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SWMA.ST - Q3 2019 Swedish Match AB Earnings Call

EVENT DATE/TIME: OCTOBER 25, 2019 / 12:00PM GMT



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PRESENTATION

Operator

Ladies and gentlemen, thank for standing by, and welcome to the Q3 2019 conference call. (Operator Instructions)

I must advise also that the call is being recorded today, Friday, the 25th of October 2019.

And without any further delay, I would now like to hand over the call to your speaker today, Alexander Bergendorf. Thank you. Please go ahead.

Alexander Bergendorf

Thank you and good afternoon. This is the Swedish Match Third Quarter 2019 Telephone Conference. And with me today are Lars Dahlgren, our President and CEO; and Tom Hayes, our CFO.

In the Investors section of our swedishmatch.com website, you will find the presentation for today's call, which is intended to be viewed in conjunction with our prepared commentary. So we encourage you to follow along with that presentation. After our prepared commentary, we will be taking questions.

During today's call, there may be certain comments that constitute forward-looking statements and are subject to risks and uncertainties. Management believes that these statements are based on reasonable assumptions. We can give no assurance that expectations will be achieved. Risk factors are outlined in the latest interim report and annual report, which are available on our website. Swiss Match assumes no obligation to update information concerning its expectations.

A recording of this call will be made available on the Swedish Match website.

Slide 3 of this presentation reiterates the headline bullets from our interim report released this morning, and we refer you to the report rather than repeating them on this call.

I will now turn the conference call over to Lars, who will begin on Slide 4.



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Lars Dahlgren - *Swedish Match AB (publ) - President & CEO*

Thank you, Alexander, and good afternoon, everyone. Let me start off with a few summary comments from the quarter where Swedish Match delivered very strong financial results, both as reported and on a local currency basis, driven by another record quarter for our snus and moist snuff product segments.

In the U.S., our national rollout for ZYN has met or exceeded our expectations on a number of fronts. We continue to expand distribution, adding another 10,000 stores in Q3, bringing us above our initial full year distribution target of 60,000 stores. More stores are planned to be added during the remainder of the year and during 2020.

The anticipated Q3 reduction in distributor pipeline inventories following the larger-scale distribution build in Q2 was relatively modest. And we experienced further increases in average sales per store in our more established markets in the Western region, and initial velocities in new launch geographies are meeting or exceeding levels that we have experienced in the Western region based on comparable time in the market.

Our production efficiencies for ZYN in the U.S. continued to improve, and production costs per unit declined sequentially compared to the second quarter. Additional production capacity will be operational in the fourth quarter to support further growth.

In Scandinavia, overall market growth for the combined snus and nicotine pouch markets has remained very strong with volume growth at more than 6%, with the lion's share of the growth coming from nicotine pouches. For Swedish match, shipment volumes were up by 2% and up a bit less than 1% when adjusting for calendar and acquisition effects as a result of segment mix shifts and share declines in certain segments.

For other tobacco products, or our OTP segment, the U.S. mass market cigar category remained soft in the quarter as HTL segments continued to experience volume declines. For Swedish Match, our shipment volume growth in natural leaf cigars offset declines in HTL, and we saw growth in both sales and operating profit in local currencies.

Our Lights business financial performance experienced a notable rebound from an unusually weak second quarter, also benefiting from land and forestry asset sales. As the Brazilian match market continues to decline, cash proceeds from the sale of excess forestry provide a nice funding source for operation restructurings that may need to occur from time to time in our match business. When adjusted for land and forestry asset sales, operating profit improved for lighters and matches but declined for complementary products compared to the prior year.

And finally, a brief comment on one regulatory development that occurred after the quarter. Earlier this week, Switch Match became the first tobacco company to receive Modified Risk Tobacco Product, known as MRTP, designations from the FDA. The order covers 8 of our General snus varieties in the U.S., including our Wintergreen and Mint varieties. The FDA's decision is a great recognition for Swedish Match and a testament to our vision and our commitment to product stewardship and public health. We also applaud the FDA for its science-based approach and for the MRTP pathway, which allows products like General snus to play an active role in harm reduction and improved public health.

Thomas Hayes - *Swedish Match AB (publ) - Senior VP & CFO*

On Slide 5, we've summarized some of the quarterly highlights of the snus and moist snuff product segment.

