim for 70% of our purchased flue-cured tobacco to be cured with renewables by 2021

Year	Self-sufficient firewood	Biomass	Non self-sufficient firewood	Coal	Other fossil fuel
2020	45%	22%	1%	11%	21%
2019	36%	13%	8%	18%	25%
2018	32%	10%	19%	17%	22%

Climate protection continued

Our Monitoring and Verification Framework for Sustainable Leaf Curing Fuels enables us to assess the risk of deforestation represented by different wood fuels, collect sourcing information on the wood fuels farmers use to cure tobacco, and confirm that those sources do not contribute to deforestation. In 2020, we achieved our target of having 100 percent of the tobacco we purchase cured with no risk of deforestation of old-growth forests (i.e., primary and protected forests).

(i) Read more: **Forest conservation**

Eliminating coal
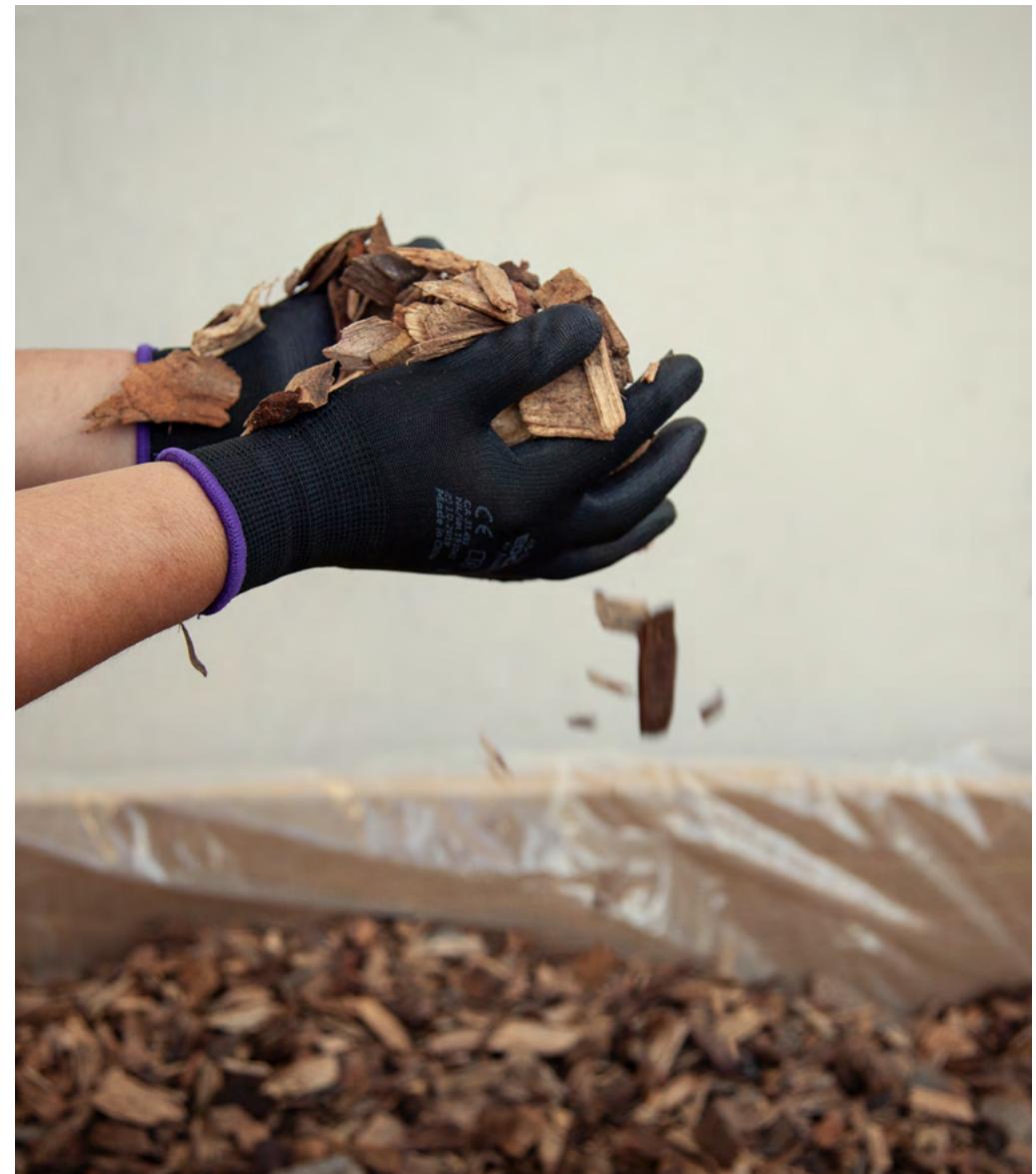
Eliminating coal by switching to renewable fuels, which implies the conversion of curing infrastructures, remains a priority for us. We had set a target to phase out coal completely by the end of 2020 and had made steady progress in switching to more sustainable fuels across our sourcing countries. However, shifts in our sourcing strategy and local curing capacities in certain regions resulted in 11 percent of the flue-cured tobacco we purchased in 2020 being still cured with coal (down from 16 percent in 2019).

100%

Of the flue-cured tobacco we purchased in 2020 was cured at no risk of deforestation of old-growth forests

This pertained to tobacco purchased from the Yunnan and Guizhou provinces of China, where the prevailing curing fuel used by tobacco farmers is coal due to its competitive price and availability.

In 2016, we embarked on a multistakeholder initiative led by the China National Tobacco Corporation and supported by local governments aimed at converting curing barns from coal to biomass and creating a fuel pellets supply chain produced from agricultural waste. By the end of 2020, more than 71,000 curing barns had phased out coal and converted to biomass, leading to a significant reduction in GHG emissions from tobacco curing (from 4.62 to 2.84 kg per kilogram of cured tobacco), measured and verified through our Monitoring and Verification Framework. Beyond the carbon reduction achieved by the barn conversions, the project increased farmers' incomes, as commercial tobacco grades were lifted between 8.6 percent and 11.8 percent for the farmers who switched to biomass-based curing. More detail on this project is available in a **case study** we published with the World Business Council for Sustainable Development in 2020. Biomass pellet auto-feeder attached to the burner has reduced by half the requirements in hours of labor for fuel loading and ash cleaning, lowering the overall cost of production. The estimated cost saving in labor equates close to USD 43 per farmer per season. Coupled with an average price increase of USD 0.17 per kilogram of tobacco driven by quality improvement compared with coal curing, we estimate an average additional income of USD 357 per farmer and per season from tobacco sales.

We remain committed to eliminating coal from our curing fuel portfolio and expect to phase out coal completely by 2023.

Wood chips used for fuel in Guadalajara, Mexico

Climate protection continued

Fertilizers

The use of fertilizers in tobacco production represented around 8 percent of PMI's total carbon footprint in 2020, making it the second largest contributor of GHG emissions upstream in our supply chain, after acetate tow. While we encourage the optimization of fertilizers—minimizing their use in line with our **Good Agricultural Practices**—the adoption of carbon abatement technologies in the manufacturing of fertilizers has also contributed to reducing their CO_2 footprint.

In 2019, PMI updated its calculation model for the CO_2 emissions of fertilizers. In 2020, we refined the calculations to more precisely assess their impact on the company's carbon footprint using more accurate primary inputs on production yield against fertilizer application rate. We focused on understanding the geographic origin (i.e., production plant location) of the nitrogen component of some fertilizers to assign them a more precise emissions factor. By taking into consideration efficiency gains and technological developments occurring in the manufacturing of fertilizers, the total emissions calculated for 2020 are more accurate. While emissions represented an increased share of PMI's total carbon footprint in 2020, they were 11 percent lower in absolute terms than in 2019. The next step in developing the model will be aimed at understanding the impact on emissions of different types of application method of nitrogen-based fertilizers. In 2020, we focused our efforts on improving productivity versus inputs, through the constant implementation of our GAP program and some specific projects linked to better use of inputs. For instance, in Argentina we started together with our farmers to switch irrigation technology to drip in order to both save water and reduce the application of fertilizer per hectare.

In-setting and nature-based solutions

In 2020, we developed a targeted study to map the potential of nature-based solutions (NBS) in our tobacco supply chain and evaluate natural carbon sinks in the context of our carbon neutrality ambition. The focus has been on testing multiple methodologies in three markets (Brazil, Mozambique, and the Philippines) where we believe opportunities are significant and investments could yield the best return in carbon removals generated. The methodologies that we selected are internationally recognized and aligned with the strategy of promoting more resilient forests and sustainable agriculture. We applied reforestation, afforestation, and adoption of sustainable agricultural land management methodological approaches. The study was useful to define the lines of intervention and the scale we will be adopting for future NBS projects in our supply chain. We plan to pilot NBS on the ground by developing one project in 2021, leveraging on the experience that we have acquired this year.

In our last report, we communicated on plans related to an in-setting project related to provision of clean and safe drinking water to farmers within the tobacco-growing areas of Mozambique. The development of the in-setting project has been postponed for a year, given challenges brought by the COVID-19 pandemic. We are actively working on its implementation in 2021 with Carbonsink and we will report on progress next year.

Climate protection in our direct materials supply chain

Beyond tobacco, the materials and services we purchased represented 45 percent of our total GHG footprint in 2020. Of this, 66 percent originated from the direct materials we source, such as cellulose acetate tow, pulp and paper, and our smoke-free electronic devices.

Engagement with our suppliers is instrumental in driving carbon reduction efforts. We accomplish this in a variety of ways. For instance, we organized two webinars in 2020 involving over 50 suppliers across our supply chain categories. The webinars reaffirmed PMI's carbon neutrality commitments and explained our strategies while also training participants on CDP disclosure. In recognition of our efforts, CDP placed PMI on its Supplier Engagement Leaderboard in 2020 for the fourth consecutive year for our actions and strategies to reduce emissions and lower climate-related risks in our supply chain.

Within our supply chain, the direct materials used in the manufacturing of our products—cellulose acetate tow, pulp, and paper (packaging board)—have the greatest impact on our footprint. During the year, we developed and launched a new and comprehensive Supplier Engagement program with our suppliers to collect primary carbon data and understand their GHG emission reduction programs and targets. In 2020, we engaged with 41 suppliers across our direct materials category, representing 80 percent of the category's total carbon footprint. This engagement and the data collected allowed us to significantly improve the accuracy level of the associated carbon emissions calculation, drive the future engagement strategy, and develop a comprehensive roadmap to accelerate the decarbonization of our supply chain. In our engagements with suppliers, we also emphasized our **Zero Deforestation Manifesto** as a critical driver in tackling climate change.

In 2020, emissions from our non-tobacco direct materials supply chain amounted to 1,182,445 tons of CO_2e, a decrease of 14 percent versus 2019.

"An organization's upstream emissions are typically more than 10 times greater than their direct operations. Therefore, we must replicate and champion our own sustainability efforts with suppliers by working together on solutions and programs that have the greatest impact in reducing our environmental footprint. This year's recognition from CDP further reinforces our commitment to transparently report on our progress as we work toward tackling climate change and accelerating our sustainability efforts."

Laurence Ruffieux
PMI Director of Operations, Sustainability

14%

Reduction in emissions from our non-tobacco direct materials supply chain in 2020 versus 2019

Climate protection continued

Next steps

In 2021, we will roll out our new internal carbon pricing to help drive PMI's transition to a low-carbon operating scheme. We will further accelerate the decarbonization of our fleet and offices, deploying the strategies developed in 2020.

In our factories, we will continue to implement energy efficiency and conservation initiatives, increase the share of renewables, switch to green electricity, and promote efficient energy use through our Drive 4 Zero program. We plan to certify additional sites as carbon-neutral by the end of 2021 and aim to develop a roadmap to certify the majority of our factories—that will be representing around 80 percent of PMI's estimated total production—by 2025. In the

medium term, we aim for a gradual shift from improved process technologies to more disruptive technologies such as carbon removal technologies.

In our fleet, we will roll out our new Global Fleet policy, accelerating the transition to electric and hybrid cars and equipping our vehicles with new technologies to drive efficiency. As regards our offices and warehouses, we will start rolling out our strategy in our top 10 contributing markets. Best practices we will gather related to facility management (e.g., lighting and temperature efficiency, renewable energy sources, and purchase of green energy) will be recorded and used for further reapplication across other markets.

In our tobacco supply chain, we will focus on our newly set targets and further reduce absolute emissions through continuous improvement in

curing fuels and additional emissions-reduction initiatives for fertilizers and mechanization. Building on the major progress we have achieved over the past several years, we are now exploring natural climate solutions, working with our contracted farmers on actively managing and restoring soils and growing more trees, which will naturally remove CO_2 from the atmosphere if properly preserved. In 2020, we conducted a preliminary study to assess the potential of nature-based solutions in three markets and, in 2021, we will develop our first pilot project on the methodologies we have tested. The contribution of removal projects will be reported separately from the reductions.

In our non-tobacco supply chain, we plan to extend our supplier engagement and data collection efforts in 2021 to cover additional product categories. We are also exploring the use of a digital platform to facilitate our carbon data management and amplify our supplier-focused activities. Moreover, we plan to evaluate the inclusion of reduction commitments in our business volume allocation criteria and carbon pricing as part of the tender process.

Encouraged by our progress, recent achievements, external recognition by CDP's Triple A, and the validation of our new targets by the SBTi, we are confident we can achieve our carbon neutrality target in our operations (scope 1+2) before 2030. During 2021, we will work on developing a plan to significantly accelerate our efforts and communicate on it accordingly.

We also plan to reassess climate change risks and opportunities in line with a 1.5 degrees Celsius scenario in 2022.

PMI wants to remain at the forefront of the climate neutral agenda. We believe investments and bold strategies will be key, and conditions today are optimal to accelerate decarbonization strategies and projects, and to reduce the overall company's footprint and improve our supply chain resiliency in managing climate-related risks and seizing opportunities in the low-carbon economy.

A tobacco farmworker in Salta, Argentina

2020 performance highlights

See our performance metrics >

18%
Reduction in CO2e emissions across our value chain versus 2019 (scope 1+2+3)

26%
Reduction in CO2e emissions in our direct operations versus 2019 (scope 1+2)

67%
Of flue-cured tobacco purchased cured with renewable fuel sources

78%
Of electricity purchased and produced in PMI factories that is from renewable sources

TIER 1

Littering prevention

Around the world each year, over 360 million tons of plastic waste are generated.[1] Littering is what happens when waste products are discarded incorrectly. It spoils the environment and pollutes the land and the waters, and it has increasingly become a cause for concern in many countries. As individuals are largely responsible for littering, it is important to understand why people litter, as well as how to encourage people not to litter. About one million tons of cigarette filters are produced annually across the tobacco industry. Whereas most cigarette butts are properly disposed, yet too many are casually littered into the environment and are among the most frequently found litter items.[2]

The right thing to do

While most of a cigarette's tobacco and paper wrapping disintegrate when smoked, some parts remain after consumption. A cigarette butt consists mostly of a filter, fine paper, small amounts of tobacco, and residues of smoke constituents in the filter. Whereas the fine paper and tobacco residues degrade rapidly, the filter material—which is made of cellulose acetate (CA), a wood-sourced bioplastic—biodegrades slowly. Depending on the surrounding biophysical conditions, the biodegradation times for cigarette butts can range from three months to 15 years. This, as well as other kinds of litter, can have serious consequences for the environment, such as pollution, harm to wildlife, and spread of disease. Committing to the safe and responsible disposal of post-consumer waste is the right thing to do, as we share the concerns regarding the effects of litter and recognize our responsibility to work toward an unaffected natural environment. Moreover, there is a proven social impact which we believe we can drive, by engaging with our stakeholders, to take action on matters regarding cleanup initiatives and encouraging behavioral change.

The business case

Beyond environmental considerations, cigarette butt litter and litter in general have a social and financial impact which ranges from cleanup costs to the perception of untidiness and lack of safety in areas of high litter prevalence. Cleaning streets of litter is costly for society, and any reduction of littering at the source, by educating and encouraging consumers to dispose properly, can help reduce these costs. Producers are increasingly asked to participate in these costs.

At PMI, we believe we can and should play a role in addressing the issue of littering by helping develop and scale up new emerging and innovative solutions. Appropriately addressing post-consumer waste will help us enhance brand and reputation by directly addressing consumer misperception; it will also allow us to mitigate national and international regulatory risks, which can have financial implications for our bottom line. Finally, it invites us to innovate in a way that can secure our competitive advantage by devising more circular value chains. These are correlated not only with less waste and less litter, but also with less extraction, conversion, and manufacture of raw materials, a better use of materials, and higher operational efficiency—all of which are good for the triple bottom line.

A waste management facility in Jakarta, Indonesia

1 Source: https://www.statista.com/statistics/282732/global-production-of-plastics-since-1950/#:~:text=In%202019%2C%20the%20global%20production,quarter%20of%20the%20global%20production.

