ALTRIA GROUP INC

FORM 10-K405
(Annual Report (Regulation S-K, item 405))

Filed 3/11/1997 For Period Ending 12/31/1996

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Industry	Tobacco
Sector	Consumer/Non-Cyclical
Fiscal Year	12/31

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 1996

COMMISSION FILE NUMBER 1-8940

PHILIP MORRIS COMPANIES INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

VIRGINIA

(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)

13-3260245

(I.R.S. EMPLOYER IDENTIFICATION NO.)

120 PARK AVENUE, NEW YORK, N.Y.

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

10017

(ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: 212-880-5000

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

TITLE OF EACH CLASS

Common Stock, $1 par value
NAME OF EACH EXCHANGE ON
WHICH REGISTERED

New York Stock Exchange

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes /X/ No / /

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form

10-K or any amendment to this Form 10-K. /X/

At March 6, 1997, the aggregate market value of the shares of Common Stock held by non-affiliates of the registrant was approximately $107.8 billion. At such date, there were 809,597,699 shares of the registrant's Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's annual report to stockholders for the year ended December 31, 1996, are incorporated in Part I, Part II and Part IV hereof and made a part hereof. The registrant's definitive proxy statement for use in connection with its annual meeting of stockholders to be held on April 24, 1997, is incorporated in Part III hereof and made a part hereof.

PART I

ITEM 1. DESCRIPTION OF BUSINESS.

(A) GENERAL DEVELOPMENT OF BUSINESS

GENERAL

Philip Morris Companies Inc. is a holding company whose principal wholly-owned subsidiaries, Philip Morris Incorporated, Philip Morris International Inc., Kraft Foods, Inc., and Miller Brewing Company, are engaged in the manufacture and sale of various consumer products. A wholly-owned subsidiary of the Company, Philip Morris Capital Corporation, engages in various financing and investment activities. As used herein, unless the context indicates otherwise, the term "Company" means Philip Morris Companies Inc. and its subsidiaries. The Company is the largest consumer packaged goods company in the world.*

Philip Morris Incorporated ("PM Inc."), which conducts business under the trade name "Philip Morris U.S.A.," and its subsidiaries and affiliates are engaged in the manufacture and sale of cigarettes. PM Inc. is the largest cigarette company in the United States. Philip Morris International Inc. ("Philip Morris International") is a holding company whose subsidiaries and affiliates and their licensees are engaged primarily in the manufacture and sale of tobacco products (mainly cigarettes) internationally. A subsidiary of Philip Morris International is the leading United States exporter of cigarettes. MARLBORO, the principal cigarette brand of these companies, has been the world's largest-selling cigarette brand since 1972. Certain subsidiaries and affiliates of Philip Morris International manufacture and sell a wide variety of food products in Latin America.

Kraft Foods, Inc. ("Kraft"), is the largest processor and marketer of retail packaged foods in the United States. A wide variety of cheese, processed meat products, coffee and grocery products are manufactured and marketed in the United States and Canada by Kraft. Subsidiaries and affiliates of Kraft Foods International, Inc. ("Kraft Foods International"), a subsidiary of Kraft, manufacture and market coffee, confectionery, cheese, grocery and processed meat products in Europe and the Asia/Pacific region.

Miller Brewing Company ("Miller") is the second largest brewing company in the United States.

SOURCE OF FUNDS--DIVIDENDS

Because the Company is a holding company, its principal source of funds is dividends from its subsidiaries. The Company's principal wholly-owned subsidiaries currently are not limited by long-term debt or other agreements in their ability to pay cash dividends or make other distributions with respect to their common stock.

(B) FINANCIAL INFORMATION ABOUT INDUSTRY SEGMENTS

In 1996, the Company's significant industry segments were tobacco products (principally cigarettes), food products, beer, and financial services and real estate. Operating revenues, operating profit (together with a reconciliation to operating income) and identifiable assets attributable to each such segment for each of the last three years are set forth in Note 10 to the Company's consolidated financial statements and are incorporated herein by reference to the Company's annual report to stockholders for the year ended December 31, 1996 (the "1996 Annual Report").

In 1996, operating profit from tobacco products was approximately 67% of the Company's total operating profit (up from 65% in 1995), with PM Inc. and Philip Morris International contributing 34% and 33%, respectively (compared with 34% and 31%, respectively, in 1995). Food products, beer, and

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* References to the Company's competitive ranking in its various businesses are based on sales data or, in the case of cigarettes and beer, shipments, unless otherwise indicated.

financial services and real estate accounted for approximately 27%, 4% and 2%, respectively, of the Company's total operating profit in 1996 (compared with 29%, 4% and 2%, respectively, in 1995).

(C) NARRATIVE DESCRIPTION OF BUSINESS

TOBACCO PRODUCTS

PM Inc. manufactures, markets and sells cigarettes in the United States (including military sales). Subsidiaries and affiliates of Philip Morris International and their licensees manufacture, market and sell tobacco products outside the United States and export tobacco products from the United States.

DOMESTIC TOBACCO PRODUCTS

PM Inc. is the largest tobacco company in the United States, with total cigarette shipments in the United States of 230.8 billion units in 1996 (an increase of 4.1% from 1995), accounting for 47.8% of the cigarette industry's total estimated shipments in the United States (an increase of 1.7 share points from 1995). The industry's estimated cigarette shipments in the United States increased by 0.4% in 1996, compared with 1995, due to two additional shipping days in 1996 and distributor buying patterns. While PM Inc. cannot predict future growth rates, it believes that, over the long term, the United States industry's shipments will continue to decline in line with their historical average decline of 1% to 2% per annum. The following table sets forth the industry's estimated cigarette shipments in the United States, PM Inc.'s shipments and its share of United States industry shipments:

YEARS ENDED DECEMBER 31	INDUSTRY*	PM INC.	PM INC. SHARE OF INDUSTRY*
	(IN BILLIONS OF UNITS)		(%)
1996	483.3	230.8	47.8
1995	481.1	221.8	46.1
1994	489.6	219.4	44.8

PM Inc.'s major premium brands are MARLBORO, BENSON & HEDGES, MERIT, VIRGINIA SLIMS and PARLIAMENT. Its principal discount brands are BASIC and CAMBRIDGE. All of its brands are marketed to satisfy differing preferences of adult smokers. PM Inc. has been the leading cigarette company in the United States market since 1983.+ MARLBORO is the largest selling cigarette brand in the United States, with shipments of 156.2 billion units in 1996 (up 7.8% from 1995), equating to 32.3% of the United States market (up from 30.1% in 1995).

In 1996, the premium and discount segments accounted for approximately 71.6% and 28.4%, respectively, of domestic cigarette industry volume, versus approximately 70% and 30%, respectively, in 1995, reflecting a continued shift to the higher-margin premium segment, which began in the second half of 1993.

In 1996, PM Inc.'s share of the premium segment was 56.3%, an increase of 1.9 share points over 1995. Shipments of premium cigarettes accounted for 84.4% of PM Inc.'s 1996 volume, up from 82.7% in 1995. In 1996, United States industry shipments within the discount segment declined 4.9% from 1995 levels; PM Inc.'s 1996 shipments within this category declined 6.3%, resulting in a share of 26.2% of the discount segment (down 0.4 share points from 1995).

PM Inc. cannot predict future change or rates of change in the relative sizes of the premium and discount segments or in PM Inc.'s shipments, market share (based on shipments) or retail market share.

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* Source: Wheat, First Securities, Inc., publishers of The Maxwell Consumer Report.

+ Source: The Maxwell Consumer Report (issued by Wheat, First Securities, Inc.).

INTERNATIONAL TOBACCO PRODUCTS

Philip Morris International's total cigarette shipments grew 11.3% in 1996, to approximately 660 billion units, including approximately 17 billion units of local Polish brands acquired in 1996 (see discussion below). Philip Morris International's share of the world cigarette market (excluding the United States) was approximately 13% in 1996, up from approximately 12% in 1995. Philip Morris International estimates that world cigarette industry unit shipments (excluding the United States) were approximately 5.1 trillion units in 1996, which represents a compounded annual increase of approximately 1% per year over the last five years. Philip Morris International estimates that the American-style segment of the world market (excluding the United States), of which it accounts for approximately 36%, has increased at a compounded annual rate of more than 3% per year over the last five years. It also estimates that the American-style segment constituted approximately 32% of the world cigarette market (excluding the United States) in 1996, up from approximately 31% in 1995. Unit sales of Philip Morris International's principal brand, MARLBORO, increased 9.2% in 1996 over 1995, to 302.2 billion units, nearly 6% of the world cigarette market (excluding the United States).

Philip Morris International has a cigarette market share of at least 15%--and in a number of instances substantially more than 15%--in more than 40 markets, including Argentina, Australia, Belgium, the Canary Islands, the Czech Republic, Finland, France, Germany, Hong Kong, Italy, Japan, the Netherlands, the Philippines, Poland, Singapore, Spain, Switzerland and Turkey. Philip Morris International's leading international brands are MARLBORO, L&M, PHILIP MORRIS, BOND STREET, CHESTERFIELD, LARK, PARLIAMENT, MERIT and VIRGINIA SLIMS.

In 1996, Philip Morris International increased capacity and improved productivity through various acquisitions and capital projects. During the year, Philip Morris International acquired a controlling interest in Poland's largest tobacco company, Zaklady Przemyslu Tytoniowego w Krakowie S.A. Also in 1996, Philip Morris International began exports for selected Asian markets from its newly completed leaf-processing facility in Malaysia, and expanded its infrastructure by investing in manufacturing and distribution facilities in Europe and by opening additional sales and representative offices in Eastern Europe. In January 1997, Philip Morris International acquired a controlling interest in Tabaqueira-Empresa Industrial de Tabacos, S.A., Portugal's formerly state-owned tobacco company.

TAXES, LEGISLATION, REGULATION AND OTHER MATTERS REGARDING TOBACCO AND SMOKING

The tobacco industry, both in the United States and abroad, has faced, and continues to face, a number of issues that may adversely affect volume, operating revenues and operating profit of PM Inc., Philip Morris International and the Company. These issues include tax increases, health concerns relating to the use of tobacco products and exposure to environmental tobacco smoke ("ETS"), governmental regulation, privately imposed smoking restrictions, governmental and grand jury investigations, decreasing social acceptance of smoking, increased pressure from anti-smoking groups and unfavorable press reports.

Cigarettes are subject to substantial excise taxes in the United States and to similar taxes in most foreign markets. The United States federal excise tax on cigarettes, last increased in 1993, is $12 per 1,000 cigarettes ($0.24 per pack of 20 cigarettes). Recently, several measures have been proposed to increase the federal excise tax on cigarettes. In general, excise taxes, sales taxes and other cigarette-related taxes levied by various states, counties and municipalities have been increasing, and additional increases have been proposed in a number of states. These taxes vary considerably and, when combined with the current federal excise tax, may be as high as $1.28 per pack.

In the opinion of PM Inc. and Philip Morris International, past increases in excise and similar taxes have had an adverse impact on sales of cigarettes. Any future increases, the extent of which cannot be predicted, could result in volume declines for the cigarette industry, including PM Inc. and Philip Morris International, and might cause shifts from the premium segment to the discount segment.

Reports with respect to the alleged harmful physical effects of cigarette smoking have been publicized for many years, and the sale, promotion and use of cigarettes continue to be subject to increasing governmental regulation. Since 1964, the Surgeon General of the United States and the Secretary of Health and Human Services have released a number of reports purporting to link cigarette smoking with a broad range of health hazards, including various types of cancer, coronary heart disease and chronic lung disease, and recommending various governmental measures to reduce the incidence of smoking. The 1988, 1990, 1992 and 1994 reports focus upon the purported "addictive" nature of cigarettes, the purported effects of smoking cessation, the decrease in smoking in the United States and the economic and regulatory aspects of smoking in the Western Hemisphere, and cigarette smoking by adolescents, particularly the purported "addictive" nature of cigarette smoking in adolescence.

In 1996, the journal SCIENCE reported the results of a study that suggest that a metabolite of a chemical found in cigarette smoke may be involved in a cellular mechanism leading to lung cancer. The Company believes that the study merits careful review.

The Comprehensive Smoking Education Act (the "Smoking Education Act"), enacted in 1984, requires cigarette manufacturers and importers to include the following warning statements in rotating sequence on cigarette packages and in advertisements: "SURGEON GENERAL'S WARNING: Smoking Causes Lung Cancer, Heart Disease, Emphysema, And May Complicate Pregnancy"; "SURGEON GENERAL'S WARNING:
Quitting Smoking Now Greatly Reduces Serious Risks to Your Health"; "SURGEON GENERAL'S WARNING: Smoking By Pregnant Women May Result in Fetal Injury, Premature Birth, And Low Birth Weight"; and "SURGEON GENERAL'S WARNING:
Cigarette Smoke Contains Carbon Monoxide." The Smoking Education Act also covers the size and format of warnings on cigarette packages and in cigarette advertising, and prescribes a modified version of the warnings for outdoor billboard advertisements. In addition to the warning statements, pursuant to an agreement sanctioned by the Federal Trade Commission (the "FTC"), cigarette advertising in the United States must disclose the average "tar" and nicotine yields of the advertised brand or variety. The FTC is considering proposing changes to the existing method of measuring and disclosing "tar" and nicotine yields.

Cigarette manufacturers and importers are also required to provide annually to the Secretary of Health and Human Services a list of ingredients added to tobacco in the manufacture of cigarettes, and the Secretary is directed to report to Congress concerning the health effects, if any, of such ingredients.

Most of the cigarettes sold by Philip Morris International are sold in countries where warning statement requirements for cigarette packages have been adopted. In markets where such statements are not legally required, Philip Morris International's policy is to place the United States Surgeon General's warnings on all cigarette packages.

Studies with respect to the alleged health risk to nonsmokers of ETS have received significant publicity. In 1986, the Surgeon General of the United States and the National Academy of Sciences reported that nonsmokers were at increased risk of lung cancer and respiratory illness due to ETS. In January 1993, the United States Environmental Protection Agency (the "EPA") issued a report concluding, among other things, that ETS is a human lung carcinogen and that ETS increases certain health risks for young children. In June 1993, PM Inc. joined five other representatives of the tobacco manufacturing and related industries in a lawsuit against the EPA, seeking a declaration that the EPA does not have the authority to regulate ETS, and that, in view of the available scientific evidence and the EPA's failure to follow its own guidelines in making the determination, the EPA's final risk assessment be declared arbitrary and capricious and ordered withdrawn. The outcome of this lawsuit cannot be predicted. The EPA report, together with adverse publicity on ETS, have resulted in the enactment of legislation and privately imposed limitations that restrict or ban cigarette smoking in certain public places and some places of employment. It has been reported that the International Agency for Research on Cancer of the World Health Organization is conducting research on ETS that may be published during 1997.

Enactments by regulatory agencies and other governmental authorities, together with private initiatives, have restricted or prohibited smoking aboard certain common carriers, including domestic and certain international commercial airline flights, in certain public places and in some places of employment.

In April 1994, the United States Occupational Safety and Health Administration ("OSHA") issued a proposed rule that could, as a practical matter, ultimately ban smoking in the workplace. Hearings on this proposed rule were held from September 1994 through March 1995. The period for post-hearing submissions on the proposed rule ended in February 1996. OSHA has not yet issued either a final rule or a proposed revised rule.

Television and radio advertising of cigarettes is prohibited in the United States, and prohibited or restricted in many other countries. In June 1995, PM Inc. entered into a consent decree with the Department of Justice, pursuant to which it agreed to reposition its brand advertising at professional football, baseball, basketball and hockey arenas so as to minimize incidental television coverage.

In June 1992, the Alcohol, Drug Abuse and Mental Health Act was reauthorized. This act requires states to adopt a minimum age of at least 18 for purchases of tobacco products and to establish a system to monitor, report and reduce the illegal sale of tobacco products to minors in order to continue receiving federal funding for mental health and drug abuse programs. In January 1996, regulations implementing this legislation were announced by the Department of Health and Human Services.

In June 1995, PM Inc. announced that it had voluntarily undertaken a program to limit minors' access to cigarettes. Elements of the program include discontinuing free cigarette sampling to consumers in the United States, discontinuing the distribution of cigarettes by mail to consumers in the United States, placing a notice on cigarette cartons and packs for sale in the United States stating "Underage Sale Prohibited," working with others in support of state legislation to prevent youth access to tobacco products, taking measures to encourage retailer compliance with minimum-age laws, and independent auditing of the program.

In May 1996, PM Inc. proposed that comprehensive federal legislation be enacted to respond to concerns by the President and others regarding the use of tobacco products by minors. The proposed legislation would establish a federal minimum age of 18 for the sale of tobacco products, and would ban, restrict or otherwise limit the following, among other things: cigarette vending machines; tobacco product brand names, logos, characters and selling messages displayed on non-tobacco-related items such as hats or T-shirts; tobacco product sponsorship of events with significant youth audiences; outdoor advertisements for tobacco products within 1,000 feet of any playground or elementary or secondary school, including outward-facing window display advertising; advertisements for tobacco products in or on trains, buses, subways and taxis, and in terminals, stations, platforms or stops for these vehicles; and advertisements for tobacco products in youth-oriented publications. The proposed legislation would restrict youth access to tobacco products by calling for a ban on the sale of single cigarettes or packs with fewer than 20 cigarettes; requiring all tobacco sales to be face-to-face where proof of age can be verified for anyone appearing under age 21; mandating that tobacco products in retail establishments be displayed within the control or line of sight of an employee; banning sampling except in locations where minors are denied access; and requiring retailers and their employees to certify that they understand and will comply with minimum-age laws. To ensure compliance, the proposed legislation calls for penalties of up to $50,000 for violations by a tobacco manufacturer. The proposed legislation also calls for a $250 million contribution from the tobacco industry (based on market share) over a five-year period to assist the government and others in implementation and enforcement. The proposed legislation, which as of yet has not been introduced into either house of Congress, would preclude the United States Food and Drug Administration (the "FDA") from regulating tobacco products, except with respect to brands for which a manufacturer makes an express health claim to consumers.

In August 1996, the FDA issued final regulations purportedly designed to reduce youth smoking. In the regulations, the FDA purports to exercise jurisdiction over cigarettes as a "medical device" (a "nicotine delivery system") under the provisions of the Food, Drug and Cosmetic Act. The final regulations include severe restrictions on the distribution, marketing and advertising of cigarettes, and would require the industry to comply with a wide range of labeling, reporting, recordkeeping, manufacturing, and other requirements applicable to medical devices and their manufacturers. For the most part, the regulations are scheduled to become effective on August 28, 1997. The FDA's exercise of jurisdiction, if not reversed by judicial or legislative action, could lead to more expansive FDA-imposed restrictions on cigarette operations than those set forth in the final regulations, and could adversely affect the volume, operating revenues and operating profit of PM Inc. in amounts that cannot be determined. PM Inc. and other domestic cigarette manufacturers and an advertising firm have sued the FDA, seeking a judicial declaration that the FDA has no authority to regulate cigarettes and asking the court to permanently enjoin the FDA from enforcing its regulations. Similar suits have been filed against the FDA by manufacturers of smokeless tobacco products, by a trade association of cigarette retailers and by advertising agency associations. A hearing on the plaintiffs' motion for summary judgment was held on February 10, 1997. The outcome of the litigation challenging the FDA regulations cannot be predicted.

In August 1996, the Commonwealth of Massachusetts enacted legislation that would require cigarette manufacturers to disclose the flavorings and other ingredients used in each brand of cigarettes sold in the Commonwealth, and to provide "nicotine-yield ratings" for their products based on standards to be established by the Massachusetts Department of Public Health. PM Inc. believes that enforcement of the statute, which is scheduled to take effect on July 1, 1997, could require the disclosure of valuable proprietary information concerning its brands. PM Inc. and three other domestic cigarette manufacturers have filed suit in federal district court in Boston challenging the legislation as being preempted by the Federal Cigarette Labeling and Advertising Act (the "Labeling Act") and as violating the commerce, full faith and credit, due process and takings clauses of the U.S. Constitution. In February 1997, the court ruled on summary judgment motions that the Labeling Act does not preempt the requirement that ingredient information be provided to the Commonwealth. The plaintiffs intend to appeal that decision, and will continue to assert their other constitutional claims. The ultimate outcome of this lawsuit cannot be predicted. The enactment of this legislation has encouraged, and continues to encourage, efforts to enact similar legislation in other states. The Department of Public Health has proposed regulations to implement the Massachusetts legislation, and has invited public comment on the proposed regulations. PM Inc. and three other domestic cigarette manufacturers filed comments objecting to the proposed regulations. Final regulations have not been issued.

For several years, Congress has provided funds for the development of test methodologies and standards aimed at measuring the propensity of cigarettes to ignite upholstered furniture or mattresses. The Company cannot predict whether these efforts will result in further legislation or regulation.

In recent years, various members of Congress have introduced legislation--some of which has been the subject of hearings or floor debate--that would subject cigarettes to various regulations under the Department of Health and Human Services or regulation under the Consumer Products Safety Act, establish anti-smoking educational campaigns or anti-smoking programs, or provide additional funding for governmental anti-smoking activities, further restrict the advertising of cigarettes, including requiring additional warnings on packages and in advertising, provide that the Labeling Act and the Smoking Education Act could not be used as a defense against liability under state statutory or common law, allow state and local governments to restrict the sale and distribution of cigarettes, and further restrict certain advertising of cigarettes and eliminate or reduce the tax deductibility of tobacco advertising.

Some foreign countries have also taken steps to restrict or prohibit cigarette advertising and promotion, to require ingredient disclosure, to impose maximum constituent levels, to increase taxes on cigarettes, to control prices, to restrict imports, to ban or severely restrict smoking in workplaces and public places, and otherwise to discourage cigarette smoking.

It is not possible to determine the outcome of the FDA regulatory initiative or the related litigation, or to predict what, if any, other foreign or domestic governmental legislation or regulations will be adopted relating to the manufacturing, advertising, sale or use of cigarettes, or to the tobacco industry generally. However, if any or all of the foregoing were to be implemented, the volume, operating revenues and operating profit of PM Inc., Philip Morris International and the Company could be adversely affected, in amounts that cannot be determined.

PM Inc. has received requests for information (including grand jury subpoenas) in connection with governmental investigations of the tobacco industry, and is cooperating with respect to such requests. Certain present and former employees of PM Inc. have testified or have been asked to testify in connection with certain of these matters. The investigations are as follows:

An investigation by the United States Attorney for the Eastern District of New York relating to The Council for Tobacco Research-U.S.A., Inc., a research organization of which PM Inc. is a sponsor; and an investigation by the United States Department of Justice relating to issues raised in testimony provided by tobacco industry executives before Congress and other related matters.

PM Inc. has been informed that an investigation by the United States Attorney for the Southern District of New York, which had been initiated following the publication of an article in THE NEW YORK TIMES that made allegations about PM Inc. documents and supposedly secret research relating to nicotine, has been consolidated with the United States Department of Justice investigation discussed immediately above.

While the outcomes of these investigations cannot be predicted, PM Inc. believes it has acted lawfully.

PM Inc. has been informed that previously reported investigations by the United States Attorney for the Eastern District of Virginia relating to Healthy Buildings International, Inc., and by the United States Department of Justice relating to the possibility of alleged joint activity to restrain competition in the manufacture and sale of cigarettes, have been closed.

In July 1996, an affiliate of Philip Morris International received a request for information from the Competition Directorate of the European Commission concerning the relationship of certain affiliates of Philip Morris International with the Italian state cigarette monopoly. Philip Morris International and its affiliates believe that they have acted in accordance with European Community law.

SMOKING AND HEALTH LITIGATION

Note 13 to the Company's consolidated financial statements ("Note 13"),
incorporated herein by reference to the Company's 1996 Annual Report, describes certain litigation pending against the Company and its subsidiaries and related entities. Item 3 herein describes certain subsequent developments in such litigation. Further reference is made to such Note 13 and Item 3.

During 1996, press reports discussed proposals to forge a comprehensive legislative solution to smoking and health claims against the tobacco industry. The Company believes that any such legislation would involve significant, and perhaps insurmountable, difficulties in reconciling the views of many competing interests. However, the Company will explore all reasonable measures that may be in the best interests of its shareholders and, toward that end, may enter into discussions with appropriate parties. Were that to happen, the Company would not contemplate making any further comment as to the existence or progress of any such discussions. In any event, the Company continues to believe that it has a number of valid defenses to the smoking and health cases pending against it and will continue to defend all cases vigorously.

DISTRIBUTION, COMPETITION AND RAW MATERIALS

PM Inc. sells its tobacco products principally to wholesalers (including distributors), large retail organizations, including chain stores, vending machine operators and the armed services. Subsidiaries and affiliates of Philip Morris International and their licensees market cigarettes and other tobacco products worldwide, directly or through export sales organizations and other entities with which they have contractual arrangements.

The market for tobacco products is highly competitive, characterized by brand recognition and loyalty, with product quality, price, marketing and packaging constituting the significant methods of competition. Promotional activities include, in certain instances, allowances, the use of incentive items, price reductions and other discounts. The tobacco products of the Company's subsidiaries, affiliates and their licensees are advertised and promoted through various media, although television and radio advertising of cigarettes is prohibited in the United States and is prohibited or restricted in many other countries.

PM Inc. and Philip Morris International's subsidiaries and affiliates and their licensees purchase domestic burley and flue-cured leaf tobaccos of various grades and types each year, primarily at domestic auction. In addition, oriental tobacco and certain other tobaccos are purchased outside the United States. The tobacco is then graded, cleaned, stemmed and redried prior to its storage for aging up to three years. Large quantities of leaf tobacco inventory are maintained to support cigarette manufacturing requirements. Tobacco is an agricultural commodity subject to United States government controls, including the tobacco price support (subject to Congressional review) and production adjustment programs administered by the United States Department of Agriculture (the "USDA"), either of which can substantially affect market prices. PM Inc. and Philip Morris International believe there is an adequate supply of tobacco in the world markets to satisfy their current production requirements.

FOOD PRODUCTS

During 1995, 1996 and the first quarter of 1997, Kraft sold several domestic and international food businesses, including its bakery business, its North American margarine, specialty oils, marshmallows, caramels and Kraft Foodservice distribution businesses, its bagel business, its sugar confectionery business in Scandinavia, its margarine businesses in the U.K. and Italy, and several small international food businesses. The sales of these businesses have not had and are not expected to have a material effect on the Company's results of operations and have improved the profit margins of its food operations.

NORTH AMERICA

Kraft is the largest packaged food company in North America. Kraft's principal products include cheese and cheese products, processed meat and poultry products, coffee, ready-to-eat cereals, salad and other dressings, powdered and ready-to-drink beverages, frozen pizza, packaged and refrigerated desserts and snacks, packaged pasta dinners, lunch combinations, barbecue sauces, frozen toppings and other cultured dairy and grocery products. Its principal brands include KRAFT, VELVEETA and CRACKER BARREL cheese and cheese products, PHILADELPHIA BRAND cream cheese, CHEEZ WHIZ cheese sauce, OSCAR MAYER luncheon meats, hot dogs, bacon, ham and other meat products, LOUIS RICH luncheon meats, poultry franks, turkey bacon and other poultry products, LUNCHABLES lunch combinations, CLAUSSEN pickles, MAXWELL HOUSE, YUBAN and NABOB coffees, GENERAL FOODS INTERNATIONAL COFFEES flavored coffees, POST ready-to-eat cereals, MIRACLE WHIP salad dressing, KRAFT spoonable and pourable salad dressings, KOOL-AID, TANG, CAPRI SUN, CRYSTAL LIGHT and COUNTRY TIME powdered and ready-to-drink beverages, TOMBSTONE and JACK'S frozen pizzas and DIGIORNO pastas, sauces, cheeses and frozen pizzas, JELL-O desserts, HANDI-SNACKS snacks, KRAFT MACARONI & CHEESE dinners, KRAFT and BULL'S-EYE barbecue sauces, COOL WHIP whipped toppings, STOVE TOP stuffing mix, MINUTE rice, LOG CABIN syrups, SHAKE 'N BAKE coatings, LIGHT N' LIVELY cultured dairy products, and TACO BELL grocery products (acquired by Kraft in August 1996).

INTERNATIONAL

Subsidiaries and affiliates of Kraft Foods International manufacture and market a wide variety of coffee, confectionery, cheese and grocery and processed meat products in Europe, the Middle East, Africa and the Asia/Pacific region. In Latin America, subsidiaries and affiliates of Philip Morris International manufacture and market a wide variety of food products, including ice cream, various powdered soft drinks and a number of the other products sold by Kraft. In 1996, approximately 82% of operating revenues for the international foods businesses were derived from sales made in Europe. International brands include a wide variety of the products sold by Kraft in North America, as well as JACOBS CAFE, GEVALIA, CARTE NOIRE, JACQUES VABRE, KAFFE HAG, GRAND' MERE, KENCO, SAIMAZA and SPLENDID coffees, MILKA, SUCHARD, KIBON, COTE D'OR, MARABOU, TOBLERONE, FREIA, TERRY'S, DAIM and CALLARD & BOWSER confectionery products, HOLLYWOOD chewing gum, DAIRYLEA, EL CASERIO and INVERNIZZI cheeses, MIRACOLI pasta dinners and sauces, VEGEMITE spread, ESTRELLA and MAARUD snacks and SIMMENTHAL meats. In 1996, Philip Morris International acquired nearly all of the remaining voting shares of Industrias de Chocolate Lacta S.A., the leading confectionery company in Brazil.

DISTRIBUTION, COMPETITION AND RAW MATERIALS

Kraft's products in North America are generally sold to supermarket chains, wholesalers, club stores, mass merchandisers, distributors, individual stores and other retail food outlets. Products are distributed through distribution centers, satellite warehouses, company-operated and public cold-storage facilities, depots and other facilities. Selling efforts are assisted by national and regional advertising on television and radio and in magazines and newspapers, as well as by sales promotions, product displays, trade incentives, informative material offered to customers and other promotional activities. Subsidiaries and affiliates of Kraft Foods International and Philip Morris International sell their food products primarily in the same manner and also through sales offices and agents. Advertising is tailored by product and country to reach targeted audiences.

Kraft is subject to highly competitive conditions in all aspects of its business. Competitors include large national and international companies and numerous local and regional companies. Its food products also compete with generic products and private label products of food retailers, wholesalers and cooperatives. Kraft competes primarily on the basis of product quality, service, marketing, advertising and price.

Kraft is a major purchaser of milk, cheese, green coffee beans, poultry, meat cuts, wheat, cocoa, hazelnuts, vegetable oil, fruits and berries, and sugar and other sweeteners. Kraft continuously monitors worldwide supply and cost trends of these commodities to enable it to take appropriate action to obtain ingredients needed for production.

Kraft purchases all of its milk requirements and a substantial portion of its cheddar cheese requirements from independent sources, principally from cooperatives and individual producers. The prices for United States milk and other dairy product purchases are substantially influenced by government programs, as well as market supply and demand.

The most significant cost item in coffee products is green coffee beans, which are purchased on world markets. Green coffee bean prices are affected by the quality and availability of supply, trade agreements among producing and consuming nations, the unilateral policies of the producing nations, changes in the value of the United States dollar in relation to certain other currencies and consumer demand for coffee products.

The purchase price of poultry and meat cuts is the major factor in the cost of Kraft's processed meat products. Poultry and meat prices are cyclical and are affected by market supply and demand. Meats for OSCAR MAYER processed products are provided primarily by full-lot quantity purchases.

Kraft is also a major user of packaging materials purchased from many suppliers.

The prices paid for raw materials used in food products generally reflect external factors such as weather conditions, commodity market activities, currency fluctuations, and the effects of governmental agricultural programs. Although the prices of the principal raw materials can be expected to fluctuate as a result of government actions and/or market forces (which would directly affect the cost of products and value of inventories), Kraft and Philip Morris International believe such raw materials to be generally available from numerous sources and in adequate supply.

REGULATION

Almost all of Kraft's United States food products (and packaging materials therefor) are subject to regulations administered by the FDA or, with respect to products containing meat and poultry, the USDA. Among other things, these agencies enforce statutory prohibitions against misbranded and adulterated foods, establish ingredients and/or manufacturing procedures for certain standard foods, establish standards of identity for food, determine the safety of food substances, and establish labeling standards and nutrition labeling requirements for food products.

In addition, various states regulate the business of Kraft's United States operating units by licensing dairy plants, enforcing federal and state standards of identity for food, grading food products, inspecting plants, regulating certain trade practices in connection with the sale of dairy products and imposing their own labeling requirements on food products.

Many of the food commodities on which Kraft's United States businesses rely are subject to governmental agricultural programs. These programs have substantial effects on prices and supplies and are subject to Congressional review.

Almost all of the activities of the Company's food operations outside of the United States are subject to regulations similar to those applicable to Kraft's United States businesses and are subject to local and national and, in some cases, international (such as the European Union) regulatory provisions. The rules and regulations relate to labeling, packaging, food content, pricing, marketing and advertising, and related areas.

BEER

PRODUCTS

Miller's brands include MILLER LITE, MILLER LITE ICE, MILLER GENUINE DRAFT, MILLER GENUINE DRAFT LIGHT, MILLER BEER and ICEHOUSE in the premium segment; the MILLER HIGH LIFE family, including MILLER HIGH LIFE, MILLER HIGH LIFE LIGHT and MILLER HIGH LIFE ICE, and RED DOG in the near-premium segment; LOWENBRAU, brewed and sold in the United States under license from Lowenbrau Munchen AG in the above-premium segment; MEISTER BRAU, MILWAUKEE'S BEST and MAGNUM MALT LIQUOR in the below-premium segment; and SHARP'S non-alcohol brew. Competing in the specialty segment are the LEINENKUGEL, CELIS and SHIPYARD brands. Miller also owns and operates Molson Breweries U.S.A. Inc., the second largest beer importer in the United States, whose brands include MOLSON, FOSTER'S and ASAHI. Shipment volume for Miller, including imports, exports and non-alcohol brew, decreased 2.7% in 1996, compared with 1995, while the U.S. industry was up 1.8%. Despite higher shipments of MILLER LITE in 1996, shipments of premium-priced brands decreased, as did shipments of budget-priced brands. Lower volume was due to softness in most of Miller's brands and intense competition. Miller's share of the U.S. industry (based on shipments) was 21.6%, down 1.0 share point from 1995. Despite lower overall volume, Miller's premium shipments increased to 82.5% from 81.8% of Miller's total shipments.

The following table sets forth, based on shipments, the U.S. industry's sales of beer and brewed non-alcohol beverages, as estimated by Miller, Miller's unit sales and its estimated share of industry sales:

YEARS ENDED DECEMBER 31	INDUSTRY	MILLER	MILLER'S SHARE OF INDUSTRY
	(IN THOUSANDS OF BARRELS)		(%)
1996	202,332	43,799	21.6
1995	198,838	45,006	22.6
1994	199,572	45,243	22.7

During 1996, Miller took a number of actions intended to restore growth, streamline its organization and reduce costs, including a workforce reduction.

DISTRIBUTION, COMPETITION AND RAW MATERIALS

Beer products are distributed primarily through independent beer wholesalers. The United States malt beverage industry is highly competitive, with the principal methods of competition being product quality, price, distribution, marketing and advertising. Miller engages in a wide variety of advertising and sales promotion activities. Barley, hops, corn and water represent the principal ingredients used in manufacturing Miller's beer products, and are generally available in the market. The production process, which includes fermentation and aging periods, is conducted throughout the year, and at any one time Miller has on hand only a small quantity of finished products. Containers (bottles, cans and kegs) for beer products are purchased from various suppliers.

REGULATION

The Alcoholic Beverage Labeling Act of 1988 requires all alcoholic beverages manufactured for sale in the United States to include the following warning statement on containers: "GOVERNMENT WARNING: (1) According to the Surgeon General, women should not drink alcoholic beverages during pregnancy because of the risk of birth defects; (2) Consumption of alcoholic beverages impairs your ability to drive a car or operate machinery and may cause health problems." The statute empowers the Bureau of Alcohol, Tobacco and Firearms to regulate the size and format of the warning.

The federal excise tax is 32 cents per package of six 12-ounce containers. Excise taxes, sales taxes and other taxes affecting beer are also levied by various states, counties and municipalities. In the opinion of Miller, increases in excise taxes have had, and could continue to have, an adverse effect on shipments.

Advertising of alcoholic beverages, including beer, has come under increasing scrutiny by governmental agencies, and others. The FTC's Division of Advertising Practices is conducting an investigation of advertising of alcoholic beverages. As part of its investigation, the Division of Advertising Practices has issued to Miller a voluntary request for certain information and materials relating to Miller's advertising. Miller is cooperating with this request. While the outcome of the investigation cannot be predicted, Miller believes it has acted lawfully.

FINANCIAL SERVICES AND REAL ESTATE

Philip Morris Capital Corporation ("PMCC") invests in leveraged and direct finance leases, other tax-oriented financing transactions, third-party financial instruments, and engages in various financing activities for customers and suppliers of the Company's subsidiaries. Mission Viejo Company, a wholly-owned subsidiary of PMCC, is engaged in land planning, development and sales activities in Southern California and in the Denver, Colorado, area. Total assets of PMCC increased to $5.9 billion at December 31, 1996, compared with $5.6 billion at December 31, 1995, reflecting an increase in net finance assets.