Our Scandinavian snus business delivered improved sales and operating profit in the quarter compared to the prior year from a combination of favorable price/mix and higher shipment volumes. As noted earlier, ZYN in the U.S. was a major contributor to sales and operating profit growth within the snus and moist snuff product segment. Third quarter shipment volumes for ZYN in the U.S. approximated 13.5 million cans. Most of the shipment volume came from reorder activity, indicating very solid consumption trends and very good trial. While we had expected third quarter shipment volumes to be negatively affected by reductions in distributor inventories following our larger-scale distribution build in Q2, distributor orders remained robust in the third quarter, likely the result of very rapid ZYN sell-throughs, encouraging the distributor and retail channels to maintain sufficient stock for future growth. We have also been increasing our presence for ZYN outside of the U.S. and Sweden, and ZYN is now in shops in 8 other countries, both within and outside of the European Union.



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Shipment volumes of our U.S. moist snuff business can experience quarterly volatility due to promotional phasing, and volumes declined modestly in the third quarter compared to the prior year. We continue to grow volumes, however, in the attractive pouch and tub segments. When adjusted for the new retailer merchandising program, sales were essentially flat due to improved pricing, offset by volume declines and adverse mix shifts. Operating profits grew as a result of lower operating expenses.

The source of our sales and operating profit growth in the snus and moist snuff product segment as well as the operating margin associated with such growth has positively impacted our reported operating margin for this product segment on a year-on-year and sequential basis. The abnormally high operating margin attributed to sales growth has favorably benefited from a number of factors, including significant operating expense scale benefits associated with increased U.S. ZYN volumes, lower ZYN manufacturing costs from U.S. production and relatively modest marketing efforts given the current competitive landscape.

And finally, just a reminder of the change in our U.S. cost allocation methodology earlier this year for shared operating expenses of our U.S. business impacting the year-on-year comparability of operating profits and EBIT margins for our snus and moist snuff and OTP product segments. In comparing against Q3 2018 reported results, the effect was negative for the snus and moist snuff product segment by SEK 18 million and positive for the other tobacco products segment by the same amount.

On Slide 6, we provided our estimates of trended total market and Swedish Match volume growth in Scandinavia, adjusted for hoarding and calendar effects as well as Swedish Match underlying price/mix effects by quarter. Despite a challenging comparable quarter in the prior year, the market growth in Scandinavia remained robust at well over 6%. With pricing and some portfolio mix effects, Swedish Match price/mix component remained positive. Although we have seen a marked decline in Norwegian market growth in traditional channels according to Nielsen, consumption growth by Norwegians has remained relatively healthy, supported by a trend (inaudible) bought in Swedish border trade shops, tax-free channels and on e-comm. Our underlying volume development relative to the overall market reflects the market share challenges we face. When looking at the snus category in isolation, Swedish Match has been losing market share in Sweden and gaining share on the Norwegian market.

On Slide 7, we provide further details of the growth of the Scandinavian market when combining snus with nicotine pouches. Scandinavian market growth is being sourced from both Sweden and Norway. And in recent quarters, roughly 2/3 of the growth in Scandinavia is coming from nicotine pouches. In Sweden, the contribution to year-to-date market growth is split quite evenly between snus and nicotine pouches, with snus growth largely attributable to the rapidly growing Premium 2 segment. In Norway, all of the growth is coming from its version of nicotine pouches, which by Norwegian law must contain at least trace amounts of tobacco, while the snus market in Norway is experiencing volume declines.

Given the strong growth for nicotine pouches and the fact that these products now represent a meaningful part of the overall smokeless category in Scandinavia, we have decided to present volume growth and market share information for snus and nicotine pouches separately in our discussion of the Swedish and Norwegian markets.

On Slide 8, we have presented Swedish snus volume and value growth and market share dynamics, excluding nicotine pouches, according to Nielsen.

Despite declines in some segments, the Swedish snus market is growing in both volume and value terms, with a stable mix between value and premium priced products. In 2017 and '18, the retail value of the market for snus has grown at a somewhat faster pace than market volumes. While for the 12-month period ended September 2019, the volume and retail value of the market have grown at a similar pace. For the latest 12-month period, price and tax changes have been offset by mix effects with strong growth in the Premium 2 segment being partially offset by declines for Premium 1.

Our year-on-year share decline is, to some extent, attributable to mix shifts but most notably due to market share decline in the Premium 2 segment, where our own growth has not been as robust as that of the competition. Some of our new product initiatives more recently have been targeted at mitigating this adverse trend.

On Slide 9, we present the market trend in market shares for the nicotine pouch category in Sweden according to Nielsen.



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Supported by strong competitive activity in terms of product launches in (inaudible) category has more than doubled in size over the past year, and that was roughly 5% relative to the snus category, according to Nielsen. We believe that the nicotine pouches have an even larger share relative to the snus category as e-commerce and certain high-volume independents are not taken into account in the Nielsen figures. Despite intense competitive activity and new entrants, our market share in the nicotine pouch category has been stable to improving over time but our continued objective is to capture a higher percentage of growth within this attractive category.