2 Source: https://missionmegots.fr/ and https://www.pmi.com/media-center/news/new-pmi-survey-finds-encouraging-signs-in-cigarette-butt-littering-behavior-and-attitudes-and-key-areas-to-address

Our aim

50%

Reduction of plastic litter from our products by 2025 (versus 2021)

Littering prevention continued

Achieving our aims

While many consumers dispose of their waste properly, sadly still too much waste ends up in the environment. We seek to help change behavior to prevent cigarette butt littering and to encourage proper waste disposal. To do this, we have an **Anti-Littering Policy** in place and are acting across PMI to deliver on it; accordingly, we have launched global awareness campaigns and run anti-littering campaigns in several countries across the world.

Our approach to address the issue of littering is three-pronged:

- **Reduce litter on the ground** through efficient and cost-effective collection schemes and cleanup campaigns.

- **Encourage behavioral change:** Inspire change in consumer habits through impactful anti-littering awareness campaigns, involving for example the promotion of effective disposal solutions.

- **Design for circularity:** Replace the plastic in our products with better, more sustainable material alternatives where possible.

Through these three simultaneous strategies, we aim to reduce by 50 percent the amount of plastic littered from our products by 2025.

We plan to use three KPIs to track progress:

- Plastic footprint, which indicates the amount of plastic in the products we commercialize in a year

- Plastic litter footprint, which indicates how much of our plastic footprint ends up as litter

- Plastic litter density, which measures the density of plastic litter resulting from our products found on the ground

A model has been developed which will extrapolate data collected locally to provide global figures, based on georeferenced data. The model was calibrated in 2020 in a city pilot (Lisbon, Portugal). We are aware that COVID-19 is still affecting outdoor activities in many countries, which will impact the amount of litter found on the ground. This may result in relatively low litter prevalence still in 2021 and any baseline data points quantifying the litter incidence taken during this period may require controlling for this.

Stakeholder engagement

We have partnered with the anti-littering NGO Litterati, data analyst CARTO, and high-tech clean city expert Cortexia to develop a global plastic litter model that will allow us to calculate our annual plastic litter footprint and measure plastic litter prevalence. In 2020, we worked with these organizations to develop a methodology to measure plastic litter prevalence and track progress against our plastic litter target. We plan to establish our baseline in 2021.

Smoking habits, environmental awareness, and disposal practices vary by country, so combating cigarette butt littering requires a customized approach. Accordingly, our affiliates work, based on our global methodology, to devise impactful, context-based strategies appropriate for their respective market realities. These local anti-littering campaigns are run by our affiliates, with central support and guidance.

We understand that scalable solutions require the right kind of partnership, and in that regard, we also collaborate with industry peers, work with anti-littering organizations, and engage with public authorities.

Moreover, and to ensure activities are implemented globally and have a tangible impact, we have developed an anti-littering toolkit for use by our affiliates.

Our efforts to raise awareness focus on littering hot spots, such as highly frequented urban areas, squares, and parks identified as priority areas by local authorities. Some of the awareness-raising campaigns are paired with cleanup efforts involving PMI employee participation.

Cleanup campaigns are predominantly designed to raise public awareness on the littering problem in the communities they take place, yet they are not meant to resolve the problem of littering or to replace cost-efficient public cleaning services.

They must be accompanied by convenient cigarette butt disposal solutions. We continuously seek expert input to develop and share innovative approaches to alternative waste receptables, as well as portable solutions for consumers.

PMI's 2020 plastic footprint

As a global manufacturer, we source plastic materials and plastic-containing items for products such as our consumables, packaging, and devices. In 2020, the amount of plastic we purchased was around 127,000 tons.

The largest share (79 percent) of that amount came from the bioplastics used in the filters of conventional cigarettes and *IQOS* heated tobacco units.

Cigarette filters	54%
Heated tobacco unit filters	25%
Packaging	20%
Electronic devices	1%

Note: In 2020, we adjusted our methodology to calculate our plastic footprint based on purchased quantities.

Sorting of cigarette butt litter at a waste management facility in Jakarta, Indonesia

Littering prevention continued

Progress in 2020

Impact of COVID-19 on our activities in 2020

Reducing litter on the ground

In the EU, cigarette manufacturers will be required to participate in the collection and cleanup of cigarette butt litter. The Single-Use Plastics (SUP) Directive will mandate that producers participate in industry-wide Extended Producer Responsibility (EPR) schemes. EPR is an established governance scheme to collect waste for recycling or special treatment; it is now being used for the first time to address littering. We support the concept of an industry-wide EPR, provided such schemes are managed in a cost-efficient, proportionate, and targeted way which addresses the objective of reducing litter and changing consumers' behavior.

The question on how to better enforce existing anti-littering regulations, or to introduce regulation seeking to address the problem of plastic litter, and more specifically cigarette butt litter, is being discussed in other countries such as Australia, Brazil, Canada, Costa Rica, and the U.S. Regulatory initiatives in this context primarily seek to raise the general public's awareness on the litter problem and its environmental impacts, and at the same time propose that producers of products with plastic packaging, or containing plastics, assume responsibility for related litter cleaning cost.

In this regard, we are exploring opportunities to participate in plastic litter collection projects that can reduce not only cigarette butt litter but possibly other unrecyclable plastic waste as well.

In 2019, we had joined the annual World Clean Up Day, the world's largest litter cleanup event. Our affiliates' participation in World Clean Up Day symbolizes the company's commitment to address the issue of cigarette butt litter and is part of our public sensitization efforts. In 2020, given the generalized restrictions in place at the time of the event (September), we decided it was not appropriate for us to run a global mobilization campaign to take part in this event. Nonetheless, a few of our affiliates, where the pandemic-related restrictions were less severe, were able to participate. That was the case for our affiliate in Pakistan (PMPKL), where over 70 of our employees got together with partners from the local NGO NOWPDP, during Pakistan's independence day, collecting over 700 kg of litter from the shoreline in Karachi.

> "While our primary focus is on changing people's behavior to encourage the proper disposal of cigarette butts, awareness raising will not prevent all littering. To meet our target of halving our plastic litter footprint by 2025, we need to continue exploring innovative solutions to reduce and collect plastic litter."
>
> **Jens Rupp**, PMI Head Environmental Sustainability

Tailoring our efforts to local realities

Despite all the constraints arising from the COVID-19 pandemic, some affiliates were still able to deploy a comprehensive strategy involving trade partners, local NGOs, experts, and local authorities. These involved not only awareness-raising initiatives, but also the deployment and assessment of innovative cigarette butt disposal solutions, and even the trialing of alternative disposal methods.

In **the Nordics**, in partnership with reputed local organizations, we supported the launch of portable ashtrays and anti-litter communications, with QR codes linking to websites with key facts about cigarette butt littering (involving approximately 20 key account partners and reaching around 2,750 points of sale). Additionally, in Oslo we supported the deployment of ballot bins in strategic parts of the city, partnering with a group of behavioral scientists (Mindshift) and the local municipality. With them, we conducted several experiments in a city park to assess the efficacy of pocket ashtrays, environmental messaging, and gamification. These experiments showed reductions of cigarette butt littering of up to 32 percent and generated important insights that are being incorporated in our plans.

In **Germany**, our affiliate's activities aimed to establish the usage of pocket ashtrays, assess the behavioral change triggered by visual, auditive and integrative methods, and measure the effectiveness of the campaign in the prevention of cigarette butt littering in pre-defined areas in Berlin. The project was developed in partnership with the local NGO wirBerlin and it ran on eight different locations (outdoor hotspots) over the summer of 2020. Despite the adjustments necessary due to COVID-19 (which limited the execution of some activities and measurements), the overall feedback from Berliners was very positive with measurements showing it is possible to decrease the incidence of cigarette butt littering through education.

In **Russia**, our affiliate launched *Marlboro*'s "Leave no Trace" limited editions and, in partnership with the All-Russian Society for Nature Conservation and National Geographic Russia, launched the project "Russia without trash." This project includes a series of educational publications, webinars, and online activities to sensitize the Russian public to the overall problem of waste and pollution sources, including cigarette butts (**here** a link to one of the websites of the project). Also, in six major cities along the river Volga, our affiliate supported a series of initiatives involving the Ministry of Natural Resources and Environment, including measurements of water quality and microplastic pollution, to sensitize the public in these cities to the link between littering and the contamination of this vital water stream.

In **Mexico**, most of our affiliate's ongoing activities had to be adjusted as of March and a greater focus placed on the online education and awareness-raising campaign. Notwithstanding, in partnership with the local company Ecofilter, PM Mexico was able to deploy 300 public cigarette bins in Mexico City and will continue this effort in 2021; 400 butt collection centers have also been deployed nationally. This deployment was supported with the launch of a dedicated **website**, a social media plan, and an out of home (OOH) communication campaign. The level of engagement of this campaign was outstanding, with over 30 million impressions and a reach of over 120,000 people on social media and OOH. Also, we continue to support Ecofilter with a view to trial environmentally friendly alternative disposal solutions.

Littering prevention continued

Encouraging behavior change

In July 2020, we launched **Our World Is Not an Ashtray**, a web-based, corporate platform to educate, inspire, and engage the public on the issue of littering. Through this awareness campaign, we share facts and figures, testimonials, and calls to action.

Besides leveraging on our brands to encourage adult smokers to change behavior and switch to better alternatives, we also aim to promote post-consumption behaviors related to proper disposal. In that regard, in 2020 we continued the deployment of our *Marlboro* limited-edition "Leave No Trace" pack, which communicates anti-littering messages to adult smokers. Developed in 2019, the pack was sold in nine markets in 2020.

Our proprietary toolkit aims to support our markets to be able to achieve that, adapting their efforts to local realities. We are committed to working in partnership with all relevant stakeholders to develop and share the most innovative approaches. By the end of 2020, 65 markets were using our global toolkit to develop localized strategies, with 33 of them having started implementation. The toolkit provides guidance on the development, monitoring, and evaluation of local programs, as well as best practices.

Eco-design for better filters

From an environmental perspective, the ideal scenario would be for our products not to result in any litter at all. In line with our **Environmental Commitment** and our litter reduction target, we must play our role in designing options that avoid or at least significantly reduce the amount and impact of our plastic litter, and develop filters with more natural, biodegradable, or recyclable materials.

We are aware that material change itself does not solve the littering problem but helps to mitigate the impacts of residual littering of those users who do not respond to anti-littering campaigns.

For many years, we have been actively evaluating exploring and assessing the viability of alternative cigarette filter materials with a lower environmental impact than cellulose acetate (CA), an already renewable and partially biodegradable material. Any new material must satisfy the following criteria:

1. Consumer impact:
- Comparable filtration efficiency and consistent performance to CA filters
- Acceptable taste characteristics, as a product must be successful in the market to have the desired positive impact on the environment

2. Environmental impact:
- Significant reduction in total carbon footprint
- Substantial improvement in marine, aquatic, and soil biodegradation versus CA filters, and/or significant reduction in the plastic content of the filter

3. Commercially viable:
- Material needs to be allowed to be utilized for purpose
- Conducive to industrialization at scale

We evaluate alternative filter materials via extensive chemical testing, machinability trials, biodegradation evaluations, and prototype testing among consumers.

Despite challenges faced during 2020 due to COVID-19 restrictions at our suppliers and facilities, we continued to explore and assess alternative filtering materials with improved biodegradability, including some plastic-free materials.

To date, while some tested materials have met one or more of the above criteria, we are yet to find an alternative to CA that satisfies those criteria. We will continue to explore options as new materials and processes become available.

With regard to our smoke-free products and our packaging, we seek to alleviate their environmental impacts through eco-design.

ⓘ Read more: **Product eco-design and circularity**

Next steps

In 2021, if conditions allow, we will ramp up anti-littering campaigns across the countries in which we operate, in coordination with key stakeholders.

We remain committed to our target of halving the plastic litter from our products by 2025. In 2021, we will also establish our plastic litter baseline.

We plan to deploy our *Marlboro* limited-edition "Leave No Trace" pack in 14 additional markets in 2021 and we will continue to expand it into other brands and find solutions to increase the awareness of the issue across our adult smokers.

We will continue to explore and assess alternative filtering materials to cellulose acetate, considering both manufacturability and product performance.

2020 performance

See our performance metrics ›

A "ballot bin" used to raise awareness on cigarette butt litter in Senec, Slovakia

TIER 1

Product eco-design and circularity

There is a need to move to more restorative economic models of production and use. Building sustainability considerations into product design is a way to control environmental and social impacts across a product's life cycle—from development and manufacturing to use and disposal.

The right thing to do

By integrating sustainability considerations into our products—from development to end-of-use—we can lower their environmental and social impacts and associated costs. Potential benefits include energy savings, reduced consumption of natural resources, waste minimization, and a longer product life span. Minimizing the negative environmental and social impacts of products commercialized at scale can help safeguard the interests of future generations.

The business case

Natural and social capital costs of non-renewable resource extraction and disposal impact the cost of doing business. Commodity and raw material prices will continue to remain volatile as climate change, demographics, and technological innovation impact resource supply and demand. In addition, regulatory requirements, including landfill closures, material bans, and extended producer responsibility policies, are proliferating globally. The concept of the eco-design and circularity makes business sense as it represents a remarkable economic opportunity, while simultaneously delivering environmental and social benefits. It increases speed and reduces cost across different electronic products due to common components. It also reduces costs of returns, obsolescence, and disposal, which can otherwise be significant. We further believe that investing in eco-design and circularity may accelerate growth by spurring innovation of new products and reducing operating costs. Moreover, it can prevent reputational challenges by strenghtening relationships with customers and employees.

Our aims

100%
Percentage of PMI smoke-free product users who have access to collection and recovery for devices and consumables by end 2025

100%
Percentage of PMI's smoke-free electronic devices introduced on the market as of end 2025 that have eco-design certification

An *IQOS* store in Lausanne, Switzerland

Overview

Innovating for
better products

Operating
with excellence

Caring for the
people we work with

Protecting the
environment

Performance
metrics

Product eco-design and circularity continued

Achieving our aims

At PMI, we are committed to understanding and managing environmental and social impacts across our entire value chain, including the life cycle of our products. Focusing on their sustainability is particularly important as we continue to deliver technologically advanced products that are at the heart of our transition to a smoke-free future.

With respect to our smoke-free products, our 2025 eco-design and circularity ambitions, which extend to electronic devices, accessories, and consumables, are as follows:

- Provide access to collection and recovery for the device and its consumables to all *IQOS* users
- Continue to reduce the carbon footprint of our smoke-free products in line with our science-based targets
- Achieve eco-certification for all our PMI smoke-free electronic devices introduced on the market as of the end of 2025

Meeting these goals relies on a systematic approach whereby sustainability is considered from the start of the product development process. Our work is guided by our sustainable product design strategies, which account for impacts related to materials selection and sourcing, components production and product manufacturing, distribution, use, and end-of-life.

Our sustainable design guidelines, developed in 2019, support decision-making and help to integrate sustainability throughout our innovation process. We have now fully embedded these guidelines into our innovation stage-gate processes and continually reinforce our requirements and principles at each stage. In 2020, we continued to advance this program by incorporating sustainability into our predevelopment processes, recognizing that the exploration of new technologies will play a critical role in the sustainability performance of our future product portfolio. Our five eco-design principles are applied to various degrees across PMI's product innovation, with an eye to achieving the highest sustainability impact. Each product generation we launch incorporates improvements in, for example, quality, functionality, ease of use, or robustness.

> "Our design and engineering teams have been trained by internal and third-party experts to embed our eco-design standards. This applies to devices, consumables, accessories, as well as packaging. To continue building momentum for this program, the Product Sustainability team regularly engages in various departmental forums to promote sustainability in design, share strategies, and workshop ways in which individuals and teams can better contribute to meeting our overall product design goals. We have set expectations and requirements for each new product iteration and monitor them throughout the design and production process."

Bin Li, PMI Chief Product Officer

Five fundamental eco-design principles guide our progress

1.
Effective use of sustainable (such as renewable, recyclable or recycled) materials

2.
Minimization of carbon footprint related to energy consumption and transport

3.
Product lifetime optimization

4.
Circularity: Reuse, repair, recycling, recovery, and zero waste

5.
Social responsibility in the production, use, and end-of-life phases

Product eco-design and circularity continued

Performance is shared regularly with senior management in our Product and Consumer teams through the established development governance framework. We are committed to evaluating sustainability characteristics and making design choices that will continually enhance the performance of all our products and packaging. Life-cycle analysis (LCA) and other relevant environmental assessments are performed prior to the launch of any product, and results are presented in internal decision-making forums per our sustainable design governance programs. We continue to advance these technical environmental assessments earlier into our development cycle, understanding the impacts and sustainability potential of new innovations at the earliest stage.