OTHER MATTERS

CUSTOMERS

None of the Company's business segments is dependent upon a single customer or a few customers, the loss of which would have a material adverse effect on the Company's results of operations.

EMPLOYEES

At December 31, 1996, the Company employed approximately 154,000 people worldwide.

TRADEMARKS

Trademarks are of material importance to all three of the Company's consumer products businesses and are protected by registration or otherwise in the United States and most other markets where the related products are sold.

ENVIRONMENTAL REGULATION

The Company and its subsidiaries are subject to various federal, state and local laws and regulations concerning the discharge of materials into the environment, or otherwise related to environmental protection, including the Clean Air Act, the Clean Water Act, the Resource Conservation and Recovery Act and the Comprehensive Environmental Response, Compensation and Liability Act, which imposes joint and several liability on each responsible party (commonly known as "Superfund"). In 1996, subsidiaries (or former subsidiaries) of the Company were involved in approximately 197 matters subjecting them to potential remediation costs under Superfund or otherwise. The Company and its subsidiaries expect to continue to make capital and other expenditures in connection with environmental laws and regulations. Although it is not possible to predict precise levels of environmental-related expenditures, compliance with such laws and regulations, including the payment of any remediation costs and the making of such expenditures, have not had and are not expected to have a material adverse effect on the Company's results of operations, capital expenditures or financial position.

SHARE REPURCHASE PROGRAM

On February 26, 1997, the Company announced a new program to spend up to $8 billion to repurchase shares of its Common Stock in open market transactions over three years. This new program will commence following the anticipated completion in the next few weeks of the Company's current three-year $6 billion repurchase program. Under that program, through March 6, 1997, the Company repurchased approximately 67 million shares of its Common Stock.

COMMON STOCK SPLIT

On February 26, 1997, the Company announced a three-for-one split of its Common Stock, to be effected by a distribution on April 10, 1997, of two shares for each share held of record at the close of business on March 17, 1997. Effective at the close of business on March 17, 1997, the par value of the Company's Common Stock will be changed from $1.00 to $0.33 1/3, and authorized shares of Common Stock will be increased from 4 billion to 12 billion shares. After giving effect to the stock split, earnings and dividends per share amounts reported in the Company's consolidated financial statements, incorporated herein by reference to the Company's 1996 Annual Report, would be as follows:

PER SHARE DATA:	1996	1995	1994
Earnings before cumulative effect of accounting changes	$ 2.56	$ 2.17	$ 1.82
Cumulative effect of changes in method of accounting	--	(.01)	--
Net earnings	$ 2.56	$ 2.16	$ 1.82
Dividends declared	$ 1.467	$ 1.217	$ 1.01

FORWARD-LOOKING AND CAUTIONARY STATEMENTS

The Company and its representatives may from time to time make written or oral forward-looking statements, including statements contained in the Company's filings with the Securities and Exchange Commission and in its reports to stockholders. In connection with the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, the Company is hereby identifying important factors that could cause actual results to differ materially from those contained in any forward-looking statement made by or on behalf of the Company; any such statement is qualified by reference to the following cautionary statements.

The tobacco industry continues to be subject worldwide to health concerns relating to the use of tobacco products and exposure to ETS, legislation, including tax increases, governmental regulation, privately imposed smoking restrictions, governmental and grand jury investigations, and litigation. Each of the Company's operating subsidiaries is subject to intense competition, changes in consumer preferences, the effects of changing prices for its raw materials and local economic conditions. The performance of each of Philip Morris International and Kraft Foods International is affected by foreign economies and currency movements. Developments in any of these areas, which are more fully described elsewhere in Part I hereof and in Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") on pages 21-29 of the Company's 1996 Annual Report, each of which is incorporated into this section by reference, could cause the Company's results to differ materially from results that have been or may be projected by or on behalf of the Company. The Company cautions that the foregoing list of important factors is not exclusive. The Company does not undertake to update any forward-looking statement that may be made from time to time by or on behalf of the Company.

(D) FINANCIAL INFORMATION ABOUT FOREIGN AND DOMESTIC OPERATIONS AND EXPORT SALES

The amounts of operating revenues, operating profit and identifiable assets attributable to each of the Company's geographic segments and the amount of export sales from the United States for each of the last three fiscal years are set forth in Note 10 to the Company's consolidated financial statements, incorporated herein by reference to the Company's 1996 Annual Report.

Subsidiaries of Philip Morris International, Kraft and Miller export tobacco and tobacco-related products, coffee products, grocery products, cheese, processed meats and beer. In 1996, the value of all exports from the United States by these subsidiaries amounted to approximately $6.5 billion.

ITEM 2. DESCRIPTION OF PROPERTY.
TOBACCO PRODUCTS

PM Inc. owns nine tobacco manufacturing and processing facilities--six in the Richmond, Virginia, area, two in Louisville, Kentucky, and one in Cabarrus County, North Carolina. Subsidiaries and affiliates of Philip Morris International own, lease or have an interest in 47 cigarette or component manufacturing facilities in 28 countries outside the United States, including cigarette manufacturing facilities in Bergen Op Zoom, the Netherlands, and in Berlin, Germany.

FOOD PRODUCTS

The Company's subsidiaries have 60 manufacturing and processing facilities and 229 distribution centers and depots throughout the United States, as well as 113 foreign manufacturing and processing facilities in 34 countries, and various distribution and other facilities outside the United States. All significant plants and properties used for production of food products are owned, although the majority of the domestic distribution centers and depots are leased.

BEER

Miller currently owns and operates eight breweries, located in Milwaukee, Wisconsin (two); Fort Worth, Texas; Eden, North Carolina; Albany, Georgia; Irwindale, California; Trenton, Ohio; and Chippewa Falls, Wisconsin. Miller owns a majority interest in the Celis Brewery in Austin, Texas, and the Shipyard Brewery in Portland, Maine. Miller also owns a hops-processing facility in Wisconsin, and owns or leases warehouses in several locations.

GENERAL

The plants and properties owned and operated by the Company's subsidiaries are maintained in good condition and are believed to be suitable and adequate for present needs. In the fourth quarter of 1993, the Company provided for the costs of restructuring its worldwide operations. The charge related primarily to the downsizing or closure of approximately 40 manufacturing and other facilities. Write-downs of such facilities included in the restructuring charge were $429 million, of which $141 million, $211 million and $77 million related to tobacco, food and beer facilities, respectively. The 1993 restructuring and its impact on the Company's financial statements are described in the MD&A, incorporated herein by reference to the Company's 1996 Annual Report.

ITEM 3. LEGAL PROCEEDINGS.

Reference is made to Note 13, incorporated herein by reference to the Company's 1996 Annual Report, for a description of certain pending legal proceedings. The following summarizes recent developments with respect to such litigation.

In January 1997, defendants in the BROIN case, discussed in Note 13, filed a motion to dismiss on the grounds that the suit is preempted by the Labeling Act.

In February 1997, the judge in the LACEY case, discussed in Note 13, entered a written order confirming the court's oral decision to grant defendants' motion for summary judgment on the grounds that the suit was preempted by the Labeling Act.

In February 1997, the trial court in the CASTANO case, discussed in Note 13, denied defendants' motions for summary judgment as to the individual claims asserted by the two remaining named plaintiffs in the case.

In February 1997, plaintiffs in the SCOTT case, discussed in Note 13, filed briefs that seek to change the scope of this purported class action to include not only individuals with claims relating to "nicotine dependence" but also those with claims of physical injury.

In February 1997, plaintiffs in the MCGINTY case, discussed in Note 13, filed a class certification motion on behalf of all current residents of Arkansas who were smokers as of November 4, 1996, and who began smoking at or before age 19.

In January 1997, the court in the HARRIS PRO SE case, discussed in Note 13, dismissed PM Inc. and the Company.

In January 1997, a purported class action was filed in West Virginia state court against United States cigarette manufacturers and others, including the Company, on behalf of all "nicotine dependent" residents of West Virginia, their estates and families. Defendants have removed this case to federal court.
MCCUNE, ET AL., V. THE AMERICAN TOBACCO COMPANY, ET AL., UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF WEST VIRGINIA, CASE NO. 97-C-00204.

In February 1997, a purported class action was filed in Hawaii state court against United States cigarette manufacturers and others, including the Company, on behalf of citizens of Hawaii who have purchased and smoked cigarettes manufactured by defendant tobacco companies and all persons who have claims because of their personal relationship with those who purchased and smoked such cigarettes. Defendants have removed this case to federal court. PETERSON, ET AL., V. THE AMERICAN TOBACCO COMPANY, INC., ET AL., UNITED STATES DISTRICT COURT, DISTRICT OF HAWAII, CASE NO. 97-00233-HG.

In February 1997, a purported class action was filed in Kansas state court against United States cigarette manufacturers and others, including the Company, on behalf of citizens of Kansas who have purchased and smoked cigarettes manufactured by defendant tobacco companies and all persons who have claims because of their personal relationship with those who purchased and smoked such cigarettes. Defendants have removed this case to federal court. EMIG, ET AL., V.
THE AMERICAN TOBACCO COMPANY, INC., ET AL., UNITED STATES DISTRICT COURT, DISTRICT OF KANSAS AT WICHITA, CASE NO. 97-1121-MLB.

In February 1997, a purported class action was filed in Oklahoma state court against United States cigarette manufacturers and others, including the Company, on behalf of citizens of Oklahoma who have purchased and smoked cigarettes manufactured by defendant tobacco companies and those individuals who have claims that derive from the individuals who purchased and smoked such cigarettes. Defendants have removed this case to federal court. WALLS, ET AL., V. THE AMERICAN TOBACCO COMPANY, INC., ET AL., UNITED STATES DISTRICT COURT, NORTHERN DISTRICT OF OKLAHOMA, CASE NO. 97-CIV-0218.

In February 1997, the court in the FLORIDA health care cost recovery action, discussed in Note 13, granted plaintiffs' motion to strike all of defendants' affirmative defenses to the counts brought under Florida's Medicaid recovery statute. In response to defendants' motion for reconsideration, the court permitted certain of the affirmative defenses to be asserted. The court also ruled that defendants are entitled to the names of the individual Medicaid recipients whose medical expenses form the basis of the State's damages and that defendants may depose and obtain the medical records of twenty-five recipients of defendants' choice.

In February 1997, the court in the WEST VIRGINIA health care cost recovery action, discussed in Note 13, granted defendants' motion to dismiss the State's common law and equitable claims on the grounds that the State did not have a direct cause of action against defendants on these claims.

In February 1997, plaintiffs in the TEXAS health care cost recovery action, discussed in Note 13, filed a motion seeking to prevent defendants from asserting a "set off" defense based on the excise taxes that the State collects from the sale of tobacco products.

In February 1997, certain defendants, including PM Inc., in the LOUISIANA health care cost recovery action, discussed in Note 13, appealed the trial court's ruling that the Attorney General of Louisiana had procedural capacity to bring this action.

In February 1997, the court in the SAN FRANCISCO health care cost recovery action, discussed in Note 13, granted defendants' motion to dismiss the suit, with leave to file an amended complaint.

In February 1997, defendants in the WASHINGTON health care cost recovery action, discussed in Note 13, filed a motion to dismiss claims of special duty and unjust enrichment and a claim for disgorgement of profits.

In March 1997, defendants in the CONNECTICUT health care cost recovery action, discussed in Note 13, filed a motion seeking to dismiss the complaint on various grounds.

In February 1997, defendants in the UTAH health care cost recovery action, discussed in Note 13, filed a motion to dismiss the complaint on the grounds that the State's exclusive remedy is subrogation.

In February 1997, the court in the declaratory judgment action filed by plaintiff tobacco companies against the State of Utah, discussed in Note 13, denied plaintiffs' motion for partial summary judgment challenging the ability of the State to prosecute a health care cost recovery action on a contingent fee basis.

In February 1997, defendants in the LOS ANGELES health care cost recovery action, discussed in Note 13, moved to dismiss plaintiffs' misrepresentation and breach of warranty claims.

In February 1997, defendants in the MICHIGAN health care cost recovery action, discussed in Note 13, filed motions to dismiss the complaint on the grounds that plaintiff's exclusive remedy is subrogation and in response to plaintiff's motion attacking certain affirmative defenses.

In March 1997, the court dismissed the action, discussed in Note 13, brought by plaintiff tobacco companies challenging the right of the New Jersey Attorney General to bring a health care cost recovery action and to prosecute such a case on a contingent fee basis.

In February 1997, defendants in the NEW YORK CITY health care cost recovery action, discussed in Note 13, removed the case to federal court.

In January 1997, the State of New York filed a health care cost recovery action in New York State court. Defendants have removed this action to federal court. STATE OF NEW YORK AND DENNIS C. VACCO, ATTORNEY GENERAL OF THE STATE OF NEW YORK V. PHILIP MORRIS INC., ET AL., UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK, CASE NO. 97-CIV-0794 (LMM).

In February 1997, the State of Hawaii filed a health care cost recovery action in Hawaii state court. STATE OF HAWAII V. BROWN & WILLIAMSON TOBACCO CORPORATION AS SUCCESSOR BY MERGER TO THE AMERICAN TOBACCO COMPANY, ET AL., FIRST CIRCUIT COURT, HONOLULU, HAWAII, CASE NO. 97-0441-01.

In February 1997, the State of Wisconsin filed a health care cost recovery action in Wisconsin state court. STATE OF WISCONSIN V. PHILIP MORRIS INCORPORATED, ET AL., CIRCUIT COURT, DANE COUNTY, WISCONSIN, CASE NO. 30704.

In February 1997, the State of Indiana filed a health care cost recovery action in Indiana state court. STATE OF INDIANA V. PHILIP MORRIS INCORPORATED, ET AL., MARION COUNTY SUPERIOR COURT, INDIANA, CASE NO. 49D07-9702-CT-0236.

As reported in Note 13, during 1996, tax assessments alleging the underpayment of certain Italian taxes were asserted against affiliates of the Company. In February 1997, the Italian tax authorities withdrew assessments totaling $104.5 million, leaving total outstanding assessments of $693.9 million. The Company anticipates that further substantial tax assessments may be claimed. The Company and its affiliates believe they have complied with applicable Italian tax laws and intend to vigorously contest the assessments.

The Company and each of its subsidiaries named as a defendant believe, and each has been so advised by counsel handling the respective cases, that it has a number of valid defenses to all litigation pending against it. All such cases are, and will continue to be, vigorously defended. It is not possible to predict the outcome of this litigation. Litigation is subject to many uncertainties, and it is possible that some of these actions could be decided unfavorably. An unfavorable outcome of a pending smoking and health case, such as the CARTER case mentioned in Note 13, could encourage the commencement of additional similar litigation. There have also been a number of adverse legislative, regulatory, political and other developments concerning cigarette smoking and the tobacco industry. These developments generally receive widespread media attention. The Company is not able to evaluate the effect of these developing matters on pending litigation and the possible commencement of additional litigation.

Management is unable to make a meaningful estimate of the amount or range of loss that could result from an unfavorable outcome of all pending litigation. It is possible that the Company's results of operations or cash flows in a particular quarterly or annual period or its financial position could be materially affected by an ultimate unfavorable outcome of certain pending litigation. Management believes, however, that the ultimate outcome of all pending litigation should not have a material adverse effect on the Company's financial position.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None.

EXECUTIVE OFFICERS OF THE COMPANY

The following are the executive officers of the Company as of March 1, 1997:

NAME	OFFICE	AGE
Geoffrey C. Bible	Chairman of the Board and Chief Executive Officer	59
John D. Bowlin	President and Chief Executive Officer of Kraft Foods International	46
Murray H. Bring	Executive Vice President, External Affairs, and General Counsel	62
Bruce S. Brown	Vice President, Taxes	57
Louis C. Camilleri	Senior Vice President and Chief Financial Officer	42
Katherine P. Clark	Vice President and Controller	48
Dinyar S. Devitre	Senior Vice President, Corporate Planning	49
Marc S. Goldberg	Senior Vice President, Worldwide Operations and Technology	53
G. Penn Holsenbeck	Vice President, Associate General Counsel and Secretary	50
James M. Kilts	Executive Vice President, Worldwide Food	49
George R. Lewis	Vice President and Treasurer	55
John N. MacDonough	Chairman and Chief Executive Officer of Miller	53
James J. Morgan	President and Chief Executive Officer of PM Inc.	54
Robert S. Morrison	Chairman and Chief Executive Officer of Kraft Foods, Inc.	54
Steven C. Parrish	Senior Vice President, Corporate Affairs	46
Timothy A. Sompolski	Senior Vice President, Human Resources and Administration	44
William H. Webb	President and Chief Executive Officer of Philip Morris International	57

All of the above-mentioned officers, with the exception of Messrs. Holsenbeck and MacDonough, have been employed by the Company in various capacities during the past five years. Mr. Holsenbeck was elected to his current position with the Company in January 1995. Previously, Mr. Holsenbeck held various positions with Bethlehem Steel Corporation, including Secretary and Deputy General Counsel from 1992 to January 1995. Mr. MacDonough was Executive Vice President, Marketing, of Anheuser-Busch International, Inc., from 1991 until September 1992, when he became President and Chief Operating Officer of Miller. He assumed his current position in August 1993.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

The information called for by this Item is hereby incorporated by reference to the paragraph captioned "Quarterly Financial Data (Unaudited)" on page 52 of the Company's 1996 Annual Report and made a part hereof.

ITEM 6. SELECTED FINANCIAL DATA.

The information called for by this Item is hereby incorporated by reference to the information appearing under the caption "Selected Financial Data" on page 30 of the Company's 1996 Annual Report and made a part hereof.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The information called for by this Item is hereby incorporated by reference to the paragraphs captioned "Management's Discussion and Analysis of Financial Condition and Results of Operations" on pages 21-29 of the Company's 1996 Annual Report and made a part hereof.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The information called for by this Item is hereby incorporated by reference to the Company's 1996 Annual Report as set forth under the caption "Quarterly Financial Data (Unaudited)" on page 52 and in the Index to Consolidated Financial Statements and Schedules (see Item 14) and made a part hereof.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

Not applicable.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

ITEM 11. EXECUTIVE COMPENSATION.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

Except for the information relating to the executive officers of the Company set forth in Part I of this Report, the information called for by Items 10, 11 and 12 is hereby incorporated by reference to the Company's definitive proxy statement for use in connection with its annual meeting of stockholders to be held on April 24, 1997, and made a part hereof.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

Not applicable.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K.

(a) Index to Consolidated Financial Statements and Schedules

	REFERENCE	
	FORM 10-K ANNUAL REPORT PAGE	1996 ANNUAL REPORT PAGE
Data incorporated by reference to the Company's 1996 Annual Report:		
Consolidated Balance Sheets at December 31, 1996 and 1995....	--	32-33
Consolidated Statements of Earnings for the years ended December 31, 1996, 1995 and 1994...........................	--	34
Consolidated Statements of Stockholders' Equity for the years ended December 31, 1996, 1995 and 1994.....................	--	36
Consolidated Statements of Cash Flows for the years ended December 31, 1996, 1995 and 1994...........................	--	34-35
Notes to Consolidated Financial Statements...................	--	37-52
Report of Independent Accountants...........................	--	53
Data submitted herewith:		
Report of Independent Accountants.............................	S-1	--
Financial Statement Schedule--Valuation and Qualifying Accounts..	S-2	--

Schedules other than those listed above have been omitted either because such schedules are not required or are not applicable.

(b) Reports on Form 8-K: No Current Reports on Form 8-K were filed during the last quarter of the period for which this Report is filed. Subsequent to the last quarter of the period for which this Report is filed, the Company filed its Current Report on Form 8-K dated January 30, 1997.

(c) The following exhibits are filed as part of this Report (Exhibit Nos. 10.1-10.15 are management contracts, compensatory plans or arrangements):

1.1. Form of Underwriting Agreement, including form of Terms Agreement.(1)

1.2. Form of Selling Agency Agreement.(2)

1.3. Form of First Amendment to Selling Agency Agreement.(3)

3.1. Restated Articles of Incorporation of the Company.(4)

3.2. By-Laws, as amended, of the Company.(5)

4.1. Plan of Exchange and Articles of Incorporation.(6)

4.2. Form of Indenture between the Company and The Chase Manhattan Bank, Trustee.(7)

4.3. 5-Year Loan and Guaranty Agreement dated as of October 26, 1995, among the Company, the Banks named therein and Citibank, N.A., as Agent.(4)

10.1. Financial Counseling Program of PM Inc. and the Company.(8)

10.2. Philip Morris Benefit Equalization Plan, as amended.

10.3. Form of Employee Grantor Trust Enrollment Agreement.(4)

10.4. Automobile Policy of PM Inc. and the Company.(8)

10.5. Agreement, dated March 8, 1989, between the Company and Robert S. Morrison.

10.6. Agreement, dated October 12, 1987, between the Company and Murray H. Bring, as amended.(3)

10.7. Agreement, dated November 1, 1989, between the Company and Murray H. Bring.(9)

10.8. Agreement, dated March 8, 1989, between the Company and James M. Kilts.(9)

10.9. Form of Employment Agreement between the Company and its executive officers.(9)

10.10. Supplemental Management Employees' Retirement Plan of the Company, as amended.

10.11. The Philip Morris 1992 Incentive Compensation and Stock Option Plan.(10)

10.12. 1992 Compensation Plan for Non-Employee Directors, as amended.(4)

10.13. Unit Plan for Incumbent Non-Employee Directors, effective January 1, 1996.(4)

10.14. The Philip Morris 1987 Long Term Incentive Plan.(11)

10.15. Form of Executive Master Trust between the Company, The Chase Manhattan Bank (formerly known as Chemical Bank) and Handy Associates.(9)

12. Statements re computation of ratios.(1)

13. Pages 21-53 of the Company's 1996 Annual Report, but only to the extent set forth in Items 1, 5, 6, 7, 8 and 14 hereof. With the exception of the aforementioned information incorporated by reference in this Annual Report on Form 10-K, the Company's 1996 Annual Report is not to be deemed "filed" as part of this Report.

21. Subsidiaries of the Company.

23. Consent of independent accountants.

24. Powers of attorney.

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(1) Incorporated by reference to the Company's Current Report on Form 8-K dated January 30, 1997.

(2) Incorporated by reference to the Company's Registration Statement on Form S-3 (No. 33-49195) dated November 25, 1992.

(3) Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 1993.

(4) Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 1995.

(5) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the period ended September 30, 1996.

(6) Incorporated by reference to the Company's Registration Statement on Form S-14 (No. 2-96149) dated March 1, 1985.

(7) Incorporated by reference to the Company's Registration Statement on Form S-3 (No. 333-16955) dated November 27, 1996.

(8) Incorporated by reference to the Company's Registration Statement on Form 8-B (No. 1-8940) dated July 1, 1985.

(9) Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 1994.

(10) Incorporated by reference to the Company's proxy statement in connection with its annual meeting of stockholders held on April 23, 1992, filed on March 12, 1992.

(11) Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 1990.

SIGNATURES

PURSUANT TO THE REQUIREMENTS OF SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934, THE REGISTRANT HAS DULY CAUSED THIS REPORT TO BE SIGNED ON ITS BEHALF BY THE UNDERSIGNED, THEREUNTO DULY AUTHORIZED.

PHILIP MORRIS COMPANIES INC.

BY: /S/ GEOFFREY C. BIBLE
(Geoffrey C. Bible, Chairman of the Board)

Date: March 11, 1997

PURSUANT TO THE REQUIREMENTS OF THE SECURITIES EXCHANGE ACT OF 1934, THIS REPORT HAS BEEN SIGNED BELOW BY THE FOLLOWING PERSONS ON BEHALF OF THE REGISTRANT AND IN THE CAPACITIES AND ON THE DATE INDICATED:

SIGNATURE	TITLE	DATE
/s/ GEOFFREY C. BIBLE (Geoffrey C. Bible)	Director, Chairman of the Board and Chief Executive Officer	March 11, 1997
/s/ LOUIS C. CAMILLERI (Louis C. Camilleri)	Senior Vice President and Chief Financial Officer	March 11, 1997
/s/ KATHERINE P. CLARK (Katherine P. Clark)	Vice President and Controller	March 11, 1997

* ELIZABETH E. BAILEY, MURRAY H. BRING, HAROLD BROWN, WILLIAM H. DONALDSON, JANE EVANS, ROBERT E. R. **HUNTLEY, RUPERT MURDOCH, JOHN D. NICHOLS, RICHARD D. PARSONS, ROGER S. PENSKE, JOHN S. REED,**

STEPHEN M. WOLF, *Directors*

**BY: /S/ LOUIS C. CAMILLERI*
(Louis C. Camilleri Attorney-in-fact) *March 11, 1997*

REPORT OF INDEPENDENT ACCOUNTANTS

Our report on our audits of the consolidated financial statements of Philip Morris Companies Inc. has been incorporated by reference in this Form 10-K from the 1996 annual report to stockholders of Philip Morris Companies Inc. and appears on page 53 therein. In connection with our audits of such financial statements, we have also audited the related financial statement schedule listed in the index in Item 14(a) on page 20 of this Form 10-K.

In our opinion, the financial statement schedule referred to above, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information required to be included therein.

COOPERS & LYBRAND L.L.P.

New York, New York
January 27, 1997

PHILIP MORRIS COMPANIES INC. AND SUBSIDIARIES

VALUATION AND QUALIFYING ACCOUNTS

FOR THE YEARS ENDED DECEMBER 31, 1996, 1995 AND 1994
(IN MILLIONS)

COL. A	COL. B	COL. C		COL. D	COL. E
		ADDITIONS			
DESCRIPTION	BALANCE AT BEGINNING OF PERIOD	CHARGED TO COSTS AND EXPENSES	CHARGED TO OTHER ACCOUNTS	DEDUCTIONS	BALANCE AT END OF PERIOD
			(A)	(B)	
1996:					
CONSUMER PRODUCTS:					
Allowance for discounts	$ 12	$ 492	$ --	$ 499	$ 5
Allowance for doubtful accounts	163	27	16	39	167
Allowance for returned goods	3	64	--	62	5
	$ 178	$ 583	$ 16	$ 600	$ 177
FINANCIAL SERVICES AND REAL ESTATE:					
Provision for losses	$ 101	$ --	$ --	$ --	$ 101
1995:					
CONSUMER PRODUCTS:					
Allowance for discounts	$ 15	$ 551	$ --	$ 554	$ 12
Allowance for doubtful accounts	168	35	(12)	28	163
Allowance for returned goods	4	40	--	41	3
	$ 187	$ 626	$ (12)	$ 623	$ 178
FINANCIAL SERVICES AND REAL ESTATE:					
Provision for losses	$ 104	$ --	$ --	$ 3	$ 101
1994:					
CONSUMER PRODUCTS:					
Allowance for discounts	$ 18	$ 538	$ --	$ 541	$ 15
Allowance for doubtful accounts	153	38	8	31	168
Allowance for returned goods	4	100	--	100	4
	$ 175	$ 676	$ 8	$ 672	$ 187
FINANCIAL SERVICES AND REAL ESTATE:					
Provision for losses	$ 94	$ 10	$ --	$ --	$ 104

Notes:

(a) Related to divestitures, acquisitions and currency translation.

(b) Represents charges for which allowances were created.

EXHIBIT 10.2

PHILIP MORRIS BENEFIT EQUALIZATION PLAN

Effective September 2, 1974

(As amended and in effect as of January 1, 1994)

PHILIP MORRIS BENEFIT EQUALIZATION PLAN

The Philip Morris Benefit Equalization Plan governs the rights of a person whose benefits under the Retirement Plan or the Profit-Sharing Plan, or both Plans, are subject to the Statutory Limitations.

The Plan as hereinafter set forth shall, in the case of Benefit Equalization Retirement Allowances payable under Article II, A hereof, be effective with respect to each Employee whose date of retirement (as specified in an application for retirement under Article II, B of the PM Retirement Plan) is on or after April 1, 1993 or who has filed an application for an Optional Payment pursuant to Article II, C(2) of the Plan after March 1, 1992. The rights of a person who retired or otherwise terminated employment before March 1, 1993 shall be governed by the provisions of the Plan as in effect on the date of retirement or other termination of employment, unless an application for an Optional Payment was filed after March 1, 1992.

The Plan as hereinafter set forth shall, in the case of Benefit Equalization Profit-Sharing Allowances payable under Article II, B hereof, be effective with respect to Employees whose date of retirement or other termination of employment is on or after April 1, 1993 or who has filed an application for an Optional Payment pursuant to Article II, C(2) of the Plan after March 1, 1992. The rights of a person who retired or otherwise terminated employment before April 1, 1993 shall be governed by the provisions of the Plan as in effect on the date of retirement or other termination of employment, unless an application for an Optional Payment was filed after March 1, 1992.

That portion of the Philip Morris Benefit Equalization Plan which provides benefits to a Beneficiary solely in excess of the Section 415 Limitations shall be treated as a separate plan from that portion of the Plan which provides benefits to a Beneficiary attributable solely to the Compensation Limitation or to the Compensation Limitation and the Section 415 Limitations.

ARTICLE I

DEFINITIONS

The following terms as used herein shall have the meanings set forth below. Capitalized terms used herein and not defined below shall have the meanings set forth in the PM Retirement Plan or the Profit-Sharing Plan, as the context may require.

(a) "ACTUARIAL EQUIVALENT" shall mean a benefit which is equivalent in value to the benefit otherwise payable pursuant to the terms of the Plan, based on the actuarial principles and assumptions set forth in Exhibit "I" to the PM Retirement Plan; provided, however, that a Single Sum Payment shall be the Actuarial Equivalent of the Benefit Equalization Retirement Allowance payable in equal monthly payments during a twelve (12) month period for the life of the Retired Employee, using the actuarial principles and assumptions set forth in Exhibit "A" to the Plan.

(b) "ALLOWANCES" shall mean a Benefit Equalization Retirement Allowance and a Benefit Equalization Profit-Sharing Allowance.

(c) "BENEFICIARY" shall mean an Employee or the Spouse or other beneficiary of such Employee whose benefits under the Retirement Plan or Profit-Sharing Plan, or both Plans, are subject to the Statutory Limitations.

(d) "BENEFIT EQUALIZATION PROFIT-SHARING ALLOWANCE" or "PROFIT- SHARING ALLOWANCE" shall mean the benefit determined under Article II, B hereof and payable at the time and in the manner set forth in Article II, D hereof.

(e) "BENEFIT EQUALIZATION JOINT AND SURVIVOR ALLOWANCE" shall mean the total amount payable during a twelve (12) month period as a reduced Benefit Equalization Retirement Allowance to a Retired Employee for life and after his death the amount payable to his Spouse for life equal to one-half of the reduced Benefit Equalization Retirement Allowance payable to the Retired Employee, which together shall be the Actuarial Equivalent of the Benefit Equalization Retirement Allowance of the Retired Employee.

(f) "BENEFIT EQUALIZATION OPTIONAL PAYMENT ALLOWANCE" shall mean (1) the total amount payable during a twelve (12) month period in accordance with one of the payment methods described in Article II, A(4)(d) of the PM Retirement Plan designated by the Employee in the application for an Optional Payment under Article II, C(2) hereof pursuant to which the Employee receives for life after his retirement a reduced Benefit Equalization Retirement Allowance and after his death after retirement his beneficiary receives for life a benefit according to the option elected by the Employee, which together shall be the Actuarial Equivalent of the Benefit Equalization Retirement Allowance payable in equal monthly payments for the life of the Employee after his retirement, or (2) the total amount payable during a twelve (12) month period in accordance with one of the payment methods described in Article II, A(4)(d) of the PM Retirement Plan pursuant to an election described in Article II, A (4)(c) of the PM Retirement Plan and designated by the Employee in the application for an Optional Payment under Article II, C(2) hereof pursuant to which the Employee receives for life after his retirement a reduced Benefit Equalization Retirement Allowance and after his death his beneficiary receives for life a benefit according to the option elected by the Employee, which together shall be the Actuarial Equivalent of the Benefit Equalization Retirement Allowance accrued to the date of election.

(g) "BENEFIT EQUALIZATION RETIREMENT ALLOWANCE" shall mean the benefit determined under Article II, A hereof and payable at the time and in the manner set forth in Article II, C, provided, that payment to a Retired Employee in any form shall be the Actuarial Equivalent of a Benefit Equalization Retirement Allowance expressed as a benefit payable in equal monthly payments during a twelve (12) month period for the life of the Retired Employee commencing at the Retired Employee's Normal Retirement Age.

(h) "BENEFIT EQUALIZATION SURVIVOR ALLOWANCE" shall mean the total amount payable during a twelve (12) month period in equal monthly payments for the life of the Spouse of a Deceased Employee or deceased Retired Employee who has died after the date of his retirement and prior to the date his Optional Payment under Paragraph I(r)(i) or (ii) hereof commences to be paid in an amount equal to one-half of the reduced Benefit Equalization Retirement Allowance which would have been payable as a Benefit Equalization Joint and Survivor Allowance to the Deceased Employee or deceased Retired Employee.

(i) "CHANGE IN CIRCUMSTANCE" shall mean (1) the marriage of the Employee or Retired Employee, (2) the divorce of the Employee or Retired Employee from his Spouse, provided such Spouse was designated as the beneficiary in the currently effective application to receive an Optional Payment, or the Employee or Retired Employee elected to receive an Optional Payment pursuant to clause (i) of Paragraph (r) hereof, (3) the death of the beneficiary designated in the application to receive an Optional Payment, or (4) a medical condition, based on medical evidence satisfactory to the Administrator, which is expected to result in the death of the beneficiary (including the Spouse) who is designated to receive a benefit after the death of the Retired Employee in accordance with the application to receive an Optional Payment originally filed with the Administrator, within five (5) years of the filing of an application for change in Optional Payment method pursuant to Article II, C(2) or Article II,D(2) hereof.

(j) "COMMITTEE" shall mean the Corporate Employee Benefit Committee of the Company charged with the administration of the Plan as from time to time constituted.

(k) "COMPANY" shall mean Philip Morris Companies Inc.

(l) "COMPENSATION LIMITATION" shall mean the limitation of Section 401(a)(17) of the Code on the annual compensation of an Employee which may be taken into account under the Plans.

(m) "DEFERRED RETIREMENT ALLOWANCE" shall mean the Retirement Allowance payable pursuant to Article II, A(2) of the PM Retirement Plan.

(n) "EARLY RETIREMENT ALLOWANCE" shall mean the Retirement Allowances payable pursuant to Article II, A(3) of the PM Retirement Plan.

(o) "EMPLOYEE" shall mean any person employed by a Participating Company on a salaried basis whose benefits under the Retirement Plan or Profit-Sharing Plan, or both Plans, are subject to the Statutory Limitations.

(p) "FULL RETIREMENT ALLOWANCE" shall mean the Retirement Allowance payable pursuant to Article II, A(1) of the PM Retirement Plan.

(q) "FUND" shall mean the trust fund provided for in the Profit-Sharing Plan and established under the trust agreement with respect to the Profit-Sharing Plan.

(r) "OPTIONAL PAYMENT" shall mean (1) in the case of a Benefit Equalization Retirement Allowance, the following optional forms in which the Benefit Equalization Retirement Allowance of an Employee who has made an election pursuant to Article II, C(2) hereof may be paid: (i) in equal monthly payments for the life of the Retired Employee, (ii) as a Benefit Equalization Joint and Survivor Allowance, or (iii) as a Benefit Equalization Optional Payment Allowance, and (2) in the case of a Benefit Equalization Profit-Sharing Allowance, any of the methods of distribution permitted under Article VI of the Profit-Sharing Plan (other than a Single Sum Payment payable at the time specified in Article II, D(1) hereof) and in the event the Retired Employee dies before distribution of his Benefit Equalization Profit-Sharing Allowance is made, commences to be made or is fully distributed, to the beneficiary designated in the notification set forth in Article II, E, hereof, in accordance with the method of distribution specified in such notification; provided however, that an Employee may not revoke or modify the method or the timing of any distribution of his Benefit Equalization Profit-Sharing Allowance later than at the times specified in Article II, D (2) hereof. Any election to receive an Optional Payment with respect to a Retired Employee's Allowances under the Plan shall be independent of any election with respect to his benefits payable under the Retirement Plan, the Profit-Sharing Plan, or any other plan of a member of the Controlled Group.

(s) "PARTICIPATING COMPANY" shall mean the Company and any other corporation which is a member of the Controlled Group and which, with the approval of the Committee, determines to participate in the Plan for the benefit of its eligible employees and executes such instruments of participation as the Committee deems necessary.

(t) "PLAN" shall mean the Philip Morris Benefit Equalization Plan described herein and in any amendments hereto.

(u) "PLANS" shall mean the Retirement Plan and the Profit-Sharing Plan.

(v) "PM RETIREMENT PLAN" shall mean the Philip Morris Salaried Employees' Retirement Plan, effective as of September 1, 1978 and as amended from time to time.

(w) "PROFIT-SHARING PLAN" shall mean the Philip Morris Deferred Profit-Sharing Plan, effective January 1, 1956 and as amended from time to time.

(x) "RETIREMENT PLAN" shall mean the PM Retirement Plan and each other defined benefit plan qualified under Section 401(a) of the Code maintained by a member of the Controlled Group in which an Employee has an accrued benefit, other than a defined benefit plan whose benefits in excess of the Statutory Limitations are payable from one or more of the following plans maintained by a member of the Controlled Group other than a Participating Company: (1) an excess benefit plan (as defined in Section 3(36) of ERISA), or (2) a plan maintained primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees.