In terms of pricing, nicotine pouches are typically priced in line with or above Premium 1 snus. And the dramatic growth of nicotine pouches has, therefore, contributed to a positive price/mix effect in the combined category.

Now turning to Slide 10. We have provided an overview of our estimates of the underlying market development in Norway, where we continue to see market growth for both the combined snus and nicotine pouch market.

For snus, Swedish Match has been holding its share of the rapidly declining loose segment and growing share in the pouch snus segment, helping Swedish Match to record overall market share gains in the snus category. However, all of the growth in our Norwegian market has been in the nicotine pouch category. And here, we have been underperforming.

On Slide 11, you can see that the nicotine pouch segment in Norway has grown dramatically over the past 2 years and is now more than 20% of the size of the Norwegian snus category. In the Nicotine pouch segment, our share progression has been disappointing, and addressing our market share development in this segment is a key focus area of our Scandinavian business. However, as we have noted, quick solutions to this challenge are particularly difficult given the regulatory landscape in Norway.

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

On Slide 12, you can see some of our more recent new product launches of snus and nicotine pouches in Scandinavia and in markets outside of Scandinavia.

Here, you can see the clear focus on nicotine pouches and the Premium 2 segment.

In Sweden, we have added 2 new ZYN varieties as well as 9 extensions positioned in the Premium 2 snus segment. In Norway, we just recently added a new variety of nicotine pouches under our G.4 brand.

Now outside of Scandinavia, we are now marketing ZYN in a number of varieties and countries, and recent launch markets include Russia, Germany, Slovenia, Austria, Croatia and the U.K.

Turning to U.S. moist snuff on Slide 13. Swedish Match shipment volumes were down 1% reported and 3% on a constant trading day basis compared to the third quarter of the prior year following a strong second quarter. Based on distributor shipments to retail, we estimate that volume growth within the U.S. moist snuff category has been slightly negative for more than a year now due in large part to more aggressive price increases taken by manufacturers within the category.

The pouch segment in the U.S. continues to grow as a share of the overall category, and Swedish Match has been gaining share within this attractive segment. Based on our measure of distributor shipments to retail, the pouch segment grew about 3% in the first 9 months versus the prior year. And based on the same measure, Swedish Match experienced moist snuff pouch volume growth of more than 11%.

On Slide 14, the 2 charts illustrate the dramatic growth on snus and nicotine pouches outside of Scandinavia with ZYN volume in the U.S. accounting for substantially all of this growth. ZYN is now available in the U.S. and shipment volume -- is now nationally available in the U.S., and shipment volume for ZYN in the U.S. approximated 13.5 million cans during the quarter. While today we are in close to 62,000 stores, the chart to the right-hand side of the slide presents average store count and velocity rates measured on a can per store per week basis by quarter in the markets in which we were present prior to the national launch. We added a bit more than 1,800 stores to the initial launch markets during the quarter. Despite this build



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in distribution, in-store velocity rates have continued to increase and more of the volume growth over the periods presented has resulted from increased velocities rather than distribution gains.

Thomas Hayes - *Swedish Match AB (publ) - Senior VP & CFO*

Moving on to Slide 15 in our other tobacco products, or OTP, segment.

Within OTP, Swedish Match cigar shipment volumes were up slightly less than 1% as volume declines for our HTL, or homogenized tobacco leaf cigars, were more than offset by growth for our natural leaf

varieties. Sales and operating profits were higher for our U.S. chewing tobacco business. While for chewing products outside the U.S., chew bags and chew bits and tobacco bits, sales were flat on an underlying basis while operating profit declined. The improvement in operating profit for U.S. chewing tobacco was partly attributable to the revised cost allocation methodology for our U.S. business.

On Slide 16, we provide the split by cigar type for Swedish Match and for the cigar category, in each case excluding pipe tobacco cigar varieties where our participation is quite limited.

Swedish Match is heavily skewed toward natural leaf varieties compared to the overall category. While the overall category has remained soft, volume declines have been almost entirely attributable to HTL varieties where we are underrepresented.

On the chart on the right-hand side of the slide, you can see that despite declines in our HTL varieties, our shipment volumes over the past 3 quarters have been rather stable. It is also worth noting the sequential progression in shipment volumes for our rolled leaf varieties from the fourth quarter of 2018 as we have put in place alternative measures to secure tobacco leaf for this growing segment.

Turning to the U.S. chewing tobacco on Slide 17. Swedish Match is well positioned in both the premium segment and the value segment. And based on our measure of distributor shipments to retail, we once again outperformed the overall category in both segments. The shift in the portfolio toward more value-priced products places added pressure on average selling prices and margin.

