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SWMA.ST - Q4 2021 Swedish Match AB Earnings Call

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## PRESENTATION

### Operator

Welcome to the Swedish Match Full Year 2021 Conference. (Operator Instructions) Today, I am pleased to present Emmett Harrison, Senior Vice President of Investor Relations. Please begin your meeting.

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### Emmett Harrison - *Swedish Match AB (publ) - SVP of IR & Corporate Sustainability*

Thank you. This is the Swedish Match Full Year 2021 Telephone Conference. And with me today are Lars Dahlgren, our President and CEO; and Anders Larsson, our CFO. In the Investors section of our [swedishmatch.com](http://swedishmatch.com) website, you will find our full year investor presentation. We encourage you to have that presentation at hand as you listen to our prepared commentary for this call. Several of the slides in the investor presentation repeat key messages from the interim report that we published this morning. We will focus our commentary on select slides only. And while doing so, we will refer to the applicable page number of the 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, but can give no assurance that expectations will be achieved. Risk factors are outlined in today's interim report as well as the annual report, which are available on our website. Swedish Match assumes no obligation to update information concerning its expectations. A recording of this call will be made available on the Swedish Match website. And with that, I will now hand the word over to Lars.

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

Thank you, Emmett, and good afternoon, everyone. The publication of our 2021 full year report this morning marked the close of another highly successful year for Swedish Match. In fact, 2021 was the fourth year in a row in which Swedish Match reported double-digit growth in sales and operating profit from product segments. For 2021, specifically, revenues and earnings in local currencies grew at double-digit rates for all 3 product segments.

Once again, the Smokefree segment led the way with impressive performance for ZYN in the U.S., attracting adult consumers across the nicotine consumption spectrum, and successfully defending its leading position despite ongoing and intense competitive activity. While the financial performance of the Scandinavian Smokefree business benefited from timing factors, it delivered robust revenues and operating profit growth on an underlying basis with good volume, volume development and improved pricing. Despite production-related challenges, cigars delivered record sales and earnings on the back of increased volumes and improved pricing. The Lights business reported extra strong cash flow generation benefiting from the successful continuation of its asset rationalization program and strong underlying profit growth when adjusting for timing effects on asset gains and similar items. The solid financial performance in 2021 and in prior years are particularly encouraging given the significantly ramped up investments to support growth, with additions of fixed capital, strengthening our organizational scopes and capabilities and market-related investments. Not only does the payoff from these investments show in our reported numbers, but importantly, across the group, the quality of revenues has improved markedly over the past years. Within cigars, the successful strategy of focusing on the faster-growing natural leaf segment, has further enhanced the prospects of our cigar business. In a category with historical overall growth rates that stand out in the tobacco industry.

When the intended separation of the cigar business is completed, the cigar business will have even better possibilities to exploit opportunities as an independent company. The profile of our Lights business has become increasingly attractive as the match and lighter portfolios have developed with adjacent consumer products and technological developments that have resulted in growth of business-to-business revenue streams with exposure to growing consumer products categories. But the most notable effects are seen within our largest product segment, Smokefree.

Local currency sales for Smokefree have grown on a compound annual basis by 20% over the past 2 calendar years, with the result being that 2021, the Smokefree product segment by itself, registered sales that were very close to the sales for the entire group as recently as 2018. 2 years ago, less than 20% of Smokefree sales were comprised of nicotine pouches. In 2021, this number had more than doubled to close to 40%, reflecting both stellar market growth and success in execution. In both Scandinavia and the U.S., the market for nicotine pouches continued to grow by well above 50% in volume terms in 2021. In addition, while still small in size, nicotine pouch category growth in some of the geographies included in other markets was significant.

Another indication of our portfolio adaptation towards providing adult consumers with attractive and viable alternatives is the share of pouch products generally in our portfolio. In 2019, 2/3 of our Smokefree can volumes were comprised of pouch products. In 2021, that number had grown to 93%, even as our loose varieties continue to perform well.