(y) "SECTION 415 LIMITATIONS" shall mean: (1) in the case of the Retirement Plan, the limitations on benefits applicable to defined benefit plans set forth in Section 415 of the Code and the Treasury Regulations promulgated thereunder, and (2) in the case of the Profit-Sharing Plan, the limitations on contributions applicable to defined contribution plans set forth in Section 415 of the Code and the Treasury Regulations promulgated thereunder.

(z) "SINGLE SUM PAYMENT" shall mean (1) in the case of a Benefit Equalization Retirement Allowance, the normal form of distribution to a Retired Employee who is eligible for a Full, Deferred or Early Retirement Allowance, which distribution shall be made in one payment to the Retired Employee (or his Spouse or

other beneficiary) at the time set forth in Article II, C(1)(a) hereof and which is the Actuarial Equivalent of the Benefit Equalization Retirement Allowance payable in equal monthly payments during a twelve
(12) month period for the life of the Retired Employee and (2) in the case of a Benefit Equalization Profit-Sharing Allowance, the normal form of distribution of the balance to the credit of a Retired Employee as determined in accordance with Article II, B hereof, which distribution shall be made in one payment to the Retired Employee (or his Spouse or other beneficiary) at the time set forth in Article II, D(1) hereof.

(aa) "STATUTORY LIMITATIONS" shall mean (1) the Section 415 Limitations and (2) the Compensation Limitation.

(ab) "VESTED RETIREMENT ALLOWANCE" shall mean the Retirement Allowance payable pursuant to Article II, A(6) of the PM Retirement Plan.

ARTICLE II

BENEFIT EQUALIZATION RETIREMENT ALLOWANCES AND BENEFIT EQUALIZATION PROFIT-SHARING ALLOWANCES

A. Benefit Equalization Retirement Allowances and other benefits payable under this Plan shall be as follows:

(1) (a) The Benefit Equalization Retirement Allowance with respect to a Retired Employee who has retired on a Full, Deferred or Early Retirement Allowance shall equal the amount by which the Full, Deferred or Early Retirement Allowance under the Retirement Plan accrued to the date of retirement, if computed without regard to the Statutory Limitations, exceeds the amount of the Full, Deferred or Early Retirement Allowance actually payable under the Retirement Plan; provided, however, that in the event the Benefit Equalization Retirement Allowance with respect to the Retired Employee is paid in a Single Sum Payment pursuant to Paragraph C(1)(a) hereof prior to the Retired Employee's Benefit Commencement Date, the amount of such Benefit Equalization Retirement Allowance shall equal the amount by which the Full, Deferred or Early Retirement Allowance under the Retirement Plan accrued to the date of retirement, if computed without regard to the Statutory Limitations, is reasonably estimated by the Administrator to exceed the amount of the Full, Deferred or Early Retirement Allowance which is projected by the Administrator to be actually payable under the Retirement Plan.

(b) (i) The Spouse of a Retired Employee described in Subparagraph (1)(a) above whose request for an Optional Payment pursuant to Article I(r)(1)(i) or (ii) hereof has been granted by the Management Committee, but who has died after the date of his retirement and prior to the date his Optional Payment commences to be paid shall be eligible to receive a Benefit Equalization Survivor Allowance.

(ii) The beneficiary of a Retired Employee described in Subparagraph (1)(a) above whose request for a Benefit Equalization Optional Payment Allowance pursuant to Article I(f)(1) has been granted by the Management Committee, but who has died after the date of his retirement and prior to the date his Optional Payment commences to be paid shall be eligible to receive that portion of the Benefit Equalization Optional Payment Allowance elected by the Retired Employee which is payable after the death of the Retired Employee.

(2) (a) The Benefit Equalization Retirement Allowance with respect to a Retired Employee who is only eligible for a Vested Retirement Allowance and who is living on his Benefit Commencement Date shall equal the amount by which the Vested Retirement Allowance under the Retirement Plan accrued to the date of his termination of employment

with the Controlled Group, if computed without regard to the Statutory Limitations, exceeds the amount of the Vested Retirement Allowance actually payable under the Retirement Plan.

(b) The Spouse of a Retired Employee described in Subparagraph 2(a) above who has died after termination of his employment with the Controlled Group and prior to his Benefit Commencement Date shall be eligible to receive a Benefit Equalization Survivor Allowance.

(3) (a) The Spouse of a Deceased Employee who has died prior to the date of his retirement or other termination from the service of any member of the Controlled Group shall be eligible to receive a Benefit Equalization Survivor Allowance unless the Management Committee has granted the request of the Deceased Employee to receive a Benefit Equalization Optional Payment Allowance described in Article I(f)(2) hereof in which event such Spouse shall receive the Benefit Equalization Survivor Allowance accrued after the date specified in the election.

(b) The beneficiary of a Deceased Employee or deceased Retired Employee whose request for a Benefit Equalization Optional Payment Allowance described in Article I(f)(2) has been granted by the Management Committee shall be eligible to receive that portion of the Benefit Equalization Optional Payment Allowance elected by the Retired Employee which is payable after the death of the Deceased Employee or deceased Retired Employee.

B. Benefit Equalization Profit-Sharing Allowances payable under this Plan shall be as follows:

The Benefit Equalization Profit-Sharing Allowance with respect to a Retired Employee shall equal the amounts which would have been credited, but were not credited to his Company Account as a result of the Statutory Limitations. All such amounts shall be deemed to have been invested in Part C of the Fund and valued in accordance with the provisions of the Profit-Sharing Plan.

C. Commencement and termination of Benefit Equalization Retirement Allowances:

(1) (a) The Benefit Equalization Retirement Allowance payable pursuant to Paragraph A(1)(a) hereof shall be distributed to the Retired Employee in a Single Sum Payment no later than sixty (60) days following the Retired Employee's date of retirement (or, if the Retired Employee dies after the date of retirement and before distribution of his Single Sum Payment is made, to his beneficiary as determined pursuant to Paragraph E hereof, in a Single Sum Payment within sixty (60) days following the date of the Retired

Employee's death) unless the Employee has elected to have distribution of his Benefit Equalization Retirement Allowance made in accordance with Subparagraph
(2) hereof.

(b) The Benefit Equalization Retirement Allowance payable pursuant to Paragraph A(2)(a) hereof shall be distributed as an Optional Payment under Article I(r)(1)(i) or (ii) hereof (which Optional Payment shall be in the same form which the Retired Employee's benefits are paid from the PM Retirement Plan) and shall commence on the Employee's Benefit Commencement Date.

(c) (i) The Benefit Equalization Survivor Allowance payable pursuant to Paragraphs A(1)(b)(i), (A)(2)(b) and A(3)(a) hereof shall commence to be paid on the later of (A) the first day of the calendar month coincident with or next following the date the Deceased Employee or deceased Retired Employee would have attained the age of fifty-five (55) years, or (B) the first day of the calendar month in which the Deceased Employee or deceased Retired Employee died, provided that the Spouse may elect in accordance with the provisions of Article II, A(5)(c) or (f) of the PM Retirement Plan, as applicable to the Spouse, that the Benefit Equalization Survivor Allowance shall commence on the first day of any month thereafter, but not later than the first day of the calendar month in which the Deceased Employee or deceased Retired Employee would have attained his Normal Retirement Age. Any such Benefit Equalization Survivor Allowance shall terminate with the payment due on the first day of the month in which the Spouse dies.

(ii) The benefit payable to the beneficiary of the Deceased Employee or deceased Retired Employee pursuant to Paragraph A(1)(b)(ii) or (3)(b) hereof shall commence on the first day of the calendar month following the month in which the Deceased Employee or deceased Retired Employee died.

(2) An Employee who is eligible to retire on a Full, Deferred or Early Retirement Allowance and whose Benefit Equalization Retirement Allowance is otherwise payable in a Single Sum Payment pursuant to Paragraph C(1)(a) hereof may make application to the Administrator to receive an Optional Payment. The application may be filed prior to the date the Employee is eligible for an Early Retirement Allowance and shall specify the form of Optional Payment, the beneficiary and the date on which the Optional Payment is to commence to be made, which date shall be on or before the first day of the month coincident with or next preceding the Employee's Required Benefit Commencement Date, but in no event shall the Employee's Optional Payment commence to be paid prior to the later of the first day of the month following the first anniversary of the date of the filing of his application with the Administrator or the Employee's Benefit Commencement Date; provided, however, that in the event the Employee or former Employee incurs a Change in Circumstance on or after the date of the filing of the application and prior to the date his Optional Payment commences to be paid, the Employee or former Employee may file an application with the Administrator within ninety (90) days of the Change in Circumstance,

but in no event later than the date his Optional Payment is to commence, to change the form of Optional Payment or to change the beneficiary who is designated to receive a benefit after the death of the Retired Employee in accordance with the Optional Payment method originally filed with the Administrator; provided, further that any election to change the form of Optional Payment filed after the date of his retirement and prior to the date his Optional Payment is to commence may only change the form of Optional Payment to one of the forms specified in Article I (r)(i) or (ii) hereof. In the case of an Employee who eighteen (18) months prior to attaining the age of sixty-five (65) years could be compulsorily retired by his Participating Company upon attaining the age of sixty-five (65) years pursuant to Section 12(c) of the Age Discrimination in Employment Act, any application to receive an Optional Payment must be filed with the Administrator more than one (1) year preceding the date the Employee attains the age of sixty-five (65) years. The Administrator shall notify the Management Committee of all applications for an Optional Payment. The Management Committee may grant or deny any such application in its sole and absolute discretion. Any such application shall be of no force and effect if (i) the Employee does not retire on a Full, Deferred or Early Retirement Allowance, (ii) the Employee incurs a disability at any time before the date his Optional Payment commences to be made which causes him to be eligible for benefits under the Philip Morris Long-Term Disability Plan, or (iii) the Employee is retired for ill health, disability or hardship under Article II, A(3)(a) of the PM Retirement Plan, provided that in the event the application is of no force and effect under clauses (ii) or (iii) hereof, payment of the Employee's Benefit Equalization Retirement Allowance shall be made in a Single Sum Payment pursuant to Paragraph C(1)(a) hereof within sixty (60) days of the date of his retirement, but otherwise such application shall be irrevocable and effective on the Employee's retirement on a Full, Deferred or Early Retirement Allowance and the Employee's benefits shall commence on the date specified in the application; provided, however, that (A) if within the one (1) year period following the date of the filing of the application with the Administrator the Employee's service with any member of the Controlled Group is involuntarily terminated other than by reason of the Employee's death, disability or misconduct (as determined by the Management Committee), such Employee's Optional Payment shall commence to be paid on the Employee's Benefit Commencement Date, or (B) if within the one (1) year period following the date of the filing of the application with the Administrator the Employee voluntarily retires or his employment is terminated for misconduct (as determined by the Management Committee) by any member of the Controlled Group, the Optional Payment shall be reduced as specified in Paragraph C(4)(a) hereof.

(3) (a) Notwithstanding the preceding provisions of this Paragraph, the Committee may cause the distribution of the Benefit Equalization Retirement Allowance to any group of similarly situated Beneficiaries in a Single Sum Payment or as an Optional Payment.

(b) Notwithstanding the preceding provisions of this Paragraph, the Administrator shall distribute an Employee's Benefit Equalization Retirement Allowance in a

Single Sum Payment if the Benefit Equalization Retirement Allowance payable in equal monthly payments is not more than $250 per month.

(4) (a) The Benefit Equalization Retirement Allowance payable to an Employee pursuant to clause (B) of Paragraph C(2) hereof shall be further reduced by one percent (1%) for each month (or portion of a month) by which the month in which the Employee's termination of employment precedes the first anniversary of the filing of the application with the Administrator.

(b) Any Benefit Equalization Survivor Allowance or Benefit Equalization Optional Payment Allowance payable under this Plan to any Beneficiary other than a Retired Employee commencing at an age other than the Retired Employee's Normal Retirement Age shall be the Actuarial Equivalent of the Beneficiary's benefit payable pursuant to the terms of the Plan in equal monthly payments for life commencing at the Retired Employee's Normal Retirement Age.

D. Commencement and termination of Benefit Equalization Profit-Sharing Allowances:

(1) The Benefit Equalization Profit-Sharing Allowance payable pursuant to Paragraph B shall be distributed to the Retired Employee in a Single Sum Payment no later than sixty (60) days following the Retired Employee's date of retirement (or, if the Retired Employee dies after the date of retirement and before distribution of his Single Sum Payment is made, to his beneficiary as determined pursuant to Paragraph E hereof, in a Single Sum Payment within sixty
(60) days following the date of the Retired Employee's death) unless the Employee's Benefit Equalization Profit-Sharing Allowance is distributed in accordance with Subparagraph (2) hereof.

(2) An Employee who is eligible for a Benefit Equalization Profit-Sharing Allowance may make application to the Administrator to receive an Optional Payment. The application shall specify the form of Optional Payment, the beneficiary and the date on which the Optional Payment is to be paid or commence to be paid, which date shall be on or before the first day of the month coincident with or next preceding the Employee's Required Benefit Commencement Date, but in no event shall the Employee's Optional Payment commence to be paid prior to the later of the first day of the month following the first anniversary of the date of the filing of his application with the Administrator or the Employee's date of retirement; provided, however, that in the event the Employee or former Employee has elected to receive his Optional Payment over the joint life expectancies of the Employee and his beneficiary and incurs a Change in Circumstance described in Article I(i)(2), (3) or (4) hereof on or after the date of the filing of the application and prior to the date his Optional Payment commences to be paid, the Employee or former Employee may file an application with the Administrator within ninety (90) days of the Change in Circumstance, but in no event later than the date his Optional Payment commences to be made to designate a new

beneficiary or elect to receive his Optional Payment over the life expectancy of the Employee or former Employee. In the case of an Employee who eighteen (18) months prior to attaining the age of sixty-five (65) years could be compulsorily retired by his Participating Company upon attaining the age of sixty-five (65) years pursuant to Section 12(c) of the Age Discrimination in Employment Act, any application to receive an Optional Payment must be filed with the Administrator more than one (1) year preceding the date the Employee attains the age of sixty-five (65) years. The Administrator shall notify the Management Committee of all applications for an Optional Payment. The Management Committee may grant or deny any such application in its sole and absolute discretion. If within the one (1) year period following the date of the filing of the application with the Administrator the Employee voluntarily retires (other than for ill health, disability or hardship under Article II, A(3)(a) of the PM Retirement Plan), voluntarily terminates his employment with his Participating Company (other than for a disability which causes him to be eligible for benefits under the Philip Morris Long-Term Disability Plan) or his employment is terminated for misconduct (as determined by the Management Committee) by any member of the Controlled Group, the Optional Payment shall be reduced in the same manner as specified in Paragraph C(4)(a) hereof. If the Employee dies after the date of retirement and prior to the date his Benefit Equalization Profit-Sharing Allowance is paid or commences to be paid, payment shall be made to his designated beneficiary commencing in the form and on the date specified in the application and if no such form or commencement date shall be specified in the application, to his designated beneficiary in a Single Sum Payment within sixty (60) days of the date of his death.

(3) (a) Notwithstanding the preceding provisions of this Paragraph, the Committee may cause the distribution of the Benefit Equalization Profit-Sharing Allowance to any group of similarly situated Beneficiaries in a Single Sum Payment or as an Optional Payment.

(b) Notwithstanding the preceding provisions of this Paragraph, the Administrator shall distribute an Employee's Benefit Equalization Profit-Sharing Allowance in a Single Sum Payment if the value of such Benefit Equalization Profit-Sharing Allowance is not more than $10,000.

E. Application or Notification for payment of Allowances:

An application for a Retirement Allowance, Survivor Allowance or optional form of benefit under the Retirement Plan shall be deemed notification to the Administrator that payment of the Benefit Equalization Retirement Allowance or other benefit is to be made or commence to be made to the Retired Employee, Spouse or other beneficiary in accordance with the terms of this Plan. An application for distribution of the Employee's Accounts shall be deemed notification to the Administrator that payment of the Benefit Equalization Profit-Sharing Allowance is to be made or commence to be made to the Retired Employee, Spouse or other beneficiary in accordance with the terms of this Plan. In the event the Employee shall not have elected an Optional Payment method with respect to his Benefit Equalization Retirement Allowance, any such notification shall specify the beneficiary to whom payment of the Single Sum Payment shall be made in the event the Employee dies after the date of his retirement and prior to the date the Single Sum Payment is made, provided, that if the Employee shall fail to designate a beneficiary or if the beneficiary shall predecease the Employee, the Administrator shall distribute the Single Sum Payment to the duly authorized representative of the former Employee's estate.

ARTICLE III

FUNDS FROM WHICH ALLOWANCES ARE PAYABLE

Individual accounts shall be established for the benefit of each Beneficiary under the Plan. Separate individual accounts shall be established for that portion of each Beneficiary's benefits under the Plan attributable solely to the Section 415 Limitations, and for that portion of each Beneficiary's benefits under the Plan attributable solely to the Compensation Limitation, or to the Compensation Limitation and the Section 415 Limitations. If any portion of a Beneficiary's benefits are attributable to the Compensation Limitation, the total amount of all benefits payable to the Beneficiary under the Plan shall be paid from that portion of the Plan which provides benefits attributable solely to the Compensation Limitation or to the Compensation Limitation and the Section 415 Limitations. Any benefits payable from an individual account shall be payable solely to the Beneficiary for whom such account was established. The Plan shall be unfunded. All benefits intended to be provided under the Plan shall be paid from time to time from the general assets of the Employee's Participating Company and paid in accordance with the provisions of the Plan; provided, however, that the Participating Companies reserve the right to meet the obligations created under the Plan through one or more trusts or other agreements. The contributions by each Participating Company on behalf of its Employees to the individual accounts established pursuant to the provisions of the Plan, whether in trust or otherwise, shall be in an amount which such Participating Company, with the advice of an actuary, determines to be sufficient to provide for the payment of the benefits under the Plan.

ARTICLE IV

THE CORPORATE EMPLOYEE BENEFIT COMMITTEE AND ITS DELEGATEES

The general administration of the Plan shall be vested in the Committee, the Management Committee and the Administrator.

All powers, rights, duties and responsibilities assigned to the Committee, the Management Committee and the Administrator under the Retirement Plan applicable to this Plan shall be the powers, rights, duties and responsibilities of the Committee, the Management Committee and the Administrator under the terms of this Plan, except that the Committee, the Management Committee and the Administrator shall not be fiduciaries (within the meaning of Section 3(21) of ERISA) with respect to that portion of the Plan which is intended to be exempt from the requirements of ERISA pursuant to Section 4(b)(5) thereof.

ARTICLE V

AMENDMENT AND DISCONTINUANCE OF THE PLAN

The Board may, from time to time, and at any time, amend the Plan; provided, however, that authority to amend the Plan is delegated to the following committees or individuals where approval of the Plan amendment or amendments by the shareholders of the Company is not required: (1) to the Committee, if the amendment (or amendments) will not increase the annual cost of the Plan by $10,000,000, (2) to the Management Committee, if the amendment (or amendments) will not increase the annual cost of the Plan by $4,000,000, (3) to the Administrator, if the amendment (or amendments) will not increase the annual cost of the Plan by $500,000.

Any amendment to the Plan may effect a substantial change in the Plan and may include (but shall not be limited to) any change deemed by the Company to be necessary or desirable to obtain tax benefits under any existing or future laws or rules or regulations thereunder; provided, however, that no such amendment shall deprive any Beneficiary of any Allowances accrued at the time of such amendment.

The Plan may be discontinued at any time by the Board; provided, however, that such discontinuance shall not deprive any Beneficiary of any Allowances accrued at the time of such discontinuance.

ARTICLE VI

FORMS; COMMUNICATIONS

The Management Committee shall provide such appropriate forms as it may deem expedient in the administration of the Plan and no action to be taken under the Plan for which a form is so provided shall be valid unless upon such form. All communi-cations concerning the Plan shall be in writing addressed to the Committee, the Management Committee or the Administrator at such address as may from time to time be designated. No communication shall be effective for any purpose unless received by the Committee, the Management Committee or the Administrator.

ARTICLE VII

INTERPRETATION OF PROVISIONS

The Management Committee shall have the full power and authority to grant or deny requests for payment of a Benefit Equalization Retirement Allowance in accordance with a form of distribution authorized under the Retirement Plan and the Committee shall have full power and authority with respect to all other matters arising in the administration, interpretation and application of the Plan. Any member of the Management Committee who makes a request for payment of a Benefit Equalization Retirement Allowance in accordance with a form of distribution authorized under the Retirement Plan shall excuse himself from any and all deliberations and decisions of the Management Committee in connection with such request.

ARTICLE VIII

CHANGE IN CONTROL PROVISIONS

A. In the event of a Change of Control, each Employee shall be fully vested in his Allowances and any other benefits accrued through the date of the Change of Control ("Accrued Benefits"). Each Employee (or his beneficiary) shall, upon the Change of Control, be entitled to a lump sum in cash, payable within 30 days of the Change of Control, equal to the actuarial equivalent of his Accrued Benefits, determined using actuarial assumptions no less favorable than those used under the Supplemental Management Employees' Retirement Plan immediately prior to the Change of Control.

B. Definition of Change of Control.

"Change of Control" shall mean the happening of any of the following events:

(1) The acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, and amended (the "Exchange Act")) (a "Person") of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 20% or more of either (i) the then outstanding shares of common stock of the Company (the "Outstanding Company Common Stock") or (ii) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities"); provided, however, that the following acquisitions shall not constitute a Change of Control: (i) any acquisition directly from the Company, (ii) any acquisition by the Company, (iii) any acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company or (iv) any acquisition by any corporation pursuant to a transaction described in clauses (i), (ii) and (iii) of paragraph (3) of this Section B; or

(2) Individuals who, as of the date hereof, constitute the Board (the "Incumbent Board") cease for any reason to constitute at least a majority of the Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board shall be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial assumption of office occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board; or

(3) Approval by the shareholders of the Company of a reorganization, merger, share exchange or consolidation (a "Business Combination"), in each case, unless, following such Business Combination, (i) all or substantially all of the individuals and entities who were the beneficial owners, respectively, of the Outstanding Company Common Stock and Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 80% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Business Combination (including, without limitation, a corporation which as a result of such transaction owns the Company through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common Stock and Outstanding Company Voting Securities, as the case may be, (ii) no Person (excluding any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination) beneficially owns, directly or indirectly, 20% or more of, respectively, the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership existed prior to the Business Combination and (iii) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or

(4) Approval by the shareholders of the Company of (i) a complete liquidation or dissolution of the Company or (ii) the sale or other disposition of all or substantially all of the assets of the Company, other than to a corporation, with respect to which following such sale or other disposition, (A) more than 80% of, respectively, the then outstanding shares of common stock of such corporation and the combined voting power of the then outstanding voting securities of such corporation entitled to vote generally in the election of directors is then beneficially owned, directly or indirectly, by all or substantially all of the individuals and entities who were the beneficial owners, respectively, of the Outstanding Company Common Stock and Outstanding Company Voting Securities immediately prior to such sale or other disposition in substantially the same proportion as their ownership, immediately prior to such sale or other disposition, of the Outstanding Company Common Stock and Outstanding Company Voting Securities, as the case may be, (B) less than 20% of, respectively, the then outstanding shares of common stock of such corporation and the combined voting power of the then outstanding voting securities of such corporation entitled to vote generally in the election of directors is then beneficially owned, directly or indirectly, by any Person (excluding any employee benefit plan (or related trust) of the Company or such corporation), except to the extent that such Person owned 20% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities prior to the sale or disposition and (C) at least a majority of the members of the board of directors of such corporation were members of the Incumbent Board at the time of the execution of the

initial agreement, or of the action of the Board, providing for such sale or other disposition of assets of the Company or were elected, appointed or nominated by the Board.

EXHIBIT A

PHILIP MORRIS BENEFIT EQUALIZATION PLAN

ACTUARIAL ASSUMPTIONS USED TO CALCULATE A SINGLE SUM PAYMENT

INTEREST RATE: Average of the interest rates established by the Pension Benefit Guaranty Corporation to value immediate annuities in the case of a plan termination for the 24 months preceding the Employee's date of retirement, less 1/2 of 1%.

MORTALITY ASSUMPTION: UP-1984 Unisex Mortality Table

Exhibit 10.5

[Philip Morris Companies Inc. letterhead]

March 8, 1989

Mr. Robert S. Morrison
1193 Scott Avenue
Winnetka, IL 60093

Dear Bob:

On behalf of Philip Morris Companies Inc., I would like to thank you for your efforts in connection with the integration of the management of our food operations. Your continued participation in this integration is essential to enable us to build an effective food operations management team that will assure future growth and continued success. The purpose of this letter is to confirm our recent understandings regarding your Deferred Incentive Payment.

In recognition of your importance to management of the food operations, we have agreed that you will be paid a Deferred Incentive Payment designed to provide you with a special incentive to remain with us during the integration of Kraft and General Foods. Your Deferred Incentive Payment award will be computed and paid to you at the time and in the form described in Appendix A.

If your employment terminates for any reason (including death), you will be entitled, subject to the following provisions, to the amount of any Deferred Incentive Payment, including any interest, dividends and appreciation thereon, and also entitled to any unpaid compensation. Generally, any payment to which you are entitled on termination of employment will be paid to you within 30 days of your date of termination. However, if you retire or otherwise voluntarily terminate employment prior to February 15, 1991, your Deferred Incentive Payment will be paid in accordance with Appendix A. If your employment is terminated prior to February 15, 1991, for any reason you will not be entitled to other payments under any severance plan or policy.

Although our discussions have focused on your employment during the next two years, we recognize the need to provide a level of continuing financial assurance after the expiration of the two-year business integration period. In the event your employment is involuntarily terminated without cause after February 15, 1991, you will receive an amount equal to the greater of (1) the sum of your annual base salary at the rate in effect at the time your employment is terminated and the annual incentive payment (excluding amounts attributable to the Deferred Incentive Payment) which you received for the most recent calendar year for which the computation of such award has been made at the time of your termination of employment, or (2) the amount to which you would be entitled under the terms of the normal severance plans or policies of Philip Morris Companies Inc. or its subsidiaries then applicable to you.

Whenever your employment terminates, you and your family will be covered by lifetime medical, dental and life insurance benefits on terms at least as favorable as those currently available to other peer executives retiring from service with Kraft, Inc., but not less favorable than those available to you and your family, in the aggregate, under the medical, dental and life insurance plans of Kraft, Inc. as of December 1, 1988 (for this purpose the Kraft, Inc. life insurance plan for active employees shall be applicable until age 65 and thereafter the Kraft, Inc. life insurance plan for retire employees shall be applicable). If you are reemployed and are eligible to receive any medical or dental benefits under your new employer's plans, the medical and dental plans of Philip Morris Companies Inc. or its subsidiaries will only provide secondary coverage to you and your family during such applicable period of eligibility under the new employer's plans.

This letter is intended to summarize our previous understanding relating to your employment with Philip Morris Companies Inc. and its subsidiaries. It replaces any prior employment agreements you had with Kraft or Philip Morris Companies Inc. or its subsidiaries, and any such agreements are to be of no effect. However, nothing in this letter precludes you from participating in any compensation plan, benefit plan or other executive benefit which is generally available to similarly situated executives of Kraft Inc. or its successors and which has not been expressly addressed by this letter. Nothing in this letter replaces or otherwise changes the obligations of Philip Morris Companies Inc. under its indemnification agreement with you dated December 16, 1988.

The payments referred to in this letter are obligations of your employer. Philip Morris Companies Inc. will cause your employer to comply with the terms of this letter and to assume its obligations and will also serve as a guarantor with respect to the payments. In the event of any merger, reorganization or similar event, Philip Morris Companies Inc. will cause any successor entity to assume the obligations evidenced by this letter. In addition, if payment of any of the amounts provided for in Appendix A subjects you to federal excise tax, on those amounts or any other amounts you have received, you will receive additional payments sufficient to place you in the position that would have existed had no such excise tax been payable.

If this letter accurately describes the matters set forth above, please sign the enclosed copy of this letter and Appendix A which should be returned to us, and will then constitute our entire agreement on this subject.

Sincerely,

PHILIP MORRIS COMPANIES INC.

By /s/ Richard L. Snyder
Richard L. Snyder
Senior Vice President, Human Resources Administration

Agreed to this 11th day of

March, 1989

By /s/ Robert S. Morrison
Robert S. Morrison
President, Kraft General Foods Canada

APPENDIX A
DEFERRED INCENTIVE PAYMENT

On the terms and conditions set forth in the attached letter agreement and this Appendix, your employer and Philip Morris Companies Inc. promise to make the Deferred Incentive Payment as follows:

(a) a "shadow stock account" will be credited as of February 15, 1989, with 12,335 shadow shares. Each shadow share will have a value equal to that of one share of the common stock of Philip Morris Companies Inc.

(b) When dividends are paid on the common stock, additional shadow shares will be credited to the account in an amount determined by multiplying the number of shadow shares by the dividend per share paid on the common stock and dividing this product by the closing price of the common stock on the New York Stock Exchange on the date the dividend is paid.

(c) The number and value of shadow shares will be appropriately adjusted in the event of any stock dividend, stock split, subdivision or combination of shares, reclassification or conversion of stock in the event of a merger or consolidation, or similar event with respect to the common stock so that the aggregate value of shadow shares credited will be at least as great immediately after as immediately before any such event. In the event of any dissolution or liquidation of Philip Morris Companies Inc., or if trading in the common stock on the New York Stock Exchange ceases for five or more consecutive days during which such Exchange is open for trading, then regardless of any other provision of this Appendix you will receive an immediate cash payment of an amount equal to the value of the shadow stock account computed on the basis of the average closing prices for the common stock on the New York Stock Exchange on the last five days on which such stock was traded.

(d) The number of shadow shares shall also be adjusted in the following circumstances:

(i) In the event that on or before February 15, 1991, you die, become disabled for six consecutive months, have your employment involuntarily terminated, or take normal or employer approved early retirement, the number of shadow shares credited to your shadow stock account will be increased by the amount, if any, necessary to bring the aggregate value of the shadow shares credited, determined as of the date of any such event, to the amount determined by crediting $1,233,403 with interest from December 6, 1988 to the date of such event at a rate equal to (A) the annual rate on 12 month obligations of the United States Treasury on February 15, 1989 for the portion of the period prior to February 15, 1990, and (B) the annual rate on such obligations on February 15, 1990 (applied to the balance of both principal and interest on that date) for any portion of the period on or after February 15, 1990.

(ii) If you continue your employment with Philip Morris Companies Inc. or any of its subsidiaries until February 15, 1991, the number of shadow shares credited to your shadow stock account shall be increased in the amount, if any, necessary to bring the aggregate value of the shadow shares credited to your account on February 15, 1991 to the amount determined by crediting the dollar amount specified in (i) above with interest at the rates and in the manner described therein to February 15, 1991.

For purposes of this Appendix, other than for purposes of the last sentence of paragraph (c), the value of each shadow share will be the closing price of a share of the common stock on the most recent New York Stock Exchange trading day preceding the date of the determination of value.

(e) The amount of the Deferred Incentive Payment payable to you will be determined by multiplying the number of shadow shares credited to you on the most recent New York Stock Exchange trading preceding payment by the closing price of the common stock on such day. Such amount shall be paid to you in cash, or at the discretion of Philip Morris Companies Inc. in shares of common stock equal in number to your shadow shares, at the time you select by initialing one of the following alternative payment schedules:

[ ] The Deferred Incentive Payment will be paid within 30 days after the earliest to occur of your death, disability for six consecutive months, or other termination of employment;

except in the event of your voluntary termination of employment for reasons other than normal or employer approved early retirement, the Deferred Incentive Payment will be paid no earlier than February 15, 1991.

OR

[X] The Deferred Incentive Payment will be paid within 30 days after the earliest to occur of your death, disability for six consecutive months, other termination of employment, or February 16, 1991; except in the event of your voluntary termination of employment for reasons other than normal or employer approved early retirement, the Deferred Incentive Payment will be paid no earlier than February 15, 1991.

Your entitlement to the Deferred Incentive Payment does not constitute an interest in specific assets of your employment or Philip Morris Companies Inc. Your status with respect to such payment shall be that of an unsecured general creditor.

The Deferred Incentive Payment may not be assigned or otherwise transferred by you (other than by your will or by operation of law in the event of your death) prior to the date you actually receive such payment or payments.

PHILIP MORRIS COMPANIES INC.

By /s/ Richard L. Snyder

Richard L. Snyder
Senior Vice President, Human Resources Administration

Agreed to this 11th day of

March, 1989

By /s/ Robert S. Morrison

Robert S. Morrison
President, Kraft General Foods Canada

Exhibit 10.10

SUPPLEMENTAL MANAGEMENT EMPLOYEES' RETIREMENT PLAN

OF

PHILIP MORRIS COMPANIES INC.

Effective October 1, 1987

(As amended and in effect as of January 1, 1994)

SUPPLEMENTAL MANAGEMENT EMPLOYEES' RETIREMENT PLAN
OF
PHILIP MORRIS COMPANIES INC.

The Supplemental Management Employees' Retirement Plan of Philip Morris Companies Inc., as hereinafter set forth shall be effective with respect to an Employee designated as a Participant (as defined herein) whose date of retirement (as specified in an application for retirement in Article II, B of the PM Retirement Plan) is on or after April 1, 1993, or who has filed an application for an Optional Payment pursuant to Article II D(3) of the Plan after March 1, 1992 and with respect to former Employees designated as Participants on or after April 1, 1993. The rights of an Employee or former Employee designated as a Participant who retired before such dates shall be governed by the provisions of the Plan as in effect on the date of retirement or, if later, the date of designation as a Participant, unless an application for an Optional Payment was filed after March 1, 1992.

ARTICLE I

DEFINITIONS

The following terms as used herein shall have the meanings set forth below. Capitalized terms used herein and not defined below shall have the meanings set forth in the PM Retirement Plan or the Profit-Sharing Plan, as the context may require.

(a) "Accredited Service" shall have the same meaning as in the PM Retirement Plan, provided, however, that Accredited Service shall also include the additional periods of Accredited Service which may be credited to a Participant under the provisions of Article II, A(1)(a) of the Plan.

(b) "Actuarial Equivalent" shall mean a benefit which is equivalent in value to the benefit otherwise payable pursuant to the terms of the Plan, based on the actuarial principles and assumptions set forth in Exhibit "I" to the PM Retirement Plan; provided, however, that a Single Sum Payment shall be the Actuarial Equivalent of the Supplemental Retirement Allowance payable in equal monthly payments during a twelve (12) month period for the life of the Retired Participant, using the actuarial principles and assumptions set forth in Exhibit "A" to the Plan.

(c) "Administrator" shall mean the Senior Vice President, Human Resources and Administration of Philip Morris Companies Inc. (or his delegatee) designated by the Committee to carry out certain responsibilities in connection with the administration of the Plan.

(d) "Allowances" shall mean a Supplemental Retirement Allowance and a Supplemental Profit-Sharing Allowance.

(e) "Appointee" shall mean the person or entity who, pursuant to the provisions of the Plan, is empowered, in his, her or its sole discretion, to designate an Employee as a Participant and grant one or more Allowances under the Plan. The Appointee for an Employee who is not a chief executive officer of a Participating Company shall be the chief executive officer of his Participating Company. The Appointee for a Retired Employee and an Employee who is a chief executive officer of a Participating Company other than the Company shall be the Chief Executive Officer. The Appointee of the Chief Executive Officer shall be the Committee.

(f) "Benefit Equalization Plan" shall mean the Philip Morris Benefit Equalization Plan, effective as of September 2, 1974 and as amended from time to time, but only to the extent that benefits are payable pursuant to Article II, A thereof.

(g) "Change in Circumstance" shall mean (1) the marriage of the Participant or Retired Participant, (2) the divorce of the Participant or Retired Participant from his Spouse, provided such Spouse was designated as the beneficiary in the currently effective application to receive an Optional Payment, or the

Participant or Retired Participant elected to receive an Optional Payment pursuant to clause (1) of Paragraph (u) hereof, (3) the death of the beneficiary designated in the application to receive an Optional Payment, or (4) a medical condition, based on medical evidence satisfactory to the Administrator, which is expected to result in the death of the beneficiary (including the Spouse) who is designated to receive a benefit after the death of the Retired Employee in accordance with the application to receive an Optional Payment originally filed with the Administrator, within five (5) years of the filing of an application for change in Optional Payment method pursuant to Article II, D(3) hereof.

