Long Pitch:
Philip Morris International
(NYSE: PM)

Prepared by James Rogers, CFO | August 27, 2009
Presentation Outline

- Fundamentals of Value Investing
- Company and Stock Overview
- Thesis Points
- Value Added Research (VAR)
- Ethical Issue
- Risks
- Catalysts
- Disclosure and Recommendation
Value Investing Approach

- Value investing is “the strategy of investing in securities trading at an appreciable discount from underlying value” – Seth Klarman, Margin of Safety

- “The value of any stock, bond or business today is determined by the cash inflows and outflows – discounted at an appropriate interest rate – that can be expected to occur during the remaining life of the asset.” – John Burr Williams, The Theory of Investment Value

- MII invests in stocks that are undervalued by the market and shorts, or bets against, stocks that are overvalued by the market

- MII picks stocks by engaging in rigorous research and analysis of company fundamentals, industry trends, and macroeconomic conditions

- We use an organic, bottom-up approach. We do not pick companies based solely on macroeconomic trends.

- We do not engage in “greater fool investing” or speculation
- Philip Morris International (PM) manufacturers and sells cigarettes outside of the United States

- PM was spun off from Altria (NYSE: MO) on March 28, 2008

- PM is the world’s largest publicly traded tobacco company with 15.6% of international market share in 2008

- It owns seven of the top 15 global cigarette brands

- PM follows US GAAP and American corporate governance standards

- PM is incorporated in Virginia, headquartered in New York City, and has its operations center in Lausanne, Switzerland
Stock Overview

- Market Cap: $89.1 Billion
- Earnings per Share (TTM): $3.24

- Share Price (8/26): $46.68
- Quarterly Dividend: $2.16

- 52-Week Range: $32.04 – 55.73
- Dividend Yield: 4.63%

- P/E Ratio: 14.21
- Short Interest (as of 8/15): 1.64
Thesis Points

- **Company Fundamentals**
  - Weather a recession
  - Moat with great brands
  - Superior management
  - Strong earnings

- **Cigarette Pricing Dynamics**
  - PM pricing power
  - Taxation effects

- **Growth Potential**
  - Premium brand growth
  - Attracting smokers from rivals
  - Expansion into new markets
Company Fundamentals

Inelastic Demand

- Tobacco is highly addictive and demand for it will remain relatively steady despite moderate price increases and/or drops in income

- Smokers are more likely to down-trade, or buy cheaper cigarettes, than they are to quit smoking

Defensive Stock:

- Due to its strong cash flow, low debt, product mix, and relatively high dividend, PM is attractive to investors during a recession

Comparison of Cumulative Total Return

The graph below compares the cumulative total return on common stock since the spin-off with the cumulative total return for the same period of the S&P 500 Index and the Philip Morris International (PMI) peer group index. The graph assumes the investment of $100 in PMI common stock (at prices quoted on the New York Stock Exchange) and each of the indices as of the market close on March 28, 2008 and reinvestment of dividends on a quarterly basis.

<table>
<thead>
<tr>
<th>Date</th>
<th>Philip Morris International</th>
<th>PMI Peer Group</th>
<th>S&amp;P 500</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 28, 2008</td>
<td>$100.00</td>
<td>$100.00</td>
<td>$100.00</td>
</tr>
<tr>
<td>December 31, 2008</td>
<td>$88.00</td>
<td>$91.50</td>
<td>$70.39</td>
</tr>
</tbody>
</table>

*The PMI Peer Group consists of the following companies with substantial global sales that are direct competitors, or have similar market capitalization, or are primarily focused on consumer products (excluding high technology and financial services); and one company for which comparable executive compensation data are readily available: Bayer AG, British American Tobacco plc, The Coca-Cola Company, Dr Pepper Snapple Group, Heineken NV, Imperial Tobacco Group PLC, Johnson & Johnson, Inc., Kraft Foods Inc., McDonald's Corp., Nestle SA, Novartis AG, PepsiCo Inc., Philip Morris International, Roche AG, Unilever PLC & NV and Unimile Group PLC.*
Company Fundamentals - Moat