Shipment volumes of Swedish Match brands declined notably in both the first and second quarters compared to the prior year. Shipment volumes can experience quarterly volatility due to promotional phasing. And for the year-to-date period ending September 30, shipment volumes were down for Swedish Match brands by 7%, while the price/mix effect is plus 6%.

Moving on to Slide 18 in our Lights product segment. While this product segment is susceptible to fluctuations in quarterly performance, we had noted last quarter that the second quarter was -- financial performance was unusually weak. As anticipated, operating profits rebounded from those low Q2 levels. Excluding gains from the sale of timber and land, which amounted to SEK 34 million, the operating profit was essentially flat on an underlying basis compared to the prior year.

While volumes were down notably for both matches and lighters, sales in these businesses declined only modestly due to positive market and portfolio mix effects. Also, while still a burden, higher nylon pricing has had a less significant impact on year-on-year cost comparisons. Complementary products mostly sold in Brazil remain weak.

Moving on to regulatory topics on Slide 19. I'd like to highlight a few noteworthy developments.

With regard to the FDA's potential final guidance on flavored cigars, we have nothing new to report. We expect, however, that the final guidance will be published soon and anticipate that the guidance will include restrictions on cigar category portfolios with a focus on characterizing flavors. We have been preparing for flavor restrictions for some time, and our own portfolio is well balanced with an established portfolio mix of flavored and non-flavored products within each product segment. While any decision by the FDA carries risk and can be disruptive in the immediate term, we believe that we are well positioned to participate in future growth opportunities in the cigar category following a potential flavor ban.



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In Germany, the Bavarian Administrative Court has found that certain Thunder chew bag products do not fall under the chewing tobacco classification of the European tobacco directive and expects to issue its final order regarding this matter in late October or early November. The European Court of Justice has deferred to national courts in determining whether products qualify as chewing tobacco. And absent a final order, it remains unclear what specific product attributes of the Thunder chew bag products influenced the Bavarian court's decision. Total Swedish Match chew bag sales for the first 9 months of 2019 represented slightly more than 1% of group sales with approximately half of those sales being derived from Germany.

In Maryland, the FDA has agreed with the courts to move the deadline for PMTA and SE applications from 2021 and 2022 to May 2020. We are extremely well placed to meet the revised deadlines for our PMTA applications for ZYN and are well under way with SE preparation efforts, very large and strategically relevant portions of our cigar portfolio.

And on Slide 20, and as previously noted by Lars, we're extremely pleased that Swedish Match was the first company to have been granted authorization by the FDA for modified risk tobacco products or MRTP. This landmark decision by the FDA demonstrates that a major food and drug authority can take the necessary steps to acknowledge the role that certain tobacco products can play in harm reduction and improved public health.

The FDA path to MRTP has been long and difficult. But we are confident that with responsible and appropriate messaging to adult tobacco users, we can help ensure that consumers will be aware of the alternatives to their cigarette smoking habit that will reduce their risk for a number of diseases.

We should note that the FDA authorized MRTP for every submission, 8 in all, of our U.S. General snus portfolio, including our Mint and Wintergreen varieties. The FDA's action not only elevates the continuum of risk concept by providing U.S. consumers with clear information on relative risks but should also provide encouragement to others outside of the U.S. to adopt a more science-based regulatory approach and to acknowledge the significant potential health benefits to their populations by facilitating the transition from cigarettes to less harmful alternatives.

And on Slide 21, we summarized relevant metrics from our interim report relating to finance costs, our financial position and earnings per share.

Net finance costs during the quarter were in line with levels that we experienced during the past few quarters. The weighted average interest rate of our loan portfolio at September 30 was 2.08% compared to 2.18% at the end of 2018.

During the second quarter of this year, we repaid SEK 892 million in bond debt, and no further debt is due for repayment in 2019. Our net debt-to-EBITA for the 12-month period ended September 30 was 2.2. And as of September 30, 2019, Swedish Match had SEK 12.827 billion of interest-bearing debt, excluding retirement benefit obligations but including the recognition of lease liabilities of SEK 267 million from the adoption of IFRS 16. The capital duration was 3.9 years with 98% of the portfolio subject to fixed interest rates.

The EPS bridge illustrates the components of our 22% growth in EPS for the 9-month period ended September 30. Apart from the after-tax effect of our increased operating profit, the reduced number of shares outstanding had a meaningfully positive effect.

During the first 9 months of the year, we made share repurchases in the amount of SEK 1.875 billion, which means that so far this year, a bit more than SEK 3.650 billion has been returned to our shareholders via share repurchases and dividends.

Finally, as always, fluctuations in currency rates will impact our future reported results, and you may want to take note of some of the more important average exchange rates versus the SEK. The average exchange rate in the fourth quarter of 2018 for the U.S. dollar was SEK 9.04; the NOK, SEK 1.07; and the Brazilian real, SEK 2.38.