(h) "Change of Control" shall mean the happening of any of the following events:

(1) The acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) (a "Person") of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 20% or more of either (i) the then outstanding shares of common stock of the Company (the "Outstanding Company Common Stock") or (ii) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities"); provided, however, that the following acquisitions shall not constitute a Change of Control:
(i) any acquisition directly from the Company, (ii) any acquisition by the Company, (iii) any acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company or (iv) any acquisition by any corporation pursuant to a transaction described in clauses (i), (ii) and (iii) of paragraph 3 of this subsection (h); or

(2) Individuals who, as of the date hereof, constitute the Board (the "Incumbent Board") cease for any reason to constitute at least a majority of the Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board shall be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial assumption of office occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board; or

(3) Approval by the shareholders of the Company of a reorganization, merger, share exchange or consolidation (a "Business Combination"), in each case, unless, following such Business Combination, (i) all or substantially all of the individuals and entities who were the beneficial

owners, respectively, of the Outstanding Company Common Stock and Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 80% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Business Combination (including, without limitation, a corporation which as a result of such transaction owns the Company through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common Stock and Outstanding Company Voting Securities, as the case may be, (ii) no Person (excluding any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination) beneficially owns, directly or indirectly, 20% or more of, respectively, the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership existed prior to the Business Combination and (iii) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or

(4) Approval by the shareholders of the Company of (i) a complete liquidation or dissolution of the Company or (ii) the sale or other disposition of all or substantially all of the assets of the Company, other than to a corporation, with respect to which following such sale or other disposition, (A) more than 80% of, respectively, the then outstanding shares of common stock of such corporation and the combined voting power of the then outstanding voting securities of such corporation entitled to vote generally in the election of directors is then beneficially owned, directly or indirectly, by all or substantially all of the individuals and entities who were the beneficial owners, respectively, of the Outstanding Company Common Stock and Outstanding Company Voting Securities immediately prior to such sale or other disposition in substantially the same proportion as their ownership, immediately prior to such sale or other disposition, of the Outstanding Company Common Stock and Outstanding Company Voting Securities, as the case may be, (B) less than 20% of, respectively, the then outstanding shares of common stock of such corporation and the combined voting power of the then outstanding voting securities of such corporation entitled to vote generally in the election of directors is then beneficially owned, directly or indirectly, by any Person (excluding any employee benefit plan (or related trust) of the Company or such corporation), except to the extent that such Person owned 20% or more of the Outstanding Company Common Stock or Outstanding Company Voting

Securities prior to the sale or disposition and (C) at least a majority of the members of the board of directors of such corporation were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such sale or other disposition of assets of the Company or were elected, appointed or nominated by the Board.

(i) "Chief Executive Officer" shall mean the chief executive officer of the Company.

(j) "Committee" shall mean the Corporate Employee Benefit Committee of the Company charged with the administration of the Plan as from time to time constituted.

(k) "Company" shall mean Philip Morris Companies Inc.

(l) "Deceased Participant" shall mean any former Participant who died while he was a Participant, provided that no Optional Payment pursuant to clause (3) of Paragraph (u) hereof will be made under the Plan after the death of the Deceased Participant.

(m) "Deceased Retired Participant" shall mean a Retired Participant who has elected to receive an Optional Payment but who has died prior to the date his Optional Payment commences to be paid.

(n) "Deferred Retirement Allowance" shall mean the Retirement Allowance payable pursuant to Article II, A(2) of the PM Retirement Plan.

(o) "Early Retirement Allowance" shall mean the Retirement Allowances payable pursuant to Article II, A(3) of the PM Retirement Plan.

(p) "Employee" shall mean any person who (1) is employed on a salaried basis by a Participating Company, (2) is a member of a select group of management or a highly compensated employee of his Participating Company and (3) is eligible to receive a Retirement Allowance under the PM Retirement Plan. An Employee shall cease to be such under the Plan upon termination of his service for any cause whatsoever; provided, however, that he shall be deemed to be an Employee during the periods of service accredited to him pursuant to Article III of the PM Retirement Plan.

(q) "Exchange Act" shall mean the Securities Exchange Act of 1934, as amended from time to time, and any successor thereto.

(r) "Fiduciary" shall mean the Committee, the Management Committee and the Administrator to the extent that such person or body (1) exercises any

discretionary authority or control respecting management of the Plan, or
(2) has discretionary authority or responsibility in the administration of the Plan.

(s) "Full Retirement Allowance" shall mean the Retirement Allowance payable pursuant to Article II, A(1) of the PM Retirement Plan.

(t) "Management Committee" shall mean the Philip Morris Management Committee for Employee Benefits designated by the Committee to carry out certain responsibilities in connection with the administration of the Plan.

(u) "Optional Payment" shall mean the following forms in which a Supplemental Retirement Allowance of a Participant who has made an election pursuant to Article II, D(3) hereof may be paid: (1) in equal monthly payments for the life of the Retired Participant, (2) as a Supplemental Joint and Survivor Allowance, or (3) as a Supplemental Optional Payment Allowance. Any election to receive an Optional Payment with respect to a Retired Participant's Supplemental Retirement Allowance under the Plan shall be independent of any election with respect to his benefits under any Other Plan.

(v) "Other Plan" shall mean (1) the Retirement Plan, (2) the Benefit Equalization Plan, (3) any other plan, except a defined contribution or similar plan, maintained by the Company, or any domestic or foreign subsidiary of the Company, which provides retirement income to one or more employees on or after termination of employment and (4) any employment contract or other agreement between an Employee and the Company or any other member of the Controlled Group providing for retirement benefits or benefits in the event of a termination of employment or a Change in Control of the Company or of any other member of the Controlled Group.

(w) "Participant" shall mean an Employee or Retired Employee who is designated as such by his Appointee pursuant to the terms of the Plan. The designation of an Employee or Retired Employee as a Participant by a chief executive officer of a Participating Company shall be communicated in writing to the Committee. An Employee or Retired Employee shall become a Participant as of the date designated in writing by his Appointee. Except as otherwise specifically provided for in the Plan, a Participant shall cease to be such whenever he ceases to be an Employee.

(x) "Participating Company" shall mean the Company and any other corporation which is a member of the Controlled Group and which, with the approval of the Committee determines to participate in the Plan for the benefit of its Employees and executes such instruments of participation as the Committee deems necessary.

(y) "Plan" shall mean this Supplemental Management Employees' Retirement Plan of Philip Morris Companies Inc., as amended from time to time.

(z) "PM Retirement Plan" shall mean the Philip Morris Salaried Employees' Retirement Plan, effective as of September 1, 1978 and as amended from time to time.

(aa) "Profit-Sharing Plan" shall mean the Philip Morris Deferred Profit-Sharing Plan, effective as of January 1, 1956 and as amended from time to time.

(bb) "Retired Participant" shall mean a Participant who ceases to be such but is eligible for, or who has retired and is receiving a Supplemental Retirement Allowance from the Plan. A former Employee shall cease to be a Retired Participant as of the date he receives a Single Sum Payment.

(cc) "Retirement Plan" shall mean the PM Retirement Plan and each other defined benefit plan qualified under Section 401(a) of the Code maintained by a member of the Controlled Group in which a Participant has an accrued benefit.

(dd) "Single Sum Payment" shall mean (1) in the case of a Supplemental Retirement Allowance, the normal form of distribution to a Retired Participant who is eligible for a Full, Deferred or Early Retirement Allowance, which distribution shall be made in one payment to the Retired Participant (or his designated beneficiary) at the time set forth in Article II, D(2)(a) hereof and which is the Actuarial Equivalent of the Supplemental Retirement Allowance payable in equal monthly payments during a twelve (12) month period for the life of the Retired Participant and (2) the sole form of distribution of the Retired Participant's Supplemental Profit-Sharing Allowance.

(ee) "Supplemental Joint and Survivor Allowance" shall mean the total amount payable during a twelve (12) month period as a reduced Supplemental Retirement Allowance to a Retired Participant for life and after his death the amount payable to his Spouse for life equal to one-half of the reduced Supplemental Retirement Allowance payable to the Retired Participant, which together shall be the Actuarial Equivalent of the Supplemental Retirement Allowance of the Retired Participant.

(ff) "Supplemental Optional Payment Allowance" shall mean (1) the total amount payable during a twelve (12) month period in accordance with one of the payment methods described in Article II, A(4)(d) of the PM Retirement Plan designated by the Participant in the application for an Optional Payment under Article II, D(3) hereof pursuant to which the Participant receives for life after his retirement a reduced Supplemental Retirement Allowance and after his death after retirement his beneficiary receives for life a benefit according to the option elected by the Employee, which together shall be the Actuarial Equivalent of the Supplemental Retirement Allowance payable in equal monthly payments for the life of the Participant after his retirement, or (2) the total amount payable during a twelve (12) month period in accordance with one of the payment methods described in Article II, A(4)(d) of the PM Retirement Plan pursuant to an election described in Article II, A(4)(c) of the PM Retirement Plan and designated by the Participant in the application for an Optional Payment under Article II, D(3) hereof pursuant to which the Participant receives for life after his retirement a reduced Supplemental Retirement Allowance and after his death his beneficiary receives for life a benefit according to the option elected by the Participant, which together shall be the Actuarial Equivalent of the Supplemental Retirement Allowance accrued to the date of election.

(gg) "Supplemental Profit-Sharing Allowance" shall mean the benefit determined and payable in a Single Sum Payment upon termination of a Participant's service with the Controlled Group pursuant to Article III hereof.

(hh) "Supplemental Retirement Allowance" shall mean the benefit determined under Article II, A hereof and payable at the time and in the manner set forth in Article II, D, provided, however, that, except as otherwise required by Article II, A(1) or Article II, D(3) of the Plan, payment to a Retired Participant in any form shall be the Actuarial Equivalent of a Supplemental Retirement Allowance expressed as a benefit payable in equal monthly payments during a twelve (12) month period for the life of the Retired Participant commencing at the Retired Participant's Normal Retirement Age.

(ii) "Supplemental Survivor Allowance" shall mean the total amount payable during a twelve (12) month period in equal monthly payments for the life of the Spouse of a Deceased Participant or Deceased Retired Participant who has died after the date of his retirement and prior to the date his Optional Payment under Paragraph (u)(1) or (2) hereof commences to be paid in an amount equal to one-half of the reduced Supplemental Retirement Allowance which would have been payable as a Supplemental Joint and Survivor Allowance to the Deceased Participant or Deceased Retired Participant. Payment of the Supplemental Survivor Allowance to the Spouse of a Deceased Participant or Deceased Retired Participant who is eligible for such benefit under Article II, B hereof shall be payable at the time set forth in Article II, D(4) hereof.

(jj) "Supplemental Survivor Income Benefit Allowance" shall mean the total amount payable during a twelve (12) month period to the Spouse of a Deceased Participant or Deceased Retired Participant equal to one-half of the reduced Supplemental Retirement Allowance which would have been payable to the Deceased Participant or Deceased Retired Participant had he elected to receive a Supplemental Joint and Survivor Allowance. Payment of the Supplemental Survivor Income Benefit Allowance to the Spouse of a Deceased Participant or Deceased Retired Participant who is eligible for such benefit under Article II, B hereof shall be payable at the time set forth in Article II, D(4) hereof.

(kk) "Supplemental Survivor Income Benefit Plan" shall mean the Philip Morris Survivor Income Benefit Equalization Plan, effective as of January 1, 1985 and as amended from time to time.

(ll) "Survivor Income Benefit Plan" shall mean the Philip Morris Survivor Income Benefit Plan, effective as of February 1, 1974 and as amended from time to time.

(mm) "Vested Retirement Allowance" shall mean the Retirement Allowance payable pursuant to Article II, A(6) of the PM Retirement Plan, provided, however, that a Participant who is only eligible for a Vested Retirement Allowance may be deemed to be eligible for an Early Retirement Allowance for any and all purposes of this Plan if in accordance with his designation as a Participant in the Plan.

As used in this Plan, the masculine pronoun shall include the feminine and the feminine pronoun shall include the masculine unless otherwise specifically indicated.

ARTICLE II

SUPPLEMENTAL RETIREMENT ALLOWANCES

A. Supplemental Retirement Allowances payable under this Plan shall be as follows:

(1) A Participant may be granted one or more of the following Supplemental Retirement Allowances under the Plan:

(a) A Supplemental Retirement Allowance in an amount determined by using the formula for calculating the Participant's Retirement Allowance under the PM Retirement Plan, but, subject to the limitations of Subparagraph (2) hereof, crediting Accredited Service in addition to that credited to the Participant pursuant to the PM Retirement Plan in recognition of previous service by the Participant deemed to be of special value to the Company or his Participating Company;

(b) A Supplemental Retirement Allowance in an amount equal to (i) a stated dollar amount per year, or (ii) a stated percentage of not more than sixty (60) percent of the Participant's Five-Year Average Compensation, or (iii) the Participant's Retirement Allowance under the PM Retirement Plan, which Supplemental Retirement Allowance accrues at a rate as a percentage of the Participant's Five-Year Average Compensation which is greater than the rate of accrual under the PM Retirement Plan, such Supplemental Retirement Allowances to be calculated in individual instances on the basis of specific instructions which may depart only for such purpose from the terms, conditions and requirements of the PM Retirement Plan; or

(c) A Supplemental Retirement Allowance in an amount determined by using the formula for calculating the Participant's Retirement Allowance under the PM Retirement Plan, such Supplemental Retirement Allowance to be payable on and after the Participant's retirement in an amount which is greater than the Retirement Allowance otherwise payable to the Participant at such age.

(2) If a Supplemental Retirement Allowance under Subparagraph (1) hereof is determined pursuant to a formula in the PM Retirement Plan using the Participant's Compensation (including awards under incentive compensation plans of the Company), the aggregate number of years of Accredited Service used in calculating the amount of the Participant's Supplemental Retirement Allowance under this Plan shall not exceed thirty-five (35) years.

(3) The name of each Participant and the Supplemental Retirement Allowance awarded to him pursuant to Subparagraph (1) above shall be set forth in Appendix I to the Plan.

B. Supplemental Survivor Allowances, Supplemental Survivor Income Benefit Allowances and Supplemental Optional Payment Allowances payable to the Spouse or beneficiary of certain Deceased Participants and Deceased Retired Participants shall be as follows:

(1) (a) If a Deceased Participant has died prior to date he would have attained the age of sixty-five (65) years, his Spouse shall be eligible to receive a Supplemental Survivor Allowance determined in accordance with the applicable provisions of Article II, A(1) of this Plan.

(b) If a Deceased Participant who is eligible for a Supplemental Retirement Allowance under Subparagraphs (a), (b)(iii) or (c) of Article II, A (1) has died prior to date he would have attained the age of sixty-five (65) years and has (or is deemed to have) completed five (5) or more years of Accredited Service, his Spouse shall be eligible to receive a Supplemental Survivor Income Benefit Allowance determined in accordance with Subparagraphs
(a), (b)(iii) or (c) of Article II, A(1) as applicable to such Deceased Participant, assuming such Deceased Participant had continued in the employ of his Participating Company until the age of sixty-five (65) years, that his compensation (as defined in the Survivor Income Benefit Plan) for all periods of time subsequent to his death and until age sixty-five (65) had been his compensation as in effect immediately prior to his death and that the Deceased Participant died the day after attaining the age of sixty-five (65) years, reduced by the amount of any Supplemental Survivor Allowance payable pursuant to Subparagraph (a) hereof.

(2) If a Deceased Participant has died after attaining the age of sixty-five (65) years his Spouse shall be eligible to receive a Supplemental Survivor Allowance determined in accordance with the applicable provisions of Article II, A(1) hereof.

(3) (a) The Spouse of a Deceased Retired Participant (other than a Deceased Retired Participant who is only eligible for a Vested Retirement Allowance) whose request for an Optional Payment pursuant to Article I(u)(1) hereof has been granted by the Management Committee, but who has died prior to the date his Optional Payment commences to be paid shall be eligible to receive a Supplemental Survivor Allowance determined in accordance with the applicable provisions of Article II, A(1) of this Plan.

(b) The Spouse of a Deceased Retired Participant (other than a Deceased Retired Participant who is only eligible for a Vested Retirement Allowance) who prior to his death commenced to receive an Optional Payment pursuant to Article I(u)(1) hereof shall be eligible to receive a Supplemental Survivor Income Benefit Allowance.

(4) The Spouse of a Deceased Retired Participant who is only eligible for a Vested Retirement Allowance under the PM Retirement Plan but who has died prior to his Benefit Commencement Date shall be eligible to receive a Supplemental Survivor Allowance determined in accordance with the applicable provisions of Article II, A(1) of this Plan.

(5) The beneficiary of a Retired Participant whose request for a Supplemental Optional Payment Allowance in accordance with Article I(ff)(1) hereof has been granted by the Management Committee but who has died after the date of his retirement and prior to the date his Optional Payment commences to be paid shall be eligible to receive that portion of the Supplemental Optional Payment Allowance elected by the Retired Participant which is payable after the death of the Retired Participant.

(6) The beneficiary of a Deceased Participant or Deceased Retired Participant whose request for a Supplemental Optional Payment Allowance described in Article I(ff)(2) hereof has been granted by the Management Committee shall be eligible to receive that portion of the Supplemental Optional Payment Allowance elected by the Deceased Participant or Deceased Retired Participant which is payable after the death of the Deceased Participant or Deceased Retired Participant.

C. Reduction of benefits under the Plan

(1) (a) The Supplemental Retirement Allowance payable to a Retired Participant pursuant to Article II, A hereof shall be reduced by the Actuarial Equivalent of the benefits payable pursuant to any Other Plan to the extent that service used to determine the amount of benefits payable from such Other Plan is also used to calculate the amount of a Retired Participant's Supplemental Retirement Allowance under this Plan and assuming that the Participant elected to receive such benefits in equal monthly payments for his life; provided, however, that (1) in the event the Supplemental Retirement Allowance is paid to the Retired Participant (or his beneficiary) in a Single Sum Payment prior to the Retired Participant's Benefit Commencement Date, such Supplemental Retirement Allowance shall be computed in accordance with the applicable provisions of Paragraph A(1) hereof, as reasonably estimated by the Administrator, reduced by the Actuarial Equivalent of the projected annual amount of benefits payable pursuant to any Other Plan assuming that such benefits are payable to the Retired Participant in equal monthly payments for life and (2) in the event the benefit equalization retirement allowance under the Benefit Equalization Plan is paid to the Retired Participant (or his Spouse or other beneficiary) in a single sum payment (as defined in the Benefit Equalization Plan) prior to the Retired Participant's Benefit Commencement Date, the amount of the reduction to the Participant's Supplemental Retirement Allowance shall be determined in good faith by the Administrator.

(b) Any Supplemental Survivor Allowance or Supplemental Survivor Income Benefit Allowance payable to the Spouse of a Deceased Participant or Deceased Retired Participant pursuant to Article II, B hereof shall be reduced by the Actuarial Equivalent of the maximum benefits for which the Spouse was actually eligible under the Retirement Plan, the Benefit Equalization Plan, the Survivor Income Benefit Plan and the Supplemental Survivor Income Benefit Plan assuming that the Participant elected to receive a Retirement Allowance under the Retirement Plan and a benefit equalization retirement allowance under the Benefit Equalization Plan in equal monthly payments for the life of the Retired Participant.

(c) Any Supplemental Optional Payment Allowance payable to the beneficiary of a Deceased Participant or Deceased Retired Participant pursuant to Article II, B hereof shall be reduced by the Actuarial Equivalent of the benefits payable pursuant to the Retirement Plan and the Benefit Equalization Plan assuming that the Participant had elected to receive such benefits in equal monthly payments for life.

(2) No benefits shall be payable to the Spouse or other beneficiary of a Deceased Retired Participant pursuant to Article II, B hereof, if prior to his death the Deceased Retired Participant received a Single Sum Payment from this Plan or the Single Sum Payment is made after his death to his Spouse or a beneficiary.

D. Notification for Supplemental Retirement Allowances; Commencement and termination of Supplemental Retirement Allowances

(1) An application for a Retirement Allowance, Survivor Allowance or optional form of benefit under the PM Retirement Plan shall be deemed notification to the Administrator that payment of a Supplemental Retirement Allowance or other benefit is to be made or commence to be made to the Retired Participant, Spouse or other beneficiary in accordance with the terms of the Plan. In the event the Participant shall not have elected an Optional Payment method with respect to his Supplemental Retirement Allowance, any such notification shall specify the beneficiary to whom payment of the Single Sum Payment shall be made in the event the Participant dies after the date of retirement and prior to the date the Single Sum Payment is made, provided, that if the Participant shall fail to designate a beneficiary or if the beneficiary shall predecease the Participant, the Administrator shall distribute the Single Sum Payment to the duly authorized representative of the former Participant's estate.

(2) (a) A Retired Participant who is eligible for a Full, Deferred or Early Retirement Allowance shall receive his Supplemental Retirement Allowance in a Single Sum Payment no later than sixty (60) days following the Retired Participant's date of retirement (or, if the Retired Participant dies after the date of retirement and before distribution of his Single Sum Payment is made, to his beneficiary as determined pursuant to Subparagraph (1) hereof, in a Single Sum Payment within sixty (60) days following the date of the Retired Participant's death) unless the Participant has elected to have distribution of his Supplemental Retirement Allowance made in accordance with Subparagraph (3) hereof.

(b) The Supplemental Retirement Allowance with respect to an Employee who is only eligible for a Vested Retirement Allowance shall be distributed as an Optional Payment under clauses (1) or (2) of Article I(u) hereof (which Optional Payment shall be in the same form which the Retired Participant's benefits are paid from the PM Retirement Plan) and shall commence on the Participant's Benefit Commencement Date.

(3) A Participant who is eligible to retire on a Full, Deferred or Early Retirement Allowance and whose Supplemental Retirement Allowance is otherwise payable in a Single Sum Payment pursuant to Paragraph D(1) hereof may make application to the Administrator to receive an Optional Payment. The application may be filed prior to the date the Participant is eligible for an Early Retirement Allowance and shall specify the form of Optional Payment, the beneficiary and the date on which the Optional Payment is to commence to be made, which date shall be on or before the first day of the month coincident with or next preceding the Participant's Required Benefit Commencement Date, but in no event shall the Participant's Optional Payment commence to be paid prior to the later of the first day of the month following the first anniversary of the date of the filing of his application with the Administrator or the Participant's Benefit Commencement Date; provided, however, that in the event the Participant incurs a Change in Circumstance on or after the date of the filing of the application and prior to the date his Optional Payment commences to be paid, the Participant may file an application with the Administrator within ninety (90) days of the Change in Circumstance, but in no event later than the date his Optional Payment is to commence, to change the form of Optional Payment or to change the beneficiary who is designated to receive a benefit after the death of the Retired Participant in accordance with the Optional Payment method originally filed with the Administrator; provided, further, that any election to change the form of Optional Payment filed after the date of his retirement and prior to the date his Optional Payment is to commence may only change the form of Optional Payment to one of the forms specified in Article I(u)(1) or (2) hereof. In the case of a Participant who eighteen (18) months prior to attaining the age of sixty-five (65) years could be compulsorily retired by his Participating Company upon attaining the age of sixty-five (65) years pursuant to Section 12(c) of the Age Discrimination in Employment Act, any application to receive an Optional Payment must be filed with the Administrator more than one (1) year preceding the date the Participant attains the age of sixty-five (65) years. The Administrator shall notify the Management Committee of all applications for an Optional Payment. The Management Committee may grant or deny any such application in its sole and absolute discretion. Any such application shall be of no force and effect if (i) the Participant does not retire on a Full, Deferred or Early Retirement Allowance, (ii) the Participant incurs a disability at any time before the date his Optional Payment commences to be paid which causes him to be eligible for benefits under the Philip Morris Long-Term Disability Plan, or (iii) the Participant is retired for ill health, disability or hardship under Article II, A(3)(a) of the PM Retirement Plan, provided that in the event the application is of no force and effect under clauses (ii) or (iii) hereof, payment of the Participant's Supplemental Retirement Allowance shall be made in a Single Sum Payment pursuant to Paragraph D (2)(a) hereof within sixty (60) days of the date of his retirement, but otherwise such application shall be irrevocable and effective on the Participant's retirement on a Full, Deferred or Early Retirement Allowance and the Participant's benefits shall commence on the date specified in the application; provided, however, that (A) if within the one (1) year period following the date of the filing of the application with the Administrator

the Participant's service with any member of the Controlled Group is involuntarily terminated other than by reason of the Participant's death, disability or misconduct (as determined by the Management Committee), such Participant's Optional Payment shall commence to be paid on the Participant's Benefit Commencement Date, or (B) if within the one (1) year period following the date of the filing of the application with the Administrator the Participant voluntarily retires or his employment is terminated for misconduct (as determined by the Management Committee) by any member of the Controlled Group, the Optional Payment shall be reduced as specified in Subparagraph (6) hereof.

(4) The Supplemental Survivor Allowance payable to the Spouse of a Deceased Participant pursuant to Paragraphs B(1)(a) or B(2) hereof or to the Spouse of a Deceased Retired Participant pursuant to Paragraphs B(3)(a) and B(4) above shall commence to be paid on the later of (a) the first day of the calendar month coincident with or next following the date the Deceased Participant or Deceased Retired Participant would have attained the age of fifty-five (55) years, or (b) the first day of the calendar month in which the Deceased Participant or Deceased Retired Participant died, provided that the Spouse may elect in accordance with the provisions of Article II, A(5)(c) or (f) of the PM Retirement Plan, as applicable to the Spouse, that the Supplemental Survivor Allowance shall commence on the first day of any month thereafter, but not later than the first day of the calendar month in which the Deceased Participant or Deceased Retired Participant would have attained his Normal Retirement Age and any such Supplemental Survivor Allowance shall terminate on the first day of the month in which the Spouse dies. The Supplemental Survivor Income Benefit Allowance payable to the Spouse of a Deceased Participant pursuant to Paragraph B(1)(b) above or to the Spouse of a Deceased Retired Participant pursuant to Paragraph B(3)(b) above shall commence and terminate simultaneously with the date on which a survivor income benefit allowance would have been payable to the Spouse pursuant to Article II, A(2)(b) or A(4), as applicable, of the Survivor Income Benefit Plan. The Supplemental Optional Payment Allowance payable to the beneficiary of a Deceased Retired Participant pursuant to Paragraph B(5) hereof or to the beneficiary of a Deceased Participant or Deceased Retired Participant pursuant to Paragraph B(6) above shall commence on the first day of the calendar month following the month in which the Deceased Participant or Deceased Retired Participant died.

(5) (a) Notwithstanding the previous provisions of this Paragraph, the Committee may cause the distribution of the Supplemental Retirement Allowance or other benefit to any group of similarly situated Retired Participants, or Spouses or beneficiaries in a Single Sum Payment or as an Optional Payment.

(b) Notwithstanding the preceding provisions of this Paragraph, the Administrator shall distribute a Participant's Supplemental Retirement Allowance in a Single Sum Payment if the Supplemental Retirement Allowance payable in equal monthly payments is not more than $250.

(6) (a) The Supplemental Retirement Allowance payable to a Retired Participant pursuant to clause (B) of Subparagraph (3) hereof shall be further reduced by one percent (1%) for each month (or portion of a month) by which the month in which the Retired Participant's termination of employment precedes the first anniversary of the filing of the application with the Administrator.

(b) The Supplemental Survivor Allowance of a Spouse of a Deceased Participant or Deceased Retired Participant commencing at an age other than the Deceased Participant's or Deceased Retired Participant's Normal Retirement Age shall be the Actuarial Equivalent of the Supplemental Retirement Allowance payable as a Joint and Survivor Supplemental Allowance at the Deceased Participant's or Deceased Retired Participant's Normal Retirement Age unless otherwise required by Article II, A(1) of the Plan. The Supplemental Optional Payment Allowance payable to the beneficiary of a Deceased Participant or Deceased Retired Participant commencing at an age other than the Deceased Participant's or Deceased Retired Participant's Normal Retirement Age shall be the Actuarial Equivalent of the Supplemental Retirement Allowance payable as a Supplemental Optional Payment Allowance at the Deceased Participant's or Deceased Retired Participant's Normal Retirement Age unless otherwise required by Article II, A(1) of the Plan.

E. Cessation of accruals of Supplemental Retirement Allowance

Any right or claim to any Supplemental Retirement Allowance or other benefit under the Plan which any Participant, Spouse or designated beneficiary may have shall terminate if the Committee shall find that such Participant has been guilty of fraud or dishonesty towards a Participating Company, or has willfully damaged the property of a Participating Company, or has wrongfully disclosed any secret process or imparted any confidential information, or has done any other act materially inimical to the interest of a Participating Company.

ARTICLE III

SUPPLEMENTAL PROFIT-SHARING ALLOWANCES

A Participant may be granted a Supplemental Profit-Sharing Allowance equal to the amount, if any, by which the sum of the Contribution which would have been made to the Profit-Sharing Plan and the amount which would have been credited to his account under the Benefit Equalization Plan had such Participant been eligible to participate in such plans for a plan year, exceeds the amount, if any, of employer contributions (excluding any contributions which the Participant has elected to have an employer make on his behalf pursuant to a cash or deferred arrangement) actually made or credited for the plan year on behalf of such Participant under a defined contribution plan qualified under
Section 401(a) of the Code, an excess benefit plan (as defined in ERISA) and a plan maintained primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees maintained by any other member of the Controlled Group.

Any amounts credited to a Participant's account pursuant to the provisions of this Article III shall be deemed to have been invested in Part C of the Fund under the Profit-Sharing Plan and shall be valued in accordance with the provisions of the Profit-Sharing Plan.

A Retired Participant shall receive his Supplemental Profit-Sharing Allowance in a Single Sum Payment no later than sixty (60) days following the Participant's date of retirement or other termination of employment with the Controlled Group.

ARTICLE IV

FUNDS FROM WHICH ALLOWANCES ARE PAYABLE

An individual account shall be established for the benefit of each Participant (and Spouse or designated beneficiary) under the Plan. The Plan shall be unfunded. All benefits intended to be provided under the Plan shall be paid from time to time from the general assets the Participant's Participating Company and paid in accordance with the provisions of the Plan; provided, however, that the Participating Companies reserve the right to meet the obligations created under the Plan through one or more trusts or other arrangements. The contributions by each Participating Company on behalf of its Participants to the individual accounts established under the Plan, whether in trust or otherwise, shall be in an amount which such Participating Company and the Management Committee, with the advice of an actuary, determines to be sufficient to provide for the payment of the benefits under the Plan. No Participant, Spouse or designated beneficiary shall, unless the Plan expressly provides otherwise, have any right or claim whatsoever to any specific assets of a Participating Company or of any trust.

Each Participating Company shall maintain such reserves on its books with respect to Participants who are employed by such Participating Company as determined by the actuary for the Plan.

ARTICLE V

APPLICABILITY OF PROVISIONS OF PM RETIREMENT PLAN AND SURVIVOR INCOME BENEFIT PLAN

Except as expressly provided to the contrary, all of the provisions, conditions and requirements set forth in the PM Retirement Plan and where applicable, the Survivor Income Benefit Plan, with respect to eligibility for and payment of benefits thereunder shall be equally applicable to the granting of Supplemental Retirement Allowances and other benefits to Participants and Beneficiaries pursuant to this Plan and the payment thereof pursuant to the provisions of Article III hereof. Whenever a Participant's rights under this Plan are to be determined, appropriate reference shall be made to the PM Retirement Plan.

ARTICLE VI

ADMINISTRATION

The Committee, the Management Committee and the Administrator shall be responsible for the general administration of the Plan. The appropriate Fiduciary shall have full authority to determine all questions arising in connection with the Plan; provided, however, that any Fiduciary who makes a request for payment of a Supplemental Retirement Allowance in accordance with a form of distribution authorized under the Retirement Plan shall excuse himself from any and all deliberations and decisions in connection with such request. Decisions of the appropriate Fiduciary shall be conclusive and binding on all persons.

The Fiduciaries may employ and rely on actuaries, legal counsel, accountants and agents as they deem advisable.

ARTICLE VII

CERTAIN RIGHTS AND LIMITATIONS

A. No benefit under the Plan shall be subject in any manner to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance, or charge, and any attempt to do so shall be void; nor shall any benefit be in any manner liable for or subject to the debts, contracts, liabilities, engagements, or torts of the person entitled to such benefit. In the event that the Administrator shall find that any Participant, Retired Participant or Spouse or other beneficiary under the Plan has become bankrupt or that any attempt has been made to anticipate, alienate, sell, transfer, assign, pledge, encumber, or charge any of his benefits under the Plan, then such benefits shall cease and determine, and in that event, the Administrator shall hold or apply the same to or for the benefit of such Participant, Retired Participant, Spouse or other beneficiary or apply the same to or for the benefit of such Participant, Retired Participant, Spouse or other beneficiary, in such manner as the Administrator may deem proper.

B. Except as otherwise expressly provided in the Plan, Supplemental Retirement Allowances and other benefits shall be payable only if the Participant meets all of the requirements for benefits under the Plan.

ARTICLE VIII

AMENDMENT AND TERMINATION OF THE PLAN

A. The Board may, by resolution, from time to time and at any time, amend or modify, in whole or in part, any and all of the provisions of the Plan; provided, however, that authority to amend the Plan is delegated to the following Fiduciaries where approval of the Plan amendment (or amendments) by the shareholders of Philip Morris Companies Inc. is not required: (1) to the Committee, if the amendment (or amendments) will not increase the annual cost of the Plan by $10,000,000, (2) to the Management Committee, if the amendment (or amendments) will not increase the annual cost of the Plan by $4,000,000, and (3) to the Administrator, if the amendment (or amendments) will not increase the annual cost of the Plan by $500,000; provided, further, that no such amendment or modification shall adversely affect the rights of any Participant, Retired Participant, Spouse or beneficiary to benefits accrued at the time such amendment or modification is adopted or becomes effective, whichever is later.

B. (1) The Board may terminate the Plan for any reason at any time, provided that such termination shall not adversely affect the rights of any Participant, Retired Participant, Spouse or beneficiary to benefits accrued to the date of termination.

(2) In the event the Plan is terminated, each Participant, whether or not such Participant is eligible to receive benefits under this Plan, shall be immediately and fully vested in the benefits set forth in Article II accrued to the date of termination of the Plan. Payment of any such benefits shall be made or commence to be made at the time such Participant (or his Spouse or designated beneficiary) meets, under the terms of the Plan at the time of its termination, the requirement for payment of benefits under the Plan.

C. Notwithstanding any other provision of the Plan to the contrary, in the event of a Change of Control of the Company, each Participant shall immediately be fully vested in the benefits set forth in Article II which have accrued through the date of the Change of Control and, upon the Change of Control, each Participant (or his Spouse or designated beneficiary) shall be entitled to a Single Sum Payment in an amount which is the Actuarial Equivalent of such accrued benefits, which amount shall be paid within 30 days of the Change of Control.

EXHIBIT A

SUPPLEMENTAL MANAGEMENT EMPLOYEES' RETIREMENT PLAN
OF PHILIP MORRIS COMPANIES INC.
ACTUARIAL ASSUMPTIONS USED TO CALCULATE A SINGLE SUM PAYMENT

INTEREST RATE: Average of the interest rates established by the Pension Benefit Guaranty Corporation to value immediate annuities in the case of a plan termination for the 24 months preceding the Participant's date of retirement, less 1/2 of 1%.

MORTALITY ASSUMPTION: UP-1894 Unisex Mortality Table

Management's Discussion and Analysis of
Financial Condition and Results of Operations

Consolidated Operating Results--Operating Revenues

(in millions)	1996	1995	1994
Tobacco	$36,549	$32,316	$28,671
Food	27,950	29,074	31,669
Beer	4,327	4,304	4,297
Financial services and real estate	378	377	488
Operating revenues	$69,204	$66,071	$65,125

Consolidated Operating Results--Operating Income

(in millions)	1996	1995	1994
Tobacco	$ 8,263	$ 7,177	$ 6,162
Food	3,362	3,188	3,108
Beer	437	444	413
Financial services and real estate	192	164	208
Operating profit	12,254	10,973	9,891
Unallocated corporate expenses	(485)	(447)	(442)
Operating income	$11,769	$10,526	$ 9,449

1996 Compared with 1995

Operating revenues for 1996 increased $3.1 billion (4.7%) and operating profit increased $1.3 billion (11.7%) over 1995. Operating profit, as defined for segment reporting purposes, is operating income before unallocated corporate expenses. Operating revenues increased in 1996 over 1995 due primarily to increases in tobacco revenues, partially offset by the impact of divestitures of food businesses. Operating profit increased in 1996 over 1995 due primarily to increases in the tobacco and food segments.

Excluding the results of divested North American food businesses (discussed below in Food--Business Environment), operating revenues and operating profit in 1996 increased $5.2 billion (8.1%) and $1.4 billion (12.9%), respectively, over 1995.

Currency movements, primarily the strengthening of the U.S. dollar versus the Japanese yen, decreased operating profit by $116 million in 1996. Although the Company cannot predict future movements in currency rates, it anticipates that the continued strength of the U.S. dollar versus the Japanese yen and European currencies will have an unfavorable impact on operating profit in 1997.

Interest and other debt expense, net, decreased $93 million (7.9%) compared to 1995, due primarily to a lower average interest rate on outstanding debt and higher interest income in 1996.

Excluding the cumulative effect of accounting changes discussed below, earnings per share of $7.68 in 1996 increased by 18.0% over 1995, due to higher net earnings and lower shares outstanding. As a result of the Company's share repurchase program, the weighted average number of shares outstanding decreased to 821 million in 1996 from 842 million in 1995.

In 1996, the American Institute of Certified Public Accountants' Accounting Standards Executive Committee issued Statement of Position No. 96-1, "Environmental Remediation Liabilities," which, as required, was adopted by the Company as of January 1, 1997. The effect of adoption will not be material to the Company's 1997 results of operations or financial position.

1995 Compared with 1994

Operating revenues for 1995 increased $946 million (1.5%) over 1994, primarily due to increases in tobacco revenues, partially offset by the impact of divestitures of food businesses. Operating profit increased $1.1 billion (10.9%), reflecting increases in all consumer products business segments. Currency movements, primarily the Japanese yen and German mark, increased operating profit by $213 million in 1995. Excluding the results of divested food businesses (discussed below), operating revenues and operating profit increased $5.1 billion (8.7%) and $1.2 billion (13.0%), respectively, over 1994.