Warren Buffett on the concept of a “moat”

“The might of their brand names, the attributes of their products, and the strength of their distribution systems give them an enormous competitive advantage, setting up a protective moat around their economic castles.” – p. 93, The Essays of Warren Buffett

PM Moat

- Although there are few substantive differences between competing cigarettes, branding is incredibly important as customers are buying into a lifestyle by purchasing a certain brand

- PM’s flagship brand, Marlboro, is the most popular and recognizable cigarette in the world

- Such enormous brand equity is PM’s greatest intangible asset and helps differentiate its products from competitors

- PM has significant pricing power with its premium brands

- Well-established premium brands also deter competitors from entering markets
Company Fundamentals - Management

Experienced Management

- Weathered lawsuits in US

- Knowledgeable in navigating challenging public health, regulatory, and taxing situations

- Brand management
  - PM executives have created and perpetuated one of the world’s strongest brands and convinced people to pay premium prices for a commodity good

- Market penetration
  - The corporate motto is “Veni, Vidi, Vici”
  - Gaining access to China
  - Shifting the Turkish market away from oriental cigarettes

- Catering to local markets
  - Slimmer cigarettes in Eastern Europe
  - Introduction of Marlboro Gold as smoother alternative to harsh Marlboro Red
Company Fundamentals - Management

Committed to Creating Shareholder Value

- Positive dividend policy and share buyback program
  - PM has an annualized dividend of $2.16 (~4.5% yield at current share price)
  - Its target dividend payout ratio is 65%
- It also began a $13 billion share buyback program in May 2008. Since then, $8.1 billion has been spent on share repurchases, including $2.7 billion during the Q1 and Q2 of 2009 at an average share price of $37.82.

Acquisitions

- PM managers have a disciplined and opportunistic acquisition strategy. Since separating from Altria, they have acquired the following:
  - Rothmans, a Canadian firm, for $1.9 billion
  - Interval, which makes fine cut cigarettes, for $407 million
  - Colombian manufacturer for $452 million
  - South African affiliate of Swedish Match for approximately $222 million
Company Fundamentals - Earnings

Cash Flow

- Through the first six months of 2009, PM had gross profit of $7.575 billion and net earnings of over $3 billion. It had a cash balance of $2.6 billion.

Long-Term Debt

- As of June 30, 2009, PM had nearly $13.5 billion in long-term debt. $195 million of this was current.

Costs

- PM’s largest expenses are marketing (43% of 2008 costs) and tobacco leaf (22% of 2008 costs).

Currency Hedging

- PM does not speculate on exchange rates but instead just does transactional hedging.
- It primarily hedges the Euro, Japanese Yen, Mexican Peso, Russian Ruble, Turkish Lira, and Indonesian Rupiah.
Price Increases

- Since October 2008, PM has increased prices in the following major markets: Germany, Italy, Spain, UK, Mexico, Brazil, Turkey, Indonesia, Romania, Russia, and Ukraine

### Rise of Ukraine Prices over Past 19 Months*

<table>
<thead>
<tr>
<th></th>
<th>Jan 2008</th>
<th>Jan 2009</th>
<th>May 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parliament</td>
<td>7.00</td>
<td>8.50</td>
<td>11.00</td>
</tr>
<tr>
<td>Marlboro</td>
<td>4.75</td>
<td>6.25</td>
<td>8.00</td>
</tr>
<tr>
<td>Chesterfield</td>
<td>3.10</td>
<td>4.50</td>
<td>6.50</td>
</tr>
<tr>
<td>L&amp;M</td>
<td>2.90</td>
<td>4.00</td>
<td>6.00</td>
</tr>
<tr>
<td>Vatra</td>
<td>1.45</td>
<td>2.50</td>
<td>4.50</td>
</tr>
</tbody>
</table>