With that, operator, please open up the line for questions.



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QUESTIONS AND ANSWERS

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question is from the line of Owen Bennett.

Owen Michael Bennett - Jefferies LLC, Research Division - Equity Analyst

Yes. A couple of questions from me. First, just a quick one on General now. With the MRTP coming through, I was just wondering if your strategy around that brand is going to change. And what should all know, whether that will get increased focus.

And then secondly, just kind of more of an admin one. Have you got the market share numbers in Sweden and Norway, not breaking it out between snus and nicotine pouches and what the total market share is like it was reported in previous quarters, if that's possible, please?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

It's Lars here. If I take the first one, a question on MRTP. First of all, let me just say that although we see exponential growth for ZYN, it's not that we don't see a future for snus in the U.S. market also even before the MRTP decision. But it's been clear to us that the snus category has more evolved to become a niche category but where we have been fast approaching profitability. But with that said, of course, we welcome very much the MRTP decision also from the demand side. And what we will do is now that the FDA has granted us authority to communicate certain messages to the consumers, we will naturally ensure that those messages are visible to consumers in, for example, in-store displays and certain ads and so forth. So we will increase marketing behind snus in the short term, but it will be in proportion, so to say, to the potential we see there with snus being an evolving niche category.

Thomas Hayes - Swedish Match AB (publ) - Senior VP & CFO

And the numbers on a total market perspective. So in Sweden, that combined number for Q3, 59.7%; Norway was 48.9%.

Operator

Our next question is from the line of Gaurav Jain.

Gaurav Jain - Barclays Bank PLC, Research Division - Research Analyst

I have 3 questions. So first is on the ZYN U.S. capacity right now and how that is expanding over the next 12 months. So you have sold 13.5 million cans this quarter, and sequential run rate growth seems to be 4 million to 5 million cans. So -- and I believe your capacity right now is 5 million to 6 million cans per month. So then in the next 2 quarters, you will hit peak capacity, unless the math is incorrect. So how should one think of growth through the next year? And then you also mentioned that you're adding more stores in 2020. So how will you service all these new stores?

Thomas Hayes - Swedish Match AB (publ) - Senior VP & CFO

Yes. So the -- on the capacity front, keep in mind that even before we operationalized U.S. capacity, we were drawing kind of in that number of 13 million to 15 million cans from Sweden. And I would say that we still have that source of capacity available for our U.S. business. Yes, I would say current capacity for our Owensboro facility is approaching -- it's a little over 5 million cans with planned expansion to that with what would be the final stages of our second capacity build in Owensboro. We are still planning for and have efforts in place for our third capacity expansion, but we won't see the effects of that toward the tail end of 2020 and into 2021.



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Gaurav Jain - Barclays Bank PLC, Research Division - Research Analyst

Sure. Okay. And then on the cigar volumes. So they were quite -- I mean, they were plus 1%, which was a surprise for us. And the ASP per stick in dollar terms also seems to be quite positive. It is up mid-single digit. So what is explaining the strong volume and pricing right now?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

I mean, when you look in the cigar category, what we see overall in the market, we see softness. But where we see the clear softness is in the HTL segment, although the growth rates in the natural leaf segment have come down as well. But as you know, we are favorably positioned with an overskew of the natural leaf cigars in our portfolio relative to the overall market. With that said, of course, it's -- those segments are becoming increasingly competitive because other players are also going after that growth. But we have a good position in those segments. And over this year, we've been addressing the issues we have had and, to some extent, they're still having with the shortage on leaf, but it's largely behind us now, those problems, so -- which means that going forward, we think that we should be able to better match the full demand on the rolled leaf side.

And when you look last year, we had relatively strong volumes also in Q3. But particularly in Q4, we saw a clear negative impact from the shortage of rolled leaf. So the comps in the fourth quarter are the easiest for the previous year. So our clear ambition is to continue growing volumes in the fourth quarter. Our ambition is to grow volumes for the full year, but it remains to be seen if we will be successful in that ambition given the overall category softness.

Gaurav Jain - Barclays Bank PLC, Research Division - Research Analyst

Sure. And if I can ask one last question. So we are seeing e-cigarettes now stagnating or beginning to decline, and especially in the month of September is when this trend started. So have you seen your cigar pick up especially in September? And also, are you seeing any e-cigarette consumers as they are transitioning across categories? Are they moving into ZYN by any chance?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

Definitely. I mean it's very difficult to get accurate data in a period of a lot of noise, so to say, out there in the market and for those short time periods that you referred to. But anecdotally, what we can refer is that at least on the retail side, I would say that from being a very strong interest for ZYN, some retailers are expressing an extra strong interest for ZYN given the uncertainty that they see in the e-cigarette category and the benefits with ZYN not being an inhaled product.