Interest and other debt expense, net, decreased $54 million (4.4%) in 1995, due primarily to lower average outstanding debt during the year, partially offset by higher average commercial paper rates.

Effective January 1, 1995, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 116, "Accounting for Contributions Received and Contributions Made." This Statement requires the Company to recognize an unconditional promise to make a contribution as an expense in the period the promise is made. The Company had previously expensed contributions when payment was made.

The cumulative effect at January 1, 1995 of adopting SFAS No. 116 reduced 1995 net earnings by $7 million ($.01 per share). The application of SFAS No. 116 did not materially reduce 1995 earnings before cumulative effect of accounting changes.

Effective January 1, 1995, the Company adopted SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," for non-U.S. postretirement benefits other than pensions. The cumulative effect at January 1, 1995 of adopting SFAS No. 106, for the non-U.S. plans, reduced 1995 net earnings by $21 million ($.02 per share). However, application of SFAS No. 106 for non-U.S. employees during the year ended December 31, 1995 did not materially reduce earnings before cumulative effect of accounting changes.

Excluding the 1995 cumulative effect of accounting changes discussed above, net earnings increased by $753 million (15.9%) in 1995, primarily due to increased operating profit ($1.1 billion), which was partially offset by a higher income tax provision ($378 million).

Excluding the 1995 cumulative effect of accounting changes discussed above, earnings per share increased by 19.4% in 1995, due to a 15.9% increase in net earnings to $5.5 billion and fewer shares outstanding. As a result of the Company's share repurchase program, the weighted average number of shares outstanding decreased to 842 million in 1995 from 867 million in 1994.

1993 Restructuring

In the fourth quarter of 1993, the Company provided for the restructuring of its worldwide operations to reduce its cost structure and to improve its future growth, profitability and cash flow. The charge related primarily to the downsizing or closure of approximately 40 manufacturing and other facilities. This restructuring charge reduced 1993 earnings before income taxes, net earnings and earnings per share by $741 million, $457 million and $.52, respectively. Included in this charge were asset write-downs of $429 million, with the remainder of the charge representing anticipated cash expenditures to be funded with cash provided by operating activities. During 1996, 1995 and 1994, the Company expended approximately $300 million in connection with this program. The estimate of planned annual after-tax savings by year-end 1997 is approximately $500 million.

Effective January 1, 1993, the Company adopted SFAS No. 112 "Employers' Accounting for Postemployment Benefits." The liability established upon adoption was sufficient to provide for costs associated with workforce reductions contemplated by the 1993 restructuring.

Operating Results by Business Segment

Tobacco

Business Environment

The tobacco industry, including Philip Morris Incorporated ("PM Inc."), the Company's domestic tobacco subsidiary, and Philip Morris International Inc. ("PMI"), the Company's international tobacco subsidiary, have faced, and continue to face, a number of issues which may adversely affect volume, operating revenues and operating profit.

In the United States, these issues include proposed federal regulatory controls (including, as discussed below, the issuance of final regulations by the United States Food and Drug Administration (the "FDA") which purport to regulate tobacco products as "medical devices"); actual and proposed excise tax increases; new and proposed federal, state and local governmental and private restrictions on smoking (including proposals to ban or restrict smoking in workplaces and in buildings permitting public access); new and proposed restrictions on tobacco manufacturing, marketing, advertising (including decisions by certain companies to limit or not accept tobacco advertising) and sales; new and proposed legislation and regulations to require substantial additional health warnings on cigarette packages and in advertising, and to eliminate the tax deductibility of tobacco advertising and promotional costs; actual and proposed requirements regarding disclosure of cigarette ingredients and other proprietary information; increased assertions of adverse health effects associated with both smoking and exposure to environmental tobacco smoke ("ETS"); legislation or other governmental action seeking to ascribe to the industry responsibility and liability for the purported adverse health effects associated with both smoking and exposure to ETS; the diminishing social acceptance of smoking; increased pressure from anti-smoking groups; unfavorable press reports; governmental and grand jury investigations; private plaintiff class action litigation; and actions brought primarily by states and local governments seeking Medicaid and health care reimbursement and existing and proposed laws to help facilitate such recoveries.

In August 1996, the FDA issued final regulations purportedly designed to reduce youth smoking. In the regulations, the FDA purports to exercise jurisdiction over nicotine as a "drug" and over cigarettes as a "medical device" (a "nicotine delivery system") under the provisions of the Food, Drug and Cosmetic Act. The final regulations include severe restrictions on the distribution, marketing and advertising of cigarettes and would require the industry to comply with a wide range of labeling, reporting, recordkeeping, manufacturing and other requirements applicable to medical devices and their manufacturers. For the most part, the regulations are scheduled to become effective on August 28, 1997. The FDA's exercise of jurisdiction, if not reversed by judicial or legislative action, could lead to more expansive FDA-imposed restrictions on cigarette operations than those set forth in the final regulations and could adversely affect the volume, operating revenues and operating profit of PM Inc. in amounts that cannot be determined. PM Inc. and other domestic cigarette manufacturers and an advertising firm have sued the FDA, seeking a judicial declaration that the FDA has no authority to regulate cigarettes and asking the court to permanently enjoin the FDA from enforcing its regulations. Similar suits have been filed against the FDA by manufacturers of smokeless tobacco products, by a trade association of cigarette retailers and by advertising agency associations. A hearing on plaintiffs' motion for summary judgment was held on February 10, 1997. The outcome of the litigation challenging the FDA regulations cannot be predicted.

In August 1996, the Commonwealth of Massachusetts enacted legislation that would require cigarette manufacturers to disclose the flavorings and other ingredients used in each brand of cigarettes sold in the Commonwealth, and to provide "nicotine-yield ratings" for their products based on standards to be established by the Massachusetts Department of Public Health. PM Inc. believes that enforcement of the statute, which is scheduled to take effect on July 1, 1997, could require the disclosure of valuable proprietary information concerning its brands. PM Inc. and three other domestic cigarette manufacturers have filed suit in federal district court in Boston challenging the legislation as being preempted by the Federal Cigarette Labeling and Advertising Act (the "Labeling Act") and as violating the commerce, full faith and credit, due process and takings clauses of the U.S. Constitution. In February 1997, the court ruled on summary judgment motions that the Labeling Act does not preempt the requirement that ingredient information be provided to the Commonwealth. The plaintiffs intend to appeal that decision and will continue to assert their other constitutional claims. The ultimate outcome of this lawsuit cannot be predicted. The enactment of this legislation has encouraged, and continues to encourage, efforts in other states to enact similar legislation. The Department of Public Health has proposed

regulations to implement the Massachusetts legislation, and has invited public comment on the proposed regulations. PM Inc. and three other domestic cigarette manufacturers filed comments objecting to the proposed regulations. Final regulations have not been issued.

In June 1995, PM Inc. announced that it had voluntarily undertaken a program to limit minors' access to cigarettes. Elements of the program include discontinuing free cigarette sampling to consumers in the United States, discontinuing the distribution of cigarettes by mail to consumers in the United States, placing a notice on cigarette cartons and packs for sale in the United States stating "Underage Sale Prohibited," working with others in support of state legislation to prevent youth access to tobacco products, taking measures to encourage retailer compliance with minimum-age laws, and independent auditing of the program.

In May 1996, PM Inc. proposed that comprehensive federal legislation be enacted to respond to concerns by the President and others regarding the use of tobacco products by minors. The proposed legislation would establish a federal minimum age of 18 for the sale of tobacco products and would ban, restrict or otherwise limit the following, among other things: cigarette vending machines; tobacco product brand names, logos, characters and selling messages displayed on non-tobacco-related items such as hats or T-shirts; tobacco product sponsorship of events with significant youth audiences; outdoor advertisements for tobacco products within 1,000 feet of any playground or elementary or secondary school, including outward-facing window display advertising; advertisements for tobacco products in or on trains, buses, subways and taxis, and in terminals, stations, platforms or stops for these vehicles; and advertisements for tobacco products in youth-oriented publications. The proposed legislation would restrict youth access to tobacco products by calling for a ban on the sale of single cigarettes or packs with fewer than 20 cigarettes; requiring all tobacco sales to be face-to-face, where proof of age can be verified for anyone appearing to be under age 21; mandating that tobacco products in retail establishments be displayed within the control or line of sight of an employee; banning sampling except in locations where minors are denied access; and requiring retailers and their employees to certify that they understand and will comply with minimum-age laws. To ensure compliance, the proposed legislation calls for penalties of up to $50,000 for violations by a tobacco manufacturer. The proposed legislation also calls for a $250 million contribution from the tobacco industry (based on market share) over a five-year period to assist the government and others in implementation and enforcement. The proposed legislation, which as of yet has not been introduced in either house of Congress, would preclude the FDA from regulating tobacco products.

Some foreign countries have also taken steps to restrict or prohibit cigarette advertising and promotion, to require ingredient disclosure, to impose maximum constituent levels, to increase taxes on cigarettes, to control prices, to restrict imports, to ban or severely restrict smoking in workplaces and public places, and to otherwise discourage cigarette smoking.

It is not possible to predict what, if any, other foreign or domestic governmental legislation or regulations will be adopted relating to the manufacturing, advertising, sale or use of cigarettes or to the tobacco industry generally.

As further discussed in Note 13 to the Consolidated Financial Statements, there is litigation pending in various jurisdictions related to tobacco products. These cases generally fall within three categories: (i) smoking and health cases alleging personal injury brought on behalf of individual smokers,
(ii) smoking and health cases alleging personal injury and purporting to be brought on behalf of a class of plaintiffs, and (iii) health care cost recovery actions brought primarily by states and local governments seeking reimbursement for Medicaid and other health care expenditures allegedly caused by cigarette smoking.

In the individual and class action smoking and health cases pending against PM Inc. and, in some cases, the Company and/or certain of its other subsidiaries, plaintiffs allege "addiction" to cigarette smoking, personal injury resulting from cigarette smoking and/or personal injury resulting from exposure to ETS and seek compensatory and, in some cases, punitive damages in amounts ranging into the billions of dollars. During the past two years, there has been a substantial increase in the number of such smoking and health cases in the United States, with a majority of the new cases having been filed in Florida on behalf of individual plaintiffs. As of December 31, 1996, there were 185 smoking and health cases filed and served on behalf of individual plaintiffs in the United States against PM Inc. and, in some cases, the Company, compared to 115 such cases as of December 31, 1995, and 84 such cases as of December 31, 1994. One hundred twenty-two of the cases filed and served as of December 31, 1996, were filed on behalf of individual plaintiffs in the state of Florida. Ten of the individual cases involve allegations of various personal injuries allegedly related to exposure to ETS.

In addition to the foregoing individual smoking and health cases, as of January 27, 1997, there were 17 purported smoking and health class actions pending in the United States against PM Inc. and, in some cases, the Company, including one that involves allegations of various personal injuries related to exposure to ETS. Twelve of these actions purport to constitute state-wide class actions and were filed after the Fifth Circuit Court of Appeals, in the Castano case discussed in Note 13 to the Consolidated Financial Statements, reversed a federal district court's certification of a purported nation-wide class action on behalf of persons who were allegedly addicted to tobacco products. Further state-wide class actions have been threatened. One purported smoking and health class action is pending in Canada and another in Brazil against affiliates of the Company. In California, individuals and local governments and other organizations purportedly acting as "private attorneys general" have filed suits seeking, among other things, injunctive relief, restitution and disgorgement of profits for alleged violations of California's consumer protection statutes. As of January 27, 1997, 26 health care cost recovery actions were pending. Other states and local government entities have announced that they are considering filing health care cost recovery actions.

The Company and each of its subsidiaries named as a defendant believe, and each has been so advised by counsel handling the respective cases, that it has a number of valid defenses to all litigation pending against it. All such cases are, and will continue to be, vigorously defended. It is not possible to predict the outcome of this litigation. Litigation is subject to many uncertainties, and it is possible that some of these actions could be decided unfavorably. An unfavorable outcome of a pending smoking and health case, such as the Carter case discussed in Note 13 to the Consolidated Financial Statements, could encourage the commencement of additional similar litigation. There have also been a number of adverse legislative, regulatory, political and other developments concerning cigarette smoking and the tobacco industry. These developments generally receive widespread media attention. The Company is not able to evaluate the effect of these developing matters on pending litigation and the possible commencement of additional litigation.

Management is unable to make a meaningful estimate of the amount or range of loss that could result from an unfavorable outcome of all pending litigation. It is possible that the Company's results of operations or cash flows in a particular quarterly or annual period or its financial position could be materially affected by an ultimate unfavorable outcome of certain pending litigation. Management believes, however, that the ultimate outcome of all pending litigation should not have a material adverse effect on the Company's financial position.

During 1996, press reports discussed proposals to forge a comprehensive legislative solution to smoking and health claims against the tobacco industry. The Company believes that any such legislation would involve significant, and perhaps insurmountable, difficulties in reconciling the views of many competing interests. However, the Company will explore all reasonable measures that may be in the best interests of its shareholders.

Tobacco--Operating Revenues

(in millions)	1996	1995	1994
Domestic tobacco	$12,462	$11,493	$11,110
International tobacco	24,087	20,823	17,561
Total	$36,549	$32,316	$28,671

Tobacco--Operating Profit

(in millions)	1996	1995	1994
Domestic tobacco	$ 4,206	$ 3,740	$ 3,302
International tobacco	4,078	3,453	2,877
Amortization of goodwill	(21)	(16)	(17)
Total	$ 8,263	$ 7,177	$ 6,162

1996 Compared with 1995

Domestic tobacco. PM Inc.'s 1996 operating revenues increased 8.4% over 1995, due to higher volume ($465 million, including excise taxes), pricing ($414 million) and improved product mix ($90 million). 1996 operating profit increased 12.5% over 1995, due primarily to price increases, net of product cost increases ($362 million), higher volume ($289 million), improved product mix ($75 million) and lower fixed manufacturing expense ($82 million, due primarily to the costs of a product recall in 1995), partially offset by higher marketing, administration and research expense ($342 million).

PM Inc.'s 1996 shipment volume was 230.8 billion units, an increase of 4.1% over 1995, compared with an industry increase of 0.4%. Industry volume increased due to two extra shipping days in 1996 and distributor buying patterns. While PM Inc. cannot predict future growth rates, it believes that, over the long term, industry shipments will continue to decline in line with their historical average decline of 1% to 2% per annum.

Based on shipments, the premium and discount segments accounted for approximately 71.6% and 28.4%, respectively, of domestic cigarette industry volume in 1996, versus approximately 70.0% and 30.0%, respectively, in 1995, reflecting a continued shift to the higher margin premium segment, which began in the second half of 1993.

PM Inc.'s 1996 shipment market share was 47.8%, an increase of 1.7 share points from 1995. In the premium segment, PM Inc.'s volume increased 6.3%, compared with a 2.7% increase for the industry, resulting in a premium segment share of 56.3%, an increase of 1.9 share points from 1995. Marlboro volume increased 11.3 billion units (7.8%) for a 32.3% share of the total industry, an increase of 2.2 share points from 1995. In the discount segment, PM Inc.'s shipments decreased 6.3%, to 36.0 billion units in 1996 compared with an industry decline of 4.9%, resulting in a discount segment share of 26.2%, a decrease of 0.4 share points from 1995.

Retail sales data (compiled by the A.C. Nielsen Company) indicate PM Inc. and Marlboro market shares of 49.4% and 33.3%, respectively, in 1996, compared with 47.3% and 30.7%, respectively, in 1995. The retail market share for PM Inc.'s other premium brands as a group was 9.0% in 1996, up slightly from 1995. In the discount segment, Basic increased its segment share of retail sales to 17.4%, an increase of 1.6 share points from 1995.

PM Inc. cannot predict future change or rates of change in the relative sizes of the premium and discount segments or in PM Inc.'s shipments, market share (based on shipments) or retail market share.

During the second quarter of 1996, PM Inc. implemented a price increase of $2.00 per thousand cigarettes on its domestic premium and discount brands. PM Inc. previously increased the price of its domestic brands by $1.50 per thousand cigarettes in the second quarter of 1995.

International tobacco. PMI's 1996 operating revenues increased 15.7%, due primarily to higher foreign excise taxes ($1.6 billion, including those for previously unconsolidated and newly acquired subsidiaries), favorable volume/mix ($1.1 billion), pricing ($469 million), and the impact of previously unconsolidated and newly acquired subsidiaries ($390 million, excluding excise taxes), partially offset by unfavorable currency movements ($287 million). Operating profit increased 18.1%, due primarily to favorable volume/mix ($506 million) and price increases, net of higher costs ($297 million) and the impact of previously unconsolidated and newly acquired subsidiaries ($22 million), partially offset by unfavorable currency movements ($128 million) and higher marketing and administration costs.

PMI's volume grew 67.1 billion units (11.3%) in 1996 over 1995 to 660.2 billion units, including local brands manufactured by Zaklady Przemyslu Tytoniowego w Krakowie S.A., a Polish cigarette manufacturer in which PMI acquired a controlling interest in February 1996. Excluding this acquisition, PMI's overall volume grew 8.4%, which continued to be driven in part by the expanding market of Eastern Europe. Although PMI cannot predict future growth rates, it anticipates an eventual return to its historic level of annual growth of 5% to 7%. In January 1997, PMI purchased a controlling interest in Tabaqueira, Portugal's formerly state-owned tobacco company. The acquisition will favorably impact volume in 1997.

Volume advanced in most major markets, including Germany, Italy, the Netherlands, Belgium, Spain, Central and Eastern Europe, Turkey, the Middle East, Japan, Korea, Singapore, the Philippines and Argentina. In Australia, PMI's volume was lower, following the unusually high levels reached during the 1995 price war. Volume and share continued to decline in Mexico, due to economic conditions and retail price increases. In Brazil, PMI lost volume and share due to intense competition.

PMI's market shares rose in most major markets, with increases recorded in Germany, Italy, France, the Netherlands, Belgium, Spain, Switzerland, Turkey, Japan, Korea, Hong Kong, Singapore, the Philippines and Argentina.

1995 Compared with 1994

Domestic tobacco. During 1995, PM Inc.'s operating revenues increased 3.4% from 1994, due primarily to pricing ($174 million), volume ($120 million) and improved product mix ($83 million). Operating profit for 1995 increased 13.3% from 1994, due primarily to pricing ($174 million), volume ($73 million), improved product mix ($76 million), lower marketing, administration and research costs ($60 million) and lower fixed manufacturing expense in 1995, partially offset by the costs from a product recall in 1995.

PM Inc.'s shipment volume for 1995 was 221.8 billion units, an increase of 1.1% over 1994, compared with an industry decline of 1.7% during 1995. The premium and discount segments accounted for approximately 70.0% and 30.0%, respectively, of domestic cigarette industry shipment volume in 1995, versus approximately 67.5% for the premium segment and 32.5% for the discount segment in 1994, continuing the shift toward the premium segment that began in the second half of 1993.

PM Inc.'s shipment market share for 1995 was 46.1%, an increase of 1.3 share points over 1994. In the premium segment, volume in PM Inc.'s brands increased 3.5%, compared with a 1.9% increase for the industry, resulting in a premium segment share of 54.5%, an increase of 0.9 share points from 1994. Marlboro volume was up 7.1 billion units (5.2%) for a 30.1% share of the total industry, an increase of 2.0 share points from 1994. In the discount segment, PM Inc.'s shipments decreased 9.1%, to 38.5 billion units, in 1995 compared with an industry decline of 9.2%, resulting in a discount segment share of 26.6%, an increase of 0.1 share points from 1994.

Retail sales data (compiled by the A.C. Nielsen Company), indicate PM Inc. and Marlboro market shares of 47.3% and 30.7%, respectively, in 1995, compared with 46.2% and 28.6%, respectively, in 1994. The retail market share for PM Inc.'s other premium brands as a group was 8.9% in 1995, unchanged from 1994. In the discount segment, Basic increased its segment share of retail sales 1.3 points, to 15.8%, in 1995.

International tobacco. During 1995, operating revenues of PMI increased 18.6%, due primarily to higher foreign excise taxes ($1.6 billion), favorable currency movements ($708 million), higher volume/mix ($713 million) and price increases ($264 million). Operating profit increased 20.0% due primarily to higher volume/mix ($338 million), price increases ($264 million) and favorable currency movements ($210 million), partially offset by higher marketing, administration and research costs ($264 million).

PMI's volume grew 57.2 billion units (10.7%) in 1995 to 593.2 billion units. Volume advanced in most major markets, including Germany, Italy, Spain, the Netherlands, Belgium, Central and Eastern Europe, Turkey, the Middle East, Japan, Korea, the Philippines, Australia and Argentina. In Eastern Europe, which includes parts of the former Soviet Union, PMI's volume climbed 54%. This emerging market has in part driven PMI's volume growth to double its historic growth level. Volume declined in France, due to tax-driven price increases; in Mexico, due to continued poor economic conditions; and in Brazil, due to competition. Importantly, however, volume and market share for Marlboro increased in France and Brazil.

PMI's market shares reached record levels in most major international markets, with strong gains in Germany, Italy, the Netherlands, Belgium, Spain, the Czech and Slovak Republics, Turkey, Japan, Korea, Hong Kong, Singapore, Australia and Argentina.

Food

Business Environment

Several steps have been taken in recent years to build the value of premium brands, reduce costs and increase profitability in the Company's food businesses. During 1995, the North American food business was reorganized to combine the operations of Kraft USA and General Foods USA. The combined organization, named Kraft Foods, Inc. ("Kraft"), has streamlined operations and improved effectiveness and customer response. Also in 1995, the international food business, Kraft Foods International, Inc. ("KFI"), was realigned to capitalize on future growth opportunities and reorganized into separate regional units: Western Europe; Northern Europe; Central and Eastern Europe, Middle East and Africa; and Asia/Pacific.

During 1995 and 1996, Kraft and KFI realigned their portfolios of businesses to focus on higher-margin premium products. During 1995, Kraft sold its bakery, North American margarine, specialty oils, marshmallows, caramels and Kraft Foodservice distribution businesses. In addition, KFI sold several smaller international food businesses. During 1996, Kraft sold its bagel business and KFI sold several non-strategic businesses (including margarine businesses in the U.K. and Italy) at net gains of $320 million. In addition, Kraft and KFI initiated cost saving programs that included downsizing facilities and increased severance for workforce reductions. The cost of these actions substantially offset the gains from businesses sold. Kraft also acquired the Taco Bell grocery and Del Monte shelf-stable pudding businesses during 1996 and 1995, respectively. In Latin America, where certain subsidiaries and affiliates of PMI manufacture and market a wide variety of food products, PMI acquired nearly all of the remaining voting shares of Industrias de Chocolate Lacta S.A. ("Lacta"), a Brazilian chocolate confectionery company, in the second quarter of 1996.

The North American and international food businesses have been and will continue to be affected by green coffee bean price volatility. Throughout 1995, green coffee bean prices were volatile, significantly affecting consumer buying patterns and leading to intense price competition among coffee companies in some markets. In 1996, intense competition continued as green coffee bean prices declined. The green coffee bean price decline lowered 1996 operating revenues as prices charged to consumers were reduced. Kraft was also affected by record high cheese commodity costs, as well as other higher dairy commodity costs, arising from low U.S. milk production. The increased commodity costs have led to higher prices charged to consumers. Additionally, Kraft's cereal business was affected by intense price competition, particularly from private label brands. In response, Kraft implemented price reductions and simplified couponing of its cereal products in the second quarter of 1996. Several competitors followed with similar pricing strategies.

Food--Operating Revenues

(in millions)	1996	1995	1994
North American food	$16,447	$17,891	$21,556
International food	11,503	11,183	10,113
Total	$27,950	$29,074	$31,669

Food--Operating Profit

(in millions)	1996	1995	1994
North American food	$ 2,628	$ 2,542	$ 2,539
International food	1,303	1,218	1,153
Amortization of goodwill	(569)	(572)	(584)
Total	$ 3,362	$ 3,188	$ 3,108

1996 Compared with 1995

North American food. During 1996, operating revenues decreased 8.1% from 1995, due primarily to the impact of divestitures ($2.0 billion), product mix ($95 million) and pricing ($82 million), partially offset by volume increases in ongoing operations ($662 million), the impact of acquisitions ($63 million) and favorable currency movements ($39 million). Operating profit increased 3.4% over 1995 due primarily to volume increases in ongoing operations ($405 million) and lower marketing, administration and research costs ($46 million), partially offset by net price reductions and net cost increases ($158 million), the impact of divestitures ($116 million), and product mix ($101 million). Kraft had net gains from sales of businesses of $250 million in 1996. In addition, Kraft initiated cost savings actions that included downsizing facilities. The cost of these actions substantially offset the gains from businesses sold. The effect of pricing on 1996 operating revenues was due primarily to price reductions in coffee and cereals, partially offset by price increases in cheese. The effect of net price reductions on 1996 operating profit was due primarily to price reductions in cereals. The effect of net cost increases on 1996 operating profit was due primarily to higher cheese commodity costs.

Excluding operating results of the divested businesses discussed above, 1996 North American food operating revenues and operating profit increased 3.8% and 8.5%, respectively, over 1995.

Significant volume gains were achieved in beverages, on the strength of ready-to-drink and powdered products, and in frozen pizza, helped by new product introductions and geographic market expansion. Volume also increased in desserts, due to strength in packaged and refrigerated products, as well as the acquisition of a shelf-stable pudding product line in the fourth quarter of 1995; coffee, aided by sales of premium-priced line extensions; processed meats, with growth in lunch combinations, driven by product introductions, and cold cuts; and meals, due to strength in dinners and stuffing. Volume increased in cereals in 1996, due primarily to product introductions and the implementation of price reductions and simplified couponing in the second quarter. Despite lower consumption in the process cheese category as prices rose, total cheese volume grew slightly due to new product introductions.

International food. Operating revenues for 1996 increased 2.9% over 1995, due primarily to higher volume ($44 million), the consolidation of previously unconsolidated operations ($612 million) and the impact of acquisitions ($105 million), partially offset by pricing ($255 million, primarily coffee), the impact of divestitures ($137 million) and unfavorable currency movements ($49 million). Operating profit during 1996 increased 7.0% over 1995, reflecting higher volume ($23 million), cost decreases, net of price reductions ($81 million), the consolidation of previously unconsolidated operations ($66 million) and favorable currency movements ($7 million), partially offset by higher marketing, administration and research costs ($101 million, primarily higher marketing costs) and the impact of divestitures ($7 million). KFI had net gains of $70 million from sales of businesses in 1996. In addition, KFI initiated cost savings actions that included increased severance for workforce reductions. The cost of these actions substantially offset the gains from businesses sold.

Higher international food volume was due primarily to the consolidation of previously unconsolidated businesses, the acquisition of Lacta and growth in coffee. KFI's coffee volume increased in all regions during 1996, particularly in several key markets such as Germany and France, KFI's largest coffee markets. The gains were a result of increased marketing and several premium product introductions. KFI's confectionery volume increased, due primarily to the emerging markets of Central and Eastern Europe, but declined in Western Europe where competition remained intense. KFI's cheese and grocery volumes decreased, due to divestitures of businesses, lower consumption of beef in Italy, and the effects of a peanut butter recall in Australia, partially offset by increased sales of snacks in Scandinavia. Latin America volume was higher as a result of the acquisition of Lacta and strong sales of powdered soft drinks throughout the region.

Steps were taken during 1996, and will continue in 1997, to lower KFI's overhead costs and strengthen the marketing of KFI brands in the intensely price competitive environments of Europe.

1995 Compared with 1994

North American food. During 1995, operating revenues decreased 17.0%, due primarily to the impact of divestitures ($4.2 billion), partially offset by increases in price/mix ($311 million) and volume ($226 million). Operating profit increased 0.1% over 1994, due primarily to price increases, net of cost increases ($61 million), gains on sales of businesses ($202 million), volume increases ($97 million) and lower marketing, administration and research costs ($14 million), partially offset by the reduction in operating profit resulting from divestitures ($166 million) and provisions for an early retirement program and the write-down of assets of facilities to be closed or downsized (aggregating $202 million).

Excluding operating results of divested businesses (discussed above), North American food operating revenues and operating profit increased 3.3% and 7.3%, respectively, in 1995 compared with 1994.

Volume grew in beverages, on the strength of ready-to-drink fruit juices; cheese, led by growth in the process and natural cheese segments; processed meats, driven by lunch combinations and cold cuts, both of which were aided by new product introductions; ready-to-eat and packaged desserts, due to enhanced marketing efforts and the introduction of line extensions; frozen pizza, helped by geographic expansion and new product introductions; and coffee, which reported volume growth in premium products. Volume decreased in cereals, due to a general slowdown in industry sales and heightened competition; and in pourable and spoonable salad dressings, due to declines in industry sales. In Canada, volume decreased, due primarily to weakness in the foodservice business, partially offset by higher retail sales, which benefited from enhanced advertising and marketing support. Market shares were higher in the majority of North American food's top categories.

International food. Operating revenues for 1995 increased 10.6% over 1994, due primarily to favorable currency movements ($652 million), price increases ($477 million, primarily coffee) and the impact of acquisitions ($92 million), partially offset by volume decreases ($151 million). Operating profit increased 5.6% over 1994, due primarily to gains on sales of businesses as discussed below ($73 million), the gain on sale of an equity investment ($43 million), and income from unconsolidated subsidiaries, reflecting higher volume in emerging markets ($77 million), partially offset by provisions recorded primarily to write-down assets of facilities to be closed ($73 million) and lower volume ($50 million).

During 1995, KFI sold a Scandinavian cereal operation, a U.K. frozen foods operation and the international distribution rights of Kraft's bakery business.

Overall volume declined in 1995. In Western Europe, volume declined, due to market softness and intense competition for core coffee and confectionery products, particularly in Germany, KFI's largest European market. Despite intense price competition in coffee and a soft confectionery market resulting from an unusually hot summer, market shares increased in Germany in both the roast and ground coffee and chocolate tablet categories. In Central and Eastern Europe, volume increased in coffee and confectionery products, while the Asia/Pacific region recorded increases in the coffee, and cheese and grocery categories. In Latin America, total volume was higher in 1995, driven by powdered soft drinks in Argentina and Brazil and higher ice cream volume in Brazil, partially offset by lower ice cream volume in Argentina and lower powdered soft drink volume in Mexico.

Beer

1996 Compared with 1995

Operating revenues of Miller Brewing Company ("Miller") for 1996 increased $23 million (0.5%) from 1995, due to price/mix improvements ($136 million) and the impact of acquisitions ($7 million), partially offset by lower volume ($119 million). Operating profit decreased $7 million (1.6%) from 1995, due to lower volume ($49 million) and unfavorable fixed manufacturing expense ($18 million), partially offset by price/mix improvements, net of higher material costs ($25 million) and lower marketing, administration and research costs ($36 million, primarily marketing). During 1996, Miller recorded its share of a restructuring charge at 20%-owned Molson Canada and realized the benefit of lower than anticipated costs for integrating Molson USA's operations. Also in 1996, Miller took several actions to restore growth, streamline its organization and reduce costs. These included a workforce reduction, the costs of which were charged against the existing postemployment liability. The impact of these items was not material to Miller's operating profit for 1996.

Miller's 1996 total shipment volume of 43.8 million barrels decreased 2.7% from 1995. Despite higher shipments of Miller Lite in 1996, shipments of premium-priced brands decreased, as did shipments of budget-priced brands. Lower volume was due to softness in most of Miller's brands and intense competition. Miller's market share of the U.S. malt industry (based on shipments) was 21.6%, down 1.0 share point from 1995. Despite lower overall volume, Miller's premium shipments increased to 82.5% from 81.8% of Miller's total shipments. Miller's volume and share in 1997 may decline further if current competitive conditions continue.

1995 Compared with 1994

Operating revenues of Miller for 1995 increased $7 million (0.2%) from 1994, due to price/mix improvements ($27 million), partially offset by volume decreases. Operating profit increased $31 million (7.5%) over 1994, due to price/mix improvements and lower costs (aggregating $39 million), partially offset by volume decreases ($9 million).

Miller's 1995 shipment volume of 45.0 million barrels of beer decreased 0.5% from 1994, in line with the industry. Miller's domestic shipments were 1.1% lower in 1995, reflecting the current softness in the domestic beer industry, but were partially offset by growth in Miller's international sales. Shipments of premium-priced beers rose 1.3% to account for 81.8% of shipments in 1995 compared with 80.4% in 1994. Premium brand growth was led by the initial success of Red Dog and increased shipments of Miller Lite, reflecting enhanced advertising and marketing. Shipments of Miller Genuine Draft and ice beers were down versus the prior year. Miller's market share of the U.S. malt beverage industry (based on shipments) was 22.6% in 1995, down 0.1 share point from 1994.

Financial Services and Real Estate

1996 Compared with 1995

In 1996, operating revenues from financial services and real estate operations were flat, and operating profit increased 17.1% from 1995. Higher financial services operating revenues and operating profit from Philip Morris Capital Corporation ("PMCC") reflect the continued growth and gains realized from PMCC's leasing and structured finance portfolio. 1996 operating revenues from real estate operations of Mission Viejo Company ("MVC") decreased from 1995, due primarily to an unfavorable comparison caused by a large land sale in Southern California during 1995, but operating profit increased slightly in 1996 due to higher margins.

1995 Compared with 1994

For 1995, operating revenues from financial services and real estate operations decreased 22.7%, and operating profit decreased 21.1% from 1994. Lower financial services operating profit reflects gains recognized in 1994 related to the sale of PMCC's marketable securities portfolio. Operating profit from MVC's real estate operations increased from 1994 levels, due primarily to improved residential land sales volume in Colorado, and higher profit margins in California.

Financial Review

Net Cash Provided by Operating Activities

During 1996, cash provided by operating activities was $7.7 billion, $782 million higher than in 1995 due primarily to higher net earnings, partially offset by increased investments in working capital.

During 1995, cash provided by operating activities was $6.9 billion, compared with $7.1 billion in 1994. The decrease was due primarily to an investment in working capital, partially offset by higher net earnings.

Including payments of income taxes on sales of businesses and PMCC's interest payment on zero coupon bonds, which matured in 1994, operating cash flow was $7.6 billion, $6.7 billion and $6.9 billion, for 1996, 1995 and 1994, respectively.

Net Cash Used in Investing Activities

During 1996, cash used in investing activities was $2.1 billion, compared with $109 million during 1995. The change was due primarily to cash used in 1996 for acquisitions (primarily for controlling interests in a Polish cigarette manufacturer and a Brazilian chocolate confectionery company) compared with cash received in 1995 from the sales of food businesses. During 1995, Kraft sold its bakery businesses and its North American margarine, specialty oils, marshmallows, caramels and Kraft Foodservice distribution businesses. In addition, several smaller international food businesses were sold in 1995. Total proceeds from the sales of these businesses were $2.1 billion. In 1996, the Company sold several domestic and international food businesses, including the North American bagel business, for proceeds of $612 million.

Cash used in investing activities for 1995 was $109 million, compared with $1.2 billion for 1994. The change was due primarily to cash received from sales of businesses in 1995, partially offset by a $797 million decrease in cash provided by PMCC, reflecting the sale of PMCC's marketable securities portfolio in 1994.

Capital expenditures for 1996 increased 9.9%, to $1.8 billion, of which 47% related to tobacco operations and 46% related to food operations, primarily for modernization and consolidation of manufacturing facilities and expansion of certain production capacity. Capital expenditures are estimated to be $1.9 billion in 1997 and a total of approximately $8.0 billion for the five-year period 1997-2001, of which approximately 57% and 48%, respectively, are projected for tobacco operations and approximately 36% and 43%, respectively, are projected for food operations.

Net Cash Used in Financing Activities

During 1996, the Company's net cash used in financing activities increased to $6.4 billion, from $5.6 billion in 1995, due primarily to increases in stock repurchases ($659 million) and dividends paid ($523 million), partially offset by lower net repayments of short-term borrowings and long-term debt. During 1995, the Company's net cash used in financing activities was $5.6 billion, compared with $5.7 billion in 1994.

Debt

The Company's total debt was $15.2 billion, $15.8 billion and $16.5 billion at December 31, 1996, 1995 and 1994, respectively. Total consumer products debt decreased $439 million in 1996, $606 million in 1995 and $1.4 billion in 1994, due primarily to favorable cash flow and scheduled debt maturities.

At December 31, 1996, the Company's credit facilities amounted to approximately $15.6 billion, of which approximately $15.3 billion were unused. These include revolving bank credit agreements totaling $12.0 billion. An agreement for $4.0 billion expires in October 1997. An agreement for $8.0 billion expires in 2000, enabling the Company to refinance short-term debt on a long-term basis, based upon its intent and ability to refinance such debt. These facilities are used to support the Company's commercial paper borrowings and are available for acquisitions and other corporate purposes. The Company expects to continue to refinance long-term and short-term debt from time to time. The nature and amount of the Company's long-term and short-term debt and the proportionate amount of each can be expected to vary as a result of future business requirements, market conditions and other factors.

Fixed rate debt constituted approximately 86% and 79% of total consumer products debt at December 31, 1996 and 1995, respectively. The average interest rate on total consumer products debt, including the impact of currency swap agreements discussed below, was approximately 7.5% and 7.7% at December 31, 1996 and 1995, respectively.