### Effects of Recent Price Hikes in Spain (Euros)

<table>
<thead>
<tr>
<th></th>
<th>Old</th>
<th>New</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marlboro KS</td>
<td>3.10</td>
<td>3.45</td>
</tr>
<tr>
<td>Chesterfield</td>
<td>2.85</td>
<td>3.20</td>
</tr>
<tr>
<td>Marlboro Pocket Pack</td>
<td>2.65</td>
<td>3.00</td>
</tr>
<tr>
<td>L&amp;M</td>
<td>2.50</td>
<td>2.85</td>
</tr>
<tr>
<td>Next</td>
<td>2.45</td>
<td>2.80</td>
</tr>
</tbody>
</table>

*All prices in local currency

Down-trading from Chesterfield to L&M
**Pricing Dynamics**

How much does a pack of Marlboro cost?

**Ukraine Price Comparison as of May 2009:**

<table>
<thead>
<tr>
<th>Item</th>
<th>Price (USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Movie Ticket</td>
<td>6.36</td>
</tr>
<tr>
<td>Colgate toothpaste</td>
<td>2.29</td>
</tr>
<tr>
<td>Big Mac Sandwich</td>
<td>1.78</td>
</tr>
<tr>
<td><strong>Marlboro</strong></td>
<td><strong>1.02</strong></td>
</tr>
<tr>
<td>Milk</td>
<td>0.72</td>
</tr>
<tr>
<td>Loaf of Bread</td>
<td>0.64</td>
</tr>
<tr>
<td>Coca-Cola (0.5 liter)</td>
<td>0.52</td>
</tr>
</tbody>
</table>

**Italy Price Comparison as of July 2009:**

<table>
<thead>
<tr>
<th>Item</th>
<th>Price (Euros)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Restaurant Pizza</td>
<td>6.00 – 8.50</td>
</tr>
<tr>
<td><strong>Marlboro</strong></td>
<td><strong>4.40</strong></td>
</tr>
<tr>
<td>75 kilometer train ticket</td>
<td>3.50</td>
</tr>
<tr>
<td>Corona Beer</td>
<td>3.30</td>
</tr>
<tr>
<td>Small Gelato</td>
<td>2.50 – 3.50</td>
</tr>
<tr>
<td>Bottle of Table Wine</td>
<td>2.00 – 3.00</td>
</tr>
<tr>
<td>Loaf of Bread</td>
<td>~1.25</td>
</tr>
</tbody>
</table>
Pricing Dynamics - Taxes

Effects of Taxes

- Taxes raise cigarette prices and can cause down-trading and an overall decrease in demand.

- Many governments are raising taxes.
  - Poland raised taxes too quickly and its cigarette market declined 9.7%.

- When cigarettes are taxed by the pack, tax increases can lower the low/premium brand spread and result in up-trading to higher margin brands if consumers have enough discretionary income.

- Governments will not significantly curb smoking because they’d lose too much revenue.

- Governments also vigorously combat cigarette smuggling and counterfeiting.

http://www.economist.com/research/articlesBySubject/displaystory.cfm?subjectid=349008&story_id=13432302
Pricing Dynamics - Inflation

Inflation Potential

- Some macroeconomists and several prominent hedge fund managers are forecasting high inflation and possibly hyperinflation across the world over the next one to five years

- Monetary policies and stimulus packages have greatly increased the money supply in many foreign countries

Inflation Protection

-Warren Buffett writes that businesses must possess the following characteristics to be well adapted to an inflationary environment:

- “an ability to increase prices rather easily (even when product demand is flat and capacity is not fully utilized) without fear of significant loss of either market share or unit volume” – p. 183, The Essays of Warren Buffett (emphasis added)

- “an ability to accommodate large dollar volume increases in business (often produced more by inflation than by real growth) with only minor additional investment of capital.” – p. 183, The Essays of Warren Buffett (emphasis added)
## Growth in Premium Brands