Operator

Our next question is from the line of Sanath Sudarsan.

Sanath Sudarsan - Morgan Stanley, Research Division - Research Associate

Two questions from my end. Just following on the cigars answer, last question. Could you just help us now understand what's the breakup of flavored cigars in your current portfolio? And has this changed because of the recent transition away from HTL? And secondly, I just wanted to come back again on the capacity question on ZYN. Do you have enough capacity to probably add more stores? Or put differently, what's the kind of upper limit for store additions you see as of now given the capacity you have to service probably at optimum store velocity levels?



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Lars Dahlgren - *Swedish Match AB (publ) - President & CEO*

On a cigar side, it tends to be a little bit volatile, the exact percentage of flavors in the portfolio, and the reason for that is that cigar category is more dynamic than some of the other tobacco categories where there are limited time offerings with specific varieties that could be flavored are unflavored. But typically, there's an overskew of flavor incidence among the limited-time offers in our portfolio. But generally speaking, given that we grow in the natural leaf segment and that's relative to HTL segment and we are stronger with the non-flavored varieties in the HTL -- or, sorry, in the natural leaf segments, over time that puts us at a favorable position. And I'd say right now, we are on or around that number of 50% flavored cigars in our portfolio a little bit depending on how you define, which is comparable to the overall industry. We are then overskewing relative the rest of the industry in the HTL segment when it comes to flavors. But on the other hand, we have a relatively stronger position then in the natural leaf segments.

And regarding the ZYN capacity, I mean, how many stores, that depends, of course, on also the continued trajectory, the demand and the continued -- and the evolution of the competitive landscape, where I think it's a fairly certain assumption that we will see increased competitive activity going forward. But we do have in our plans to continue to add some stores in the final quarter of this year and then add additional stores into the next year. And the demand from retailers continue to be strong, so there are definitely clear opportunities, some of which we have been holding back on, as we have seen, with a view to see capacity coming onboard. But it's very positive to note that the ramp-up of production in our Owensboro facility has actually exceeded our initial forecast when it comes to operating efficiency in the factory.

Sanath Sudarsan - *Morgan Stanley, Research Division - Research Associate*

And can I just squeeze in one more, please? On Scandinavia, can you just give us some color on the measures you've taken recently to perhaps address your market share concerns in Norway nicotine pouches and in premium Swedish snus category?

Lars Dahlgren - *Swedish Match AB (publ) - President & CEO*

Yes. I mean if you look at -- if you take the Scandinavian snus market, there are clear -- 3 very clear opportunities. And -- but also, that represent challenges from a market share point of view. One is the fast growth of the Premium 2 snus segment in Sweden. And then you have the nicotine pouch segment in both Sweden and in Norway.

If you take the -- start with the snus category in Sweden, an example of activities that we have done there is that we have, first of all, complemented the still highly successful XR family with some line extensions based on small batches that have been very popular at e-comm and in our concept stores where there we get a good read of consumer and insights on which line extensions and flavors that are popular with consumers, and then we've taken some of them to make them permanent SKUs in our portfolio. And another one is this repositioning of the Onyx brand, which was a very small niche but premium, premium brand and priced a little bit above Premium 1 that was launched several years ago but still has a decent-to-good awareness in the brand equity with consumers as representing a very high-quality product. And that one has recently been made available in the Premium 2 segment and complemented with 1 line extension. And if you look within the Premium 2 snus segment, there is an improvement in the trend recently with a flattening out of the share decline. And if you look at the nicotine pouch segment in Sweden, there we have, first of all, complemented the ZYN portfolio with a couple of line extensions. But also, we have been lagging and are still lagging to some extent the competition in terms of distribution in certain chains and so forth, and we've been working hard to increase the, and are continuing to do so, visibility and availability of our ZYN product at the retail level.

And if you look at the share trajectory for nicotine pouches in Sweden, as Tom mentioned on the call earlier, the -- there is a slight increase of market share, albeit we are still only at around 26% of that segment. But this is also in a period where competitive activity has been intensified. So it is encouraging to see that despite that intensified competitive activity, there is at least a slight positive share trend.

In Norway, unfortunately, the curve has continued to point the wrong way, and -- but we are having plans to address that, but it is more challenging. But one of the things that we have done now is to complement the portfolio with one SKU. That first has been launched at the Swedish border trade towards Norway, and that has done relatively well at the border trade. So we know it resonates with the Norwegian consumers, but there is a challenge to make Norwegians in Norway aware of the new product given the environment.