In 2018, we adopted a centralized approach to the end-of-life of our devices by establishing two CIRCLE (Central Inspection and Recycling for a Closed Loop Economy) hubs, in Europe and Asia. The benefits of this approach include economies of scale, regional investment, illicit trade prevention, and quality enhancement (accelerating manufacturing and design improvements minimizes product returns). On certain occasions, due to regulatory restrictions governing cross-border e-waste transportation, we may complement our centralized approach with more localized solutions.
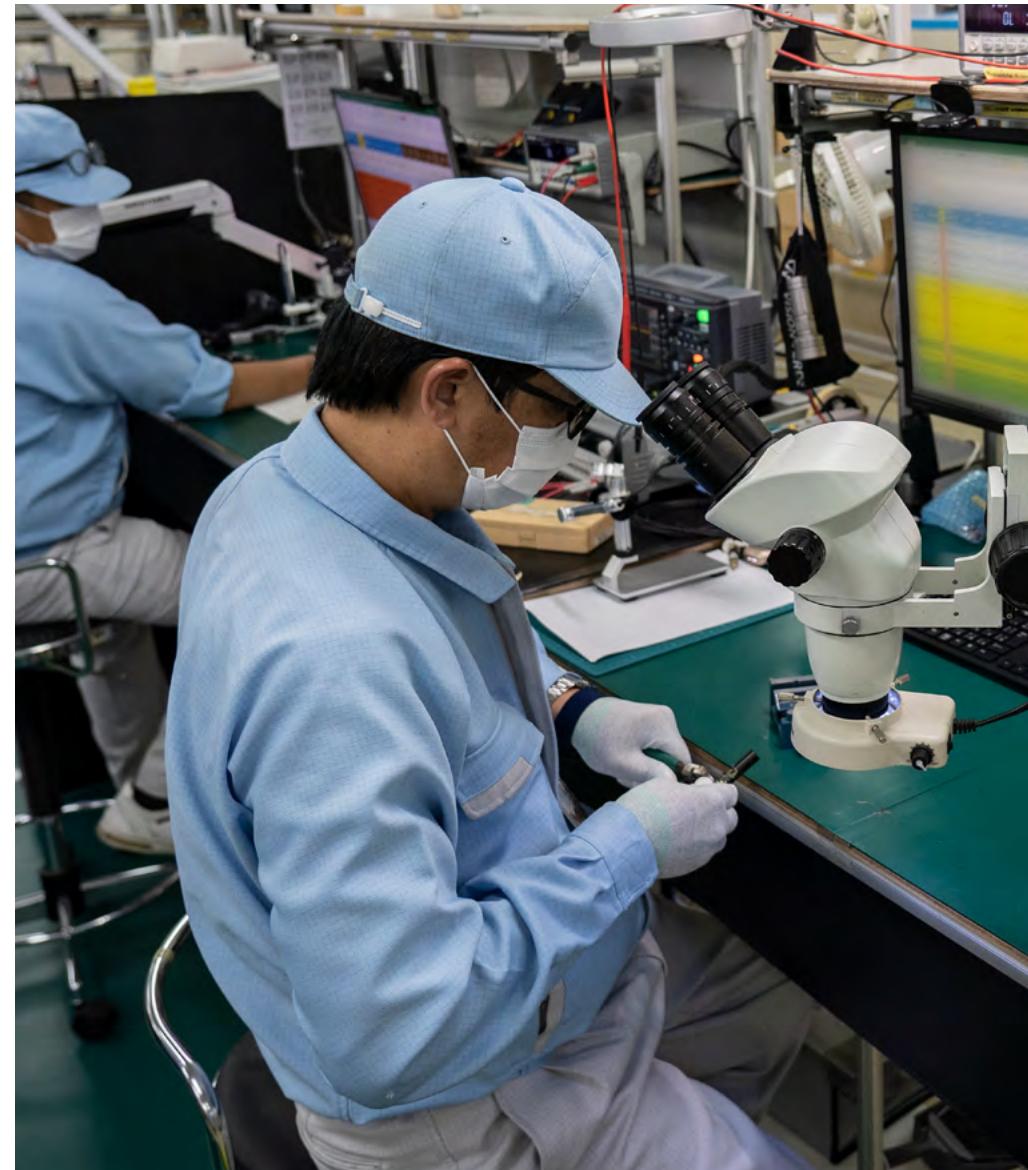
Our 2025 eco-design and circularity ambitions apply to the electronic devices developed by PMI. In 2020, PMI commercialized devices developed by KT&G under the endorsement of the *IQOS* brand in certain markets. As KT&G owns the development and manufacturing of these devices, many of our sustainability initiatives cannot be applied. However, due to our commitments toward environmental protection and product quality, the CIRCLE inspection and take-back program is open to KT&G devices commercialized by PMI, and we aim to achieve similarly high standards of performance for these devices.

Stakeholder engagement

We periodically benchmark our design program against those of other leading companies to determine whether modifications are needed to ensure the highest standards, including engagement in forums focused on circularity within the electronics industry—directly addressing some of our highest priority issues.

To support our efforts to build a more circular business model for our reduced-risk products, we actively seek to engage with external stakeholders and learn from industry leaders. In 2020, we engaged in a project with the World Business Council for Sustainable Development (WBCSD), on identifying best practices in circular electronics, including business model development and product design. The learnings identified will help PMI further develop our ambitions in eco-design and circularity.

We are committed to making design choices that will continually enhance the sustainability performance of all our products and packaging

IQOS device recycling hub in Japan

Product eco-design and circularity continued

Progress in 2020

Impact of COVID-19 on our activities in 2020

Electronic devices

In the area of product innovation, we aim to have all our new electronic devices commercialized as of end 2025 certified to validated standards for eco-design. We are also working toward the meaningful inclusion of recycled content in all devices by 2025. To those ends, we are pursuing improvements in areas such as durability, design for repair and recycling, and energy efficiency.

Sustainable design

In 2020, we started commercializing an improved version of our e-vapor product in New Zealand under the IQOS VEEV brand name. Due to efforts to minimize the size of both the device and the e-liquid cartridge, this product represents a significant enhancement in sustainability over the previous IQOS MESH product, which we commercialized in the U.K. Our design innovations decreased the product's CO_2 emissions and material consumption while providing a better consumer experience.

Another focus this year was changing the battery technology within our IQOS charging units. Our new battery chemistry offers the same performance but with a reduced carbon footprint versus our previous version. This change was incorporated in the IQOS 2.4+ and IQOS 3 DUO chargers, resulting in a 9 percent reduction in the product's CO_2 footprint.

Circularity

We strive for our products to last and increasingly aim to repair or refurbish them, so they stay in use for as long as possible.

Lifetime optimization

In 2020, we established a cross-functional global program, taking a holistic approach to address product returns and enhance the lifetime of our devices. This effort focused on reducing unnecessary device replacement and limiting e-waste generation, as a consequence. This program was the first step in our journey to improve the overall lifetime of our products, primarily through optimization with the outlook toward refurbishment and repair.

Our IQOS devices are subject to standard product warranties, generally for 12 months from the date of purchase or such other periods as required by law. In many cases, we offer warranty policies beyond the legal minimums to provide additional benefits to our consumers. In 2020, we launched or expanded several service-based solutions to minimize environmental impacts aimed at extending product lifetime through device optimization and maintenance.

We standardized our global guidelines, setting consistent criteria and procedures across all markets where our smoke-free products are commercialized. These guidelines norm our verified returns procedures, as well as the conditions which grant a replacement under warranty or specific loyalty programs. We trained our retail and call center teams on how to assess potential product issues faced by the consumer. We strived to ensure a diagnosis is made before replacing a device, as some issues may be resolved without a replacement and hindering the consumer experience—for instance, by deep cleaning the device or ensuring the software is up to date directly at our brand retail store. We also launched in certain markets a mobile application for IQOS users, which provides tips on how to use and clean the device, as well as basic troubleshooting instructions.

As a pilot effort in the last quarter of 2020, we started installing firmware upgrade capabilities across our consumer touch points, in several core markets. In 2021, we will continue to expand these capabilities across geographies, channels, and touch points leveraging our ever-evolving digital ecosystem.

Inspection, disassembly, recycling, and repair

When IQOS users return broken or end-of-service products, our reverse-logistics program helps to cycle materials back into the economy. Our CIRCLE program provides centralized hubs that inspect, process, and separate materials from our electronic devices for recycling. Our recycling partners are certified R2, a stringent certification governed by Sustainable Electronics Recycling International (SERI). This standard covers all aspects of the electronics recycling value chain—including on-site environment, health, and safety (EHS) practices, waste disposal hierarchy, and traceability of raw materials—and helps to ensure our recycling processes meet the highest possible requirements.

In addition, our CIRCLE hub in the European Union obtained WEEELabex certification in 2020, reflecting our commitment to due diligence practices and advanced recycling. Through our CIRCLE program, we recover and recycle significantly more materials than if the devices were to follow traditional electronic waste streams. Moreover, the inspection and recycling of returned products allows us to improve quality and design by feeding back into our development processes. In addition, the hubs contribute to our fight against illicit trade and counterfeiting—as they reduce opportunities for product diversion—and benefit the regional economies in which they are located.

Product eco-design and circularity continued

"We began working with PMI in 2018 to collect heated tobacco devices that have failed under warranty period and provide assistance with inspection, intellectual property protection, and recycling. During device inspection, the causes of default are identified and fed back to PMI so that return rate can be reduced through improved product design. In terms of recycling, we do not dispose of any PMI-related waste in landfill and are also making efforts to reduce the percentage of thermal recycling as much as possible. For example, in Japan, there are only a limited number of recycling businesses that will accept mixed plastics, so in order to increase the recycling rate, we sort materials into as high a purity as possible and actively seek out recycling businesses that can accept even small lots of the sorted materials. We meet with PMI regularly to discuss the possibility of reusing waste plastics for our own products, and we also work closely towards the resolution of recycling issues. Working with PMI was the first time for our company, which has 130 business locations around the world, to propose a solution that fully incorporates the concept of resource recycling. In the future, we intend to use our work with PMI as a case study for further expanding our efforts toward the realization of a circular economy."

Representative from the company running the CIRCLE hub in Japan

In 2020, we continued the rollout of our CIRCLE program, achieving 48 percent market volume coverage up from 39 percent the previous year, by adding two new markets to the program (Bulgaria and Ukraine). CIRCLE processed over 191 tons of end-of-life devices and materials (of which, around 160 tons were recycled, with the remainder going to incineration for energy recovery). We significantly improved our recycling rates in 2020 by working with our recycling partners to identify additional technologies, improved disassembly methodologies, and material applications, resulting in an increase to 84 percent in 2020, up from 74 percent in 2019. With the aim of expanding our current footprint, we also established plans to launch a third centralized facility, located in Russia, in 2021.

Since the introduction of our CIRCLE hubs in 2018, with recycling rates of 45 percent we have made tremendous progress in improving our performance. Our aggressive goals lead to top performance levels of our existing products at over 80 percent. The next step for us is to maintain these results and recycle our materials to higher quality standards, while expanding coverage of our product returns and recollection. With regular introduction of new products and versions to the *IQOS* portfolio, we recognize the continued challenge to maintain performance levels. We are now focusing on quality of material output and efficiency through improved disassembly techniques and enhanced automation, in addition to our efforts in repair and refurbishment. Moving forward while maintaining superior recycling performance of over 80 percent, our aim is to expand our geographic and volume coverage, and repair capabilities to amplify the positive impact of these programs.

Our preference is to roll out CIRCLE globally; however, it is not possible to implement the service in all markets at this time due to legislative restrictions related to e-waste transportation. In markets where CIRCLE has not yet been implemented, *IQOS* users can still return their devices to specified locations. We aim to recycle these devices via local partners with similarly high standards of electronics recycling; for example, our affiliate in the United Arab Emirates uses an R2-certified recycler.

We strive to establish commercially viable repair-and-refurbish programs to offer a second life to devices and cycle them back into the economy. We are also leveraging on digital infrastructure to ensure upgrade capabilities for all our devices. In 2020, we worked with our reverse logistics partners to leverage and expand our existing CIRCLE infrastructure for the future possibility of repair and refurbishment. We will continue to expand these initiatives in 2021.

191 tons

Of end-of-life devices and materials processed at the CIRCLE hubs in 2020

Our recycling rate increased to 84 percent in 2020, up from 74 percent in 2019

Product eco-design and circularity continued

Carbon footprint

In our operations, eco-design principles inform how we use life-cycle analysis (LCA) to assess the carbon footprint of our products, from tobacco sourcing to end-of-life impacts.

So far, we have analyzed *IQOS* devices, heated tobacco units, and packaging. In 2020, we finalized the results for our new e-vapor product, *IQOS VEEV*. This new version has a lower carbon footprint thanks to efforts to reduce the overall product size and decrease material use. We also conducted further investigations into the carbon footprint of nicotine liquid in partnership with a third party and one of our primary suppliers. This study allowed us a more detailed understanding of the impacts along the value chain and will provide insight for future improvement.

IQOS currently has a higher carbon footprint than combusted cigarettes. Primarily, this is due to the use of an electronic device, which involves new components and requires electricity to charge. This element accounts for 13 percent of the total carbon footprint of the *IQOS 3* system. Additionally, the process to manufacture heated tobacco units is more energy intensive than for cigarettes, due to the production of cast leaf tobacco.

We are working to close the gap between combustible and smoke-free products through improved manufacturing processes, extending the usable life of our electronic devices, and decreasing the total CO_2 footprint through smart material selection and sustainable design practices.

Over the past two years, we have reduced the overall CO_2 impact of our smoke-free products through improvements in manufacturing processes and in our tobacco supply chain. One of these initiatives has been to look at the density of tobacco within the product, to reduce both CO_2 impact and provide a better consumer experience. By modifying the design of the heated tobacco plug slightly, we were able to reduce the CO_2 impact per stick (considering the raw materials and manufacturing impact) by 4 percent while enabling a smoother insertion of the heated tobacco unit (HTU) in the holder and generating a more consistent aerosol delivery, addressing one of our more common consumer pain points. We continue to explore additional material optimizations for our HTUs, including material replacement to drive down CO_2 impact per stick.
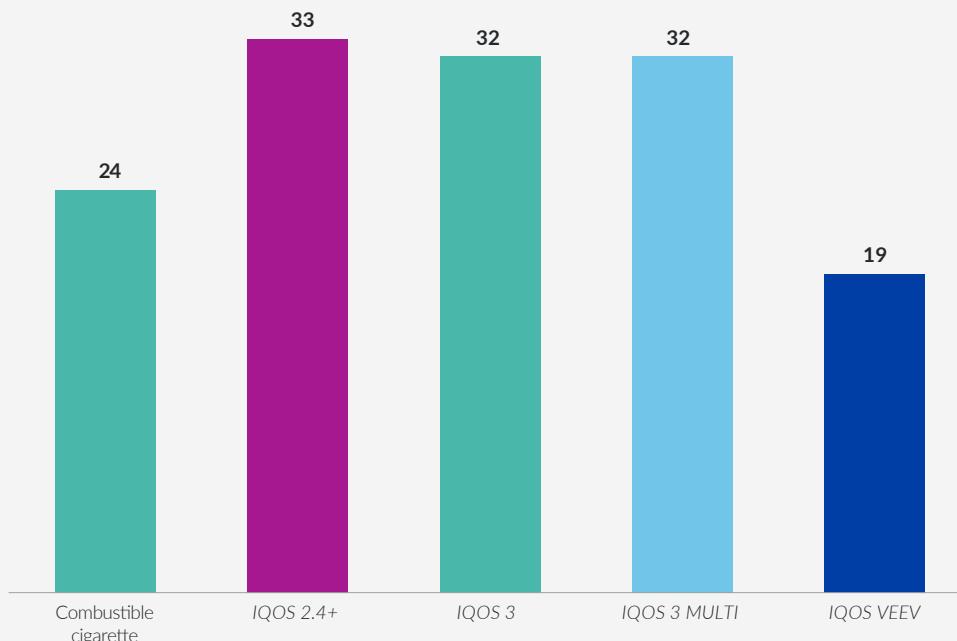
Product certifications

Product certification can help drive performance by raising the standards to pursue and provide comprehensive information to consumers, enabling them to make more sustainable product choices. These certifications are also a way for us to transparently and consistently disclose the environmental performance of our products to all of our stakeholders.

Smoke-free products—and heated tobacco products, in particular—are a relatively new product category; as such, they typically are not covered by existing eco-standards. In order to achieve our objectives, we will ensure devices are designed per our sustainable design criteria and we will seek to develop and implement new category standards as necessary to achieve our certification goals.

In 2020, we launched a program to identify relevant certification schemes for our smoke-free product devices as part of our efforts to reach our target of having all electronic devices eco-design certified by the end of 2025. This exercise was conducted with third-party experts and informed by comprehensive benchmarking. The next step in our journey is to reach out to the prioritized agencies and evaluate the process for rule making for our heat-not-burn product portfolio. We will also, in the short term, work to identify other ways to publicly disclose performance of our products through structured disclosure programs. Establishing a robust roadmap is the foundation to achieve our aim of eco-certification for all PMI developed devices launched by the end of 2025.