<table>
<thead>
<tr>
<th>Country</th>
<th>2008</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russia</td>
<td>17.9%</td>
<td>11.9%</td>
</tr>
<tr>
<td>Ukraine</td>
<td>14.8%</td>
<td>8.9%</td>
</tr>
<tr>
<td>Turkey</td>
<td>19.6%</td>
<td>16.7%</td>
</tr>
<tr>
<td>Romania</td>
<td>43.5%</td>
<td>23.3%</td>
</tr>
<tr>
<td>Indonesia</td>
<td>23.1%</td>
<td>21.0%</td>
</tr>
<tr>
<td>Mexico</td>
<td>65.4%</td>
<td>62.8%</td>
</tr>
<tr>
<td>Argentina</td>
<td>35.7%</td>
<td>31.6%</td>
</tr>
</tbody>
</table>

Premium brands have increased in popularity, but still have room to grow in major emerging markets.

## Low/Premium Price Differentials

<table>
<thead>
<tr>
<th>Country</th>
<th>Low</th>
<th>Mid</th>
<th>Premium</th>
<th>Low/Pre. Multiple</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russia</td>
<td>0.34</td>
<td>0.81</td>
<td>1.12</td>
<td>3.29</td>
</tr>
<tr>
<td>Turkey</td>
<td>1.67</td>
<td>2.28</td>
<td>2.92</td>
<td>1.74</td>
</tr>
<tr>
<td>Indonesia</td>
<td>0.70</td>
<td>0.76</td>
<td>1.06</td>
<td>1.51</td>
</tr>
<tr>
<td>Mexico</td>
<td>1.32</td>
<td>1.54</td>
<td>1.95</td>
<td>1.48</td>
</tr>
</tbody>
</table>

As the price differential between low and premium brands narrows, more consumers should upgrade to mid and premium brands, which provide higher profit margins for PM.
Cigarette Consumption Trends

- Western Europe:
  - A maturing market with 1-2% declines in the smoking rate per year

- Eastern Europe:
  - Smoking is prevalent in the former Soviet Bloc
  - PM market share in Romania has greatly increased the past five years

- India:
  - Despite being one of the world’s largest tobacco producers, India does not have a large demand for cigarettes

- Africa:
  - PM and its major competitors are just beginning to enter Africa. PM does not have operations in Nigeria, the continent’s most populous country.

- Asia:
  - With a population of 237 million, over half of which is under the age of 20, Indonesia is one of the world’s largest cigarette markets

Source: http://insideindonesia.org/content/view/741/29/
China

- China is the world’s largest cigarette market

- PM established an international joint venture with China National Tobacco Company, which is state-owned, in 2005

- Under the agreement, PM launches Chinese brands in foreign markets and in return gains entry for its brands in China

- As a result, the first domestically produced Marlboros were sold in China last year

- This first-mover status gives PM a competitive advantage vis-à-vis its main competitors, British American Tobacco and Japan Tobacco

- Currently, domestic manufacturers are owned by the Chinese government, and provide 8-11% of its revenue annually

- Upon joining the World Trade Organization, China agreed to remove all barriers to the tobacco industry by 2010
## Growth – Market Expansion