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Operator

Our next question is from the line of Andreas Lundberg.

Andreas Lundberg - ABG Sundal Collier Holding ASA, Research Division - Research Analyst

Andreas Lundberg with SCB. I heard you mention there, Lars, on distribution of ZYN in Sweden that you're lagging a little bit. Could you update us on the status on your distribution currently for ZYN in Sweden?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

I don't have those numbers here in front of me, but it's -- particularly the co-op chain, which is a relatively sizable snus chain and nicotine pouching in Sweden, we have had a challenge to get to full distribution of our products. So we are behind our main competitor there. But if you take the rate on outlets, which is 7-Eleven and the convenience kiosk Pressbyrå in Sweden and -- which is kind of an urban convenience outlet there, we have comparable distribution to our main competitor. And there our market share is around 33%, so roughly 1/3 of the market in that chain, compared to 26% then on a national level.

Andreas Lundberg - ABG Sundal Collier Holding ASA, Research Division - Research Analyst

Okay. And from a production capacity point of view, can you ship as many ZYN as you want to in Sweden at the moment?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

On the dry one that goes to the U.S., we have been hampered in -- historically in the buildup phase, but that's a problem that is, to a large extent, behind us. And on the Slim one, we have built up capacity so that we basically don't have any capacity constraints. But with that said, we have had technical challenges and some delivery issues across the white assortment in Sweden.

Andreas Lundberg - ABG Sundal Collier Holding ASA, Research Division - Research Analyst

Okay. And over to ZYN in the U.S., of this new store rollout, so the national rollout, is -- are there any particular regions that are doing extremely well or less good?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

All regions are actually trending above -- if you strictly measure it on a cans per store per week basis and you look -- if you take the April and May in stores, where we have a little bit more data by now, the first 2 months of the national launch, all regions are trending above the Western region on a cans per store per week basis, on that strict measure. And the Eastern region is doing the best, and the Central and Southern region are -- follow one another very closely. But one caveat to reading too much into this. I think you should all be aware that given the success that ZYN has had in the West, in many cases we know that ZYN wasn't completely unknown, a new phenomenon in the rest of the country. There have been consumers who've been exposed to that product in the West. Retailers are familiar with the success story in the West, and some consumers have obviously bought it online, et cetera. So that means that the fact that they are above in absolute term -- cans per store per week shouldn't necessarily be, we think at this point, interpreted as that the absolute potential is higher in the rest of the country than what has proven to be in the West. But it's certainly very encouraging, the level we see but especially that the shape of the curve, the inclination of the curve look very similar to what we saw in the West. It continues to go up week-by-week basically.



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Andreas Lundberg - *ABG Sundal Collier Holding ASA, Research Division - Research Analyst*

And lastly, are you in a lot of the stores where you also have competing products for ZYN? And if so, what's the implication so far?

Lars Dahlgren - *Swedish Match AB (publ) - President & CEO*

More and more, BAT is rapidly building distribution with its Velo brand. Altria has expanded some distribution with its ON! brand but to a more limited extent than BAT. And we are looking, of course, at stores and regions and so forth where we compete. But what we can see is typically, shipments from retailer -- or, sorry, from distributors into retailers, they tend to be relatively volatile. But having said that, we are rather encouraged with some of the trends that we're seeing in terms of the ZYN proposition with consumers.

If you take, for example, the Chicago market, where we've been competing with ON! for a longer period of time, according to the measures that we can see in stores where both products exist, although ON! was there first in the markets, ZYN has surpassed ON! in velocity. And Velo, you have even shorter time. But there typically, we see rather large sell-in volumes, and then for natural reasons the velocity has come down. And it's hard to say what is the true market share, but what we can see is that it doesn't -- it hasn't really affected the growth trajectory much of ZYN. It's more that these volumes seem to have come at -- on top and adding to category growth at this point of view, measured by shipments to -- into retail.

Operator

Our next question is from the line of Adam Spielman.

Adam Justin Spielman - *Citigroup Inc, Research Division - MD and European Tobacco and Beverage Analyst*

It's sort of quite a simple question but maybe quite hard, too. Can you talk about your -- in your cigar portfolio about your 2 -- pre-2007 cigars? In other words, I suppose what I'm asking, if there is a flavor ban either of characterizing flavors or indeed more extensively than that, will the -- will you be able to replace the business you lose with pre-2007 products? And in particular, bearing in mind you're growing so much within the natural and rolled leaf subsegments, how does your pre-2007 portfolio look in those cast-up categories? I hope that's a clear question.