Life-cycle assessment—comparison of some PMI products (kgCO$_2$e/year)

Combustible cigarette	IQOS 2.4+	IQOS 3	IQOS 3 MULTI	IQOS VEEV
24	33	32	32	19

Note: This graphic is an internal assessment based on data compiled from three different LCAs and assumes 20 heated tobacco units or cigarettes per day. Scope includes materials, manufacturing, use, and end-of-life, but excludes logistics.

Product eco-design and circularity continued

Consumables

We are exploring ways to minimize the environmental and social impacts of the consumables for our smoke-free products; these include the HTUs used with our *IQOS* heat-not-burn product and the cartridges used with our *IQOS VEEV* e-vapor product.

In addition to developing services to reduce the end-of-life impact of our products, our innovation and design teams are exploring low-carbon, recyclable, and biodegradable options for the materials used in our heated tobacco units and combustible cigarettes. We are committed to investing significantly in continued research on the sustainability of materials contained in our consumables, and we are working toward viable solutions that meet strict international standards, satisfy market requirements, and work with high-volume manufacturing (read more: **Littering prevention**).

We are clear that there is a risk that HTUs could be littered, but we have good indication that the littering rate for HTUs is lower than for cigarette butts. We want to make littering a thing of the past—along with cigarette smoking. In recent years, we conducted surveys in Italy and Japan, and counted littered HTUs compared with cigarette butts in Athens. Those surveys indicated that the new rituals introduced to legal-age smokers following their conversion to smoke-free products present an opportunity to help consumers change former habits of cigarette butt littering.

In 2020, we deepened our understanding of consumer behavior related to the disposal of used HTUs and consumers' potential motivations and requirements for participating in a PMI-driven collection scheme. More specifically, we found that the statements that resonate most with consumers are those referring to anti-littering and streets cleanup as opposed to recycling applications, HTUs' second life, or broader statements about corporate responsibility. Adult users believe that recycling initiatives require effort on their part; consequently, 60 percent of them believe that incentives (e.g., product discounts) could positively influence a program's participation rate. Finally, participatory recycling initiatives were shown to have the potential to differentiate the brand and its attractiveness, and to reinforce adult smokers' decision to switch from combustible cigarettes to *IQOS*. We explored ways to deploy an effective and economically viable end-of-life collection service for our *IQOS* products to further reduce littering.

We continue to work with waste management and recycling partners to explore the potential second life we could give to recycled HTUs. Our research to date shows that the properties of cellulose acetate would enable the material to be given a second life through a variety of applications such as spinning the fibers into fabrics or creating pellets that can be pressed/injection-molded into a variety of hard goods. Though these results are promising, recycling opportunities for cellulose acetate—unlike for many metals and plastics—are not widely available, and there is not yet a developed waste stream across the globe that we can leverage.
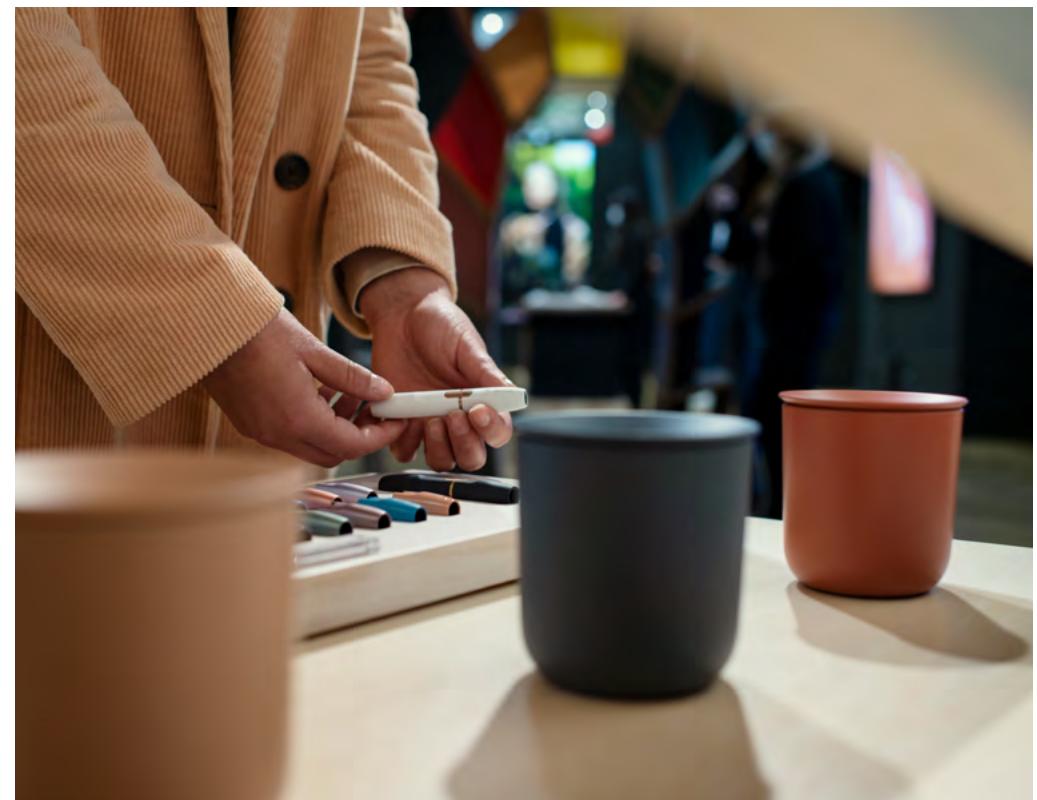
As HTUs and cartridges don't burn, and the consumers don't have to stub them out, we aim to offer effortless, convenient, and fully recyclable solutions for these consumables. We believe that this would allow us to support our consumers to adopt better behaviors from a sustainability perspective by giving them the practical, easy, and free tools they need. In 2020, we designed pilot programs to collect and recycle the consumables from our smoke-free products (including various generations of HTUs and cartridges), partnering with the best-in-class recycling companies all around the world to make sure the used consumables don't end up in landfill but are used for recycling or energy creating incineration. We plan to launch our first pilot in Switzerland in 2021 and will communicate progress in our next report.

Accessories

A focus in 2020 was exploring potential uses of recycled materials processed through our CIRCLE hubs to manufacture *IQOS* accessories. We identified PC/ABC, a common plastic found in many electronics and consumer goods, as the material with the highest potential. We have laid the groundwork to set up a closed-loop recycling system in one of our CIRCLE hubs and have developed several Proof of Concepts in our investigations considering our current *IQOS* accessories range. We expect to operationalize this project in the coming years with closed-loop accessories sold globally. In addition to closed-loop material reuse, we continue to explore alternative sustainable materials for our accessories range.

In line with the EU SUP Directive, we modified our *IQOS* cleaning sticks so they are now composed of paper instead of plastic. We commercialized these sticks in the U.K. and France in 2020 and will deploy them in all EU markets in 2021. Going beyond the regulatory requirements, we are investigating packaging improvements, including moving to a fiber-based solution.

IQOS accessories in an *IQOS* store in Rome, Italy

Product eco-design and circularity continued

Packaging

Our approach to packaging contributes significantly to our efforts to preserve and protect the planet's resources.
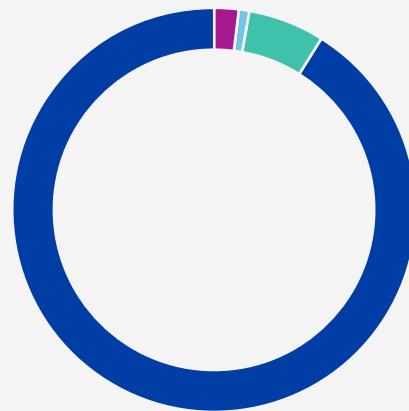
We use packaging for all our products, including combustible cigarettes and our smoke-free electronic devices, consumables, and accessories. Our product packaging is made primarily from board and paper. In 2020, we estimate (mainly based on preliminary suppliers self-declarations) that over 70 percent of the volume of board and paper we sourced for our packaging came from suppliers certified to Forest Stewardship Council (FSC) or Programme for the Endorsement of Forest Certification (PEFC) standards. Furthermore, we developed an assurance framework coupling the wood, pulp, and fiber's countries of origin with the holding of FSC or PEFC Chain of Custody certifications by our board and paper suppliers and their supply chain partners. This methodology was

reviewed and validated by a third party. As a result, based on our 2020 purchased volumes, 61 percent of our board- and paper-based packaging materials were sourced at no risk of deforestation of primary and high conservation value forests. These results are being audited by a third party at the time of preparation of this report.

We aim to develop solutions that minimize the use of packaging materials and improve their circularity without compromising protection and convenience. We are driving our approach through ambitious commitments. By 2025, we aim to achieve:

- 100 percent of packaging made with recyclable materials
- 95 percent of packaging materials from renewable sources
- 15 percent reduction in packaging weight (versus 2018 baseline)

A sales representative in an *IQOS* store in Rome, Italy

Use of materials in our packaging in 2020

Paper and board		**91%**
(Packs and bundles, inner liners, shipping cases) (388,850 tons)		
Plastic		**6%**
(Overwrap of packs and bundles, pouches, seal inner liners and labels) (25,470 tons)		
Aluminum		**1%**
(Inner liners (including seal) and other tobacco product packaging) (3,400 tons)		
Other		**2%**
(Inks and composite materials used in other tobacco product packaging) (10,4200 tons)		

To deliver on these commitments, we employ a twofold strategy: First, we aim to eliminate unnecessary packaging, and in particular plastic packaging, and to implement solutions allowing us to minimize materials used. Second, to prevent the depletion of finite resources, we seek to increase the recyclability of our packaging and to reduce the use of materials made from non-renewable sources. We are working to eliminate the use of aluminum inner liners by the end of 2022 and of non-recyclable plastics by the end of 2025.

Fundamental to our work is integrating circularity considerations covering the sourcing of renewable materials, the minimization of packaging, and the reduction of end-of-life implications. In the design stage, for instance, we prioritize the use of recyclable mono-materials and reducing the void inside packaging to optimize transportation, both of which reduce the product's CO_2 footprint. To ensure circularity, the packaging should be

easily recycled by consumers; this requires that a recycling infrastructure be available for the materials selected in markets across the globe.

Our teams in the Consumer, Product, and Procurement departments work hand-in-hand to promote the various elements of circular package design. We leverage our in-house R&D and product development capabilities, for instance, to formulate the appropriate chemistry to produce new materials and to develop packaging concepts and packing technologies. It is equally important that we engage with our materials and equipment suppliers, as they must implement at industrial scale any solution we develop. Such engagement also allows us to benefit from their expertise and technological developments.

Reducing packaging

Key to our work in 2020 were our efforts to reduce the volume of board required in our HTU and cigarette packaging. Working with our key suppliers, we began replacing the packaging board across all of our brands portfolio with a 10 percent lighter alternative that offers the same pack strength and, therefore, a similar consumer experience. The shift to this alternative will allow us to save approximately 25,000 tons of board over a four years period. We expect to complete a full rollout of this initiative across all our consumables—both combustible cigarettes and heated tobacco units—by 2024.

We also achieved significant progress in the packaging of the devices and accessories for our smoke-free products. We developed a new *IQOS* mobility kit (which contains the device and necessary accessories) and accessories packaging, which we plan to launch in 2021. The removal of shrink film in the mobility kit and plastic windows in the accessories packaging will allow us to meet our target of having 95 percent of packaging materials made from renewable sources by 2025. In addition, we were able to reduce the packaging weight of our new mobility kit by 17 percent and our accessories packaging by approximately 35 percent, which will contribute significantly to reaching our target of a 15 percent reduction in material used in our packaging by 2025. As a next step, we aim to replace plastic laminated board in our packaging by mid-2022 to achieve full recyclability of the packaging of our devices and accessories in the paper stream.

We are also exploring further improvements, including the potential replacement of rigid boxes by lighter packaging designs. This would further reduce the use of packaging materials and optimize our transportation CO_2 footprint.

Increasing recyclability

Acting on our commitment to eliminate non-recyclable materials and increase renewable material use to 95 percent by 2025, we set up a program to replace aluminum inner liners with paper versions, and we are exploring alternatives to plastic overwraps.

Eliminating aluminum

Our combustible cigarettes and HTUs are encased in an inner liner inside the pack. These liners typically are made of non-recyclable aluminum foil or recyclable alternatives such as metalized paper or white paper.

Already, around 74 percent of the inner liners in our packaging are recyclable in paper stream. In 2020, the proportion of packs sold with aluminum inner liners was 26 percent, down from 34 percent in 2019.

We aim to eliminate the use of non-recyclable aluminum foil by the end of 2022, by deploying substitution programs.

In a few markets, we will have to continue using recyclable metalized inner liner to comply with local regulatory requirements. In order to contain the environmental and social impact it may represent, we aim to source certified aluminum from our tier 1 suppliers. In 2020, 84.2 percent of the aluminum used in our packaging was Aluminium Stewardship Initiative (ASI) certified, either under the Performance Standard or the Chain of Custody.

Replacing non-recyclable plastic packaging

Currently, the polypropylene wrap around our packs of consumables is recyclable but is not made from renewable sources and requires consumers to separate plastic wraps from the pack for recycling. We are exploring the use of alternative bio-based materials to make overwraps easier to recycle. We have received positive feedback from consumer panels and plan to pilot the new packaging solution in selected markets in 2022.

IQOS device recycling hub in Japan

Product eco-design and circularity continued

Next steps

We will continue the systematic implementation of our sustainable design principles throughout our product and packaging development. This will include continued internal training to increase awareness and ensure uptake of our programs across PMI.

Research will continue on device, accessory, consumables, and packaging design to identify technologies and materials that could enhance the overall sustainability of our smoke-free product portfolio. Cross-functional teams already are hard at work establishing these innovation pipelines.

We plan to pilot our second-hand life program in 2021, focusing on the newest versions of our *IQOS* heat-not-burn device. We expect to conduct a small number of market pilots to test this new operating model. As we continue to refine our products, we expect iterations at the design stage, to leverage our eco-design principles, further supporting our repair program ambitions.

We will continue to roll out our CIRCLE program across the markets where our smoke-free products are commercialized; this includes the establishment of a new centralized hub in Russia, amplifying our reach to additional markets, and addressing upcoming new product and technology introductions.

In addition to open-loop recycling systems, we continue to actively pursue closed-loop models for the recycling of our returned devices.
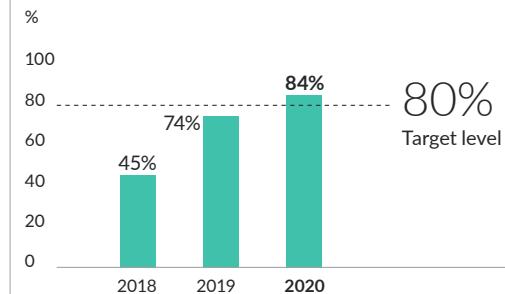
One such initiative is developing accessories from recycled plastic materials collected at our CIRCLE hubs. We aim to develop and launch a commercial line of accessories made from these materials within the next 18 months.

We will continue to evaluate and expand our offerings regarding the take-back of devices and consumables, such as HTUs and e-vapor cartridges, with pilot programs for consumables planned in 2021.

As we move forward, we are embedding our design principles to establish robust sustainability requirements in our consumable development process to identify opportunities which will lead to optimal performance while lowering CO_2 emissions and material consumption to the extent possible.

We expect continued progress in 2021 on our overall packaging weight reduction, driven by a full-scale implementation of our board-reduction initiative across all our consumables brands. And we foresee major headway in our efforts to eliminate aluminum inner liners, as we will focus our efforts on Indonesia, one of the top markets in which the new practice is yet to be implemented.

Currently, PMI's use of recycled content materials is limited to shipping cases and represented only 12 percent of the total weight of our packaging materials in 2020. To further increase packaging material circularity and recycled content in our packaging, our technical experts are assessing the feasibility of using recycled content board in primary and secondary packaging, which would require solving a technical challenge related to mineral oil migration.

As commercialization channels evolve, so does the role of packaging. For instance, the shift from retail toward e-commerce has prompted us to rethink our packaging strategy for online sales. Also, we seek to better understand how to reduce packaging at our flagship stores. We plan to gather learnings and consumer insights to explore solutions fitting the realities of the various retail channels.

IQOS device recycling hub in Japan

2020 performance highlights

See our performance metrics

Recycling rate of *IQOS* devices at the CIRCLE hubs

%
- 2018: 45%
- 2019: 74%
- 2020: 84%

80% Target level

94.7% of our packaging material recyclable

89.8% of our packaging material is from renewable source

Overview

Innovating for
better products

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with excellence

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people we work with

Protecting the
environment

Performance
metrics

TIER 2

Forest conservation

A significant portion of our environmental management effort is devoted to protecting forests. To PMI, this means preventing deforestation linked to our operations and sourcing activities. To accomplish this, we seek to use sustainable and traceable curing fuels in our tobacco supply chain and responsibly source paper and pulp-based products.