### Cigarette Volume (in millions):

<table>
<thead>
<tr>
<th>Region</th>
<th>2008</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>European Union</td>
<td>243,451</td>
<td>257,541</td>
<td>258,145</td>
</tr>
<tr>
<td></td>
<td>(28%)</td>
<td>(30.3%)</td>
<td>(31.1%)</td>
</tr>
<tr>
<td>Eastern Europe, Middle East, Africa</td>
<td>303,205</td>
<td>290,310</td>
<td>288,285</td>
</tr>
<tr>
<td></td>
<td>(34.9%)</td>
<td>(34.2%)</td>
<td>(34.8%)</td>
</tr>
<tr>
<td>Asia</td>
<td>223,724</td>
<td>211,480</td>
<td>193,380</td>
</tr>
<tr>
<td></td>
<td>(25.7%)</td>
<td>(24.9%)</td>
<td>(23.3%)</td>
</tr>
<tr>
<td>Latin America and Canada</td>
<td>99,377</td>
<td>89,307</td>
<td>89,490</td>
</tr>
<tr>
<td></td>
<td>(11.4%)</td>
<td>(10.5%)</td>
<td>(10.8%)</td>
</tr>
<tr>
<td><strong>Total:</strong></td>
<td><strong>869,757</strong></td>
<td><strong>848,638</strong></td>
<td><strong>829,300</strong></td>
</tr>
</tbody>
</table>

Strong volume growth in Asia while Europe sees steady decline
## Growth – Market Expansion

### Net Revenues (in millions):

<table>
<thead>
<tr>
<th>Region</th>
<th>2008</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>European Union</td>
<td>30,265</td>
<td>26,829</td>
<td>23,745</td>
</tr>
<tr>
<td></td>
<td>(47.6%)</td>
<td>(48.6%)</td>
<td>(49.2%)</td>
</tr>
<tr>
<td>Eastern Europe, Middle East, Africa</td>
<td>14,817</td>
<td>12,166</td>
<td>10,012</td>
</tr>
<tr>
<td></td>
<td>(23.3%)</td>
<td>(22%)</td>
<td>(20.7%)</td>
</tr>
<tr>
<td>Asia</td>
<td>12,222</td>
<td>11,097</td>
<td>10,139</td>
</tr>
<tr>
<td></td>
<td>(19.2%)</td>
<td>(20.1%)</td>
<td>(21%)</td>
</tr>
<tr>
<td>Latin America and Canada</td>
<td>6,336</td>
<td>5,151</td>
<td>4,406</td>
</tr>
<tr>
<td></td>
<td>(10%)</td>
<td>(9.3%)</td>
<td>(9.1%)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>63,640</strong></td>
<td><strong>55,243</strong></td>
<td><strong>48,302</strong></td>
</tr>
</tbody>
</table>

EEMA is seeing a steady increase in revenues despite a negligible rise in volume due to migration to premium brands that have higher profit margins. Asia’s decline in revenue is due to competitive pricing and the prevalence of low and medium brands.
Developing a Variant Perception

Publicly Accessible Information

- All the information I have presented thus far is publicly available through corporate presentations, print media, and SEC regulatory filings

- Wall Street analysts assigned to monitor and provide recommendations on PM are likely aware of everything I have mentioned

Sell-Side Analysts

- 13 Wall Street analysts cover PM and all have a “buy” recommendation

- S&P 12-month target price: $52.00

- S&P EPS 2010 estimate: $3.45

- S&P 3-year projected EPS growth: 7%
Developing a Variant Perception

- So, the only way to identify hidden value is to employ superior analysis and/or acquire information that most shareholders do not know.

- MII seeks to acquire such information through value added research (VAR), which is gained by:
  - Talking to customers, competitors, and current and former employees of the companies we research
  - Reading industry newsletters, foreign newspapers, and trade journals
  - Observing customer behavior
  - Polling the company’s target markets
  - Interviewing experts such as professors and researchers

Source: Thomson Reuters 2009
PM Supplier Relations

*Southeast Farm Press* article recognizing Doug Langley as Kentucky’s Sunbelt Farmer of the Year:

- “Our burley tobacco is sold through direct contract to Philip Morris International, he adds. Since the quota buyout, buyers have demanded top-quality, consistent tobacco, and the contracts can be revoked if the tobacco fails to measure up.”

- “I am building two new state-of-the art curing barns to provide the product Philip Morris demands,” says Langley.

- “We also grow tobacco transplants we sell to other producers,” he says. “One of my customers is a Tennessee farmer I met through the Philip Morris Leadership Program.”