Our successful strategy is not only the foundation for our ambition to generate strong shareholder returns over time. Our success has also resulted in significant and meaningful contributions to societies and our focus and execution on our strategy will provide even greater opportunities for improved public health in the future. In the U.S., a significant proportion of ZYN consumers have a history of cigarette smoking and less than 6 years since we started to establish ZYN in the Western region, we estimate that the number of ZYN users correspond to 8% to 12% of the number of cigarette smokers.

In Scandinavia, we are approaching an exciting milestone. Many countries have a long-term goal of reducing their smoking incident rates to below 5%. In Sweden, we will soon be there. Official numbers now show that daily smoking is down to 6%. And the trend in Norway shows that the same goal is also well within reach. Among consumer segments, more adaptable to change, the positive transition trends are faster and even more impactful. Measured in the adult population below 34 years of age, consumption of Smokefree products in Sweden and Norway, most notably nicotine pouches, has grown markedly in the recent years, an incidence of daily smoking in this cohort has declined to well below 5% in both countries.

As the true pioneer within the Smokefree space, Swedish Match will continue to develop and adapt through consumer insight, research and development, capital investments, product quality assurance and improvements and with a continually evolving product portfolio, we will continue to offer adult consumers attractive product alternatives that meet and exceed their changing demands. Through the execution of our vision and Smokefree strategy, we are committed to our ambitions for strong shareholder returns and societal contributions.

For a full potential of societal impact, rational sound and proportionate regulations that recognize the power of reduced risk products in the harm reduction equation are needed. In this respect, there were some positive developments in 2021. Regulation specifically recognizing nicotine pouches were adopted in Switzerland and in the Czech Republic. Now we are waiting for the implementation of these regulations. In Denmark,

the regulations adopted in 2020 that differentiate nicotine pouches were implemented during the year. There are other European countries where we expect to see developments in 2022. We have, for instance, since long been in a dialogue with the Swedish government advocating for nicotine pouch specific regulation. It now looks like we will see such regulation in place during 2022.

Taxation that reflects the relative harm of product is also a regulatory goal. In Norway, we saw a tax reduction of 25% on snus in 2021 without the corresponding decrease for cigarettes. In 2022, the Norwegian snus tax will be increased by 5.9%, but the increase in cigarettes will be higher. We also noted that harm reduction played a prominent role in the discussions related to what was proposed U.S. federal nicotine tax at the end of last year.

As we turn the page in the book and look forward to 2022 and beyond, I would like to take this opportunity to thank all our employees for their passion, dedication, perseverance throughout this past and highly successful year. Following these introductory remarks, we will now provide some more comments to select slides from our Q4 presentation. And we start on Page 8, which illustrates the ZYN U.S. volume trajectory over the past 5 years on a 12-month rolling basis.

We are very pleased to have shipped more than 48 million cans of ZYN in the fourth quarter, bringing the full year volume to 174 million cans. This corresponds to an impressive year-on-year growth rate of over 50%, both in the quarter and for the full year. Once again, while increased distribution for ZYN has been a supporting factor for the volume growth, higher velocities have been the primary driver. In fact, according to MSA data that captures shipments from distributors to the trade, out of the total growth in the fourth quarter relative to the prior year, more than 75% of the growth was sourced from higher velocities to existing retail shops. The impressive growth was fueled by strong development in both the Western region where we started to launch the brand in 2016 and in regions outside of the West where we started building meaningful presence in mid-2019.

On the following page, you see the volume development for ZYN as well as for competitor nicotine pouches over the past quarters as measured by MSA. As we mentioned before, it's recommended that one takes a longer-term perspective in analyzing MSA data, as figures for isolated quarters can be susceptible to ways for distribution expansion changes in the data set and promotional offerings, et cetera. Viewed over several quarters, the strong and consistent growth of the U.S. nicotine pouch category is well depicted. We now estimate that the category has reached a size of around 300 million cans based on annualized Q4 run rates. This means that already now, the nicotine pouch category exceeds the size of moist snuff pouches, which previously was the fastest-growing oral Smokefree alternative for adult users.