Thomas Hayes - *Swedish Match AB (publ) - Senior VP & CFO*

No. Thanks, Adam. The -- I mean that's a somewhat challenging question to answer in that part of it is determined -- is dependent upon one's definition of changes since 2007. And given changes -- we had rolled leaf product, we had natural leaf product, we had HTL cigars on the market in 2007. But whether they were packaging changes with the FoilFresh packaging concepts or the nature of our filler tobacco, there have been marked changes in our cigars...

Adam Justin Spielman - *Citigroup Inc, Research Division - MD and European Tobacco and Beverage Analyst*

(inaudible), yes.

Thomas Hayes - *Swedish Match AB (publ) - Senior VP & CFO*

Yes.

Adam Justin Spielman - *Citigroup Inc, Research Division - MD and European Tobacco and Beverage Analyst*

Yes.



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Thomas Hayes - *Swedish Match AB (publ) - Senior VP & CFO*

Over those periods that would lead us toward a SE path. It's an SE path that has clear predicate product that was in market in 2007. So that's not challenging from that -- in that respect. But I -- to say, I mean, is there a -- are there cigars in our portfolio that is the exact same cigar as to filler, as to packaging as we sold in 2007, that is -- there may be a handful of SKUs, but that's not a significant part of our portfolio.

Operator

(Operator Instructions) Our next question is from the line of Karri Rinta.

Karri Rinta - *Handelsbanken Capital Markets AB, Research Division - Research Analyst*

Karri Rinta, Handelsbanken. Two questions. Firstly, on the potential footprint expansion in the U.S. So let's say beyond the 60,000 stores, would you then be expanding on a sort of an incremental basis? Or would you be looking into a sort of a larger chain that could, when appropriate, offer tens of thousands of outlets? Are there such distribution partners that are -- that would be open to this kind of cooperation in the U.S.?

Lars Dahlgren - *Swedish Match AB (publ) - President & CEO*

I'd say it's a little bit of both there, and it depends on what you mean by larger. But there are clearly -- there are some chains that, at this point, haven't taken the product that could in one lump, so to say, add a meaningful number of outlets. But there are also quite a lot of opportunities, so very incremental, smaller change that can be added to the mix.

Karri Rinta - *Handelsbanken Capital Markets AB, Research Division - Research Analyst*

And what would be a magnitude of such a lump, if -- I mean, is it in tens of thousands? Or are we talking thousands?

Thomas Hayes - *Swedish Match AB (publ) - Senior VP & CFO*

No. I think even your largest -- if you're talking about the convenience channel, even your largest channels within the U.S. aren't in -- above the 10,000 level. And I would say in terms of convenience, most of the, call it, the top 10, top 15 are -- we have representation in a number of their stores within their chain. So if I'm thinking in terms of a significant lump, you're probably talking of a new chain, new channels somewhere in the 3,000- to 5,000-store range.

Karri Rinta - *Handelsbanken Capital Markets AB, Research Division - Research Analyst*

All right. Good. That's helpful. Then the -- maybe a bit on the European markets. I know it's early days for nicotine pouches in Europe, but both you and BAT have been rolling out in various countries. So I guess -- and that's not a problem. But have you started to see this sort of more opportunistic smaller companies launching in physical trade? Or are they so far online-only players? Is there anyone with significant enough size behind them that you start to see them in the physical retail in some of these countries where you have launched in? And if not, is that a threat that we should be concerned with?

Lars Dahlgren - *Swedish Match AB (publ) - President & CEO*

Yes. You -- there are some smaller players that are present in physical outlets. And for example, I believe that Czech Republic is one example. And they're part of the competitive mix. And we have seen that also in chew bags, that when these type of novel categories are developing, it is a -- the



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size of the markets we're talking about here in Europe, it's quite far from U.S. penetration. So it's more niche markets but with what -- we believe, very promising long-term prospects. And certainly, in these initial phases, there have been smaller players that have been relatively successful.

Karri Rinta - *Handelsbanken Capital Markets AB, Research Division - Research Analyst*

And then finally, a sort of a detailed question. So Norway, couldn't you launch ZYN with a little bit of tobacco in it in Norway? Would that make any sense? Is it technically possible, something that you have considered?

Lars Dahlgren - *Swedish Match AB (publ) - President & CEO*

It's technically possible, but you would have a product that would be very similar to G.4.

Karri Rinta - *Handelsbanken Capital Markets AB, Research Division - Research Analyst*

Or that would be exactly like G.4, yes. Fair enough.

Operator

(Operator Instructions) There are no further questions at this moment. Please continue.

Lars Dahlgren - *Swedish Match AB (publ) - President & CEO*

Okay, then we would like to thank everybody for listening and inform you that the release of our full year report will be on February 12 next year. Thank you.

Operator

So that does conclude our conference for today. Thank you all for participating. You may all disconnect. Sirs, please stand by.

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