- “The tobacco company has also recognized Langley for his excellent production practices.”

http://southeastfarmpress.com/grains/sunbelt-expo-0805/
European Market Penetration

- Paris airport observations:
  - Designated, enclosed smoking areas were provided in terminals
  - There was a prominent Marlboro display at the duty free store with special boxes holding two or three cartons
  - During an hour span, thirteen middle-aged people and a woman in her early 20s looked at the Marlboro display
  - Marlboro was the best represented brand in the airport bookstore

- Italy observations:
  - Street signs labeled “tabacchi” pointed to the nearest cigarette vendor
  - Mostly men smoke Marlboro
  - Marlboro is used by people from all backgrounds, including: construction workers, well-dressed businessmen, and young smokers
Value Added Research - Penetration

Austria Market Penetration

-The Salzburg train station’s newsstand also sold packs and cartons of tobacco. It had the following carton counts: 42 of Marlboro Red, 49 of Parliament, and 49 of Marlboro Gold. No other brands were sold in cartons at this location.

- Cartons were sold to travelers trying to avoid paying higher taxes in their home countries.

- Another booth had cartons of non-PM brands, but Marlboro was still the best represented brand.
Value Added Research - Penetration
Incidence of “Marlboro” in Select Foreign Newspapers:

- **Nigeria**: 0 results in *Nigerian Compass*, *Daily Trust*, or *The People’s Daily*

- **India**: One article - about racing - in *The Hindustan Times*. In *The Mid-Day*, a Mumbai paper, only one article, in reference to a gangster who tried to smuggle a pack of Marlboro Lights into jail.

- **Egypt**: Five magazine articles in *Egypt Today*. Ironically, “Camel” cigarettes are not mentioned.

- **China**: 12 references in *People’s Daily* and 118 results in *China Daily*, which is an English daily and runs a lot of stories about American issues

- **Russia**: 74 articles published since 1999 in *The Moscow Times*

- **Indonesia**: 83 results in *The Jakarta Post*

- **Brazil**: 98 articles in *Jornal do Brasil*, about half of which referred to DJ Marlboro, a Brazilian funk innovator. 7 references in *Diário de Pernambuco*, a small regional newspaper

- **Mexico**: 131 results in *El Universal*
Value Added Research - Marketing
Value Added Research - Marketing

Emulating the Marlboro Man

- Globally, Marlboro sponsors Formula 1 and other racing events

- In Indonesia, Marlboro sponsors racing events, concerts, and adventure contests. According to a newspaper account, the Marlboro Adventure Team had 120,000 applicants for 50 slots.

  - The Jakarta Post reported that “Ten members of the Marlboro Adventure Team returned on Tuesday from 10 days of adventure activities in Moab, Utah, including riding jeeps, motorbiking, rappelling, rafting, horseback riding and mountain biking.”

  - Team member Tri Sigit Pamungkas said “We had a challenge-filled adventure and we enjoyed the beautiful scenery in the area. I really experienced what I saw on television.”

Strength of Marlboro Man

- Indonesia:
  - Indonesia passed a new regulation that required advertising agencies to “use only domestic actors, locations, etc., when making their commercials.”
  - However, “established icons, such as the Marlboro cowboy, will be exempt from the new regulation on the grounds that ‘no suitable cowboy in Indonesia could replace him.’” – The Jakarta Post
  - During the Bush administration, some protestors boycotted American brands, including Marlboro. Indonesians love the Obama administration.

- Mexico:
  - According to a newspaper account, a groom must “purchase permission from the father. Traditional price is a bottle of strong drink and a carton of cigarettes. Current preference is Marlboro – as in macho.”