The Company operates internationally, with manufacturing and sales facilities in various locations around the world. The Company continually evaluates its foreign currency net asset exposure (primarily the Swiss franc, German mark, Swedish krona, British pound and Canadian dollar) based on current market conditions and business strategies. It acts to manage such exposure, when deemed prudent, through various hedging transactions. The Company has entered into currency and related interest rate swap agreements to manage exposure to currency movements. The aggregate notional principal amounts of these agreements outstanding at December 31, 1996 and 1995 were $2.2 billion and $2.0 billion, respectively, of which $1.5 billion related to consumer products debt at December 31, 1996 and 1995, respectively.

The Company enters into forward exchange contracts, for purposes other than trading, to reduce the effects of fluctuating foreign currency on foreign currency denominated current assets, liabilities, commitments and short-term intercompany transactions. At December 31, 1996 and 1995, the Company had forward exchange contracts, with maturities of less than one year, of $1.7 billion and $1.2 billion, respectively.

The Company's credit ratings by Moody's at December 31, 1996, 1995 and 1994 were "P-1" in the commercial paper market and "A2" for long-term debt obligations. The Company's credit ratings by Standard & Poor's at December 31, 1996, 1995 and 1994 were "A-1" in the commercial paper market and "A" for long-term debt obligations.

Equity and Dividends

During 1996, the Company repurchased 28.6 million shares of its common stock at an aggregate cost of $2.8 billion. These purchases were made pursuant to the Company's repurchase program, announced in 1994, to purchase up to $6 billion of its common stock in the open market. These 1996 repurchases, net of 7.9 million shares issued under the Philip Morris 1992 Incentive Compensation and Stock Option Plan in 1996, resulted in lower average shares outstanding. Through December 31, 1996, cumulative purchases under the program totaled 64.1 million shares at a cost of $5.3 billion.

Dividends paid in 1996 were 17.8% higher than in 1995, reflecting an increase in dividends declared, partially offset by fewer shares outstanding. On August 28, 1996, the Board of Directors increased the Company's quarterly dividend rate to $1.20 per share, a 20.0% increase, resulting in an annualized dividend rate of $4.80 per share.

At December 31, 1996, the ratio of consumer products debt to total equity was 0.98, compared with 1.03 at December 31, 1995. The Company's ratio of total debt to total equity at December 31, 1996 was 1.07 compared with 1.13 at December 31, 1995. The changes in these ratios primarily reflect net repayments of short-term borrowings and long-term debt and an increase in stockholders' equity, due primarily to net earnings partially offset by share repurchases, dividends declared and currency translation adjustments. Return on average stockholders' equity increased to 44.7% in 1996 from 40.7% in 1995. The increase from 1995 reflects higher earnings, partially offset by higher stockholders' equity.

Cash and Cash Equivalents

Cash and cash equivalents decreased to $240 million at December 31, 1996 from $1.1 billion at December 31, 1995. The decrease primarily reflects the use of cash in 1996 for investments in foreign operations and normal working capital requirements, including repayment of short-term borrowings.

Contingencies

See Note 13 to the Consolidated Financial Statements for a discussion of contingencies.

Forward-Looking and Cautionary Statements

Reference is made to Item 1 (c) "Other Matters--Forward-Looking and Cautionary Statements" of the Company's Form 10-K regarding important factors that could cause actual results to differ materially from those contained in any forward-looking statement made by or on behalf of the Company, including forward-looking statements contained in this report.

Selected Financial Data--Fifteen-Year Review (in millions of dollars, except per share data)

	1996	1995	1994	1993	1992
Summary of Operations:					
Operating revenues	$ 69,204	$ 66,071	$ 65,125	$ 60,901	$ 59,131
United States export sales	6,476	5,920	4,942	4,105	3,797
Cost of sales	26,560	26,685	28,351	26,771	26,082
Federal excise taxes on products	3,544	3,446	3,431	3,081	2,879
Foreign excise taxes on products	11,107	9,486	7,918	7,199	6,157
Operating income	11,769	10,526	9,449	7,587	10,059
Interest and other debt expense, net (consumer products)	1,086	1,179	1,233	1,391	1,451
Earnings before income taxes and cumulative effect of accounting changes	10,683	9,347	8,216	6,196	8,608
Pretax profit margin	15.4%	14.1%	12.6%	10.2%	14.6%
Provision for income taxes	4,380	3,869	3,491	2,628	3,669
Earnings before cumulative effect of accounting changes	6,303	5,478	4,725	3,568	4,939
Cumulative effect of accounting changes		(28)		(477)	
Net earnings	6,303	5,450	4,725	3,091	4,939
Earnings per share before cumulative effect of accounting changes	7.68	6.51	5.45	4.06	5.45
Per share cumulative effect of accounting changes		(.03)		(.54)	
Net earnings per share	7.68	6.48	5.45	3.52	5.45
Dividends declared per share	4.40	3.65	3.03	2.60	2.35
Weighted average shares (millions)	821	842	867	878	906
Capital expenditures (consumer products)	1,782	1,621	1,726	1,592	1,573
Depreciation (consumer products)	1,038	1,023	1,025	1,042	963
Property, plant and equipment, net (consumer products)	11,751	11,116	11,171	10,463	10,530
Inventories (consumer products)	9,002	7,862	7,987	7,358	7,785
Total assets	54,871	53,811	52,649	51,205	50,014
Total long-term debt	12,961	13,107	14,975	15,221	14,583
Total debt--consumer products	13,933	14,372	14,978	16,364	16,269
--financial services and real estate	1,307	1,454	1,494	1,792	1,934
Total deferred income taxes	3,336	2,827	2,496	2,168	2,248
Stockholders' equity	14,218	13,985	12,786	11,627	12,563
Common dividends declared as a % of net earnings	57.3%	56.3%	55.6%	73.8%	43.0%
Book value per common share	17.55	16.83	14.99	13.26	14.07
Market price of common share--high/low	119-85 5/8	94 3/8-55 3/4	64 1/2-47 1/4	77 5/8-45	86 5/8-69 1/2
Closing price of common share at year-end	113	90 1/4	57 1/2	55 5/8	77 1/8
Price/earnings ratio at year-end	15	14	11	14	14
Number of common shares outstanding at year-end (millions)	810	831	853	877	893
Number of employees	154,000	151,000	165,000	173,000	161,000

	1991	1990	1989	1988	1987
Summary of Operations:					
Operating revenues	$ 56,458	$ 51,169	$ 44,080	$ 31,273	$ 27,650
United States export sales	3,061	2,928	2,288	1,863	1,592
Cost of sales	25,612	24,430	21,868	13,565	12,183
Federal excise taxes on products	2,978	2,159	2,140	2,127	2,085
Foreign excise taxes on products	5,416	4,687	3,608	3,755	3,331
Operating income	8,622	7,946	6,789	4,397	3,990
Interest and other debt expense, net (consumer products)	1,651	1,635	1,731	670	646
Earnings before income taxes and cumulative effect of accounting changes	6,971	6,311	5,058	3,727	3,344
Pretax profit margin	12.3%	12.3%	11.5%	11.9%	12.1%
Provision for income taxes	3,044	2,771	2,112	1,663	1,502
Earnings before cumulative effect of accounting changes	3,927	3,540	2,946	2,064	1,842
Cumulative effect of accounting changes	(921)			273	
Net earnings	3,006	3,540	2,946	2,337	1,842
Earnings per share before cumulative effect of accounting changes	4.24	3.83	3.18	2.22	1.94
Per share cumulative effect of accounting changes	(.99)			.29	
Net earnings per share	3.25	3.83	3.18	2.51	1.94
Dividends declared per share	1.91	1.55	1.25	1.01	.79
Weighted average shares (millions)	925	925	927	932	951
Capital expenditures (consumer products)	1,562	1,355	1,246	1,024	718
Depreciation (consumer products)	938	876	755	608	564
Property, plant and equipment, net (consumer products)	9,946	9,604	8,457	8,648	6,582
Inventories (consumer products)	7,445	7,153	5,751	5,384	4,154
Total assets	47,384	46,569	38,528	36,960	21,437
Total long-term debt	14,213	16,121	14,551	16,812	5,983
Total debt--consumer products	15,289	17,182	14,887	16,442	6,355
--financial services and real estate	1,611	1,560	1,538	1,504	1,378
Total deferred income taxes	1,803	2,083	1,732	1,559	2,044
Stockholders' equity	12,512	11,947	9,571	7,679	6,823
Common dividends declared as a % of net earnings	58.7%	40.5%	39.3%	40.3%	40.6%
Book value per common share	13.60	12.90	10.31	8.31	7.21
Market price of common share--high/low	81 3/4-48 1/4	52-36	45 1/2-25	25 1/2-20 1/8	31 1/8-18 1/8

Closing price of common share at year-end	80 1/4	51 3/4	41 5/8	25 1/2	21 3/8
Price/earnings ratio at year-end	19	14	13	11	11
Number of common shares outstanding at year-end (millions)	920	926	929	924	947
Number of employees	166,000	168,000	157,000	155,000	113,000

	1986	1985	1984	1983	1982
Summary of Operations:					
Operating revenues	$ 25,542	$ 16,158	$14,102	$13,256	$11,720
United States export sales	1,193	923	925	970	978
Cost of sales	11,901	6,709	5,840	5,665	5,532
Federal excise taxes on products	2,075	2,049	2,041	1,983	1,180
Foreign excise taxes on products	2,653	1,766	1,635	1,527	1,435
Operating income	3,537	2,664	1,908	1,840	1,547
Interest and other debt expense, net (consumer products)	772	311	276	230	244
Earnings before income taxes and cumulative effect of accounting changes	2,765	2,353	1,632	1,610	1,303
Pretax profit margin	10.8%	14.6%	11.6%	12.1%	11.1%
Provision for income taxes	1,287	1,098	743	706	521
Earnings before cumulative effect of accounting changes	1,478	1,255	889	904	782
Cumulative effect of accounting changes					
Net earnings	1,478	1,255	889	904	782
Earnings per share before cumulative effect of accounting changes	1.55	1.31	.91	.90	.78
Per share cumulative effect of accounting changes					
Net earnings per share	1.55	1.31	.91	.90	.78
Dividends declared per share	.62	.50	.43	.36	.30
Weighted average shares (millions)	954	959	981	1,008	1,005
Capital expenditures (consumer products)	678	347	298	566	918
Depreciation (consumer products)	514	367	341	294	250
Property, plant and equipment, net (consumer products)	6,237	5,684	4,014	4,381	4,178
Inventories (consumer products)	3,836	3,827	2,653	2,599	2,834
Total assets	19,482	18,712	9,880	9,908	9,756
Total long-term debt	6,887	8,035	2,239	2,549	3,776
Total debt--consumer products	6,889	7,887	2,566	3,054	3,728
--financial services and real estate	1,141	944	436	141	83
Total deferred income taxes	1,519	1,233	907	825	627
Stockholders' equity	5,655	4,737	4,093	4,034	3,663
Common dividends declared as a % of net earnings	39.9%	38.1%	46.8%	40.5%	38.6%
Book value per common share	5.94	4.96	4.21	4.03	3.64
Market price of common share--high/low	19 1/2-11	11 7/8-9	10 3/8-7 3/4	9-6 3/4	8 1/2-5 1/2
Closing price of common share at year-end	18	11	10 1/8	9	7 1/2
Price/earnings ratio at year-end	11	8	11	10	9
Number of common shares outstanding at year-end (millions)	951	955	971	1,000	1,007
Number of employees	111,000	114,000	68,000	68,000	72,000

See notes to the consolidated financial statements regarding the 1996 acquisitions, 1995 and 1996 divestitures of food businesses, the 1995 adoptions of SFAS No. 116 and SFAS No. 106 for non-U.S. benefit plans, the 1993 adoption of SFAS No. 112 and the 1993 restructuring of the Company's worldwide operations.

Consolidated Balance Sheets (in millions of dollars, except per share data)

at December 31,	1996	1995
Assets		
Consumer products		
Cash and cash equivalents	$ 240	$ 1,138
Receivables, net	4,466	4,508
Inventories:		
Leaf tobacco	4,143	3,332
Other raw materials	1,854	1,721
Finished product	3,005	2,809
	9,002	7,862
Other current assets	1,482	1,371
Total current assets	15,190	14,879
Property, plant and equipment, at cost:		
Land and land improvements	664	726
Buildings and building equipment	5,168	4,976
Machinery and equipment	12,481	11,542
Construction in progress	1,659	1,357
	19,972	18,601
Less accumulated depreciation	8,221	7,485
	11,751	11,116
Goodwill and other intangible assets (less accumulated amortization of $4,391 and $3,873)	18,998	19,319
Other assets	3,015	2,866
Total consumer products assets	48,954	48,180
Financial services and real estate		
Finance assets, net	5,345	4,991
Real estate held for development and sale	314	339
Other assets	258	301
Total financial services and real estate assets	5,917	5,631
Total Assets	$54,871	$53,811

See notes to consolidated financial statements.

	1996	1995
Liabilities		
Consumer products		
Short-term borrowings	$ 260	$ 122
Current portion of long-term debt	1,846	1,926
Accounts payable	3,409	3,364
Accrued liabilities:		
Marketing	2,106	2,114
Taxes, except income taxes	1,331	1,075
Employment costs	942	995
Other	2,726	2,706
Income taxes	1,269	1,137
Dividends payable	978	834
Total current liabilities	14,867	14,273
Long-term debt	11,827	12,324
Deferred income taxes	731	356
Accrued postretirement health care costs	2,372	2,273
Other liabilities	5,773	5,643
Total consumer products liabilities	35,570	34,869
Financial services and real estate		
Short-term borrowings	173	671
Long-term debt	1,134	783
Deferred income taxes	3,636	3,382
Other liabilities	140	121
Total financial services and real estate liabilities	5,083	4,957
Total liabilities	40,653	39,826
Contingencies (Note 13)		
Stockholders' Equity		
Common stock, par value $1.00 per share (935,320,439 shares issued)	935	935
Earnings reinvested in the business	22,478	19,779
Currency translation adjustments	192	467
	23,605	21,181
Less cost of repurchased stock (124,871,681 and 104,150,433 shares)	9,387	7,196
Total stockholders' equity	14,218	13,985
Total Liabilities and Stockholders' Equity	$54,871	$53,811

Consolidated Statements of Earnings (in millions of dollars, except per share data)

for the years ended December 31,	1996	1995	1994
Operating revenues	$ 69,204	$ 66,071	$ 65,125
Cost of sales	26,560	26,685	28,351
Excise taxes on products	14,651	12,932	11,349
Gross profit	27,993	26,454	25,425
Marketing, administration and research costs	15,630	15,337	15,372
Amortization of goodwill	594	591	604
Operating income	11,769	10,526	9,449
Interest and other debt expense, net	1,086	1,179	1,233
Earnings before income taxes and cumulative effect of accounting changes	10,683	9,347	8,216
Provision for income taxes	4,380	3,869	3,491
Earnings before cumulative effect of accounting changes	6,303	5,478	4,725
Cumulative effect of changes in method of accounting		(28)	
Net earnings	$ 6,303	$ 5,450	$ 4,725
Per share data:			
Earnings before cumulative effect of accounting changes	$ 7.68	$ 6.51	$ 5.45
Cumulative effect of changes in method of accounting		(.03)	
Net earnings	$ 7.68	$ 6.48	$ 5.45

Consolidated Statements of Cash Flows (in millions of dollars)

for the years ended December 31,	1996	1995	1994
Cash Provided By (Used In) Operating Activities			
Net earnings--Consumer products	$ 6,180	$ 5,345	$ 4,591
--Financial services and real estate	123	105	134
Net earnings	6,303	5,450	4,725
Adjustments to reconcile net earnings to operating cash flows:			
Consumer products			
Depreciation and amortization	1,691	1,671	1,722
Deferred income tax provision	163	15	237
(Gains) losses on sales of businesses	(320)	(275)	19
Cumulative effect of accounting changes		46	
Cash effects of changes, net of the effects from acquired and divested companies:			
Receivables, net	35	(466)	(239)
Inventories	(952)	(5)	(387)
Accounts payable	60	(260)	582
Income taxes	446	504	202
Other working capital items	(448)	(482)	(288)
Other	467	354	180

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows (continued)

for the years ended December 31,	1996	1995	1994
Financial services and real estate			
Deferred income tax provision	$ 224	$ 299	$ 376
Decrease (increase) in real estate receivables	11	35	(30)
Decrease in real estate held for development and sale	25	61	86
Other	2	(22)	(82)
Operating cash flow before income taxes on sales of businesses and interest payment on zero coupon bonds	7,707	6,925	7,103
Income taxes on sales of businesses	(73)	(238)	(8)
Interest payment on zero coupon bonds--financial services and real estate			(156)
Net cash provided by operating activities	7,634	6,687	6,939
Cash Provided By (Used In) Investing Activities			
Consumer products			
Capital expenditures	(1,782)	(1,621)	(1,726)
Purchase of businesses, net of acquired cash	(616)	(217)	(146)
Proceeds from sales of businesses	612	2,202	300
Other	(47)	17	28
Financial services and real estate			
Investments in finance assets	(439)	(613)	(582)
Proceeds from finance assets	217	123	889
Net cash used in investing activities	(2,055)	(109)	(1,237)
Cash Provided By (Used In) Financing Activities			
Consumer products			
Net (repayment) issuance of short-term borrowings	(1,119)	(21)	172
Long-term debt proceeds	2,699	564	97
Long-term debt repaid	(1,979)	(1,302)	(1,817)
Financial services and real estate			
Net (repayment) issuance of short-term borrowings	(498)	67	(325)
Long-term debt proceeds	363		185
Long-term debt repaid		(139)	(44)
Repurchase of outstanding stock	(2,770)	(2,111)	(1,532)
Dividends paid	(3,462)	(2,939)	(2,487)
Stock rights redemption		(9)	
Issuance of shares	448	291	54
Other	(88)	(28)	(20)
Net cash used in financing activities	(6,406)	(5,627)	(5,717)
Effect of exchange rate changes on cash and cash equivalents	(71)	3	17
Cash and cash equivalents:			
(Decrease) increase	(898)	954	2
Balance at beginning of year	1,138	184	182
Balance at end of year	$ 240	$ 1,138	$ 184
Cash paid: Interest--Consumer products	$ 1,244	$ 1,293	$ 1,340
--Financial services and real estate	$ 95	$ 89	$ 229
Income taxes	$ 3,424	$ 3,067	$ 2,449

See notes to consolidated financial statements.

Consolidated Statements of Stockholders' Equity (in millions of dollars, except per share data)

	Common Stock	Earnings Reinvested in the Business	Currency Translation Adjustments	Cost of Repurchased Stock	Total Stockholders' Equity
Balances, January 1, 1994	$935	$15,718	$(711)	$(4,315)	$11,627
Net earnings		4,725			4,725
Exercise of stock options and issuance of other stock awards		(217)		324	107
Cash dividends declared ($3.03 per share)		(2,623)			(2,623)
Currency translation adjustments			664		664
Stock repurchased				(1,600)	(1,600)
Net unrealized depreciation on securities		(114)			(114)
Balances, December 31, 1994	935	17,489	(47)	(5,591)	12,786
Net earnings		5,450			5,450
Exercise of stock options and issuance of other stock awards		(77)		470	393
Cash dividends declared ($3.65 per share)		(3,065)			(3,065)
Redemption of stock rights		(9)			(9)
Currency translation adjustments			514		514
Stock repurchased				(2,075)	(2,075)
Net unrealized depreciation on securities		(9)			(9)
Balances, December 31, 1995	935	19,779	467	(7,196)	13,985
Net earnings		6,303			6,303
Exercise of stock options and issuance of other stock awards		(28)		609	581
Cash dividends declared ($4.40 per share)		(3,606)			(3,606)
Currency translation adjustments			(275)		(275)
Stock repurchased				(2,800)	(2,800)
Net unrealized appreciation on securities		30			30
Balances, December 31, 1996	$935	$22,478	$ 192	$(9,387)	$14,218

See notes to consolidated financial statements.

Note 1. Summary of Significant Accounting Policies:

Basis of presentation:

The consolidated financial statements include all significant subsidiaries. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of operating revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Balance sheet accounts are segregated by two broad types of business. Consumer products assets and liabilities are classified as either current or non-current, whereas financial services and real estate assets and liabilities are unclassified, in accordance with respective industry practices.

Cash and cash equivalents:

Cash equivalents include demand deposits with banks and all highly liquid investments with original maturities of three months or less.

Inventories:

Inventories are stated at the lower of cost or market. The last-in, first-out ("LIFO") method is used to cost substantially all domestic inventories. The cost of other inventories is determined by the average cost or first-in, first-out methods. It is a generally recognized industry practice to classify the total amount of leaf tobacco inventory as a current asset although part of such inventory, because of the duration of the aging process, ordinarily would not be utilized within one year.

Advertising costs:

Advertising costs are expensed generally as incurred.

Depreciation, amortization and goodwill valuation:

Depreciation is recorded by the straight-line method. Substantially all goodwill and other intangible assets are amortized by the straight-line method, principally over 40 years. The Company periodically evaluates the recoverability of goodwill and measures any impairment by comparison to estimated undiscounted cash flows from future operations.

Financial instruments:

Derivative financial instruments are used by the Company to manage its foreign currency and interest rate exposures. Realized and unrealized gains and losses on foreign currency swaps that are effective as hedges of net assets in foreign subsidiaries are offset against currency translation adjustments as a component of stockholders' equity. The interest differential to be paid or received under the currency and related interest rate swap agreements is recognized over the life of the related debt and is included in interest and other debt expense, net. Unrealized gains and losses on forward contracts that are effective as hedges of assets, liabilities and commitments are deferred and recognized in income as the related transaction is realized.

Accounting changes:

Effective January 1, 1996, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of." This Statement requires that certain assets be reviewed for impairment and, if impaired, remeasured at fair value, whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. The adoption of SFAS No. 121 at January 1, 1996 and its application during 1996, had no material impact on the Company's financial position or results of operations.

Effective January 1, 1996, the Company adopted SFAS No. 123, "Accounting for Stock-Based Compensation," which allows companies either to measure compensation cost in connection with the employee stock compensation plans using a fair value based method or to continue to use an intrinsic value based method. The Company will continue to use the intrinsic value based method, which generally does not result in compensation cost. The Company's stock compensation plans are discussed in Note 7.

Effective January 1, 1995, the Company adopted SFAS No. 116, "Accounting for Contributions Received and Contributions Made." This Statement requires the Company to recognize an unconditional promise to make a contribution as an expense in the period the promise is made. The Company had previously expensed contributions when payment was made. The cumulative effect at January 1, 1995 of adopting SFAS No. 116 reduced 1995 net earnings by $7 million ($.01 per share). The application of SFAS No. 116 did not materially reduce 1995 earnings before cumulative effect of accounting changes.

Effective January 1, 1995, the Company adopted SFAS No. 106 for non-U.S. postretirement benefits other than pensions. The cumulative effect at January 1, 1995 of adopting SFAS No. 106, for the non-U.S. plans, reduced 1995 net earnings by $21 million ($.02 per share). However, application of SFAS No. 106 for non-U.S. employees during the year ended December 31, 1995 did not materially reduce earnings before cumulative effect of accounting changes.

In October 1996, the AICPA's Accounting Standards Executive Committee issued Statement of Position No. 96-1, "Environmental Remediation Liabilities," which requires adoption by the Company on January 1, 1997. The Company estimates that the effect of adoption will not be material.

Note 2. Divestitures and Acquisitions:

During 1996, the Company acquired a controlling interest in a Polish tobacco company, at a cost of $285 million and nearly all of the remaining voting shares of a Brazilian confectionery company, at a cost of $314 million. During 1996, the Company sold several domestic and international food businesses for total proceeds of $612 million and net pretax gains of $320 million. In addition, the Company initiated cost saving programs that included downsizing facilities and workforce reductions. The cost of these actions substantially offset the gains from businesses sold. The effect of these and other smaller acquisitions and dispositions, were not material to the Company's 1996 results of operations.

During 1995, the Company sold its bakery businesses and its North American margarine, specialty oils, marshmallows, caramels and Kraft Foodservice distribution businesses. In addition, several smaller international food businesses were sold. Operating revenues and operating income of these businesses for the period owned in 1995 were $2.0 billion and $107 million, respectively, and for the year ended December 31, 1994 were $5.9 billion and $267 million, respectively. Net assets of the businesses sold were $1.8 billion. Total proceeds and net pretax gains from the sales of these businesses were $2.1 billion and $275 million, respectively. As part of this divestiture program, the Company offered an early retirement program and downsized or closed other food facilities. The cost of these actions offset the gains from businesses sold.

During 1994, the Company sold The All American Gourmet Company (frozen dinners business) for $170 million. The effect of this disposition, and other smaller acquisitions and dispositions, was not material to the Company's 1994 results of operations.

Note 3. Inventories:

The cost of approximately 49% of inventories in 1996 and 50% of inventories in 1995 was determined using the LIFO method. The stated LIFO values of inventories were approximately $965 million and $750 million lower than the current cost of inventories at December 31, 1996 and 1995, respectively.

Note 4. Short-Term Borrowings and Borrowing Arrangements:

At December 31, the Company's short-term borrowings and related average interest rates consisted of the following:

(in millions)	1996 Amount Outstanding	1996 Average Year-End Rate	1995 Amount Outstanding	1995 Average Year-End Rate
Consumer products:				
Bank loans	$ 295	8.1%	$ 209	13.1%
Commercial paper	1,373	5.7%	2,495	5.8%
Amount reclassified as long-term debt	(1,408)		(2,582)	
	$ 260		$ 122	
Financial services and real estate:				
Commercial paper	$ 173	6.0%	$ 671	5.9%

The fair values of the Company's short-term borrowings at December 31, 1996 and 1995, based upon market rates, approximate the amounts disclosed above.

The Company and its subsidiaries maintain credit facilities with a number of lending institutions, amounting to approximately $15.6 billion at December 31, 1996. Approximately $15.3 billion of these facilities were unused at December 31, 1996. Certain of these facilities are used to support commercial paper borrowings, are available for acquisitions and other corporate purposes and require the maintenance of a fixed charges coverage ratio.

The Company's credit facilities include revolving bank credit agreements totaling $12.0 billion. An agreement for $4.0 billion expires in October 1997. An agreement for $8.0 billion expires in 2000 enabling the Company to refinance short-term debt on a long-term basis. Accordingly, short-term borrowings intended to be refinanced were reclassified as long-term debt.

Note 5. Long-Term Debt:

At December 31, the Company's long-term debt consisted of the following:

(in millions)	1996	1995
Consumer products:		

Short-term borrowings, reclassified	$ 1,408	$ 2,582
Notes, 6.15% to 9.75% (average effective rate 7.82%), due through 2008	9,550	8,598
Debentures, 6.0% to 8.5% (average effective rate 10.77%), $1.2 billion face amount, due through 2017	1,046	1,018
Foreign currency obligations:		
Swiss franc, 2.13% to 6.88% (average effective rate 5.80%), due through 2000	957	1,303
Deutsche mark, 2.75% to 6.38% (average effective rate 5.96%), due through 2002	411	392
Other foreign	49	102
Other	252	255
	13,673	14,250
Less current portion of long-term debt	(1,846)	(1,926)
	$ 11,827	$ 12,324
Financial services and real estate:		
Eurodollar notes, 6.75% and 6.63% (average effective rate 6.68%), due 1997 and 1999	$ 400	$ 400
Foreign currency obligations:		
ECU notes, 9.25% and 8.50%, due 1997 and 1998	372	383
Deutsche mark, 6.5%, due 2003	166	
French franc, 6.88%, due 2006	196	
	$ 1,134	$ 783

Aggregate maturities of long-term debt, excluding short-term borrowings reclassified as long-term debt, are as follows:

(in millions)	Consumer Products	Financial Services and Real Estate
1997	$1,846	$386
1998	1,516	186
1999	1,773	200
2000	845	
2001	1,730	
2002-2006	3,871	362
2007-2011	767	
Thereafter	131	

The revolving credit facility under which the consumer products short-term debt was reclassified as long-term debt expires in 2000 and any amounts then outstanding mature.

Based on market quotes, where available, or interest rates currently available to the Company for issuance of debt with similar terms and remaining maturities, the aggregate fair value of consumer products and financial services and real estate long-term debt, including current portion of long-term debt, at December 31, 1996 and 1995 was $15.3 billion and $15.9 billion, respectively.

Note 6. Capital Stock:

Shares of authorized common stock are 4 billion; issued, repurchased and outstanding were as follows:

	Shares Issued	Shares Repurchased	Net Shares Outstanding
Balances, January 1, 1994	935,320,439	(58,229,749)	877,090,690
Exercise of stock options and issuance of other stock awards		4,569,731	4,569,731
Repurchased		(28,801,356)	(28,801,356)
Balances, December 31, 1994	935,320,439	(82,461,374)	852,859,065
Exercise of stock options and issuance of other stock awards		6,470,262	6,470,262
Repurchased		(28,159,321)	(28,159,321)
Balances, December 31, 1995	935,320,439	(104,150,433)	831,170,006
Exercise of stock options and issuance of other stock awards		7,890,835	7,890,835
Repurchased		(28,612,083)	(28,612,083)
Balances, December 31, 1996	935,320,439	(124,871,681)	810,448,758

At December 31, 1996, 33,794,922 shares of common stock were reserved for stock options and other stock awards under the Company's stock plans and 10,000,000 shares of Serial Preferred Stock, $1.00 par value, were authorized, none of which have been issued.

Note 7. Stock Plans:

Under the Philip Morris 1992 Incentive Compensation and Stock Option Plan (the "Plan"), the Company may grant to eligible employees stock options, stock appreciation rights, restricted stock and annual incentive and long-term performance cash awards. Up to 37 million shares of common stock are authorized for grant, of which no more than 9 million shares may be awarded as restricted stock. Shares available to be granted at December 31, 1996 and 1995 were 5,882,835 and 12,639,175, respectively.

Stock options are granted at an exercise price of not less than fair value on the date of the grant. Stock options granted under the Plan generally become exercisable on the first anniversary of the grant date and have a maximum term of ten years.

The Company applies the intrinsic value based method permitted by SFAS No. 123 in accounting for the Plan. Accordingly, no compensation expense has been recognized other than for restricted stock awards. Had compensation cost for stock option awards under the Plan been determined based on the fair value at the grant dates, the effect on the Company's 1996 and 1995 net earnings would not have been material.

Option activity was as follows for the years ended December 31, 1994, 1995 and 1996:

	Shares Subject to Option	Options Exercisable	Weighted Average Exercise Price
Balance at January 1, 1994	30,035,681		$ 51.09
Options granted	511,610		69.73
Options exercised	(2,394,089)		34.63
Options cancelled	(388,045)		59.87
Balance at December 31, 1994	27,765,157	27,253,547	52.73
Options granted	7,983,200		74.78
Options exercised	(6,750,112)		45.69
Options cancelled	(590,121)		68.46
Balance at December 31, 1995	28,408,124	20,700,934	60.27
Options granted	7,542,405		108.25
Options exercised	(8,436,980)		56.81
Options cancelled	(442,422)		78.64
Balance at December 31, 1996	27,071,127	19,649,932	$ 74.42

The weighted average exercise prices of options exercisable at December 31, 1996, 1995 and 1994 were $61.67, $54.83 and $52.41, respectively.

The following table summarizes the status of stock options outstanding and exercisable as of December 31, 1996, by range of exercise price:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$20.92-$35.42	1,805,676	2 years	$ 30.56	1,805,676	$ 30.56
$46.31-$69.25	8,263,823	5 years	53.63	8,263,823	53.63
$73.56-$120.00	17,001,628	8 years	89.18	9,580,433	74.45
	27,071,127			19,649,932	

The Company may grant shares of restricted stock and rights to receive shares of stock to eligible employees, giving them in most instances all of the rights of stockholders, except that they may not sell, assign, pledge or otherwise encumber such shares and rights. Such shares and rights are subject to forfeiture if certain employment conditions are not met. During 1996, 1995 and 1994 the Company granted 60,000, 212,000 and 2,636,940 shares, respectively, of restricted stock to eligible U.S. based employees and also issued to eligible non-U.S. employees rights to receive 48,000 and 1,034,320 like shares in 1995 and 1994, respectively. At December 31, 1996, restrictions on the stock, net of forfeitures, lapse as follows:
1997-2,433,985 shares; 1998-50,000 shares; 1999-20,000 shares; 2000-262,000 shares; and 2002 and thereafter-223,000 shares.

The fair value of the restricted shares and rights at the date of grant is amortized to expense ratably over the restriction period. The unamortized portion is reported as a reduction of earnings reinvested in the business and was $47 million on December 31, 1996.

Note 8. Earnings per Share:

Earnings per common share have been calculated on the weighted average number of shares of common stock outstanding for each year, which was 821,108,904, 841,558,296 and 867,288,869 for 1996, 1995 and 1994, respectively.

Note 9. Pretax Earnings and Provision for Income Taxes:

Pretax earnings and provision for income taxes consisted of the following:

(in millions)	1996	1995	1994
Pretax earnings:			
United States	$ 7,399	$ 6,622	$ 5,781
Outside United States	3,284	2,725	2,435
Total pretax earnings	$ 10,683	$ 9,347	$ 8,216
Provision for income taxes:			
United States federal:			
Current	$ 1,836	$ 1,946	$ 1,540
Deferred	438	97	458
	2,274	2,043	1,998
State and local	430	434	419
Total United States	2,704	2,477	2,417
Outside United States:			
Current	1,727	1,175	919
Deferred	(51)	217	155
Total outside United States	1,676	1,392	1,074
Total provision for income taxes	$ 4,380	$ 3,869	$ 3,491

At December 31, 1996, applicable United States federal income taxes and foreign withholding taxes have not been provided on approximately $4.2 billion of accumulated earnings of foreign subsidiaries that are expected to be permanently reinvested abroad. If these amounts were not considered permanently reinvested, additional deferred income taxes of approximately $240 million would have been provided.

The Company and its subsidiaries are subject to tax examinations in various U.S. and foreign jurisdictions. The Company believes that adequate tax payments have been made and accruals recorded for all years.

The effective income tax rate on pretax earnings differed from the U.S. federal statutory rate for the following reasons:

	1996	1995	1994
Provision computed at U.S. federal statutory rate	35.0%	35.0%	35.0%
Increase (decrease) resulting from:			
State and local income taxes, net of federal tax benefit	2.6	3.0	3.3
Rate differences--foreign operations	3.3	1.9	1.0
Goodwill amortization	1.8	2.1	2.4
Other	(1.7)	(0.6)	0.8
Provision for income taxes	41.0%	41.4%	42.5%

The tax effects of temporary differences which gave rise to consumer products deferred income tax assets and liabilities consisted of the following:

(in millions)	December 31, 1996	1995
Deferred income tax assets:		
Accrued postretirement and postemployment benefits	$ 1,070	$ 1,018
Accrued liabilities	588	451
Restructuring, strategic and other reserves	315	331
Other	399	764
Gross deferred income tax assets	2,372	2,564
Valuation allowance	(87)	(125)
Total deferred income tax assets	2,285	2,439
Deferred income tax liabilities:		
Property, plant and equipment	(1,699)	(1,687)
Prepaid pension costs	(286)	(197)
Total deferred income tax liabilities	(1,985)	(1,884)
Net deferred income tax assets	$ 300	$ 555

Financial services and real estate deferred income tax liabilities are primarily attributable to temporary differences from investments in finance leases.

Note 10. Segment Reporting:

Tobacco, food, beer, and financial services and real estate are the major segments of the Company's operations. The Company's major products are cigarettes, coffee, cheese, chocolate confections, processed meat products, various packaged grocery products and beer. The Company's consolidated operations outside the United States, which are principally in the tobacco and food businesses, are organized into geographic regions by segment, with Europe the most significant. Intersegment transactions are not reported separately since they are not material.

For purposes of segment reporting, operating profit is operating income exclusive of certain unallocated corporate expenses. Substantially all goodwill amortization is attributable to the food segment. Identifiable assets are those assets applicable to the respective industry segments. See Note 2 regarding divestitures and acquisitions.