The extraordinary prospects of the nicotine pouch category have attracted intense competition, including deep and broad-based price discounting and aggressive distribution expansion activities. But ZYN stands apart with its outstanding quality, superior brand franchise and popularity. The resilient market share of ZYN throughout most of 2021 is a testament not only to the strong brand equity and ZYN's appeal with consumers, but also the outstanding capabilities of our organization. Even while our own promotional activities remain modest compared to most of our competitors, we ended the year with a quarterly volume market share for ZYN of 64%. In fact, mentioned in dollar terms, ZYN market share exceeds 70% by comfortable margin.

Turning to Slide 10, the number of adult tobacco consumers discovering ZYN has grown at an impressive rate. Getting an exact read on the number of consumers is challenging as various sources of consumer research indicate different penetration and consumption levels per consumer. We have therefore made a slight modification to this slide relative to what we presented in Q3. Based on indications of average weekly consumption levels per consumer, ranging from 2 to 3 cans, our estimate of the number of ZYN users in the West relative to number of cigarette smokers in that same region is in the range of 8% to 12%, as I referenced in my opening comments. On a national level, our estimate is that the number of ZYN consumers is already around 5% relative to number of cigarettes smokers. Not only do we expect the numbers in consumers to increase, but we also expect that as consumers adopt nicotine pouches more fully throughout their consumer journeys, consumption per adult consumer will also increase. As a reference, based on a sample of consumers registered in the ZYN consumer loyalty program, average weekly consumption per consumer is around 4 cans, which is also more aligned with the consumption levels in more mature oral Smokefree categories and markets. With that, I will hand over the word to Anders.

**Anders Larsson** - Swedish Match AB (publ) - CFO & Senior VP of Group Finance

Thank you, Lars. Moving on to Scandinavia on Slide 11. The Smokefree category in Scandinavia continued to demonstrate robust growth, both in the fourth quarter and for the full year, supported by strong growth in all three countries: Sweden, Norway and Denmark. With COVID-19 related impacts and timing effects on shipments, it is challenging to estimate with precision the underlying growth, but our estimate is that the Scandinavian Smokefree category grew by approximately 10% in volume terms in 2021 versus the prior year.

On Slide 12, we illustrate a more detailed view of the total Smokefree category in Scandinavia on a 12-month rolling basis based on Nielsen and online sales data. As can be seen on the slide, traditional Smokefree products, such as snus, continued to show healthy growth in 2021 versus 2020. And it is very encouraging to see the incremental contribution to the category from the fast-growing nicotine pouch market. It is clear that nicotine pouches appealed to an even broader consumer base, not the least being those remaining smokers of every gender. And as referenced in Lars's opening statement, cigarette smoking in Scandinavian countries has declined to unprecedented levels.

Along with the increased penetration, consumer demographics have become increasingly attractive from a growth perspective. It should be noted that the Norwegian tax cut for Smokefree products, which was implemented at the beginning of 2021, likely had some positive effect on overall category growth.

As measured by Nielsen, Swedish Match's market share of the overall Scandinavian Smokefree category declined by less than 1 percentage point sequentially from the third quarter, impacted by mix effects. When looking at the snus market in isolation on Page 14, you will note that our share has been holding at a consistent level and continues to be more than twice the size of the second largest producer. In Scandinavia, snus is still the dominant form of Smokefree products, and the snus market is estimated to represent approximately 3/4 of the total Smokefree category.

Our Scandinavian snus portfolio provides opportunities for strong cash flows and profits for both Swedish Match and our retail partners, which, together with our expertise in category management, provide excellent platforms to support further growth for our entire range of products, including nicotine pouches.

Moving on to Page 15 and nicotine pouches in Scandinavia with data as reported by Nielsen. With its rapid growth, the nicotine pouch market has grown to around 1/4 of the Scandinavian Smokefree category. The market continues to be highly competitive and the introduction of new brands and products often accompanied by broad-based promotional offerings has helped to fuel volume expansion in the nicotine pouch market. Swedish Match's portfolio of nicotine pouches showed strong volume gains in 2021, but at a pace that was somewhat softer than the overall market growth rate. The vibrant range of VOLT nicotine pouches that was introduced during 2021 has continued to grow its market share, finishing the year at around 5% of the Swedish nicotine pouch market. Improving our share in this rapidly growing market remains a challenge. But as we have communicated during the third quarter conference call, we have an exciting pipeline of innovations that have shown very promising test results on several key parameters.