Read more online

Biodiversity

For PMI, biodiversity is about reducing the negative impacts of our operations and sourcing activities on habitats and ecosystems and looking for contributions we can make to biodiversity. This includes the careful management of land use, protection of soil quality, and prevention of pollution. Post-consumer waste resulting from the use of our products is described separately.

Read more online

Water stewardship

Water stewardship at PMI is about reducing water use, promoting water recycling, protecting watersheds, preventing water pollution, enhancing recharge, and promoting sustainable water management in collaboration with stakeholders.

Read more online

Waste reduction

The resources we use at PMI to manufacture our products are valuable, so we aim to ensure they are used effectively, avoiding waste when possible. To us, waste reduction means minimizing the waste generated by our manufacturing facilities and offices, promoting materials reuse and recycling, and striving for responsible disposal.

Read more online

Integrating financial and nonfinancial performance

Closing remarks from the Chief Financial Officer

There is currently an expectation by both companies and investors that material environmental, social, and governance (ESG) factors should be completely integrated into a company's business strategy.

Historically, finance professionals have spoken one language for shareholders while sustainability professionals have spoken another language for ESG stakeholders. To maximize the benefits of sustainability for financial performance, each profession needs to learn the language of the other. And both must be able to explain (to both audiences) how sustainability and financial performance are mutually reinforcing.

A major barrier to this integration is that the Finance and Sustainability functions have been—and largely remain—wholly separate parts of organizations. With Sustainability reporting to the CFO, thereby integrating Sustainability into the Finance function, PMI's organizational structure has taken yet another necessary step toward delivering on its purpose: a smoke-free future that will benefit both shareholders and other stakeholders.

"At PMI, we are committed to continuously improving the way we track and report on our company's performance, taking a holistic approach that not only covers our inputs and activities but also focuses on where we can have the greatest impact: our products."

This move underscores that ESG is core to PMI's performance and success, and further demonstrates the company's leadership in sustainability and corporate purpose. It is our firm belief that sustainability and business performance do not follow separate paths and narratives. They are fully interrelated and mutually reinforcing and should be organized and presented to all stakeholders, including shareholders, in an integrated way.

The biggest remaining challenge is ensuring that ESG information and data are managed and reported with appropriate rigor. Unlike financial accounting standards, and despite evolving practices, there are no industry norms or globally recognized established practices for measuring and evaluating a company's performance on ESG factors, sometimes referred to as nonfinancial performance.

External engagement is critical to progress in this area, and I am proud to have joined others on the World Business Council for Sustainable Development's CFO Network to encourage the standardization and mainstreaming of ESG disclosure; incentivize investor engagement; sponsor, support, and drive business practice toward stakeholder capitalism; and continue leading in the implementation of ESG into business management and decision-making processes.

We are also hopeful that the Trustees of the IFRS Foundation will create their proposed Sustainability Standards Board (SSB). This will provide the basis for measuring and reporting on sustainability performance in a way that is as robust, relevant, and reliable as reporting on financial performance. PMI plans to be an early adopter of these standards as they are produced.

At PMI, we are committed to continuously improving the way we track and report on our company's performance, taking a holistic approach that not only covers our inputs and activities but also focuses on where we can have the greatest impact: our products.

Following the introduction of our 2025 Roadmap last year, our Chief Sustainability Officer now leads the work to strengthen the development of ESG-related key performance indicators linked to our sustainability targets. With these KPIs, we seek to clarify and standardize the approach we take with our nonfinancial performance data to continue building sophistication and expertise as they are also a key driver of PMI's corporate strategy, capital allocation, and operations.

We expect this work to further enable us to account for both tangible and intangible assets, understand how to minimize negative externalities and maximize positive ones, and, by extension, better manage our company's performance. We are exploring better ways to comprehend and measure our impacts, including through our membership of the Value Balancing Alliance. This work will inform our next sustainability materiality assessment, which will take place in 2021. The findings of this analysis will help ensure we continue to focus on the areas that are most relevant to us while also contributing to the global agenda for sustainable development.

We recognize that these ambitious steps do not complete our journey in reporting on our sustainable corporate strategy. ESG performance is about a company's inputs and operations; it does not address the positive and negative externalities of a company's products and services—the missing "P" (for "product") in ESG. While scientific evidence that smoke-free products represent much better alternatives than combusted cigarettes to health, PMI will continue stepping up its efforts on all fronts to contribute positively to people's lives. We can only accomplish this by keeping our approach to sustainability at the heart of the way we do business.

Emmanuel Babeau
Chief Financial Officer

PMI's performance in ESG ratings, indices, and rankings

At PMI, we understand the value of participating in ESG ratings; it helps us assess our sustainability performance, benchmark ourselves against our peers, and, most importantly, identify areas for improvement.

We prioritize our participation in ratings that are most useful to us and our stakeholders, based on:

- The credibility of the methodology and our ability to interpret and use its results
- Recognition of the rating among the investor community, as well as participation by our competitors and peers so we can benchmark our performance

- Value as a learning opportunity, with a sufficient feedback loop to allow us to improve over time
- Resources required, which should not undermine our company's focus on performance improvement
- Openness to dialogue (we want to be able to understand expectations and results, share knowledge, correct factual inaccuracies, and provide input on ratings enhancements

ESG ratings can spur greater transparency and incentivize us to improve our performance. Not surprisingly, however, our company—like many others—tends to rank differently depending on the ESG ratings agency assessing our performance. It is because each ESG rating agency uses a proprietary methodology, with different data inputs and calculations.

Regardless of their measurement methods, all ESG ratings focus on evaluating a company's activities and inputs. They largely focus on how a company produces its products and services, i.e., the environmental (E) and social (S) aspects of its manufacturing process and supply chain, and governance (G) of the company. While these are important topics, we would recommend starting with a more fundamental question: What are the most material topics related to a specific business, i.e., what drives long-term business success? For many companies, the most material topics relate to the product (P) and its impact on the consumer.

What a company makes is as important as how it makes it. Companies' products and services have

an impact on consumers and society, and this is something ESG ratings often fail to evaluate as comprehensively as they assess operational aspects of the business.

Regrettably, this is especially important in relation to the tobacco industry, where ESG ratings fail to appropriately consider the strategies deployed to address the product health impacts.

By incorporating P considerations into ESG (ESG-P), rating agencies can look deeper into a company's value proposition. Operational impact is important, but the impact of a company's products is equally, if not more, significant. By factoring in and giving greater visibility to a company's products, ESG-P ratings would help companies improve not only how they produce, but also what they produce. This would encourage business model transformations that could lead to a more sustainable economy—and a better future. In the case of our industry, this means successfully phasing out cigarettes to accelerate the end of smoking.

Rating agencies	PMI's performance in 2020	Score
Bloomberg Gender-Equality Index	Named to the Bloomberg Gender-Equality Index	Included in the index
CDP Climate, Forest, Water Security	Awarded "Triple A" score for our efforts to combat climate change, protect forests, and water security. This marks the seventh consecutive year that PMI has ranked on CDP's A List for Climate Change and the second consecutive year that the company earned a position on the Water Security A List	Triple A
CDP Supplier Engagement	Placed on Supplier Engagement Leaderboard for the fourth consecutive year	Leader
ISS-oekom	"C" score, achieving industry leadership (2019 score; assessment is updated every two years)	C
MSCI	Maintained BBB score	BBB
S&P Global Corporate Sustainability Assessment	Included in the Dow Jones Sustainability Index (DJSI) North America; ranked third in the industry; leading the industry for the third year in a row in DJSI's innovation management category	74
S&P ESG Evaluation	Scored 60/100, based on ESG Profile Score (57/100) and Preparedness Opinion ("Adequate"). PMI's ESG Profile Score is assessed based on entity-specific scores and sector/region scores (see **report**)	60
Sustainalytics	Ranked third within the tobacco subindustry ESG Risk Rating, with medium exposure score and strong management score	24.4
State Street R-Factor Score	Outperformer within the tobacco industry; industry average score of 47	56
Tobacco Transformation Index	Ranked 2 out of 15 tobacco companies assessed; leading the industry for "Strategy and Management" category	2.36

Performance tables

Financials (in millions USD, except per share data)[1]	2018	2019	2020
Revenues including excise taxes	79,823	77,921	**76,047**
Excise taxes on products[2]	50,198	48,116	**47,353**
Net revenues[3]	29,625	29,805	**28,694**
Operating income	11,377	10,531	**11,668**
Net earnings attributable to PMI	7,911	7,185	**8,056**
Earnings per share (EPS)	5.08	4.61	**5.16**
Operating cash flow[4]	9,478	10,090	**9,812**
Total assets	39,801	42,875	**44,815**
Total liabilities	50,540	52,474	**55,446**
Capital expenditures	1,436	852	**602**
R&D expenditure	383	465	**495**

1 The information is a summary and is qualified in its entirety by reference to the full texts of PMI's Annual Reports for the years ended 2018 through 2020, available on **PMI.com**.
2 This indicator refers to the amount paid by PMI entities, and excludes excise tax paid in several markets where third-party operators collected taxes on PMI products. The total amount of excise tax paid by consumers on PMI products amounted to USD 72.4 billion in 2020.
3 The decline in 2020 full-year net revenues was partly driven by unfavorable currency and the impact of the deconsolidation of PMI's Canadian subsidiary, Rothmans, Benson & Hedges, Inc. (RBH), effective March 22, 2019.
4 Net cash provided by operating activities.

Pillar 1

Innovating for better products

- Financials >
- **Innovating for better products** >
- Operating with excellence >
- Caring for the people we work with >
- Protecting the environment >

	Business Transformation Metrics	2016	2017	2018	2019	**2020**
R&D	R&D expenditure (in millions USD)*	429	453	383	465	**495**
	R&D expenditure (smoke-free/total)[1] *	72%	74%	92%	98%	**99%**
	Number of R&D positions (FTEs)[2]	n/a	n/a	764	942	**934**
	Patents granted in IP5 jurisdictions relating to smoke-free products (cumulative)[3]	170	300	480	740	**1,300**
	Number of studies completed by PMI on smoke-free products (cumulative, since 2015)					
	– Toxicological assessment	36	57	82	109	**146**
	– Clinical assessment	11	12	19	19	**22**
	– Perception and behavior (premarket and post-market)[4]	7 (7+0)	8 (7+1)	12 (9+3)	13 (9+4)	**30 (15+15)**
Sourcing	Supply chain direct spend expenditure (smoke-free/total)[5]	n/a	n/a	n/a	35%	**33%**
Operations	Cumulative investments behind smoke-free products (since 2008, in billions USD)[6]	3.2	4.6	6.2	7.2	**8.1**
	Number of factories producing smoke-free products out of total number of factories[7] *	3 out of 48	4 out of 46	8 out of 44	8 out of 38	**8 out of 39**
Commercialization	Year-on-year change in number of SKUs—combustible products[8]	-1.7%	-6.5%	-6.1%	-5.5%	**-4.1%**
	Year-on-year change in number of SKUs—smoke-free products	78.2%	9.9%	37.1%	24.9%	**38.2%**
	SKUs (smoke-free/total)	4.7%	5.5%	7.8%	10.1%	**13.9%**
	Number of markets where *IQOS* is available for sale*	20	38	44	52	**64**
	Proportion of markets where *IQOS* is available for sale that are outside the OECD[9] *	32%	41%	44%	45%	**52%**
	Number of *IQOS* stores[10]	26	63	81	199	**259**
	Number of retailers that sell PMI smoke-free product consumables (in thousands)	90	292	488	679	**749**
	Commercial expenditure (marketing) (smoke-free/total)*	15%	39%	60%	71%	**76%**
Consumers	Smoke-free product shipment volume (billion units)*	8	36	42	60	**76**
	Combustible product shipment volume (billion units)*	845	791	767	732	**654**
	Smoke-free product shipment ratio (smoke-free/total)[11] *	0.9%	4.4%	5.1%	7.6%	**10.4%**
	Total *IQOS* users (in millions)[12] *	2.1	6.9	9.6	13.5	**17.5**
	Estimated users who have switched to *IQOS* and stopped smoking (in millions)[12] *	1.5	4.7	6.6	9.6	**12.7**
	Estimated users outside the OECD countries who have switched to *IQOS* and stopped smoking (in millions)[9] *	0.0	0.2	1.1	2.9	**4.3**
Revenues	Net revenues (smoke-free/total)[13] *	2.7%	12.7%	13.8%	18.7%	**23.8%**
	Number of markets where net revenues from smoke-free products exceed 10% of total net revenues[14] *	1	5	19	31	**38**
	Number of markets where net revenues from smoke-free products exceed 50% of total net revenues[14] *	0	1	3	4	**6**

✓ New metrics   ⓡ Metrics linked to 2025 aspirations

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* The 2020 metrics marked with an asterisk (*) are subject to PwC's Assurance Report (see page 146).

1 Smoke-free products include heated tobacco units, devices, and e-cigarettes. Total products include smoke-free products, cigarettes, and other combustible products.

2 R&D positions include scientists, engineers, technicians, and support staff. Comparable data for years prior to 2018 are not available, as the scope of R&D positions changed following company organizational changes.

3 IP5 jurisdictions are Europe (patents granted by the European Patent Office), China, South Korea, Japan, and the U.S.

4 Data related to perception and behavior studies were restated to include both premarket and post-market studies.

5 Direct spend focuses on materials used in the manufacture of our products; it includes tobacco leaf, direct materials, and electronic devices and accessories.

6 Investments reflect research, product and commercial development, production capacity, scientific substantiation, and studies on adult smoker understanding. Figure does not include commercial deployment costs.

7 Production temporarily stopped at one of our factories in Germany in December 2019 and resumed early 2020.

8 "SKUs" stands for stock-keeping units. References to number of SKUs are based on the latest available data from a number of internal sources, and exclude People's Republic of China and the U.S.

9 Excluding PMI Duty Free. Data are based on 2020 OECD country list.

10 Includes flagship stores, and small, large, and temporary boutiques.

11 The smoke-free product shipment ratio is compiled based on millions of units.

12 Excluding PMI Duty Free; see **glossary**.

13 Net of excise taxes.

14 Excluding PMI Duty Free and the U.S.

Pillar 2

Operating with excellence

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Responsible marketing and sales practices

Indicators	2018	2019	2020	Goals
Total number of compliance training sessions conducted on PMI's Marketing Code (employees/third parties)	23,438	14,400 (49%/51%)	**28,569 (64%/36%)**	
Number of violations of the Marketing Code or Good Conversion Practices resulting in substantiated cases of misconduct	8	42	**29**	
Markets with youth access prevention programs in place (out of PMI's total shipment volume)[1]	n/a	n/a	**94%**	

Sustainable supply chain management

Indicators	2018	2019	2020	Goals
Total number of suppliers[2]	>36,000	>33,200	**>28,000**	
Total supply chain spend (in billions USD)[3]	11.7	11.4	**10.1**	
Supply chain direct spend expenditure (smoke-free/total)[4]	n/a	35%	**33%**	
Percentage of critical supplier spend from whom PMI sources sustainably[5]	n/a	n/a	**67%**	100% by 2025
Our nontobacco supply chain:				
Total procurement spend (in billions USD)[6]	10.0	9.9	**8.9**	
Number of critical suppliers[7]	n/a	95	**154**	
Critical suppliers, as a proportion of total procurement spend	n/a	35%	**35%**	
Critical suppliers' procurement spend assessed in PMI's supplier due diligence platform (STEP)	n/a	84%	**95%**	
Critical suppliers of direct materials assessed in STEP, expressed as a proportion of procurement spend on critical suppliers of direct materials	n/a	73%	**93%**	
Critical suppliers of electronics assessed in STEP, expressed as a proportion of procurement spend on critical suppliers of electronics	n/a	100%	**100%**	
Critical suppliers of direct materials assessed in STEP that demonstrated compliance with PMI's Responsible Sourcing Principles	n/a	50%	**45%**	
Number of suppliers assessed for environmental and social impacts[8]	n/a	154	**217**	
Number of suppliers identified as having significant actual and potential negative environmental impacts[9]	n/a	25	**55**	
Number of suppliers identified as having significant actual and potential negative social impacts[9]	n/a	44	**72**	

1 Total shipment volume includes cigarettes, heated tobacco units, other tobacco products, and e-cigarettes.
2 Suppliers refer to tier 1 suppliers, parent companies.
3 Total supply chain spend includes procurement spend and tobacco leaf sourcing spend.
4 Direct spend focuses on materials used in the manufacture of our products, it includes tobacco leaf, direct materials, electronic devices and accessories, and advanced procurement. This indicator was introduced in 2020.
5 Indicator introduced in 2020. Suppliers' criticality is evaluated considering spend segmentation and nature of component, as well as supply flexibility (single-source/not easily substitutable) as relevant. 2020 figure includes tier 1 suppliers of direct materials and electronics, and tobacco leaf suppliers.
6 Procurement spend excludes tobacco leaf sourcing.
7 In 2020, we expanded scope of our reporting to cover global and regional tier 1 suppliers of direct materials and electronics.
8 Including tier 1 and tier 2 critical and non-critical suppliers.
9 Indicator based on results of self-assessment questionnaires and desktop audit results, where relevant.