Reportable segment data were as follows:

Data by Segment for the years ended December 31, (in millions)	1996	1995	1994
Operating revenues:			
Tobacco	$36,549	$32,316	$28,671
Food	27,950	29,074	31,669
Beer	4,327	4,304	4,297
Financial services and real estate	378	377	488
Total operating revenues	$69,204	$66,071	$65,125
Operating profit:			
Tobacco	$ 8,263	$ 7,177	$ 6,162
Food	3,362	3,188	3,108
Beer	437	444	413
Financial services and real estate	192	164	208
Total operating profit	12,254	10,973	9,891
Unallocated corporate expenses	485	447	442
Operating income	$11,769	$10,526	$ 9,449
Identifiable assets:			
Tobacco	$13,314	$11,196	$ 9,926
Food	32,934	33,447	34,822
Beer	1,707	1,751	1,706
Financial services and real estate	5,917	5,632	5,193
	53,872	52,026	51,647
Other assets	999	1,785	1,002
Total assets	$54,871	$53,811	$52,649
Depreciation expense:			
Tobacco	$ 378	$ 350	$ 360
Food	538	556	539
Beer	104	101	108
Capital expenditures:			
Tobacco	$ 829	$ 525	$ 529
Food	812	948	1,072
Beer	122	115	121

Data by Geographic Region for the years ended December 31, (in millions)	1996	1995	1994
Operating revenues:			
United States--domestic	$31,993	$32,479	$35,936
--export	6,476	5,920	4,942
Europe	24,232	23,076	19,888
Other	6,503	4,596	4,359
Total operating revenues	$69,204	$66,071	$65,125
Operating profit:			
United States	$ 8,762	$ 8,031	$ 7,306
Europe	2,635	2,366	1,914
Other	857	576	671
Total operating profit	12,254	10,973	9,891
Unallocated corporate expenses	485	447	442
Operating income	$11,769	$10,526	$ 9,449

Identifiable assets:			
United States	$33,314	$32,521	$33,622
Europe	15,836	15,981	14,845
Other	4,722	3,524	3,180
	53,872	52,026	51,647
Other assets	999	1,785	1,002
Total assets	$54,871	$53,811	$52,649

Note 11. Pension Plans:

The Company and its subsidiaries sponsor noncontributory defined benefit pension plans covering substantially all U.S. employees. The plans provide retirement benefits for salaried employees based generally on years of service and compensation during the last years of employment. Retirement benefits for hourly employees generally are a flat dollar amount for each year of service. The Company funds these plans in amounts consistent with the funding requirements of federal laws and regulations.

Pension coverage for employees of the Company's non-U.S. subsidiaries is provided, to the extent deemed appropriate, through separate plans, many of which are governed by local statutory requirements. The plans provide pension benefits that are based primarily on years of service and employees' salaries near retirement. The Company provides for obligations under such plans by depositing funds with trustees or purchasing insurance policies. The Company records liabilities for unfunded foreign plans.

U.S. Plans

Net pension (income) cost consisted of the following:

(in millions)	1996	1995	1994
Service cost--benefits earned during the year	$ 143	$ 110	$ 130
Interest cost on projected benefit obligation	373	367	342
(Return) loss on assets			
--actual	(980)	(1,344)	94
--deferred gain (loss)	447	848	(605)
Amortization of net gain upon adoption of SFAS No. 87	(25)	(26)	(28)
Amortization of unrecognized net loss (gain) from experience differences	9	(13)	(12)
Amortization of prior service cost	14	13	12
Other (income) cost	(35)	75	49
Net pension (income) cost	$ (54)	$ 30	$ (18)

During 1996, 1995 and 1994, the Company sold businesses and instituted early retirement and workforce reduction programs resulting in curtailment and settlement gains of $69 million and additional pension cost of $34 million in 1996, additional pension cost of $103 million and curtailment gains of $28 million in 1995 and additional pension cost of $49 million in 1994.

The funded status of U.S. plans at December 31 was as follows:

(in millions)	1996	1995
Actuarial present value of accumulated benefit obligation--vested	$ 3,871	$ 4,116
--nonvested	359	354
	4,230	4,470
Benefits attributable to projected salaries	650	786
Projected benefit obligation	4,880	5,256
Plan assets at fair value	7,101	6,649
Excess of assets over projected benefit obligation	2,221	1,393
Unamortized net gain upon adoption of SFAS No. 87	(108)	(140)
Unrecognized prior service cost	124	131
Unrecognized net gain from experience differences	(1,404)	(807)
Prepaid pension cost	$ 833	$ 577

The projected benefit obligation at December 31, 1996, 1995 and 1994 was determined using an assumed discount rate of 7.75%, 7.25% and 8.5%, respectively, and assumed compensation increases of 4.5% at December 31, 1996 and 1995 and 5.0% at December 31, 1994. The assumed long-term rate of return on plan assets was 9% at December 31, 1996, 1995 and 1994. Plan assets consist principally of common stock and fixed income securities.

The Company and certain of its subsidiaries sponsor deferred profit-sharing plans covering certain salaried, nonunion and union employees. Contributions and costs are determined generally as a percentage of pretax earnings, as defined by the plans. Certain other subsidiaries of the Company also maintain defined contribution plans. Amounts charged to expense for defined contribution plans totaled $210 million, $201 million and $191 million in 1996, 1995 and 1994, respectively.

In addition, certain of the Company's subsidiaries participate in multiemployer defined benefit plans. Contributions to these plans were immaterial in 1996, 1995 and 1994.

Non-U.S. Plans

Net pension cost consisted of the following:

(in millions)	1996	1995	1994

Service cost--benefits earned during the year	$ 80	$ 80	$ 72
Interest cost on projected benefit obligation	166	160	136
(Return) loss on assets			
--actual	(201)	(195)	4
--deferred gain (loss)	70	74	(113)
Amortization of net loss (gain) upon adoption of SFAS No. 87	3	1	(1)
Net pension cost	$ 118	$ 120	$ 98

The funded status of the non-U.S. plans at December 31 was as follows:

(in millions)	Assets Exceed Accumulated Benefits 1996	1995	Accumulated Benefits Exceed Assets 1996	1995
Actuarial present value of accumulated benefit obligation				
--vested	$ 1,336	$ 1,257	$ 721	$ 703
--nonvested	39	46	77	69
	1,375	1,303	798	772
Benefits attributable to projected salaries	342	324	127	125
Projected benefit obligation	1,717	1,627	925	897
Plan assets at fair value	1,891	1,780	36	59
Plan assets in excess of (less than) projected benefit obligation	174	153	(889)	(838)
Unamortized net (gain) loss upon adoption of SFAS No. 87	(14)	11	13	14
Unrecognized net gain from experience differences	(22)	(42)	(5)	(34)
Prepaid (accrued) pension cost	$ 138	$ 122	$ (881)	$ (858)

The assumptions used in 1996, 1995 and 1994 were as follows:

	1996	1995	1994
Discount rates	4.0% to 12.0%	4.5% to 10.0%	5.0% to 13.0%
Compensation increases	3.0% to 8.0%	3.5% to 9.0%	3.5% to 11.0%
Long-term rates of return on plan assets	4.5% to 11.0%	4.5% to 11.0%	5.5% to 12.0%

Plan assets consist primarily of common stock and fixed income securities.

Note 12. Postretirement Benefits Other Than Pensions:

The Company and it subsidiaries have accrued the estimated cost of retiree health care benefits during the active service periods of employees in the United States and Canada. Health care benefits for retirees outside the United States and Canada are generally covered through local government plans. The Company and its U.S. and Canadian subsidiaries provide health care and other benefits to substantially all retired employees, their covered dependents and beneficiaries. Generally, employees who have attained age 55 and who have rendered at least 5 to 10 years of service are eligible for these benefits. Certain health care plans are contributory; others are noncontributory.

Net postretirement health care costs consisted of the following:

(in millions)	1996	1995	1994
Service cost--benefits earned during the period	$ 59	$ 46	$ 57
Interest cost on accumulated postretirement benefit obligation	180	179	165
Amortization of unrecognized net loss (gain) from experience differences	4	(2)	6
Amortization of unrecognized prior service cost	(12)	(13)	(15)
Other (income) cost	(8)	(13)	32
Net postretirement health care costs	$ 223	$ 197	$ 245

During 1996, 1995 and 1994, the Company sold businesses and instituted early retirement and workforce reduction programs resulting in additional income or cost.

The Company's postretirement health care plans currently are not funded. The status of the plans at December 31 was as follows:

(in millions)	1996	1995
Actuarial present value of accumulated postretirement benefit obligation:		
Retirees	$ 1,289	$ 1,353
Fully eligible active plan participants	278	253
Other active plan participants	859	927
	2,426	2,533
Unrecognized net loss from experience differences	(75)	(303)
Unrecognized prior service cost	127	140
Accrued postretirement health care costs	$ 2,478	$ 2,370

The assumed health care cost trend rate used in measuring the accumulated postretirement benefit obligation for U.S. plans was 9.0% in 1995, 8.5% in 1996 and 8.0% in 1997, gradually declining to 5.0% by the year 2003 and remaining at that level thereafter. For Canadian plans, the assumed health care cost trend rate was 15.0% in 1995, 14.0% in 1996 and 13.0% in 1997, gradually declining to 5.0% by the year 2005 and remaining at that level thereafter. A one-percentage-point increase in the assumed health care cost trend rates for each year would increase the accumulated postretirement benefit obligation as of December 31, 1996 and net postretirement health care cost for the year then ended by approximately 12% and 16%, respectively.

The accumulated postretirement benefit obligations for U.S. plans at December 31, 1996, 1995 and 1994 were determined using assumed discount rates of 7.75%, 7.25% and 8.5%, respectively. The accumulated postretirement benefit obligation at December 31, 1996 and 1995 for Canadian plans was determined using an assumed discount rate of 8.25% and 9.75%, respectively.

Note 13. Contingencies:

Legal proceedings covering a wide range of matters are pending in various U.S. and foreign jurisdictions against the Company and its subsidiaries, including Philip Morris Incorporated ("PM Inc."), the Company's wholly-owned domestic tobacco subsidiary. Various types of claims are raised in these proceedings, including but not limited to products liability, antitrust, securities law, tax and patent infringement matters.

Pending claims related to tobacco products generally fall within three categories: (i) smoking and health cases alleging personal injury brought on behalf of individual smokers, (ii) smoking and health cases alleging personal injury and purporting to be brought on behalf of a class of plaintiffs, and

(iii) health care cost recovery actions brought primarily by states and local governments seeking reimbursement for Medicaid and other health care expenditures allegedly caused by cigarette smoking.

In the individual and class action smoking and health cases pending against PM Inc. and, in some cases, the Company and/or certain of its other subsidiaries, plaintiffs allege personal injury resulting from cigarette smoking, "addiction" to cigarette smoking or exposure to environmental tobacco smoke ("ETS") and seek compensatory and, in some cases, punitive damages in amounts ranging into the billions of dollars. During the past two years, there has been a substantial increase in the number of such smoking and health cases in the United States, with a majority of the new cases having been filed in Florida on behalf of individual plaintiffs. As of December 31, 1996, there were 185 smoking and health cases filed and served on behalf of individual plaintiffs in the United States against PM Inc. and, in some cases, the Company, compared to 115 such cases as of December 31, 1995, and 84 such cases as of December 31, 1994. One hundred twenty-two of the cases filed and served as of December 31, 1996, were filed on behalf of individual plaintiffs in the state of Florida. Ten of the individual cases involve allegations of various personal injuries allegedly related to exposure to ETS.

In addition to the foregoing individual smoking and health cases, there are 17 purported smoking and health class actions pending in the United States against PM Inc. and, in some cases, the Company, including one that involves allegations of various personal injuries related to exposure to ETS. Twelve of these actions purport to constitute state-wide class actions and were filed after the Fifth Circuit Court of Appeals, in the Castano case discussed below, reversed a federal district court's certification of a purported nation-wide class action on behalf of persons who were allegedly addicted to tobacco products. One purported smoking and health class action is pending in Canada and another in Brazil against affiliates of the Company. In California, individuals and local governments and other organizations purportedly acting as "private attorneys general" have filed suits seeking, among other things, injunctive relief, restitution and disgorgement of profits for alleged violations of California's consumer protection statutes. As discussed below, 26 health care cost recovery actions are currently pending.

In August 1996, a jury awarded a former smoker and his spouse $750,000 in a smoking and health case against another United States cigarette manufacturer (Carter v. American Tobacco Co., et al.). Neither PM Inc. nor the Company was a party to that litigation. Defendant in that action has appealed the verdict. Later that month, a jury returned a verdict for defendants in a smoking and health case in Indiana against United States cigarette manufacturers, including PM Inc. (Rogers v. R.J. Reynolds Tobacco Company, et al.). Plaintiff has appealed the verdict.

Several smoking and health cases and health care cost recovery actions are scheduled for trial in 1997, although trial dates are subject to change. One individual smoking and health case in which PM Inc. is a defendant is scheduled for trial during the first quarter of 1997 and a number of other individual cases against the industry are scheduled for trial later in the year. A purported class action on behalf of flight attendants alleging injury caused by exposure to ETS aboard aircraft is set for trial in June 1997 in Florida state court. A purported class action on behalf of Florida residents who allege injury from alleged nicotine addiction is set for trial in September 1997. A similar action on behalf of Pennsylvania residents is set for trial in October 1997. Health care cost recovery actions are currently scheduled for trial in Mississippi in June 1997, in Florida in August 1997 and in Texas in September 1997.

A description of smoking and health class actions, health care cost recovery litigation and certain other actions pending against the Company and/or its subsidiaries and affiliates follows.

Smoking and Health Litigation

Plaintiffs' allegations of liability in smoking and health cases are based on various theories of recovery, including negligence, gross negligence, strict liability, fraud, misrepresentation, design defect, failure to warn, breach of express and implied warranties, conspiracy, concert of action, and violations of deceptive trade practice laws and consumer protection statutes. Defenses raised by defendants in these cases include lack of proximate cause, assumption of the risk, comparative fault and/or contributory negligence, statutes of limitations or repose, and preemption by the Federal Cigarette Labeling and Advertising Act, as amended (the "Labeling Act"). In June 1992, the United States Supreme Court held that the Labeling Act, as enacted in 1965, does not preempt common law damage claims but that the Labeling Act, as amended in 1969, preempts claims arising after July 1969 against cigarette manufacturers "based on failure to warn and the neutralization of federally mandated warnings to the extent that those claims rely on omissions or inclusions in advertising or promotions." The Court also held that the 1969 Labeling Act does not preempt claims based on express warranty, fraudulent misrepresentation or conspiracy. The Court also held that claims for fraudulent concealment were preempted except "insofar as those claims relied on a duty to disclose...facts through channels of communication other than advertising or promotion." (The Court did not consider whether such common law damage claims were valid under state law.) The Court's decision was announced by a plurality opinion. The effect of the decision on pending and future cases will be the subject of further proceedings in the lower federal and state courts. Additional similar litigation could be encouraged if legislation to eliminate the federal preemption defense, proposed in Congress in recent years, were enacted. It is not possible to predict whether any such legislation will be enacted.

A smoking and health class action against United States cigarette manufacturers has been pending in Florida state court since October 1991 in which a class has been certified consisting of "all non-smoking flight attendants who are or have been employed by airlines based in the United States" and who are allegedly suffering from exposure to ETS aboard aircraft. Broin, et al. v. Philip Morris Incorporated, et al., Circuit of the Eleventh Judicial Circuit in and for Dade County Florida, Case No. 91-49738-CA-20. Various challenges to the class certification have been denied on appeal, and the case is currently set for trial in June 1997.

Another smoking and health class action against United States cigarette manufacturers has been pending in Florida state court since May 1994 in which a class has been certified consisting of all Florida citizens and residents and their survivors who have suffered injury "caused by their addiction to cigarettes that contain nicotine." Engle, et al. v. R.J. Reynolds Tobacco Company, et al., Circuit Court of the Eleventh Judicial Circuit in and for Dade County, Florida, Case No. 94-08273-CA-20. Various challenges to the class certification have been denied on appeal, and the case is currently set for trial in September 1997.

In March 1994, a smoking and health class action was filed in Alabama state court against three United States cigarette manufacturers, and was subsequently removed to federal court. Lacey, et al. v. Lorillard Tobacco Company, Inc. et al., United States District Court, Northern District of Alabama, Jasper Division, Civil Action No. 94-4-B-0901-J. Plaintiffs, claiming to represent all smokers who have smoked or are smoking cigarettes sold by defendants in the State of Alabama, seek compensatory and punitive damages not to exceed $48,500 per each class member as well as injunctive relief arising from defendants' alleged failure to disclose additives used in their cigarettes. In August 1996, the judge orally granted defendants' motion for summary judgment on the grounds that the suit is preempted by the Labeling Act.

In March 1994, a smoking and health class action was filed in federal district court in Louisiana against United States cigarette manufacturers and others, including the Company, seeking certification of a purported class consisting of all United States residents who allege that they are addicted, or are the legal survivors of persons who were addicted, to tobacco products. Castano, et al. v. The American Tobacco Company Inc., et al., United States District Court, Eastern District of Louisiana, Case No. 94-1044. Plaintiffs alleged that the cigarette manufacturers concealed and/or misrepresented information regarding the addictive nature of nicotine and manipulated the levels of nicotine in their tobacco products to make such products addictive. In February 1995, the trial court certified the class and in

May 1996, the Fifth Circuit Court of Appeals reversed the trial court's class certification and remanded the case with instructions that the class allegations be dismissed. Summary judgment motions against the two remaining named plaintiffs in this case are pending.

Following the announcement of the Fifth Circuit's class decertification decision in Castano, lawyers for the plaintiffs announced that they would file "state-wide" smoking and health class actions in state courts. Subsequently, smoking and health class actions based on claims similar to those in Castano (a "nicotine-dependence class action") and, in some cases, claims of physical injury as well (a "physical injury class action") were filed in a number of states, as described below.

Immediately prior to the Fifth Circuit's decision in the Castano case, a purported nicotine-dependence class action was filed in Indiana state court against United States cigarette manufacturers and others. In June 1996, defendants removed the case to federal court. Norton, et al. v. RJR Nabisco Holdings Corporation, et al., United States District Court for the Southern District of Indiana, Case No. IP96-0798-C-M/S. Plaintiffs' motion to remand the case to state court is pending.

In May 1996, a purported physical injury class action was filed in Maryland state court against United States cigarette manufacturers and others, including the Company. The case was removed by defendants to federal court and was subsequently remanded to state court. Richardson, et al. v. Philip Morris Incorporated, et al., Circuit Court for Baltimore City, No. 96145050.

In May 1996, a purported nicotine-dependence class action was filed in Louisiana state court against four United States cigarette manufacturers and others, including the Company. Scott, et al. v. The American Tobacco Company, Inc., et al., Civil District Court for the Parish of Orleans, State of Louisiana, Docket No. 96-8461. A hearing on plaintiffs' motion for class certification has been scheduled for February 1997.

In June 1996, a purported nicotine-dependence class action was filed in New York state court against PM Inc., the Company, the Tobacco Institute and the Council for Tobacco Research--U.S.A., Inc. Frosina, et al. v. Philip Morris Inc., et al., Supreme Court of the State of New York, County of New York, Case No. 96110950. In December 1996, defendants filed motions to dismiss the complaint and to deny class certification.

In June 1996, a purported physical injury class action was filed in the Superior Court of the District of Columbia against United States cigarette manufacturers and others, including the Company. Reed v. Philip Morris Incorporated, et al., Superior Court of the District of Columbia, Case No. CA-05070-96. A hearing on whether plaintiffs can pursue a class action has been scheduled for June 1997.

In August 1996, a purported nicotine-dependence class action was filed in Pennsylvania state court against United States cigarette manufacturers and others, including the Company, and was subsequently removed to federal court. Arch, et al. v. American Tobacco Company Inc., et al., United States District Court for the Eastern District of Pennsylvania, Case No. 96-5903-CN. A hearing on class certification is set for March 1997, and the trial is scheduled for October 1997.

In August 1996, a purported nicotine-dependence class action was filed in Alabama state court, on behalf of Alabama and North Carolina residents, against four United States cigarette manufacturers and others, including the Company. In September 1996, the case was removed by defendants to federal court. Lyons, et al. v. The American Tobacco Co., Inc., et al., United States District Court for the Southern District of Alabama, Southern Division, Civil Action No. 96-0881-BH-S. Plaintiffs' motion to remand the case to state court is pending.

In August 1996, a purported nicotine-dependence class action was filed in Ohio state court against United States cigarette manufacturers and others, including the Company, and was subsequently removed to federal court. Chamberlain, et al. v. The American Tobacco Co., et al., United States District Court, Northern District of Ohio, Case No. 1:96CV2005. Plaintiffs' motion to remand the case to state court is pending.

In August 1996, a purported physical injury class action was filed in Florida state court against United States cigarette manufacturers, and others. Walters, et al. v. Brown & Williamson Tobacco Corp., et al., Circuit Court, Fourth Judicial District, Duval County, Florida.

In September 1996, a purported nicotine-dependence class action was filed in Minnesota state court against four United States cigarette manufacturers and others, including the Company. The case was removed by defendants to federal court in September 1996. Masepohl, et al. v. The American Tobacco Co., Inc., et al., United States District Court, District of Minnesota, Third Division, Case No. CV3-96-888. Plaintiffs' motion to remand the case to state court is pending.

In October 1996, a purported nicotine-dependence class action was filed in New Mexico state court against four United States cigarette manufacturers and others, including the Company. Connor, et al. v. The American Tobacco Co., et al., Second Judicial District Court, County of Bernalillo, State of New Mexico, Case No. CV-96-9422.

In October 1996, a purported nicotine-dependence class action was filed in federal court in Puerto Rico against four United States cigarette manufacturers and others. Ruiz, et al. v. The American Tobacco Co., et al., United States District Court for the District of Puerto Rico, Civil Action No. 96-2300.

In November 1996, a purported nicotine-dependence class action was filed in federal court in Arkansas against United States cigarette manufacturers and others, including the Company. McGinty, et al. v. The American Tobacco Co., et al., United States District Court for the Eastern District of Arkansas, Western Division, Case No. LRC 96-881.

In February 1995, Rothmans, Benson & Hedges, Inc. (in which the Company, through subsidiaries, owns a 40% interest) was served with a statement of claim commencing a purported class action in the Ontario Court of Justice, Toronto, Canada, against Imperial Tobacco Limited, RJR-MacDonald Inc., and Rothmans, Benson & Hedges, Inc. LeTourneau v. Rothmans et al., Ontario Court of Justice, Toronto, Canada, Court File No. 95-CU-82186 (now captioned Caputo v. Imperial Tobacco Limited, et al.). The lawsuit seeks damages in the amount of $1,000,000 (Canadian) per class member and punitive and exemplary damages and an order requiring the funding of rehabilitation centers. Plaintiffs seek certification of a class of persons consisting of all current and former cigarette smokers in Ontario, their families and the estates of deceased smokers. Defendants' request for a more particular statement of claim prior to delivering their statement of defense was partially granted and partially denied in April 1996. Defendants have appealed that order.

In July 1995, a purported class action on behalf of all Brazilian smokers and former smokers was filed in state court in Sao Paulo, Brazil, naming Philip Morris Marketing, S.A., a wholly-owned subsidiary of the Company, as a co-defendant. The Smoker Health Defense Association, et al. v. Souza Cruz, S.A. and Philip Morris Marketing, S.A., 19th Lower Civil Court of the Central Courts of the Judiciary District of Sao Paulo, Brazil. Plaintiffs allege that defendants failed to warn that smoking is "addictive" and engaged in misleading advertising. Plaintiffs have obtained an order, which was upheld on appeal, reversing the burden of proof and placing the burden on defendants. Defendants are seeking further appellate review of this order.

Pro se prisoners have filed two purported class actions against United States cigarette manufacturers and others seeking, in one case, class certification on behalf of prisoners in two Mississippi prisons based on alleged exposure to ETS (Lyle, et al. v. Brown & Williamson Tobacco Corporation, et al., United States District Court for the Northern District of Mississippi, Civil Action No. 3:96-CV-268WS) and, in the other, on behalf of all allegedly nicotine-dependent persons in the United States (Harris, et al. v. Philip Morris Incorporated, et al., United States District Court for the Eastern District of Pennsylvania, Civil Action No. 3:96-CV 652). In October 1996, the court issued an order dismissing the Lyle action. In November 1996, the court in Harris entered an order denying class certification.

Health Care Cost Recovery Litigation

In certain of the pending proceedings, state and local government entities and others seek reimbursement for Medicaid and/or other health care expenditures allegedly caused by tobacco products. The claims asserted in these health care cost recovery actions vary. All plaintiffs assert the equitable claim that the tobacco industry was "unjustly enriched" by plaintiffs' payment of health care costs allegedly attributable to smoking and seek reimbursement of those costs. Other claims made by some but not all plaintiffs include the equitable claim of indemnity, common law claims of negligence, strict liability, breach of express and implied warranty, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under state and federal statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under the Federal Racketeer Influenced and Corrupt Organization Act ("RICO") or state RICO statutes.

Each plaintiff seeks reimbursement of Medicaid and/or other health care costs. Other relief sought by some but not all plaintiffs includes punitive damages, treble damages for alleged antitrust law violations, injunctions prohibiting alleged marketing and sales to minors, disclosure of research, disgorgement of profits, funding of anti-smoking programs, disclosure of nicotine yields and payment of attorney and expert witness fees.

Defenses raised by defendants include failure to state a valid claim, lack of benefit, adequate remedy at law, "unclean hands" (namely, that plaintiffs cannot recover because they participated in, and benefited from, the sale of cigarettes), lack of antitrust injury, federal preemption, lack of proximate cause and statute of limitations. In addition, defendants argue that they should be entitled to "set-off" any alleged damages to the extent a state benefits economically from the sale of cigarettes through the receipt of excise taxes or otherwise. Defendants also argue that all of these cases are improper because plaintiffs must proceed under principles of subrogation and assignment. Under traditional theories of recovery, a payor of medical costs (such as an insurer or a state) can seek recovery of health care costs from a third party solely by "standing in the shoes" of the injured party. Defendants argue that plaintiffs should be required to bring an action on behalf of each individual health care recipient and should be subject to all defenses available against the injured party. In certain of these cases, defendants have also challenged the ability of the plaintiffs to use contingency fee counsel to prosecute these actions. Further, certain cigarette companies, including PM Inc., have filed related declaratory judgment actions in several states seeking to block the health care cost recovery actions in those states and/or to prevent the state from hiring contingency fee counsel.

The following is a summary of certain developments in each of the health care cost recovery suits pending against PM Inc. and, in some cases, the Company and the related declaratory judgment actions filed by cigarette manufacturers.

Florida--In May 1994, the State of Florida enacted a statute which purports, among other things, to abolish affirmative defenses in Medicaid recovery actions. In June 1994, PM Inc. and others filed suit in Florida state court challenging the constitutionality of the statute. Associated Industries of Florida, Inc., et al. v. State of Florida Agency for Health Care Administration, et al., Circuit Court of the Second Judicial Circuit in and for Leon County, Florida, Case No. 94-3128. In June 1996, the Florida Supreme Court ruled that the provisions of the statute that permitted the state to pursue its action without identifying individual Medicaid recipients violated defendants' due process rights under the Florida constitution and that defendants may rebut the state's claims of causation and damages on a recipient-by-recipient basis. The court held constitutional on its face the statutory provision abolishing affirmative defenses normally available to a third party, including assumption of the risk, but stated that this provision might be unconstitutional as applied in the state's case. The court also held that the state's independent cause of action created by the statute could apply only to Medicaid costs paid after the amendment became effective in July 1994, that defendants could be held individually liable under a market share theory, that the state could use statistical evidence to present its case, and that the agency charged with enforcing the statute was constitutionally established. In September 1996, plaintiffs' petition for rehearing on the Florida Supreme Court's rulings on abrogation of affirmative defenses and application of the statute to conduct occurring before July 1994 was denied. In December 1996, PM Inc. and another party filed a petition for a writ of certiorari to the United States Supreme Court on the grounds that the statute violates due

process because it creates a unique cause of action on behalf of the state which abrogates certain common law and equitable principles, including affirmative defenses.

In February 1995, the State of Florida filed a health care cost recovery action under the statute in Florida state court. The State of Florida, et al. v. The American Tobacco Company, et al., Circuit Court of the Fifteenth Judicial Circuit in and for Palm Beach County, Florida, Case No. CL 95 1466 AO. In September 1996, the trial court dismissed all of the state's claims except for its negligence and strict liability counts arising from Medicaid payments made after July 1, 1994, and its count for injunctive relief. The court also ordered the state to disclose the identity of the Medicaid recipients. In October 1996, the state filed a coded listing (without names) for all Medicaid recipients with alleged smoking-related illnesses. The trial court accepted the coded listing and, in January 1997, the Florida Supreme Court determined not to hear and denied defendants' challenge to the sufficiency of the state's purported identification of Medicaid recipients. In November 1996, plaintiffs amended their complaint to add claims for violations of Florida's RICO and consumer protection statutes. In December 1996, the court granted defendants' motion to dismiss various claims brought under state statutes and denied the motion to dismiss claims based on Florida's RICO statute and on a state false advertising statute. In January 1997, defendants waived their rights to a pretrial determination of whether plaintiffs can amend their complaint to include a punitive damages claim. Defendants have reserved their rights to challenge the punitive damages claim on factual or legal bases. Plaintiffs' motion to strike defendants' affirmative defenses was heard on January 24, 1997. The trial in this case is scheduled to begin in August 1997.

Mississippi--In May 1994, the Attorney General of Mississippi filed a health care cost recovery action in Mississippi state court. Moore v. The American Tobacco Company, et al., Chancery Court of Jackson County, Mississippi, Case No. 94-1429. In February 1995, the court granted plaintiff's motion to strike certain of defendants' challenges to the sufficiency of the complaint and denied defendants' motion for judgment on the pleadings. In July 1995, plaintiff filed a motion seeking to preclude defendants from asserting their "set off" defenses. That motion is pending. The Governor of Mississippi and defendants have filed petitions with the Mississippi Supreme Court challenging the authority of the Attorney General to pursue this action. The Mississippi Supreme Court heard arguments on both petitions in September 1996, but has not issued a decision on either petition. The trial is scheduled to begin in June 1997.

Minnesota--In August 1994, the Attorney General of Minnesota and Blue Cross and Blue Shield of Minnesota filed a health care cost recovery action in Minnesota state court. Minnesota, et al. v. Philip Morris Incorporated, et al., Minnesota District Court, Second Judicial District, County of Ramsey, Case No. C1-94-8565. In July 1996, the Minnesota Supreme Court ruled that Blue Cross did not have standing to pursue its tort claims against defendants, but that it could proceed against defendants for claims brought under antitrust and consumer protection statutes. The Supreme Court also held that Blue Cross could pursue directly its equitable claims, but only for injunctive (not monetary) relief. The case is scheduled to go to trial in January 1998.

West Virginia--In September 1994, the Attorney General of West Virginia filed a health care cost recovery action in West Virginia state court. McGraw v. The American Tobacco Company, et al., Circuit Court of Kanawha County, West Virginia, Case No. 94-1707. In October 1995, the court dismissed eight of ten counts of the complaint and granted defendants' motion to prohibit prosecution of this case pursuant to a contingent fee agreement with private counsel. In June 1996, the Attorney General added the Public Employees' Insurance Agency as a plaintiff. In November 1996, plaintiffs added the West Virginia Department of Health and Human Resources as a plaintiff, and three law firms as defendants, and asserted additional counts under theories of indemnity, negligent misrepresentation, negligence, and strict product liability. In December 1996, the court heard oral argument on defendants' motion to dismiss plaintiff's common law and equitable claims. A hearing on defendants' motion to dismiss plaintiff's statutory claims is scheduled for February 1997.

Texas--In March 1996, the Texas Attorney General filed a health care cost recovery action in federal court in Texas. The State of Texas v. The American Tobacco Company, et al., United States District Court, Eastern District of Texas, Civil No. 5-96CV91. Trial in this action is set for September 1997 and defendants have filed a number of motions to dismiss it. Defendants and others had previously filed an action in Texas state court in November 1995, seeking a declaration that the Texas Attorney General cannot pursue a health care cost recovery action. Philip Morris Incorporated, et al. v. Dan Morales, Attorney General of the State of Texas, et al., District Court of Travis County, Texas, No. 94-14807. The state court has stayed the action for declaratory relief pending the outcome of the Attorney General's suit.

Massachusetts--In December 1995, the Massachusetts Attorney General filed a health care cost recovery action in Massachusetts state court. Commonwealth of Massachusetts v. Philip Morris Inc., et al., Superior Court, Middlesex County, Civil Action No. 95-7378. Defendants have moved to dismiss the complaint. Defendants had previously filed an action in Massachusetts federal court in November 1995, seeking to enjoin the Attorney General from prosecuting a health care cost recovery action. Philip Morris Incorporated, et al. v. Scott Harshbarger, United States District Court, District of Massachusetts, Case No. 95-12574-GAO. In November 1996, the federal district court denied the Attorney General's motion to dismiss the complaint and stayed the injunction action.

Maryland--In May 1996, the State of Maryland filed a health care cost recovery action in Maryland state court. State of Maryland v. Philip Morris Incorporated, et al., Circuit Court for Baltimore County, Maryland, Case No. 96-122017/CL211017. Defendants' motion to dismiss the state's complaint is scheduled to be heard on January 28, 1997. The trial is scheduled for January 1999. Defendants and others had previously filed a separate action in Maryland state court seeking to enjoin the Maryland Attorney General from prosecuting a health care cost recovery action pursuant to a contingent fee arrangement with special counsel. Philip Morris Incorporated, et al. v. Parris N. Glendening, Governor of the State of Maryland, et al., Circuit Court for Talbot County, Maryland, Case No. CG 2829. In August 1996, the court granted defendants' motion for summary judgment and dismissed the injunction action. Plaintiffs have appealed.

Louisiana--In March 1996, the Attorney General of Louisiana filed a health care cost recovery action in Louisiana state court. Ieyoub, et al. v. The American Tobacco Company, et al., 14th Judicial District Court, Parish of Calcasieu, Louisiana, Case No. 96-1209. In January 1997, the court denied defendants' motion to dismiss which argued that the Attorney General lacked the authority to bring this action.

San Francisco--In June 1996, the City and County of San Francisco filed a health care cost recovery action in California federal court and has since been joined by ten other California counties. City and County of San Francisco, et al. v. Philip Morris, Inc. et al., United States District Court, Northern District of California, Civil No. C 96-2090. In January 1997, the court denied defendants' motion to disqualify plaintiffs' contingency-fee counsel and took under advisement defendants' motion to dismiss. In September 1996, plaintiffs in the federal court action, joined by several medical associations, filed an action in California state court seeking, among other things, injunctive relief and disgorgement of profits for alleged violations of California's consumer protection statutes. People of the State of California, et al. v. Philip Morris, Inc. et al., San Francisco Superior Court, County of San Francisco, Case No. 980864. In January 1997, the court granted in part defendants' motion to dismiss by requiring plaintiffs to replead certain causes of action and denied the motion on other grounds.

Washington--In June 1996, the Attorney General of the State of Washington filed a health care cost recovery action in Washington state court. State of Washington v. American Tobacco Co., Inc., et al., Superior Court of Washington, King County, No. 96-2-15056-8. In November 1996, the court dismissed claims based on special duty, unjust enrichment and restitution to the state, but did not dismiss claims brought under Washington's antitrust laws. The State of Washington recently moved to amend its complaint with the stated intention of correcting deficiencies found by the court to exist in the special duty and unjust enrichment claims and to add a claim for restitution under Washington's consumer protection statute. Trial is scheduled for September 1998.

Connecticut--In July 1996, the State of Connecticut filed a health care cost recovery action in Connecticut state court. State of Connecticut v. Philip Morris Inc., et al., Superior Court, Judicial District of Litchfield, Case No. CV-96-01534405. Defendants had previously filed an action in federal district court in June 1996, seeking to enjoin the Connecticut Attorney General from bringing the health care cost recovery action. Philip Morris Inc., et al. v. Richard Blumenthal, United States District Court, District of Connecticut, Case No. 396CV01221 (PCD). This injunction action was dismissed in December 1996 and, in January 1997, plaintiffs appealed the dismissal.

Utah--In September 1996, the Utah Attorney General filed a health care cost recovery action in federal court in Utah. State of Utah v. R.J. Reynolds Tobacco Company, et al., United States District Court, District of Utah, Case No. 2:96CV 0829W. Defendants had previously filed an action in Utah state court in July 1996, challenging the right of the Attorney General to bring such an action and to prosecute the case pursuant to a contingent fee arrangement with special counsel. Philip Morris Incorporated, et al. v. Janet C. Graham, Attorney General of the State of Utah, et al., Third Judicial District Court of Salt Lake County, Utah, No. 960904948CV. The parties have agreed that the state court action will be stayed while the federal action is proceeding, except for the challenge to the Attorney General's contingent fee arrangement with special counsel. In December 1996, a motion for partial summary judgment challenging the contingent fee arrangement was argued before the state court.

Los Angeles County--In August 1996, the County of Los Angeles filed a health care cost recovery action in California state court. County of Los Angeles v. R.J. Reynolds Tobacco Company, et al., Superior Court of California, San Diego County.

Alabama--In August 1996, a health care cost recovery action was filed in Alabama state court as a putative class action on behalf of taxpayers of the State of Alabama. Following local rules, the state court entered an order conditionally certifying the class. This action was subsequently removed by defendants to federal court. Crozier, et al. v. The American Tobacco Company, et al., United States District Court for the Middle District of Alabama, Case No. 96-A-1403-N. Plaintiffs' motion to remand to state court is pending.

Kansas--In August 1996, the Attorney General of Kansas filed a health care cost recovery action in Kansas state court. State of Kansas, ex rel. Carla J. Stovall, Attorney General v. R.J. Reynolds Tobacco Co., et al., District Court of Shawnee County, Kansas, Case No. 96-CV-919. Defendants' motion to dismiss this case is scheduled to be heard in April 1997.

Michigan--In August 1996, the Attorney General of Michigan filed a health care cost recovery action in Michigan state court. Frank J. Kelley, Attorney General, ex rel. State of Michigan v. Philip Morris Incorporated, et al., Circuit Court for the 30th Judicial Circuit, Ingham County, Michigan, Case No. 96-84281-CZ. In October 1996, defendants moved to dismiss certain counts of the complaint and to strike claims for compensatory and punitive damages.