Value Added Research – Restrictions

European Smoking Restrictions

- Smoking was prohibited on all trains in Europe and German and Austrian train stations had designated smoking areas

Emerging Market Restrictions

- According to a 600 person survey done by an Istanbul consulting firm, 90% of Turks support a ban but over 50% worry it won’t be enforced

- A restaurant owner was killed while trying to enforce a recently passed smoking ban in Turkey
  - “A customer shot Mr. Karayigit after he took away the group’s cigarettes, said a witness” – The International Herald Tribune, 7/30/09

- Every major emerging market has approved the Framework Convention on Tobacco Control
Difficulties Passing Legislative Restrictions

- Indonesian lawmakers were debating a bill that would ratify the FCTC, which Indonesia signed, but has yet to implement:
  
  - The bill sought to protect children from buying or selling cigarettes, ban smoking in certain areas, limit advertising and endorsements, and impose prison sentences of five years and hefty fines on tobacco smugglers and counterfeiters
  
  - Aria Bima, head of the Democratic Party of Struggle’s, opposes the bill because “Legislators should think of the farmers, and not just of the negative impact of tobacco.” He noted that Indonesia could lose Rp 51 trillion [$5.1 billion] in taxes if the bill passed.
  
  - Opponents noted that the adverse consequences of industry restrictions outweighed the financial burden of tobacco-related illnesses
  
  - Indeed, some legislators ran for reelection by “distributing cigarette packs branded with party logos”

Europe:

- I did not see anti-smoking campaigns or ads for nicotine therapy treatments in Italy, Austria, Germany, the Netherlands, or Switzerland

Emerging Markets:

- China: Shanghai Tobacco, a domestic company, was prevented from sponsoring the Shanghai World Expo in 2010 because China wants to present a clean and progressive image to the rest of the world

- India: According to local polling data, most Indians support graphic warnings on cigarette packs. A majority of respondents also believe Bollywood should reduce on-screen depictions of smoking. An earlier World Health Organization study found that 76% of Indian films show smoking.

Examples of anti-smoking labels:

- “Smoking kills” (Italy)
- “Smoking is addictive, do not begin” (Italy)
- “Your doctor or your pharmacist can help you stop smoking” (Austria)
- “Smoking can kill” (Spain)

Markets without warning labels:

- Indonesia
- Most of Africa

Selling cigarettes individually circumvents labels
Smoking Trends in Egypt:

-Since August 1, 2008, the image to the right has been on all Egyptian cigarette packs

-The Minister of Health was sued for allegedly deceiving the public because the picture was staged and the “patient” is actually a heavy smoker

- A lawyer demanded that the minister resign for staging the event and misleading Egyptian consumers

- Friends of the “patient” made a Facebook group with pictures of him smoking. According to Egypt Today, within a few days, "the group had more than 200 members, most of them smokers relieved to know that the dying man on their cigarettes is in fact still alive and smoking heavily."

Value Added Research - Trends

Average Egyptians on the Graphic Incident

- Islam Ragab, 20, a student at Cairo University:
  - The graphic label scared him “only about 30 percent, but I never stopped buying cigarettes.”
  - He supports the Health Ministry’s policy and says “I’ll do my best to prevent my brother from smoking.”

- Sherifa Fouad, 45, a mother of two sons:
  - “The picture on the cigarette packs gave me goosebumps. I pictured myself in the man’s position, lying on the intensive care bed, and my children are looking at me and crying.”
  - She stopped smoking for a week. She now buys separate cigarettes to avoid seeing the label.

- Mohamed Maged, 22, a personal trainer:
  - He began smoking at age 14 because of peer pressure at school
  - “I advise the people I train to quit smoking because it ruins their lungs and makes them age way beyond their real age. Yet, they don’t know that I can’t quit smoking myself.”