Sustainable supply chain management continued

Our tobacco supply chain:	2018	2019	2020	Goals
Number of tobacco farmers contracted by PMI and PMI tobacco suppliers	>350,000	335,000	**285,900**	
Number of third-party tobacco suppliers with whom PMI has a direct contractual relationship[1]	15	13	**14**	
Number of PMI leaf operations that contract tobacco farmers directly	8	8	**6**	
Number of field technicians providing support to contracted farmers and monitoring the implementation of PMI's Good Agricultural Practices (GAP) and Agricultural Labor Practices (ALP)	2,610	2,875	**2,675**	
Proportion of tobacco purchased through direct contracts by PMI and PMI tobacco suppliers	93%	96%	**99%**	≥95% (ongoing)
Number of contracts terminated due to ALP violations[2]	50	641	**1,794**	

1 Data refers to parent companies.
2 The increase can be attributed to the introduction (in 2019) of standardized guidelines related to our due diligence, consequence management, and rewards (read more about our ALP program here).

Respect for human rights

Indicators	2018	2019	2020	Goals
Cumulative number of human rights impact assessments conducted	1	2	**4**	10 by 2025

Responsible and transparent R&D

Indicators	2018	2019	2020
Cumulative number of scientific publications by PMI since 2008	340	365	**418**
Cumulative number of institutions which have taken part in sbv IMPROVER since 2011	450	500	**520**
Cumulative number of countries where institutions which have taken part in sbv IMPROVER since 2011 are located	63	65	**65**
Cumulative number of peer-reviewed publications issued as a result of sbv IMPROVER challenges since 2011[1]	16	16	**16**
Cumulative number of studies published on INTERVALS platform since 2018	9	40	**66**
Cumulative number of protocols published on INTERVALS platform since 2018	57	103	**122**
Cumulative number of data sets published on INTERVALS platform since 2018	144	354	**556**

1 Peer-reviewed publications issued as a result of sbv IMPROVER challenges conducted in the past three years are currently under preparation or validation, and are expected to be published in 2021.

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Business integrity

Indicators	2018	2019	2020
Proportion of employees participating in training sessions pertaining to PMI's Guidebook for Success	86.9%	86.6%	**77.7%**
Total number of compliance training sessions on PMI's Guidebook for Success completed (employees/third parties)	193,063 (82%/18%)	253,763 (88%/12%)	**198,170 (88%/12%)**
Total number of reports received, involving compliance allegations and other concerns	872	978	**756**
Number of closed cases involving compliance allegations (number of unsubstantiated cases/ number of substantiated cases)	582 (245/337)	652 (283/369)	**431 (198/233)**
Proportion of substantiated cases, out of all closed cases involving compliance allegations	57.9%	56.6%	**54.1%**
Number of reports that did not involve a compliance allegation	283	325	**330**

Note: Training and cases are updated based on new information available, so a slight shift in previous years data was reflected.

Illicit tobacco trade prevention[1]

Indicators	2018	2019	2020	Goals
Coverage for tracking and tracing—master case level[2]	100%	100%	**100%**	100% (ongoing)
Tracking and tracing—proportion of packs sold with unique code applied[3]	85%	100%	**100%**	100% (ongoing)
Additional Framework Cooperation Agreements signed with law enforcement agencies/ governments in a given year—number of countries	5	2	**11**	5 by 2021
Regional studies and country analysis to improve awareness of illicit trade—proportion of global consumption covered[4]	27%	20%	**19%**	15 by 2025
Number of law enforcement officers trained on how to authenticate PMI products[5]	500	6,617	**4,981**	500 by 2021
Number of countries with law enforcement agencies trained on how to authenticate PMI products	10	23	**22**	>10 per year
Anti-Counterfeiting Cooperation Agreements signed with our suppliers[6]	n/a	n/a	**57**	100% by 2025
Number of PMI IMPACT projects selected per funding round[7]	29	0	**0**	90 in total by 2025
Number of countries from which PMI IMPACT projects were selected per funding round	22	0	**0**	n/a
PMI IMPACT grants allocated in USD million (cumulative, since 2017)[8]	48	48	**48**	100

1 Data cover PMI combustible tobacco products and smoke-free product consumables and devices.
2 Full coverage equates to 95 percent tracking and tracing in our supply chain (excluding kretek business). 5 percent of master cases are not covered; these are destined for countries that are not identified as a source of potential diversion or where PMI sells to a single customer in the country.
3 Excludes kretek business. While our internal rules mandate a unique code on every pack (hence 100% mentioned), some exceptions remain, which are managed and reviewed with the impacted markets on a yearly basis.
4 In 2020, we did not reach our target of 35 percent: PMI commissions regional studies and country analysis in order to improve awareness of illicit trade. In a number of regions and markets, the frequency of studies has changed from annual to bi-annual or every three years, reflecting the market dynamics and the existing level of awareness.
5 The number of training sessions delivered each year depends on specific needs and requests raised locally by law enforcement agencies. The significant increase in 2019 was mainly driven by additional training sessions delivered in Latin America & Canada to better tackle the nature of illicit trade in the region. In 2020, physical training sessions were offset by online sessions due to lockdown measures and mobility restrictions as a result of the COVID-19 pandemic.
6 Signed Anti-Counterfeiting Cooperation Agreements based on current scope.
7 There were no funding rounds of PMI IMPACT in 2018–2020. Data for 2018 were restated. Other data related to PMI IMPACT were restated accordingly.
8 PMI pledged USD 100 million to PMI IMPACT. Goals related to PMI IMPACT are stated for the period 2016–2025.

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Note: The farm-level data related to our tobacco supply chain reported in this report cover 21 out of the 23 countries we source from. It excludes Lebanon and Switzerland.
1 Data refer to parent companies.
2 Control Union assessment in Argentina was performed before COVID-19; others were postponed to 2021.
3 As we progress with the external independent analysis, the percentage of farmers achieving a living income is currently based on a combination of external living income benchmarks, farmer income studies, and PMI internal data.
4 2020 onward, we report on all types of child labor (hazardous work performed by children, light work performed by children below 13, and children below 15 hired).
5 We introduced this category of prompt actions in 2019.
6 2020 onward, we report on all types of child labor (hazardous work performed by children, light work performed by children below 13, and children below 15 hired).
7 2020 onward, we report on all types of child labor. This indicator refers to incidents of child labor that were recorded by field technicians as prompt actions during the crop season.
8 This indicator was introduced in 2020, based on a new methodology giving us improved visibility on child labor across our sourcing markets. The 2020 data include all prompt actions raised and non-conformities reported for all contracted farms monitored for child labor. It also extends beyond hazardous tasks performed by children to cover all types of child labor (i.e., including light work performed by children below 13 and children below 15 hired). Furthermore, in the identified priority markets, the methodology combines internal monitoring data with external data (including from third party assessments) to calculate prevalence of child labor. As of 2021, we intend to use and report on this indicator, and stop reporting the proportion of farms monitored found with incidents of child labor.
9 We introduced this category of prompt actions in 2019. Scope is limited to farmers providing accommodation to workers (approximately 8 percent of the total farmer base).
10 We introduced this category of prompt actions in 2019.

Socioeconomic well-being of tobacco-farming communities

Indicators	2018	2019	2020	Goals
Number of tobacco farmers contracted by PMI and PMI tobacco suppliers	>350,000	335,000	**285,900**	
Number of countries where farmers contracted by PMI and PMI tobacco suppliers are located	27	24	**23**	
Number of farmers with whom PMI has direct contracts	21,000	16,500	**13,600**	
Number of farmers who have direct contracts with PMI tobacco suppliers	>329,000	318,500	**272,300**	
Number of third-party tobacco suppliers with whom PMI has a direct contractual relationship[1]	15	13	**14**	
Number of PMI leaf operations that contract tobacco farmers directly	8	8	**6**	
Proportion of contracted tobacco farms for which labor practices have been systematically monitored (adherence to PMI's ALP)	88%	92%	**93%**	>90% (ongoing)
Number of contracts terminated due to ALP violations (per crop season)	50	641	**1,794**	
Number of tobacco supplier locations (countries) assessed by Control Union on ALP topics[2]	3	3	**1**	
Cumulative number of tobacco supplier locations (countries) assessed by Control Union since 2013 on ALP topics[2]	21	22	**22**	
Percentage of contracted farmers who make a living income[3]	n/a	n/a	**48%**	100% by 2025
Total number of ALP prompt actions recorded by field technicians	18,543	14,440	**14,751**	
Proportion of ALP prompt actions recorded by field technicians:				
• Safe working environment	74%	73%	**73%**	
• Child labor[4]	25%	19%	**16%**	
• Income working hours	1%	8%	**11%**	
• Other	<1%	<1%	**<1%**	
Total number of ALP prompt actions resolved	13,687	8,137	**10,772**	
Number of ALP prompt actions recorded by field technicians relating to safe working environment	13,780	10,519	**10,816**	
Number of ALP prompt actions recorded by field technicians relating to nonpayment of the minimum wage to farmworkers[5]	n/a	1,158	**1,541**	
Number of ALP prompt actions recorded by field technicians relating to child labor[6]	4,587	2,712	**2,352**	
Proportion of farms monitored found with incidents of child labor[7]	1.3%	0.8%	**0.8%**	
Prevalence of child labor among farms contracted by PMI directly or by PMI's tobacco suppliers[8]	n/a	n/a	**3.5%**	
Proportion of ALP prompt actions recorded by field technicians relating to incidents of hazardous work performed by children that were resolved	89%	88%	**75%**	
Proportion of tobacco farmworkers provided with safe and adequate accommodation[9]	n/a	80%	**100%**	
Proportion of farmers and farmworkers having access to personal protective equipment for CPA application and GTS prevention[10]	n/a	99%	**100%**	100% (ongoing)

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Health, safety, and well-being at work

Indicators	2018	2019	2020	Goals
Lost time incident (LTI) rate per 200,000 hours worked—PMI employees, contracted employees, and contractors[1]	n/a	0.14	**0.08**	
LTI rate per 200,000 hours worked—PMI employees	0.13	0.12	**0.07**	
LTI rate per 200,000 hours worked—contracted employees	0.08	0.10	**0.03**	
LTI rate per 200,000 hours worked—contractors	n/a	0.23	**0.12**	
Integrated total recordable incidents rate (iTRIR) per 200,000 hours worked—PMI employees, contracted employees, and contractors[2]	n/a	0.22	**0.12**	<0.30 by 2025
TRIR per 200,000 hours worked—PMI employees	0.22	0.20	**0.11**	
TRIR per 200,000 hours worked—contracted employees	0.30	0.17	**0.06**	
TRIR per 200,000 hours worked—contractors	n/a	0.32	**0.16**	
Number of fatalities—PMI and contracted employees	2	1	**1**	
Number of fatalities—contractors	1	0	**1**	
Number of fatalities—members of the public	3	10	**5**	
Occupational illness frequency rate (OIFR) per 200,000 hours worked—PMI and contracted employees	0.0013	0	**0**	
Collision rate within PMI's fleet of vehicles per year (collisions per million km driven)	0.91	0.87	**0.53**	<0.65 by end of 2022
Proportion of PMI fleet equipped with telematics[3]	n/a	n/a	**35%**	100% by end of 2023
Proportion of manufacturing facilities with OHSAS 18001 and ISO 14001 certification[4]	97%	98%	**100%**	
Number of markets with health and well-being committees	>40	55	**53**	
Employee self-assessment psychological well-being measure[5]	n/a	n/a	**58**	63 by 2021

The 2020 metrics for our health & safety indicators are subject to external verification by SGS (see the External Verification Statements here and here).

1 We define a contracted employee as an employee who is under the direct supervision of PMI employees but employed by a temporary employment agency. We define a contractor as a person employed or working on behalf of a third-party company contracted by PMI, who remains under the direct supervision of their employer rather than PMI and are often involved in project-specific or outsourcing arrangements.
The scope of our reporting on contractors in 2020 excludes our site in South Korea (representing less than 1 percent of the total contractor population), where local legislation does not permit this monitoring.

2 Integrated total recordable incident rate (iTRIR) covers PMI employees, contracted employees, and contractors.

3 Indicator introduced in 2020. Scope covers PMI's working tool cars (representing 75 percent of PMI's total fleet).

4 Scope: Manufacturing facilities producing more than three billion cigarette equivalents annually.

5 Indicator introduced in 2020. Based on answers from employees as part of our regular employee listening survey. The indicator represents the percentage of employees who responded "good" or "very good" to the question "How would you rate your current psychological or emotional well-being at present?" in our regular employee listening survey.

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Diverse and inclusive working environment

Indicators	2018	2019	2020	Goals
Proportion of female employees	42.1%	41.7%	**41.7%**	
Proportion of management positions held by women[1]	35.1%	36.1%	**37.2%**	At least 40% by 2022
Proportion of female employees at different managerial levels:[1]				
• Managers	36.6%	37.5%	**38.8%**	
• Directors	29.4%	31.2%	**30.9%**	
• Senior leaders	15.2%	17.4%	**20.3%**	
Proportion of women in senior roles[2]	27.5%	29.2%	**29.4%**	32% by 2023
Proportion of new hires in management positions that are women[1]	40.6%	40.7%	**38.8%**	50%
Proportion of new hires at junior levels that are women[1]	40.4%	43.8%	**42.2%**	50%
Proportion of new hires that are women[1]	n/a	41.6%	**40.7%**	
Proportion of promotions in management positions that are women[1]	37.8%	37.4%	**38.9%**	
Number of women on PMI's Company Management[2]	2 (out of 22)	2 (out of 25)	**4 (out of 25)**	
Proportion of women on PMI's Company Management[2]	9%	8%	**16%**	
Number of women on PMI's Board of Directors[3]	3 (out of 12)	3 (out of 12)	**2 (out of 13)**	
Proportion of women on PMI's Board of Directors[3]	25%	25%	**15%**	
Mean gender pay gap[4]	n/a	34.6	**33.0**	
Proportion of employees at different age groups:				
• Below 25	n/a	3%	**3%**	
• Between 25 and 34	n/a	31%	**31%**	
• Between 35 and 54	n/a	61%	**62%**	
• Above 55	n/a	4%	**4%**	
Number of nationalities among PMI's employees [5]	>100	126	**131**	
Number of countries with affiliates with LGBTQ+ initiatives or networks	25	27	**28**	

Fair working conditions

Indicators	2018	2019	2020
Number of PMI employees	77,435	73,542	**70,849**
Number of PMI full-time equivalent (FTE) positions	77,039	71,795	**70,560**
Proportion of employees covered by Collective Labor Agreements	65%	63%	**62%**
Total number of Collective Labor Agreements	81	80	**79**
Total number of countries with Collective Labor Agreements	35	35	**34**

1 Our gender diversity data cover around 95 percent of PMI's total workforce.
2 See glossary.
2 Based on PMI's Company Management composition as of March 16, 2021.
3 Based on PMI's Board of Directors composition as of May 5, 2021.
4 The mean gender pay gap calculation is the sum of annual base salary, bonus, and stock options. See **PMI.com** for further detail on our gender pay gap, including breakdown by pay quartile.
5 In 2020, we expanded the scope of our reporting on employee nationalities to cover 100% of our workforce.

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PMI's workforce at year-end 2020

Number of employees by employment contract (permanent and temporary), by gender	
Women employed on a permanent contract	28,401
Women employed on a temporary contract	1,109
Men employed on a permanent contract	39,835
Men employed on a temporary contract	1,504
Number of employees by employment contract (permanent and temporary), by region	
Employees on a permanent contract in European Union region	18,292
Employees on a temporary contract in European Union region	1,637
Employees on a permanent contract in Middle East & Africa region, including PMI Duty Free	3,165
Employees on a temporary contract in Middle East & Africa region, including PMI Duty Free	145
Employees on a permanent contract in South & Southeast Asia region	28,294
Employees on a temporary contract in South & Southeast Asia region	128
Employees on a permanent contract in Eastern Europe region	6,743
Employees on a temporary contract in Eastern Europe region	196
Employees on a permanent contract in East Asia & Australia region	4,242
Employees on a temporary contract in East Asia & Australia region	99
Employees on a permanent contract in Latin America & Canada region, and U.S.	7,500
Employees on a temporary contract in Latin America & Canada region, and U.S.	408
Number of employees by employment type (full-time and part-time), by gender	
Women employed on a full-time contract	28,925
Women employed on a part-time contract	585
Men employed on a full-time contract	41,087
Men employed on a part-time contract	252

All data as of December 31, 2020. Presentation of information and data aligns with guidance of GRI standard 102-8 (2016).