Oklahoma--In August 1996, the Attorney General of Oklahoma filed a health care cost recovery action in Oklahoma state court. State of Oklahoma, et al. v. R.J. Reynolds Tobacco Co., et al., District Court for Cleveland County, Oklahoma, Case No. CJ-96-1499-L.

Arizona--In August 1996, the Attorney General of Arizona filed a health care cost recovery action in Arizona state court. State of Arizona, et al. v. American Tobacco Co., Inc., et al., Superior Court, Maricopa County, Arizona, No. CV 96-14769. The Governor of Arizona has instructed the Attorney General to dismiss the case. Subsequently, the Attorney General filed an amended complaint that abandons claims for Medicaid payments, but seeks recovery of other health care costs as well as other damages and forms of relief. Motions to dismiss the complaint are pending. The trial is scheduled for October 1998.

Hawaii--In August 1996, PM Inc. and three other cigarette manufacturers filed suit against the Hawaii Attorney General in federal district court in Hawaii seeking declaratory and injunctive relief invalidating a threatened health care cost recovery action by Hawaii. A hearing on defendant's motion to dismiss is scheduled for March 1997. The action is scheduled to go to trial in December 1997. Philip Morris Inc., et al. v. Margery Bronster, U.S. District Court, Hawaii, Civ. No. 96-00722 HG.

Ohio--In September 1996, two Ohio local officials filed a health care cost recovery action in Ohio state court, purportedly on behalf of the State of Ohio and all Ohio taxpayers.

Defendants removed the case to federal court in Ohio and have filed a motion to dismiss challenging the standing of plaintiffs to bring this action. State ex rel. Coyne, Jr., et al. v. The American Tobacco Co., et al., United States District Court, Northern District of Ohio, Case No. 96-2247. Plaintiffs motion to remand this action to state court is pending.

New Jersey--In September 1996, the New Jersey Attorney General filed a health care cost recovery action in New Jersey state court. The State of New Jersey v. R.J. Reynolds Tobacco Company, et al., Chancery Court, Middlesex County, Case No. C-254-96. In August 1996, defendants filed a separate suit challenging the right of the Attorney General to bring such an action and to prosecute the case pursuant to a contingent fee arrangement with special counsel. Philip Morris Incorporated, et al. v. Peter Verniero, Attorney General of the State of New Jersey, et al., Superior Court of New Jersey, Chancery Division, Mercer County, Case No. MER-C-000114-96. Defendants' motion to dismiss the complaint and plaintiffs' motion for summary judgment are pending.

New York City--In October 1996, the City of New York and the New York City Health and Hospitals Corporation filed a health care cost recovery action in New York state court. City of New York, et al. v. The Tobacco Institute, et al., Supreme Court of the State of New York, County of New York, Case No. 406225/96.

Illinois--In November 1996, the Attorney General of Illinois filed a health care cost recovery action in Illinois state court. People of the State of Illinois v. Philip Morris, Inc., et al., Circuit Court of Cook County, Illinois, Case No. 96 L 13146.

Iowa--In November 1996, the State of Iowa filed a health care cost recovery action in Iowa state court. State of Iowa, ex rel. Thomas J. Miller, in his capacity as Attorney General of the State of Iowa v. R.J. Reynolds Tobacco Co., et al., District Court for Polk County, Iowa, Case No. CL71048.

Alaska--In January 1997, PM Inc. and three other cigarette manufacturers filed suit against the Alaska Attorney General in federal district court seeking declaratory and injunctive relief to prohibit a threatened health care cost recovery action by Alaska on grounds that it would violate federal law. Philip Morris Inc., et al. v. Bruce Botelho, U.S. District Court, Alaska, No. A 97-003 Civil (JWS).

Erie County--In January 1997, the County of Erie filed a health care cost recovery action in New York state court. County of Erie v. The Tobacco Institute, Inc., et al., Supreme Court of the State of New York, County of Erie, Case No. I1997/359.

New York--On January 27, 1997, it was reported in the press that the State of New York filed a health care cost recovery action.

Other state and local government entities have announced that they are considering filing similar health care cost recovery actions.

In September 1996, a purported class action was filed in Tennessee state court against four United States cigarette manufacturers and others on behalf of all individuals and entities in the United States who have paid premiums to a Blue Cross or Blue Shield organization for medical insurance. The complaint alleges that defendants' actions have resulted in increased medical insurance premiums for all class members and seeks recovery under various consumer protection statutes as well as under theories of breach of special duty and unjust enrichment. This case was removed by defendants to federal court. Perry, et al. v. Philip Morris Incorporated, et al., United States District Court for the Eastern District of Tennessee, Winchester Division, Civil Action No. 4:96-CV-106. Plaintiffs' motion to remand the case to state court is pending.

Other Tobacco Related Class Actions

In May 1995, PM Inc. announced a recall of certain of its products and in June and July four purported class actions relating to the recall were filed. Three of these cases have been dismissed. In October 1995, plaintiffs in the remaining action, Tijerina, et al. v. Philip Morris, Inc., et al., United States District Court, Northern District of Texas, Amarillo Division, Case No. 2-95-CV-120, filed an amended complaint alleging that PM Inc. has, for many years, knowingly manufactured filtered products that are defective because they contain "defective filters." Plaintiffs purport to bring this action on behalf of all persons who "are Texas residents and who have smoked Philip Morris filtered cigarettes manufactured with Hoechst Celanese filter materials" and who have suffered adverse health effects. Plaintiffs allege that the filters in these products contain hazardous chemicals and that cellulose acetate fibers break away from the filters and are inhaled and ingested by the consumer when the filtered products are used. Plaintiffs further allege that they relied on PM Inc.'s false and fraudulent misrepresentations, made through advertising, regarding the safety of the use of the filters. Motions to dismiss certain of plaintiffs' claims and motions for summary judgment are pending. In October 1996, the court denied plaintiffs' motion for class certification.

In June 1995, an action was filed in federal court in Maryland against PM Inc. seeking certification of a purported class consisting of "all persons and estates injured as a result of the defendant's alleged failure to manufacture a fire safe cigarette since 1987." Sacks, et al. v. Philip Morris Inc., United States District Court, District of Maryland, Case No. WMN-95-1840. Plaintiffs alleged in their complaint that PM Inc. intentionally withheld and suppressed material information relating to technology to produce a cigarette less likely to cause fires and failed to design and sell its cigarettes using the alleged technology. Compensatory and punitive damages were sought. In September 1996, an order was entered denying plaintiffs' motion for leave to file an amended complaint and granting defendant's motion to dismiss. Plaintiffs have appealed the order.

Certain Other Actions

In April 1994, the Company, PM Inc. and certain officers and directors were named as defendants in a complaint filed as a purported class action in federal court in New York. Lawrence, et al. v. Philip Morris Companies Inc., et al., United States District Court, Eastern District of New York, Case No. 94 Civ. 1494 (JG). Plaintiffs allege that defendants violated the federal securities laws by maintaining artificially high levels of profitability through an inventory management practice pursuant to which defendants allegedly shipped more inventory to customers than was necessary to satisfy market demand. In August 1995, the court granted plaintiffs' motion for class certification, certifying this action as a class action on behalf of all persons (other than persons associated with defendants) who purchased common stock of the Company during the period July 10, 1991 through

April 1, 1993, inclusive, and who held such stock at the close of business on April 1, 1993. In September 1996, the United States Court of Appeals for the Second Circuit denied the Company's Petition for Writ of Mandamus which had requested that the Court of Appeals direct the trial court to withdraw its order granting class certification. In January 1997, the court granted a motion by an alleged class member to intervene in the action and to be named an additional class representative.

In April 1994, the Company, PM Inc. and certain officers and directors were named as defendants in several purported class actions that were consolidated in the United States District Court in the Southern District of New York. Kurzweil, et al. v. Philip Morris Companies Inc., et al., United States District Court for the Southern District of New York, Case Nos. 94 Civ. 2373 (MBM) and 94 Civ. 2546 (MBM) and State Board of Administration of Florida, et al. v. Philip Morris Companies Inc., et al., United States District Court for the Southern District of New York, Case No. 94 Civ. 6399 (MBM). In those cases, plaintiffs asserted that defendants violated federal securities laws by, among other things, making allegedly false and misleading statements regarding the allegedly "addictive" qualities of cigarettes. In each case, plaintiffs claimed to have been misled by defendants' knowing and intentional failure to disclose material information. In September 1995, the court granted defendants' motion to dismiss the two complaints in their entirety. The court granted plaintiff in the State Board action leave to replead one of its claims. In April 1996, the court entered an order stipulating the dismissal of the State Board claims. In August 1996, the court entered judgment dismissing the claims in Kurzweil. In September 1996, the Kurzweil plaintiffs filed an appeal from the judgment in the United States Court of Appeals for the Second Circuit; plaintiffs withdrew the appeal without prejudice in December 1996. In September 1996, the Kurzweil plaintiffs filed a motion in the district court to vacate the judgment and for leave to amend their complaint; this motion remains pending.

In March 1995, an antitrust action was filed in California state court against four United States cereal manufacturers, including the Post Division of Kraft Foods, Inc. ("Kraft"), by plaintiffs purporting to represent all California residents who purchased defendants' cereal products during the four years preceding the date upon which the complaint was filed. McIver, et al. v. General Mills, Inc., et al., Superior Court of the State of California, County of Santa Barbara, Case No. 206663. Plaintiffs seek treble damages and the return of profits resulting from defendants' alleged conspiracy to fix and raise prices of cereal products sold to California consumers. In April 1995, a second purported class action similar to the earlier action was filed in the same court. In August 1995, the two cases were consolidated. In September 1995, the court granted defendants' motions for summary judgment. In December 1995, plaintiffs filed an appeal of that decision with the California Court of Appeals and, in January 1997, the Court of Appeals affirmed the trial court's dismissal of this action.

In April 1996, an antitrust action was filed in federal court in Wisconsin against Kraft as a purported class action. Stuart, et al. v. Kraft Foods, Inc., et al., United States District Court, Eastern District of Wisconsin, Case No. 96-C-391. An amended complaint filed in July 1996, named two other leading dairy products manufacturers and the National Cheese Exchange as defendants. Plaintiff purports to represent all persons and entities in the United States (excluding governmental entities and political subdivisions) that sold milk and/or bulk cheese directly to Kraft or any of its alleged co-conspirators at any time since January 1, 1988. Plaintiff alleges that defendants engaged in a conspiracy to fix and depress the prices of bulk cheese and milk through their trading activity on the National Cheese Exchange and failed to deal in good faith with their bulk cheese and milk suppliers by paying them prices based on the National Cheese Exchange. Plaintiff seeks injunctive and equitable relief and treble damages. In December 1996, plaintiffs' motion for class certification was denied and defendants' motion to dismiss plaintiffs' action was denied without prejudice.

In September 1996, a second antitrust action was filed in federal court in Wisconsin against Kraft as a purported class action. Sheeks, et al. v. Kraft Foods, Inc., et al., United States District Court, Eastern District of Wisconsin, Case No. 96-C-1100. Plaintiffs are dairy farmers and assert virtually identical claims to those in the Stuart case discussed above. In December 1996, the court denied plaintiffs' motion to consolidate this action with the Stuart case.

During 1996, tax assessments alleging the underpayment of Italian value added taxes for the years 1988 to 1994 and income taxes for the year 1987 were asserted against certain affiliates of the Company. The aggregate amount of taxes claimed to be assessed to date, together with interest and penalties, is $798.4 million. The Company anticipates that further substantial value added and income tax assessments may be claimed. The Company and its affiliates believe they have complied with applicable Italian tax laws and intend to vigorously contest the assessments. A hearing concerning value added taxes is scheduled in the Italian tax court for February 4, 1997.

The Company and each of its subsidiaries named as a defendant believe, and each has been so advised by counsel handling the respective cases, that it has a number of valid defenses to all litigation pending against it. All such cases are, and will continue to be, vigorously defended. It is not possible to predict the outcome of this litigation. Litigation is subject to many uncertainties, and it is possible that some of these actions could be decided unfavorably. An unfavorable outcome of a pending smoking and health case, such as the Carter case discussed above, could encourage the commencement of additional similar litigation. There have also been a number of adverse legislative, regulatory, political and other developments concerning cigarette smoking and the tobacco industry. These developments generally receive widespread media attention. The Company is not able to evaluate the effect of these developing matters on pending litigation and the possible commencement of additional litigation.

Management is unable to make a meaningful estimate of the amount or range of loss that could result from an unfavorable outcome of all pending litigation. It is possible that the Company's results of operations or cash flows in a particular quarterly or annual period or its financial position could be materially affected by an ultimate unfavorable outcome of certain pending litigation. Management believes, however, that the ultimate outcome of all pending litigation should not have a material adverse effect on the Company's financial position.

Note 14. Additional Information:

(in millions)	1996	1995	1994
Years ended December 31:			
Depreciation expense	$ 1,038	$ 1,024	$ 1,027
Rent expense	$ 430	$ 390	$ 426
Research and development expense	$ 515	$ 481	$ 435
Advertising expense	$ 3,633	$ 3,724	$ 3,358
Interest and other debt expense, net:			
Interest expense	$ 1,183	$ 1,259	$ 1,288
Interest income	(97)	(80)	(55)
	$ 1,086	$ 1,179	$ 1,233
Interest expense of financial services and real estate operations included in cost of sales	$ 80	$ 84	$ 78

Note 15. Financial Services and Real Estate Operations:

Philip Morris Capital Corporation ("PMCC") is a wholly-owned subsidiary of the Company. PMCC invests in leveraged and direct finance leases, other tax-oriented financing transactions, third party financial instruments and engages in various financing activities for customers and suppliers of the Company's subsidiaries. Additionally, PMCC is engaged, through its wholly-owned subsidiary, Mission Viejo Company, in land planning, development and sales activities in California and Colorado.

Pursuant to a support agreement, the Company has agreed to retain ownership of 100% of the voting stock of PMCC and make periodic payments to PMCC to the extent necessary to ensure that earnings available for fixed charges equal at least 1.25 times its fixed charges. No payments were required in 1996, 1995 or 1994.

Condensed balance sheet data at December 31, follow:

(in millions)	1996	1995
Assets		
Finance leases	$7,554	$6,858
Other investments	474	471
	8,028	7,329
Less unearned income and allowances	2,682	2,336
Finance assets, net	5,346	4,993
Real estate held for development and sale	314	339
Other assets	258	302
Total assets	$5,918	$5,634
Liabilities and stockholder's equity		
Short-term borrowings	$ 173	$ 671
Long-term debt	1,134	783
Deferred income taxes	3,636	3,382
Other liabilities	145	121
Stockholder's equity	830	677
Total liabilities and stockholder's equity	$5,918	$5,634

The amounts shown above include receivables and payables with the Company and its other subsidiaries. These amounts were eliminated in the Company's consolidated balance sheets.

Finance leases consist of a portfolio of investments in transportation, manufacturing facilities, power generation and real estate. Rentals receivable for finance leases represent unpaid rentals, less principal and interest on third-party nonrecourse debt, if any.

PMCC's investment securities, included in other investments, are classified as available for sale and are recorded at fair value, with unrealized gains and losses included as a component of stockholder's equity, net of related deferred income taxes. Other investments also include real estate and commercial receivables, the total estimated fair values of which, at December 31, 1996 and 1995, approximated their carrying values. Fair values were estimated by discounting projected cash flows using the current rates for similar loans to borrowers with similar credit ratings and maturities.

Condensed income statement data follow for the years ended December 31,

(in millions)	1996	1995	1994
Revenues:			
Financial services	$222	$197	$257
Real estate	157	184	236
Total revenues	379	381	493
Expenses:			
Financial services	107	107	114
Real estate	98	129	190
Total expenses	205	236	304
Equity in earnings of limited partnership investments	15	15	17
Earnings before income taxes	189	160	206
Provision for income taxes	66	55	72
Net earnings	$123	$105	$134

Note 16. Financial Instruments:

Derivative financial instruments

The Company operates internationally, with manufacturing and sales facilities in various locations around the world. Derivative financial instruments are used by the Company for purposes other than trading, principally to reduce exposures to market risks resulting from fluctuations in interest rates and foreign exchange rates by creating offsetting exposures. The Company is not a party to leveraged derivatives.

The Company has foreign currency and related interest rate swap agreements which were executed to reduce the Company's borrowing costs and serve as hedges of the Company's net assets in foreign subsidiaries, principally those denominated in Swiss francs. At December 31, 1996 and 1995, the notional principal amounts of these agreements were $2.2 billion and $2.0 billion, respectively. Aggregate maturities at December 31, 1996 were as follows (in millions): 1997-$853; 1998-$186; 1999-$391; 2000-$215 and 2002 and thereafter-$540. The notional amount is the amount used for the calculation of interest payments which are exchanged over the life of the swap transaction and is equal to the amount of foreign currency or dollar principal exchanged at maturity.

Forward exchange contracts are used by the Company to reduce the effect of fluctuating foreign currencies on short-term foreign currency denominated intercompany and third party transactions. At December 31, 1996 and 1995, the Company had forward exchange contracts, with maturities of less than one year, of $1.7 billion and $1.2 billion, respectively.

Credit exposure and credit risk

The Company is exposed to credit loss in the event of nonperformance by counterparties to the swap agreements. However, such exposure was not material at December 31, 1996, and the Company does not anticipate nonperformance. Further, the Company does not have a significant credit exposure to an individual counterparty.

Fair value

The aggregate fair value, based on market quotes, of the Company's total debt at December 31, 1996 was $15.7 billion as compared to its carrying value of $15.2 billion. The aggregate fair value of the Company's total debt at December 31, 1995 was $16.7 billion as compared to its carrying value of $15.8 billion. The estimated fair value of financial services and real estate other investments, including commercial and real estate receivables, approximated their carrying values at December 31, 1996 and 1995.

The carrying values of the foreign currency and related interest rate swap agreements and of the forward contracts, which did not differ materially from their fair values, were not material.

See Notes 4, 5 and 15 for additional disclosures of fair value for short-term borrowings, long-term debt and financial instruments within the financial services and real estate operations, respectively.

Note 17. Quarterly Financial Data (Unaudited):

(in millions, except per share data)	1996 Quarters 1st	2nd	3rd	4th
Operating revenues	$ 17,491	$ 17,509	$ 17,414	$16,790
Gross profit	$ 6,989	$ 7,100	$ 7,092	$ 6,812
Net earnings	$ 1,565	$ 1,621	$ 1,646	$ 1,471
Per share data:				
Net earnings	$ 1.89	$ 1.97	$ 2.01	$ 1.81
Dividends declared	$ 1.00	$ 1.00	$ 1.20	$ 1.20
Market price--high	$104 5/8	$107 1/4	$107 1/2	$ 119
--low	$ 85 5/8	$ 85 5/8	$ 85 5/8	$89 3/4

During the year, the Company sold several domestic and international food businesses at net pretax gains of $320 million, most of which were reflected in fourth quarter earnings. In addition, the Company initiated cost saving programs that included downsizing facilities and workforce reductions. The cost of these actions substantially offset the gains from businesses sold. The net impact of these divestitures and provisions was not material to fourth quarter operating income, pretax earnings or earnings per share.

(in millions, except per share data)	1995 Quarters 1st	2nd	3rd	4th
Operating revenues	$ 16,517	$ 17,129	$ 16,689	$ 15,736
Gross profit	$ 6,467	$ 6,816	$ 6,764	$ 6,407
Earnings before cumulative effect of accounting changes	$ 1,363	$ 1,410	$ 1,433	$ 1,272
Cumulative effect of changes in method of accounting (See Note 1)	(28)			
Net earnings	$ 1,335	$ 1,410	$ 1,433	$ 1,272
Per share data:				
Earnings before cumulative effect of accounting changes	$ 1.60	$ 1.67	$ 1.71	$ 1.53
Cumulative effect of changes in method of accounting	(.03)			
Net earnings	$ 1.57	$ 1.67	$ 1.71	$ 1.53
Dividends declared	$ .825	$ .825	$ 1.00	$ 1.00
Market price--high	$ 68	$ 76 5/8	$ 84 1/8	$ 94 3/8
--low	$ 55 3/4	$ 65 1/4	$ 71 3/8	$ 82 5/8

During the year, the Company sold its bakery businesses and its North American margarine, specialty oils, marshmallows, caramels and Kraft Foodservice distribution businesses. In addition, several smaller international food businesses were sold. Net pretax gains from the sales of these businesses were $275 million, most of which were reflected in fourth quarter earnings. In the fourth quarter of 1995, the Company also recorded provisions in connection with these divestitures, primarily for an early retirement program and the write-down of assets of food facilities to be downsized or closed. The net impact of these divestitures and provisions was not material to fourth quarter operating income, pretax earnings or earnings per share.

The principal stock exchange, on which the Company's common stock (par value $1 per share) is listed, is the New York Stock Exchange. At January 31, 1997 there were approximately 139,700 holders of record of the Company's common stock.

Report of Independent Accountants

To the Board of Directors and Stockholders of Philip Morris Companies Inc.:

We have audited the accompanying consolidated balance sheets of Philip Morris Companies Inc. and subsidiaries as of December 31, 1996 and 1995, and the related consolidated statements of earnings, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Philip Morris Companies Inc. and subsidiaries at December 31, 1996 and 1995, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 1996, in conformity with generally accepted accounting principles.

Coopers & Lybrand L.L.P.

New York, New York
January 27, 1997

Company Report on Financial Statements

The consolidated financial statements and all related financial information herein are the responsibility of the Company. The financial statements, which include amounts based on judgments, have been prepared in accordance with generally accepted accounting principles. Other financial information in the annual report is consistent with that in the financial statements.

The Company maintains a system of internal controls that it believes provides reasonable assurance that transactions are executed in accordance with management's authorization and properly recorded, that assets are safeguarded, and that accountability for assets is maintained. The system of internal controls is characterized by a control-oriented environment within the Company, which includes written policies and procedures, careful selection and training of personnel, and audits by a professional staff of internal auditors.

Coopers & Lybrand L.L.P., independent accountants, have audited and reported on the Company's consolidated financial statements. Their audits were performed in accordance with generally accepted auditing standards.

The Audit Committee of the Board of Directors, composed of six non-management directors, meets periodically with Coopers & Lybrand L.L.P., the Company's internal auditors and management representatives to review internal accounting control, auditing and financial reporting matters. Both Coopers & Lybrand L.L.P. and the internal auditors have unrestricted access to the Audit Committee and may meet with it without management representatives being present.

EXHIBIT 21

SUBSIDIARIES OF THE COMPANY

Certain active subsidiaries of the Company and their subsidiaries as of December 31, 1996, are listed below. The names of certain subsidiaries, which considered in the aggregate would not constitute a significant subsidiary, have been omitted.

Name	State or Country of Organization
1020147 Ontario Limited	Canada
464088 Ontario Limited	Canada
AB Estrella	Sweden
AB Kraft Jacobs Suchard Lietuva	Lithuania
A/O Almaty Tobacco Company	Kazakhstan
A/O Krasnadortabakprom	Russia
A/O Philip Morris NEVA	Russia
A/S Freia	Norway
A/S Maarud	Norway
Ajinomoto General Foods, Inc.	Japan
Aktieselskabet FMD af 11 juni 1920	Denmark
American Specialty & Craft Beer Co.	Delaware
Beijing Kraft Food Corporation Limited	China
Burlington Foods, Inc.	United States
C.A. Tabacalera Nacional	Venezuela
Cafe GRAND'MERE S.A.	France
Cafe HAG S.A.	France
Callard & Bowser-Suchard, Inc.	Delaware
Capri Sun, Inc.	Delaware
Celis Brewery, Inc.	Texas
Century Importers Inc.	Delaware
Churny Company, Inc.	Delaware
Comptoir De La Confiserie	France
Cote d'Or Italia S.p.A.	Italy
DE LA S.r.l.	Italy
Daesung Machinary	Korea
Dart Resorts Inc.	Delaware
Dong Suh Foods Corporation	Korea
Dong Suh Oil & Fats Co., Ltd.	Korea
Egri Dohanygyar kft.	Hungary
El Gallito Industrial, S.A.	Costa Rica
Estrella A/S	Denmark
FTR Holding S.A.	Switzerland
Fabriques de Tabac Reunies S.A.	Switzerland
Fattorie Osella S.p.A.	Italy
Franklin Baker Company of the Philippines	Philippines
Freia Chokolade A/S	Denmark

Name	State or Country of Organization
Gardner's Good Foods, Inc.	New Jersey
General Foods Credit Corporation	Delaware
General Foods Credit Investors No. 1 Corporation	Delaware
General Foods Credit Investors No. 2 Corporation	Delaware
General Foods Credit Investors No. 3 Corporation	Delaware
General Foods Foreign Sales Corporation	Virgin Islands (U.S.)
General Foods Pty. Ltd.	Australia
Grant Holdings, Inc.	Pennsylvania
Grundstucksgemeinschaft Kraft Jacobs Suchard GbR	Germany
Guangtong Food Company Ltd.	China
HAG GF AG	Germany
Hansung Life Insurance Co. Ltd.	Korea
HNB Investment Corp.	Delaware
Industrias de Chocolate Lacta S.A.	Brazil
International Pet Foods Ltd.	New Zealand
ION SA	Greece
Jacob Leinenkugel Brewing Company, Inc.	Wisconsin
Jacobs Suchard Beteiligungs Gesellschaft GmbH	Austria
Jacobs Suchard China Limited	Hong Kong
Jacobs Suchard Figaro A.S.	Czechoslovakia
Jacobs Suchard Pavlides SA	Greece
KJS Namur SA	Belgium
Kharkov Tobacco Factory	Ukraine
Kraft Canada Inc.	Canada
Kraft Chorzele Sp. z o.o.	Poland
Kraft Food Ingredients Corp.	Delaware
Kraft Foods AB	Sweden
Kraft Foods de Mexico S.A. de C.V.	Mexico
Kraft Foods Holdings Norway, Inc.	Delaware
Kraft Foods, Inc.	Delaware
Kraft Foods (Philippines), Inc.	Philippines
Kraft Foods (Puerto Rico), Inc.	Puerto Rico
Kraft Foods International, Inc.	Delaware
Kraft Foods International Services, Inc.	United States
Kraft Foods (Asia-Pacific) Ltd.	Hong Kong
Kraft Foods (Australia) Limited	Australia
Kraft Foods (Singapore) Pte Ltd	Singapore
Kraft Foods Limited	Australia
Kraft Foods Manufacturing Corporation	Delaware
Kraft Freia Marabou AB	Sweden
Kraft Foods (New Zealand) Limited	New Zealand
Kraft Freia Marabou ApS	Denmark
Kraft Freia Marabou Danmark A/S	Denmark
Kraft Freia Marabou Norden a.s.	Norway
Kraft General Foods Europe GmbH	Germany
Kraft General Foods Norge AS	Norway
Kraft Hellas SA	Greece
Kraft Jacobs Suchard AG	Switzerland
Kraft Jacobs Suchard (Australia) Pty. Ltd.	Australia
Kraft Jacobs Suchard (Schweiz) AG	Switzerland
Kraft Jacobs Suchard BV	Netherlands

Name	State or Country of Organization
Kraft Jacobs Suchard Bulgaria AD	Bulgaria
Kraft Jacobs Suchard CS SPOL. S.R.O	Czechoslovakia
Kraft Jacobs Suchard Central & Eastern Europe Service BV	Netherlands
Kraft Jacobs Suchard Coffex	France
Kraft Jacobs Suchard Erzeugnisse GmbH & Co. KG	Germany
Kraft Jacobs Suchard France SA	France
Kraft Jacobs Suchard GmbH (Bremen)	Germany
Kraft Jacobs Suchard Hungaria KFT	Hungary
Kraft Jacobs Suchard Iberia, S.A.	Spain
Kraft Jacobs Suchard Ireland Ltd.	Ireland
Kraft Jacobs Suchard Laverune	France
Kraft Jacobs Suchard Limited	United Kingdom
Kraft Jacobs Suchard (Holdings) Limited (United Kingdom)	United Kingdom
Kraft Jacobs Suchard Management & Consulting AG	Switzerland
Kraft Jacobs Suchard Manufacturing GmbH & Co KG	Germany
Kraft Jacobs Suchard Oesterreich Gesellschaft MBH	Austria
Kraft Jacobs Suchard Polska Sp. z o.o.	Poland
Kraft Jacobs Suchard Portugal Productos Alimentares Lda.	Portugal
Kraft Jacobs Suchard Produktion GmbH	Germany
Kraft Jacobs Suchard R & D, Inc.	Delaware
Kraft Jacobs Suchard Reims	France
Kraft Jacobs Suchard Romania SA	Romania
Kraft Jacobs Suchard S.A.	Belgium
Kraft Jacobs Suchard S.p.A.	Italy
Kraft Jacobs Suchard Strasbourg	France
Kraft Japan, K.K.	Japan
Kraft Korea Inc.	Korea, Republic of
Kraft Pizza Company	Delaware
Kraft Suchard Argentina, S.A.	Argentina
Kraft Suchard Brasil S.A.	Brazil
Kraft Tianmei Food (Tianjin) Co., Ltd.	China
Krema Limited	Ireland
La Loire Investment Corp.	Delaware
La Seine Investment Corp.	Delaware
Le Rhone Investment Corp.	Delaware
MBC Holdings, Inc.	Wisconsin
Malaco A/S	Denmark
Marabou GmbH	Germany
Marsa Kraft Jacobs Suchard Sabanci Gida Sanayi ve Ticaret A.S.	Turkey
Martlet Importing Co. Inc.	New York
Massalin Particulares S.A.	Argentina
Maxpax France SA	France
Miller Brewing 1855, Inc.	Delaware
Miller Brewing Company	Wisconsin
Miller Brewing do Brasil, Ltda.	Brazil
Miller Brewing of Canada, Ltd.	Canada
Miller Brewing of Europe, Ltd.	United Kingdom
Mirabell Salzburger Confiserie-und Bisquit GmbH	German Democratic Rep.
Mission Viejo Company	California
Molson Breweries U.S. Holdings Inc.	Delaware

Name	State or Country of Organization
Molson Breweries U.S.A. Inc.	Delaware
Oy Estrella AB	Finland
Oy Kraft Freia Marabou Finland AB	Finland
P.M. Beverage Holdings, Inc.	Delaware
P.T. Kraft Ultrajaya Indonesia	Indonesia
Phenix Leasing Corporation	Delaware
Phenix Management Corporation	Delaware
Philip Morris Asia Incorporated	Delaware
Philip Morris Belgium S.A.	Belgium
Philip Morris Brasil S.A.	Delaware
Philip Morris Capital Corporation	Delaware
Philip Morris Capital (Dublin) Limited	Ireland
Philip Morris Capital (Ireland) Limited	Ireland
Philip Morris Corporate Services Inc.	Delaware
Philip Morris Credit Capital N.V.	Netherlands Antilles
Philip Morris Europe S.A.	Delaware
Philip Morris Finance Europe B.V.	Netherlands
Philip Morris G.m.b.H.	Germany
Philip Morris Holland B.V.	Netherlands
Philip Morris Hong Kong Limited	Hong Kong
Philip Morris Incorporated	Virginia
Philip Morris International Finance Corporation	Delaware
Philip Morris International Inc.	Delaware
Philip Morris Kabushiki Kaisha	Japan
Philip Morris Korea C.H.	Korea
Philip Morris Latin America Inc.	Delaware
Philip Morris Limited	Australia
Philip Morris Management Corp.	New York
Philip Morris Products Inc.	Virginia
Philip Morris SA, Philip Morris Sabanci Pazarlama ve Satis A.S.	Turkey
Philip Morris Sales Inc.	Delaware
Philip Morris Services India Inc.	Delaware
Philip Morris (Malaysia) Sdn. Bhd.	Malaysia
PHILSA Philip Morris Sabanci Sigara ve Tutunculuk Sanayi ve Ticaret, A.S.	Turkey
Pietro Negroni Limited	United Kingdom
Pietro Negroni S.A.	Switzerland
PMCC Investors No. 1 Corporation	Delaware
PMCC Investors No. 2 Corporation	Delaware
PMCC Investors No. 3 Corporation	Delaware
PMCC Investors No. 4 Corporation	Delaware
PMCC Leasing Corporation	Delaware
Porta Pack Corporation	United States
Premierfoods Corporation	Taiwan
Ridg's Finer Foods, Inc.	Delaware
Roskill Cartage and Storage Limited	New Zealand
Rye Ventures, Inc.	Delaware
SB Leasing Inc.	Delaware
Seven Seas Foods, Inc.	Delaware
Shunde Kraft Confectionery Company Limited	China

Name	State or Country of Organization
Societa Immobiliare Modenese S.p.A.	Italy
Suchard Limited	United Kingdom
Suchard Schokolade Ges. mbH Bludenz (Austria)	Austria
Superior AgResource, Inc.	Delaware
Tabacalera Centroamericana S.A.	Guatemala
Tabacalera Costarricense S.A.	Costa Rica
Tabak A.S.	Czech Republic
Taloca AG	Switzerland
Terry's Suchard Limited	United Kingdom
UAB Philip Morris Lietuva	Lithuania
Unimat Corporation	Japan
Vict. Th. Engwall & Co., Inc.	Delaware
Votesor BV	Netherlands
Zaklady Przemyslu Cukierniczego 'Olza' SA	Poland
Zaklady Przemyslu Tytoniowego w Krakowie S.A.	Poland

Exhibit 23

CONSENT OF INDEPENDENT ACCOUNTANTS

We consent to the incorporation by reference in Post-Effective Amendment No. 13 to the registration statement of Philip Morris Companies Inc. (the "Company") on Form S-14 (File No. 2-96149) and in the Company's registration statements on Form S-3 (File No. 333-16955) and Form S-8 (File Nos. 333-20747, 333-16127, 33-1479, 33-1480, 33-10218, 33-13210, 33-14561, 33-17870, 33-37115, 33-38781, 33-39162, 33-40110, 33-48781, 33-59109, 33-63975 and 33-63977) of our reports dated January 27, 1997, on our audits of the consolidated financial statements and financial statement schedule of the Company as of December 31, 1996 and 1995, and for each of the three years in the period ended December 31, 1996, which reports are included or incorporated by reference in this Annual Report on Form 10-K.

COOPERS & LYBRAND L.L.P.

New York, New York
March 10, 1997

Exhibit 24

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS THAT the undersigned, a Director of Philip Morris Companies Inc., a Virginia corporation (the "Company"), does hereby constitute and appoint Geoffrey C. Bible, Murray H. Bring and Louis C. Camilleri, or any one or more of them, his/her true and lawful attorney, for him/her and in his/her name, place and stead, to execute, by manual or facsimile signature, electronic transmission or otherwise, the Annual Report on Form 10-K of the Company for the year ended December 31, 1996 and any amendments or supplements to said Annual Report and to cause the same to be filed with the Securities and Exchange Commission, together with any exhibits, financial statements and schedules included or to be incorporated by reference therein, hereby granting to said attorneys full power and authority to do and perform all and every act and thing whatsoever requisite or desirable to be done in and about the premises as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all acts and things which said attorneys may do or cause to be done by virtue of these presents.

IN WITNESS WHEREOF, the undersigned has hereunto set his/her hand and seal this 26th day of February, 1997.

/s/ Elizabeth E. Bailey

Elizabeth E. Bailey

POWER OF ATTORNEY

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IN WITNESS WHEREOF, the undersigned has hereunto set his/her hand and seal this 26th day of February, 1997.

/s/ Murray H. Bring

Murray H. Bring

POWER OF ATTORNEY

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IN WITNESS WHEREOF, the undersigned has hereunto set his/her hand and seal this 26th day of February, 1997.

/s/ Harold Brown

Harold Brown

POWER OF ATTORNEY

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IN WITNESS WHEREOF, the undersigned has hereunto set his/her hand and seal this 26th day of February, 1997.

/s/ William H. Donaldson

William H. Donaldson

POWER OF ATTORNEY

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IN WITNESS WHEREOF, the undersigned has hereunto set his/her hand and seal this 26th day of February, 1997.

/s/ Jane Evans

Jane Evans

POWER OF ATTORNEY

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IN WITNESS WHEREOF, the undersigned has hereunto set his/her hand and seal this 26th day of February, 1997.

/s/ Robert E.R. Huntley

Robert E.R. Huntley

POWER OF ATTORNEY

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IN WITNESS WHEREOF, the undersigned has hereunto set his/her hand and seal this 26th day of February, 1997.

/s/ Rupert Murdoch

Rupert Murdoch

POWER OF ATTORNEY

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IN WITNESS WHEREOF, the undersigned has hereunto set his/her hand and seal this 26th day of February, 1997.

/s/ John D. Nichols

John D. Nichols

POWER OF ATTORNEY

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IN WITNESS WHEREOF, the undersigned has hereunto set his/her hand and seal this 26th day of February, 1997.

/s/ Richard D. Parsons

Richard D. Parsons

POWER OF ATTORNEY

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IN WITNESS WHEREOF, the undersigned has hereunto set his/her hand and seal this 26th day of February, 1997.

/s/ Roger S. Penske

Roger S. Penske

POWER OF ATTORNEY

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/s/ John S. Reed

John S. Reed

POWER OF ATTORNEY

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IN WITNESS WHEREOF, the undersigned has hereunto set his/her hand and seal this 26th day of February, 1997.

/s/ Stephen M. Wolf

Stephen M. Wolf