Smoking Trends in Egypt:

- A newspaper article encourages Muslims to abstain from smoking while feasting for Ramadan

- One journalist wrote a personal account of how he stopped smoking and provided seven steps for his readers to follow

Smoking Trends in Indonesia:

- A reporter interviews a truck driver who complains about corruption and notes that “Just about every day, to load or unload a container at the port, I have to pay Rp. 30,000. Meanwhile, just for food and cigarettes, I spend about Rp. 20,000 a day.” (emphasis added)
Ethical Concern:
- Many institutional investors (pension funds, endowments, mutual funds) will not invest in tobacco companies because of ethical concerns

Misleading Smokers:
- Anti-smoking activists claim that PM misleads customers by downplaying the health consequences of regular smoking
- However, nearly every cigarette market has explicit labels warning smokers that cigarettes can cause lung cancer, emphysema, throat cancer, and eventually death.
- In fact, labeling requirements are more stringent in most foreign countries than they are in the United States

http://www.time.com/time/photogallery/0,29307,1848212_1777635,00.html
Ethical Issue

Marketing to Children

- There are allegations that PM and other tobacco companies place advertisements at the eye level of children.

- Cigarette vending machines and unscrupulous merchants make cigarettes easily accessible for minors.

- PM marketing depicts an adventurous and glamorous lifestyle, but it does not include children in its advertisements.

- PM does not target children in its advertising or through its distribution channels.

My opinion

- Warning labels are clearly printed on packs of cigarettes in most major markets. Graphic pictures, which are used in many emerging markets, are warnings to those who cannot read.

- By purchasing cigarettes, smokers are consenting to and knowingly engaging in an activity that is destructive to their health.
Risks

Global health campaign

- Michael Bloomberg and Bill Gates have committed $500 million to combating global smoking

- These efforts complement the FCTC guidelines

- Many activists view PM and its peers as neo-colonialist powers exploiting emerging markets

- American activists that championed major lawsuits and recent legislation that allows the FDA to regulate tobacco have vowed to fight PM across the world

http://www.time.com/time/health/article/0,8599,1911796,00.html
Litigation

- “There is litigation related to cigarette smoking pending in certain jurisdictions. Damages claimed in some of the tobacco-related litigation are significant and, in certain cases in Brazil, Israel, Nigeria and Canada, range into the billions of dollars. We anticipate that new cases will continue to be filed. The FCTC encourages litigation against tobacco product manufacturers.” – 2008 PM Annual Report

- PM records provisions when it believes it will lose a case and approximates the amount of damages. Legal expenditures are expensed as they occur.

- “To date, no tobacco-related case has been finally resolved in favor of a plaintiff against us, our subsidiaries or indemnitees.” – 2008 PM Annual Report

- Russia’s top health officer recently announced that his office was suing British American Tobacco for misleading consumers – *The Moscow Times*

- Many countries have the English Rule, which requires the loser of a lawsuit to pay his own and the winner’s court fees
Risks

- Stronger US dollar
- Swine flu pandemic
- Increase in down-trading
- Higher tobacco prices
- Excessive taxation
- Lawsuits
- Cigarette counterfeiting and smuggling
- PM misses long-term growth goals:
  - Cigarette volume: 1-2% annually
  - Earnings per share: 10-12% annually
Catalysts

- Weaker US dollar
- Efficient integration of recent acquisitions
- Stronger than expected earnings
- Greater shift from low and mid brands to premium brands
- Enhanced cost cutting
  - Reduced SG&A costs
  - Lower tobacco costs
- Faster than expected growth
  - Rapid expansion in China
Summary and Recommendation

‘Leaving the question of price aside, the best business to own is one that over an extended period can employ large amounts of incremental capital at very high rates of return.’ – p. 102, The Essays of Warren Buffett

Disclosure

- I am long PM in my personal account. It is my largest holding.

Summary

- PM has an economic moat, superior management, strong and steady earnings, and significant pricing power. Its defensive nature and relatively high dividend limit the potential for loss of capital while the company still provides significant long-term growth potential.

Recommendation

- MII should execute a scaled buy-in beginning with 2.5% at a price target below $42.25 and an additional 2.5% within 90 days of the initial purchase.