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Community support

Indicators	2018	2019	2020
Number of social contributions supported by PMI (charitable donations/community investments)	280	170 (145/25)	**702 (681/21)**
Number of partner organizations supported by PMI's social contributions	239	147	**600**
Number of countries where projects supported by PMI's social contributions were implemented	63	43	**78**
Number of direct beneficiaries of projects supported by PMI's social contributions	>300,000	>467,000	**>2,700,000**
Value of cash contributions (in millions USD) (charitable donations/community investments)	28.3	17.0 (14.8/2.2)	**47.8 (46.0/1.8)**
Approximate value of in-kind donations (in '000 USD)	260	205	**12,190**
Approximate value of management costs of PMI's social contributions (in '000 USD)	n/a	650	**769**
Approximate total number of volunteer hours by PMI employees	18,000	16,700	**15,272**
Approximate value of employee time spent on volunteering (in '000 USD)	500	430	**440**

Note: In 2020, when the COVID-19 pandemic emerged as a major crisis, we reassessed our priorities and shifted our focus toward providing support in a quick and effective manner, setting a global corporate donation fund.

Talent attraction, retention, and employability

Indicators	2018	2019	2020	Goals
Employee overall turnover rate	11.51%	14.10%	**9.80%**	
Women employee overall turnover rate	10.80%	15.54%	**9.90%**	
Employee voluntary turnover rate	4.12%	4.53%	**3.13%**	
Spend for learning per FTE (in USD) total	n/a	513	**551**	
Average hours of training spend per FTE[1]	12.1	15.5	**11.2**	
Proportion of employees covered by performance review[2]	77.0%	79.4%	**90%**	
Employee Net Promoter Score[3]	n/a	+16	**+33**	At least +30 by 2025

1   In 2020, we experienced a decrease in the average hours per FTE of training due to the time required to shift many face-to-face learning to virtual learning (in adaptation to COVID-19 circumstances), and the consequent increase in virtual learning sessions that are typically shorter than live sessions.
2   2020 data based on a total of 55,393 employees in salaried grades.
3   We measure the engagement of our workforce using the employee Net Promoter Score (eNPS), following a methodology similar to that we use to measure consumer engagement. The score can range from -100 to +100.

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Climate protection

Indicators	2018	2019 (baseline)	2020	Goals	Scope
CO_2e scope 1 (metric tons)[1]	408,162	397,210	**322,633**		PMI factories, offices,[2] and fleet
CO_2e scope 2 (metric tons)[1]	175,785	158,672	**90,366**		PMI factories and offices
CO_2e scope 1+2 (metric tons)[1]	583,947	555,882	**412,999**	Carbon neutrality by 2030	PMI factories, offices, and fleet
CO_2e scope 1 from fleet (metric tons)	114,936	111,400	**79,457**		PMI fleet
CO_2e emissions from fleet (kg CO_2e per km driven)	221	222	**216**		PMI fleet
CO_2e absolute reduction in PMI fleet versus 2019 baseline	n/a	n/a	**29%**		PMI fleet
Proportion of hybrid or electrical vehicles in our fleet	n/a	n/a	**4.7%**		PMI fleet
CO_2e scope 3 ('000 metric tons)	4,714	4,309	**3,590**		PMI value chain
CO_2e scope 1+2+3 ('000 metric tons)	5,298	4,865	**4,003**	Carbon neutrality by 2050	PMI value chain
Carbon offsetting certificates (metric tons)[3]	956	1,242	**3,297**		PMI factories, offices, and fleet
CO_2e scope 1+2 absolute reduction versus 2019 baseline	n/a	n/a	**26%**	50% by 2030 (SBT)	PMI factories, offices, and fleet
CO_2e scope 3 absolute reduction versus 2019 baseline[4]	n/a	n/a	**17%**	50% by 2030 (SBT)	PMI value chain
Number of carbon-neutral factories	0	1	**2**	All by 2030	PMI factories
CO_2e scope 1+2+3 intensity (kg per million cigarettes equivalent)[5]	6,552	6,148	**5,482**		PMI value chain
CO_2e scope 1+2 intensity (kg per million cigarettes equivalent)[5]	722	702	**556**		PMI factories, offices, and fleet
CO_2e scope 3 biogenic emissions ('000 metric tons)	3,442	2,419	**2,139**		PMI value chain
CO_2e scope 1+2+3 absolute reduction versus 2019 baseline	n/a	n/a	**18%**		PMI value chain
CO_2e scope 1+2+3 intensity reduction versus 2019 baseline	n/a	n/a	**11%**		PMI value chain
CO_2e absolute emissions reduction in PMI tobacco supply chain versus 2019 baseline	n/a	n/a	**28%**	35% by 2025 50% by 2030	PMI tobacco supply chain
CO_2e intensity reduction in tobacco curing versus 2019 baseline	n/a	n/a	**44%**	75% by 2025	PMI tobacco supply chain
Proportion of flue-cured tobacco purchased cured with renewable fuel sources (self-sufficient firewood and biomass adoption)	46% (33% + 13%)	51% (36% +15%)	**67% (45% +22%)**	70% by 2021	PMI tobacco supply chain
Proportion of Virginia tobacco purchased cured with coal	15%	16%	**11%**		PMI tobacco supply chain
Approximate total number of curing barns upgraded since 2014 (cumulative)	76,000	80,800	**82,500**		PMI tobacco supply chain

Climate protection continued

Indicators	2018	2019 (baseline)	2020	Goals	Scope
Total energy consumption (gigajoules)	9,353,222	9,456,576	**7,909,157**		PMI factories, offices, and fleet
Proportion of total energy consumed that is from renewable sources	23%	27%	**29%**		PMI factories, offices, and fleet
Energy intensity (gigajoules per million cigarettes equivalent)	11.57	11.95	**10.83**		PMI factories, offices, and fleet
Fuel consumption from nonrenewable sources (gigajoules)	5,988,022	5,819,072	**4,719,647**		PMI factories, offices, and fleet
Fuel consumption from renewable sources (gigajoules)	61,163	128,967	**91,680**		PMI factories, offices, and fleet
Total electricity consumed (MWh)	899,706	959,723	**832,292**		PMI factories and offices
Total electricity consumed that is from renewable sources (MWh)	546,944	623,940	**621,620**		PMI factories and offices
Proportion of electricity used and purchased that is from renewable sources	61%	65%	**75%**		PMI factories and offices
Proportion of electricity used and purchased that is from renewable sources	65%	72%	**78%**	100% by 2025	PMI factories
CDP Climate Change rating	A	A	**A**	A	

Note: Our inventory of GHG emissions (scope 1, 2, and 3) in 2020 is subject to external verification by SGS. In 2020, we achieved significant reductions in emissions, partially driven by COVID-19 impact (read more on page 102) but also by accelerated efforts toward our carbon neutrality ambition.

1 Emissions from PMI operated *IQOS* stores are excluded from scope 1 and 2 emissions, as de minimis.
2 We include warehouses in PMI offices.
3 2020 figure includes carbon off-setting certificates purchased in our factories in Lithuania and Switzerland, as well as our Operations Center in Switzerland.
4 In 2020, we reviewed our carbon footprint model, taking into account more primary data from suppliers and updating our methodology, leading to more accurate figures for our scope 3 emissions. We have restated our 2019 data according to the new model. Other figures that include scope 3 emissions have also been restated.
5 Intensity is measured in CO_2e per million shipped cigarette equivalent.

Littering prevention

Indicators	2019	2020
Number of anti-littering initiatives conducted	54	33
Number of affiliates with an anti-littering strategy	31	47
Number of affiliates participating in litter cleanup initiatives[1]	31	n/a
Number of participants in litter cleanup initiatives (PMI employees and other volunteers)[1]	3,962	n/a
Number of cigarette butts collected during litter cleanup initiatives[1]	827,160	n/a

Note: These indicators were introduced in 2019.
1 In 2020, due to the COVID-19 restrictions, we did not initiate a global mobilization among our employees to participate in cleanup events and did not track this data even though some affiliates were able to conduct some targeted activities.

Pillar 4

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Product eco-design and circularity

Indicators	2018	2019	2020	Goals
Effective recycling rate of *IQOS* devices[1]	30%	29%	**40%**	70% by 2023 80% by 2025
Proportion of *IQOS* device sales volume covered by the CIRCLE program[2]	66%	39%	**48%**	100% by 2025
Recycling rate of *IQOS* devices at the CIRCLE hubs (weighted average)[3]	45%	74%	**84%**	>80% (ongoing)
Total volume of materials recycled at the CIRCLE hubs (in tons)	n/a	153	**191**	
Proportion of packaging material that is recyclable[4]	94.9%	94.9%	**94.7%**	100% by 2025
Proportion of packaging material that is from renewable source[4]	90.0%	89.6%	**89.8%**	95% by 2025
Reduction of packaging materials weight versus 2018 baseline[5]	Baseline	-1%	**-5%**	-15% by 2025

1 The effective recycling rate is calculated based on the proportion of *IQOS* device sales volume covered by the CIRCLE program multiplied by the recycling rate of *IQOS* devices at the CIRCLE hubs (weighted average).
2 Recycling rate: Percentage of the weight of each device that is recycled, weighted-average depending on device type and processing facility (figures provided for PMI-developed products processed through CIRCLE hubs, varied by device type, zero landfill, remainder to energy recovery or material loss).
3 We established our two recycling CIRCLE hubs in 2018. We expanded the number of markets covered by CIRCLE in 2019 and 2020, the decrease in coverage of sales volume is explained by *IQOS* growth in markets not yet covered by the program.
4 2018–2020 volume has been restated to include shipping cases.
5 Includes portfolio/volume mix and inventory movement. Includes shipping cases. 2019 figure restated due to revised actual figures on amounts of board purchased.

Forest conservation

Indicators	2018	2019	2020	Goals
Proportion of tobacco purchased cured at no risk of deforestation of primary and protected forests[1]	90%	97%	**100%**	
Proportion of flue-cured tobacco purchased cured with renewable sources (self-sufficient firewood and biomass adoption)	46% (33% + 13%)	51% (36%+15%)	**67% (45% + 22%)**	70% by 2021
Approximate cumulative number of curing barns upgraded since 2014	76,000	80,800	**82,500**	
CDP forest rating	B	A-	**A**	

1 To align to most-widely accepted definitions and metrics on measuring forest protection impacts, we decided to adopt the definition of "high conservation value" forests coming from the Accountability Framework Initiative. Please see our Zero Deforestation Manifesto for definitions.

Biodiversity

Indicators	2017	2018	2019	Goals
Proportion of tobacco purchased without detection of residues attributable to the use of WHO Toxicity Class 1 crop protection agents[1]	99%	100%	**100%**	
Proportion of tobacco purchased without detection of residues attributable to the use of HHPs, as defined by FAO and WHO guidelines in 2016[1]	88%	89%	**97%**	100% by crop year 2020

1 The 2020 crop season data were not available at the time of the publication of this report.

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Water stewardship

Indicators	2010 baseline	2018	2019	2020	Goals	Scope
Total amount of water withdrawn ('000 m³)	4,998	4,371	4,008	3,375		PMI factories
Total amount of water consumed (withdrawn minus discharged) ('000 m³)	2,449	1,958	1,883	1,619		PMI factories
Water ratio (water withdrawn in m³ per million cigarettes equivalent)[1]	5.35	5.14	4.74	4.20	3.1 by 2022	PMI factories
Number of fines[2]		0	1	1		PMI factories
Cumulative number of local water risk assessments performed		8	15	23	100% coverage	Tobacco supply chain
Quantity of blue water used per ton of tobacco produced (m³)[3]		266	330	307		Tobacco supply chain
Total amount of water used ('000 m³)		119,600	138,200	115,000		Tobacco supply chain
CDP water security rating		B	A	A	A	PMI

1 Water intensity is measured in m³ per million cigarettes produced equivalent.
2 Fines above USD 10,000 (or equivalent in converted currency). 2020 fine pertained to sewage water contamination exceeding national limitations in our factory in Ukraine.
3 Blue water refers to water used for irrigation.

Waste reduction

Indicators	2010 baseline	2018	2019	2020
Total amount of waste generated (metric tons)	143,596	134,367	131,104	119,750
Proportion of total waste generated that is recycled	n/a	84%	84%	85%
Proportion of total waste generated that is incinerated with energy recovery	n/a	12%	12%	11%
Proportion of total waste generated that is disposed to landfill	n/a	4%	4%	3%
Proportion of total waste generated that is incinerated without energy recovery	n/a	<1%	<1%	<1%
Amount of hazardous waste generated (metric tons)	n/a	1,423	1,486	1,266
Proportion of hazardous waste generated that is recycled	n/a	41%	33%	38%
Proportion of hazardous waste generated that is incinerated with energy recovery	n/a	44%	49%	43%
Proportion of hazardous waste generated that is disposed to landfill	n/a	6%	8%	7%
Proportion of hazardous waste generated that is incinerated without energy recovery	n/a	9%	10%	13%

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Glossary and acronyms

Aerosol – Gaseous suspension of fine solid particles and/or liquid droplets

ALP – Agricultural Labor Practices

AWS – Alliance for Water Stewardship

BOS – Behavioral Observation Systems

CDP – Carbon Disclosure Project

CHTP – Carbon-Heated Tobacco Product

CLAs – Collective Labor Agreements

Combusted tobacco product – A manufactured consumable product that combusts tobacco and/or generates smoke inhaled directly by the user when it is used as intended. Combusted tobacco products include, for example, cigarettes, cigarillos, cigars, "roll your own", and pipe tobacco

Combustible products – The term PMI uses to refer to cigarettes and OTP, combined

Combustion – The process of burning a substance in oxygen, producing heat and often light

Company management – The term we use to refer to the senior management of the company, as presented on our PMI.com site (also referred to as "our leadership team")

Contracted employee – We define a contracted employee as an employee who is under the direct supervision of PMI employees but employed by a temporary employment agency

Contractor – We define a contractor as a person employed or working on behalf of a third-party company contracted by PMI, who remains under the direct supervision of their employer rather than PMI and are often involved in project-specific or outsourcing arrangements

CPA – Crop protective agent

Downstream supply chain – Downstream operations are those stages in the supply chain in which materials (mostly in the form of finished products) flow away from the organization to the customers/consumers.

Directors – The term we use to refer to employees in salary grade 14 to 16

EHTS – Electrically Heated Tobacco System

E-liquids – Refers to a liquid solution that is used in/with e-cigarettes. E-liquids contain different levels of nicotine in a propylene glycol and/or vegetable glycerin-based solution with various flavors

EPR – Extended Producer Responsibility

Estimated users who have switched to *IQOS* and stopped smoking – For markets where *IQOS* is the only heat-not-burn product, this is defined as the daily individual consumption of PMI HTUs representing the totality of their daily tobacco consumption in the past seven days. For markets where *IQOS* is one among other heat-not-burn products, this is the daily individual consumption of HTUs representing the totality of their daily tobacco consumption in the past seven days, of which at least 70% are PMI HTUs. PMI HTUs include licensed KT&G HTUs

EVA – Economic value added

E-vapor product – Electrical product that generates an aerosol by heating a nicotine or non-nicotine containing liquid, such as electronic cigarettes (or "e-cigarettes")

FAO – Food and Agriculture Organization of the United Nations

FCTC – Framework Convention on Tobacco Control

FDA – U.S. Food and Drug Administration

FTs – Field technicians monitoring the implementation of PMI's Good Agricultural Practices and Agricultural Labor Practices programs

GAP – Good Agricultural Practices

GDPR – General Data Protection Regulation

Gender pay gap – The gender pay gap is the difference in average gross hourly earnings between women and men

GHG – Greenhouse gas

GPP – Global Privacy Program

GTS – Green tobacco sickness

HCV – High conservation value

Heated tobacco product or HTP – A manufactured tobacco product that delivers a nicotine-containing vapor (aerosol), without combustion of the tobacco mixture

Heated tobacco units or HTUs – The term PMI uses refer to heated tobacco consumables, which include the company's *HEETS*, *HEETS Creations*, *HEETS Dimensions*, *HEETS Marlboro* and *HEETS FROM MARLBORO* (defined collectively as *HEETS*), *Marlboro Dimensions*, *Marlboro HeatSticks* and *Parliament HeatSticks*, as well as the KT&G-licensed brands, *Fiit* and *Miix* (outside of Korea)

HHPs – Highly hazardous pesticides

HPHCs – The harmful or potentially harmful constituents which have been identified as likely causes of tobacco-related diseases

Human rights impact assessment (HRIA) – Assessments to identify human rights risks and adverse impacts

Illicit trade – Refers to domestic non-tax paid products

In-setting – The act of generating a carbon credit within the corporate's sphere of influence and retiring the unit on behalf of 1 ton of carbon that has been emitted by the corporate (source: International Carbon Reduction and Offset Alliance)

IPM – Integrated Pest Management

IPS – Integrated Production System

KPIs – Key performance indicators

LMICs – Low- and middle-income countries

LTI – Lost Time Injury

Management positions – The term we generically use to refer to all positions in a defined salary grade (10) and above

Managers – The term we use to refer to employees in salary grade 10 to 13

MRTP – Modified Risk Tobacco Product, the term used by the U.S. FDA to refer to RRPs

MRTPA – Modified Risk Tobacco Product Application under section 911 of the Federal Food, Drug, and Cosmetic Act

NGOs – Non-governmental organizations

Non-Combusted Alternatives (or NCA) – A manufactured consumable product (whether made from tobacco or not) that provides a nicotine-containing aerosol without combusting tobacco and that does not generate smoke inhaled directly by the user when it is used as intended. NCAs include any NCA device necessary for the consumption of the tobacco or nicotine-containing substance. In this report, referred to as "smoke-free products" or "reduced-risk products" indistinctively

OECD – Organisation for Economic Co-operation and Development

Offsetting – The act of purchasing a carbon credit generated outside the corporate's sphere of influence and retiring the unit on behalf of 1 ton of carbon that has been emitted by the corporate (source: International Carbon Reduction and Offset Alliance)

OTP – Defined as "other tobacco products," primarily roll-your-own and make-your-own cigarettes, pipe tobacco, cigars, and cigarillos, and does not include reduced-risk products

P&C – People and Culture

PMI Regions – Effective January 1, 2018, PMI began managing its business in six reporting segments as follows: the European Union Region (EU); the Eastern Europe Region (EE); the Middle East & Africa Region (ME&A), which includes PMI Duty Free; the South & Southeast Asia Region (S&SA); the East Asia & Australia Region (EA&A); and the Latin America & Canada Region (LA&C)

PPE – Personal protective equipment

Reduced-risk products (RRPs) or smoke-free products – Products that present, are likely to present, or have the potential to present less risk of harm to smokers who switch to these products versus continued smoking. PMI has a range of RRPs in various stages of development, scientific assessment, and commercialization. PMI's RRPs are smoke-free products that produce an aerosol that contains far lower quantities of harmful and potentially harmful constituents than found in cigarette smoke

R&D – Research and development

RSP – Responsible Sourcing Principles

SDGs – Sustainable Development Goals

Senior leaders – The term we use to refer to employees in senior leadership roles; it includes all employees in salary grade 17 and above

Glossary and acronyms continued

Senior roles – The term we generically use to refer to all positions in a defined salary grade (14) and above

Smoke – A visible suspension of solid particles, liquid droplets, and gases in air, emitted when a material burns

Smoke-free product consumables – The term PMI uses to refer to heated tobacco units used with the *IQOS* heat-not-burn product, and cartridges containing e-liquids that are used for e-vapor products

STP – Sustainable Tobacco Program

SUP – Single-use plastics

THS – Tobacco Heating System

Tier 1 suppliers – Tier 1 suppliers are suppliers that directly supply goods, materials or services to PMI

Tier 2 suppliers – Tier 2 suppliers are suppliers that provide their products and services to the Tier 1 suppliers

Tons – "Tons" equates to "metric tons" throughout this report

Total *IQOS* users – The estimated number of legal age (minimum 18 years) *IQOS* users that used PMI HTUs for at least 5% of their daily tobacco consumption over the past seven days. PMI HTUs include licensed KT&G HTUs

Total shipment volume – The combined total of cigarette shipment volume and HTU shipment volume

TPSAC – Tobacco Products Scientific Advisory Committee

TRIR – Total recordable incident rate

UNGPs – United Nations Guiding Principles on Business and Human Rights

Upstream supply chain – Upstream operations are those in which the materials flow into the organization (i.e., it mainly refers to procurement activities and inbound logistics).

WASH – Water access, sanitation, and hygiene

WHO – World Health Organization

Key definitions related to our work to improve tobacco farmer livelihoods

A **living income** and living wage are both about achieving a decent standard of living. A living income is the net annual income required for a household to afford a decent standard of living for all its members and applies to, for example, self-employed farmers. A living wage is applied in the context of hired workers (e.g., in factories or on farms). (Source: The Global Living Wage Coalition)

A **minimum legal wage**, as defined in PMI's ALP Code, is a wage for all workers (including temporary, piece-rate, seasonal, and migrant) that meets, at a minimum, the national legal standard or formalized agricultural benchmark standard. An agricultural benchmark may be formalized where a minimum legal wage is not available or applicable to a specific context.

Child labor, as defined by the ILO, is work that deprives children of their childhood, their potential and their dignity, and that is harmful to physical and mental development. Under PMI's ALP Code, the minimum age for admission to work is not less than the age at which compulsory schooling is completed and, in any case, is not less than 15 years or the minimum age accepted by the country's laws, whichever age limit affords greater protection. No person below age 18 should be involved in any type of hazardous work. In the case of family farms, a child may only help on the farm provided that the work is non-hazardous, and the child is at least 13 years old or above the minimum age for such work as defined by the country's laws, whichever affords greater protection.

Hazardous work means work that, by its nature or by virtue of when or where it is carried out, is likely to harm the health, safety, or morals of children or others. The following can, for example, be hazardous, particularly without the proper PPE: applying crop protection agents (CPA); stalk cutting; stringing; carrying heavy loads; working with sharp tools; working in extreme temperatures; and working after dark.

Green tobacco sickness (GTS) is a type of nicotine poisoning caused by the absorption of nicotine from the surface of wet, fresh, green tobacco leaves through the skin. The characteristic symptoms of GTS include nausea, vomiting, weakness, dizziness, stomach cramps, difficulty breathing, excessive sweating, headache, and fluctuations in blood pressure and heart rate. They can last from 12 to 48 hours.[1]

Personal protective equipment (PPE) in tobacco farming refers to any clothes, materials, or devices that provide protection from exposure to CPA and GTS during specific activities throughout the crop cycle.[2]

Living income benchmark studies are studies conducted in specific regions or areas to estimate the net annual income required for a household to afford a decent standard of living for all members of that household. PMI has partnered with Social Accountability International, which in conjunction with the Anker Research Network will be conducting these studies in PMI sourcing markets.

Anker Living Income Reference Values[3] represent a living income for typical families in rural (or urban) areas of low-income and middle-income countries. Reference Values provide a credible estimate of living wage or income at a country level, for rural and urban areas. They offer an insightful reference beyond the currently available indicators for many countries, which are mostly limited to poverty lines and minimum wages.

Farmer income studies are conducted, through third party service providers, to assess all income sources of contracted farmers within PMI's tobacco supply chain, including tobacco, complementary crops and off-farm income.

1 Schep LJ, Slaughter RJ, Beasley DM (September-October 2009). "Nicotinic plant poisoning." Clinical Toxicology.

2 Adapted from the FAO/WHO (2014) International Code of Conduct on Pesticide Management.

3 Reference values are built on data and knowledge gained from 40 complete Anker methodology benchmark studies. Since they are based on a statistical analysis, they have a margin of error for typical rural (or urban) areas of a country, which is generally around +/– 10% using a 95% confidence interval. Sources: Living Income Reference Values | livingincome (living-income.com) and Anker Living Wage and Living Income Reference Values | Global Living Wage Coalition.

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Forward-looking and cautionary statements

This report and related discussion contain projections of future results and other forward-looking statements. Achievement of future results is subject to risks, uncertainties and inaccurate assumptions. In the event that risks or uncertainties materialize, or underlying assumptions prove inaccurate, actual results could vary materially from those contained in such forward-looking statements. Pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, PMI is 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 PMI.

PMI's business risks include: excise tax increases and discriminatory tax structures; increasing marketing and regulatory restrictions that could reduce our competitiveness, eliminate our ability to communicate with adult consumers, or ban certain of our products; health concerns relating to the use of tobacco and other nicotine-containing products and exposure to environmental tobacco smoke; litigation related to tobacco use and intellectual property; intense competition; the effects of global and individual country economic, regulatory and political developments, natural disasters and conflicts; changes in adult smoker behavior; lost revenues as a result of counterfeiting, contraband and cross-border purchases; governmental investigations; unfavorable currency exchange rates and currency devaluations, and limitations on the ability to repatriate funds; adverse changes in applicable corporate tax laws; adverse changes in the cost, availability, and quality of tobacco and other agricultural products and raw materials, as well as components and materials for our electronic devices; and the integrity of its information systems and effectiveness of its data privacy policies. PMI's future profitability may also be adversely affected should it be unsuccessful

in its attempts to produce and commercialize reduced-risk products or if regulation or taxation do not differentiate between such products and cigarettes; if it is unable to successfully introduce new products, promote brand equity, enter new markets or improve its margins through increased prices and productivity gains; if it is unable to expand its brand portfolio internally or through acquisitions and the development of strategic business relationships; or if it is unable to attract and retain the best global talent. Future results are also subject to the lower predictability of our reduced-risk product category's performance.

The COVID-19 pandemic has created significant societal and economic disruption, and resulted in closures of stores, factories and offices, and restrictions on manufacturing, distribution and travel, all of which will adversely impact our business, results of operations, cash flows and financial position during the continuation of the pandemic. Our business continuity plans and other safeguards may not be effective to mitigate the impact of the pandemic. Currently, significant risks include our diminished ability to convert adult smokers to our RRPs, significant volume declines in our duty-free business and certain other key markets, disruptions or delays in our manufacturing and supply chain, increased currency volatility, and delays in certain cost saving, transformation and restructuring initiatives. Our business could also be adversely impacted if key personnel or a significant number of employees or business partners become unavailable due to the COVID-19 outbreak. The significant adverse impact of COVID-19 on the economic or political conditions in markets in which we operate could result in changes to the preferences of our adult consumers and lower demand for our products, particularly for our mid-price or premium-price brands. Continuation of the pandemic could disrupt our access to the credit markets or increase our

borrowing costs. Governments may temporarily be unable to focus on the development of science-based regulatory frameworks for the development and commercialization of RRPs or on the enforcement or implementation of regulations that are significant to our business. In addition, messaging about the potential negative impacts of the use of our products on COVID-19 risks may lead to increasingly restrictive regulatory measures on the sale and use of our products, negatively impact demand for our products, the willingness of adult consumers to switch to our RRPs and our efforts to advocate for the development of science-based regulatory frameworks for the development and commercialization of RRPs.

The impact of these risks also depends on factors beyond our knowledge or control, including the duration and severity of the pandemic, its recurrence in our key markets, actions taken to contain its spread and to mitigate its public health effects, and the ultimate economic consequences thereof.

PMI is further subject to other risks detailed from time to time in its publicly filed documents, including the Form 10-Q for the quarter ended March 31, 2021. PMI cautions that the foregoing list of important factors is not a complete discussion of all potential risks and uncertainties. PMI does not undertake to update any forward-looking statement that it may make from time to time, except in the normal course of its public disclosure obligations.

Independent Assurance Report on the Business Transformation Metrics Reporting 2020

To the Board of Directors of Philip Morris International Inc.

We have been engaged to perform assurance procedures to provide limited assurance on the Business Transformation Metrics reporting of Philip Morris International Inc. and Subsidiaries ('PMI').

Scope and subject matter

Our limited assurance engagement focused on selected Business Transformation Metrics of PMI for the financial year ended December 31, 2020 included in the Integrated Report 2020 and included the following:

a. The following Business Transformation Metrics as disclosed on pages 15 and 130, respectively.

- R&D expenditure (in millions USD)
- R&D expenditure (smoke-free/total)
- Number of factories producing smoke-free products out of total number of factories
- Number of markets where IQOS is available for sale
- Proportion of markets where IQOS is available for sale that are outside the OECD
- Commercial expenditure (marketing) (smoke-free/total)
- Smoke-free product shipment volume (billion units)
- Combustible product shipment volume (billion units)
- Smoke-free product shipment ratio (smoke-free/total)
- Total IQOS users (in millions)
- Estimated users who have switched to IQOS and stopped smoking (in millions)
- Estimated users outside the OECD countries who have switched to IQOS and stopped smoking (in millions)
- Net revenues (smoke-free/total)
- Number of markets where net revenues from smoke-free products exceed 10% of total net revenues
- Number of markets where net revenues from smoke-free products exceed 50% of total net revenues

b. The application of the reporting guidelines for the preparation of the Business Transformation Metrics published on pages 15, 130 and 143 (glossary); and

c. The management and reporting processes with respect to the selected Business Transformation Metrics as well as the control environment in relation to the aggregation of the data

Criteria

The reporting criteria used by PMI are described and disclosed on pages 15, 130 and 143 (glossary) and in the internal reporting guidelines. These define those procedures, by which the Business Transformation Metrics data are internally gathered, collated and aggregated.

Inherent limitations

The accuracy and completeness of Business Transformation Metrics are subject to inherent limitations given their nature and methods for determining, calculating and estimating such data. Our assurance report should therefore be read in connection with PMI's internal guidelines, definitions and procedures on Business Transformation Metrics reporting.

PMI management's responsibility

PMI management is responsible for both the subject matter and the criteria as well as for selection, preparation and presentation of the information in accordance with the criteria. This responsibility includes the design, implementation and maintenance of related internal control relevant to this reporting process that is free from material misstatement, whether due to fraud or error.

Our responsibility

Our responsibility is to express a limited assurance conclusion on the Business Transformation Metrics based on the procedures we have performed and the evidence we have obtained. We conducted our limited assurance engagement in accordance with the International Standard on Assurance Engagements 3000 (revised), "Assurance Engagements other than Audits or Reviews of Historical Financial Information" issued by the International Auditing and Assurance Standards Board. These standards require that we plan and perform this engagement to obtain limited assurance about whether the identified Business Transformation Metrics are free from material misstatement.

A limited assurance engagement undertaken in accordance with ISAE 3000 (revised) involves assessing the suitability in the circumstances of PMI's use of applicable criteria as the basis for the preparation of the Business Transformation Metrics, assessing the risks of material misstatement of the Business Transformation Metrics whether due to fraud or error, responding to the assessed risks as necessary in the circumstances, and evaluating the overall presentation of Business Transformation Metrics. A limited assurance engagement is substantially less in scope than a reasonable assurance engagement in relation to both the risk assessment procedures, including an understanding of internal control, and the procedures performed in response to the assessed risks. The procedures selected depend on the assurance practitioner's judgement.

Independent Assurance Report on the
Business Transformation Metrics Reporting 2020 continued

Our independence and quality controls

We are independent PMI in accordance with the International Code of Ethics for Professional Accountants (including International Independence Standards) issued by the International Ethics Standards Board for Accountants (IESBA Code) that are relevant to our audit of the financial statements and other assurance engagements in Switzerland. We have fulfilled our other ethical responsibilities in accordance with the IESBA Code.

Our firm applies International Standard on Quality Control 1 and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

Summary of the work performed

Our limited assurance procedures included, but were not limited to the following work:

- Reviewing the application of the internal reporting guidelines
- Interviewing PMI representatives responsible for the internal reporting and data collection
- Test a sample of data from PMI operations concerning the completeness, accuracy, consistency and classification
- Inspecting relevant documentation on a sample basis, including PMI policies, management reporting structures and documentation
- Reviewing and assessing the management reporting processes for Business Transformation Metrics data and consolidation and their related controls

We have not carried out any work on data other than outlined in the scope and subject matter section as defined above. We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our assurance conclusions.

Limited assurance conclusion

Based on the procedures we performed, nothing has come to our attention that causes us to believe that

a. The selected Business Transformation Metrics as outlined in the scope and subject matter paragraph and disclosed on page 15 not prepared and disclosed in all material respects in accordance with PMI's internal guidelines and procedures as published on pages 15, 130 and 143; and;

b. The management and reporting processes to collect and aggregate the Business Transformation Metrics as well as the control environment in relation to the data aggregation are not functioning as designed.

PricewaterhouseCoopers SA

Chad Mueller   **Raphael Rutishauser**

Lausanne, May 6, 2021

Notes

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

In this report and in related communications, the term "materiality," "material," and similar terms, when used in the context of economic, environmental and social topics, are defined in the referenced sustainability standards, and are not meant to correspond to the concept of materiality under the U.S. securities laws and/or disclosures required by the U.S. Securities and Exchange Commission.

This report contains references and links to websites operated by third parties. These references are provided as a convenience to you and as an additional avenue of access to the information contained in those sources; they should not be viewed as an endorsement by us of the content of these references and linked sites or opinions of their authors.

A glossary of terms is posted on our website.

Unless otherwise stated, all references to *IQOS* are to our *IQOS* heat-not-burn devices and consumables.

Trademarks: Trademarks and service marks in this report are the registered property of, or licensed by, the subsidiaries of Philip Morris International Inc., and are italicized or shown in their logo form.

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Filming and photography

Throughout an unprecedented and unparalleled year, COVID-19 presented its own kind of challenges for our reporting. While remaining mindful of the economic, health, and emotional tolls this pandemic has taken, we wanted to remain connected with our teams on the ground and the local communities where we operate in a way that was both authentic and empowering. For this reason, most photography contained in this report–as well as additional visual media in related communications–was taken in early 2021 by local photographers and production crews. These local crews from 14 different countries visited more than 30 locations, ranging from farms, to fields and factories, from greenhouses to R&D facilities, to distribution centers to *IQOS* stores and tobacconists. They filmed and photographed life at PMI in order to highlight what sustainability looks like from different viewpoints and perspectives. The teams followed PMI's security and safety guidelines throughout the entire process.

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