Turning to Page 16, the moist snuff in the U.S., based on MSA distributor shipment data, the category as well as Swedish Match saw declining volumes in the fourth quarter compared to the prior year. The reversal back to more normal consumption trends for the traditional Smokefree segments, which we talked about in Q3, has continued. And once again, we faced tough comparisons versus the prior year when COVID-related purchasing patterns, we believe, elevated demand. Our moist snuff shipments in Q4 increased by 2%, performing a bit better than what MSA data indicated. Our positioning toward the value price segment has benefited us as we note that Longhorn has continued its positive market share trajectory. Improved pricing has further enhanced the financial development of our moist snuff portfolio. According to MSA for the full year, while category volumes were slightly down, Swedish Match moist snuff volumes were virtually flat.

Moving on to U.S. chewing tobacco on Page 17, the reversal to historical category decline rate is clearly apparent. The 2021 volume decline of 8% should be seen in light of this and on a compounded annual basis, volumes from 2019 to 2021 declined by 4%. That volume decline rate has aligned closely with the annual average rate of price improvements during those years. The price/mix impact has remained positive even while Swedish Match volume mix has continued to shift towards our value price offerings.

We now move on to U.S. Cigars on Page 19. The graph on the left-hand side of the page depicts the solid growth of the mass market cigar category, excluding little cigars over the past 10 years, driven by a strong positive volume development for natural leaf varieties. According to MSA, despite

tough comps and a strong double-digit category growth in 2020, the total mass market cigar category grew by close to 3% in 2021 as robust growth of the natural leaf segment offset the decline of HTL segment. For the full year, Swedish Match shipments grew by close to 5%, entirely driven by natural leaf. Revenues and earnings outstripped volume growth in percentage terms as implemented price changes and mix effects further enhance the financial development.

For the isolated fourth quarter, shipment volumes declined by 14% as growth for natural leaf could not fully compensate for the decline versus the prior year elevated levels for HTL. During the second half of 2021, shifting production priorities caused by the limited availability of certain raw materials resulted in output levels that were not sufficient to meet the demand for HTL. More than 60% of Swedish Match's cigar portfolio is comprised of natural leaf cigars, and our strategic focus on this segment, along with top-notch sales and marketing execution have enabled Swedish Match to outpace category growth in most years over the course of the past 10 years.

Looking forward, we expect natural leaf varieties to continue to be the driving force behind the category development. Slide 24 restates our 2022 outlook from the interim report with the key message that we believe that nicotine pouches represent exceptionally attractive growth opportunities across markets as more and more consumers navigate the reduced risk products landscape. Swedish Match's ambitions are to exploit these growth opportunities in a proactive and decisive manner while combining long-term market investments with profitability and strong shareholder returns.

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 sales. The average exchange rate in the first quarter of 2021 for the U.S. dollar was SEK 8.40; the NOK, SEK 0.99 and the Brazilian real, SEK 1.53. In other words, should current spot rates largely prevail, one should expect significant currency translation tailwind in the upcoming first quarter for sales and earnings. And with that, operator, please open up the line for questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Our first question comes from the line of Fredrik Ivarsson of ABG.

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### **Fredrik Ivarsson** - *ABG Sundal Collier Holding ASA, Research Division - Research Analyst*

Two questions from my side. First, on the Scandi, so price mix has been very supportive during the pandemic, I think, around 5%, 6% in the 2 consecutive years. How should we think about 2022 given cross-border trade and travel retail, et cetera? That's my first question. And second one on Smokefree other markets. Obviously, big investment here in 2021. What do you expect and plan for this year?

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### **Anders Larsson** - *Swedish Match AB (publ) - CFO & Senior VP of Group Finance*

Fredrik, Anders here. On your first question on Scandi, obviously, it's a lot of moving pieces with opening and closing of borders and you also have the tax cuts in the beginning of 2021 and then followed by a tax hike now in the end of 2021. So that will, of course, play a part in the development of margins with Q1 of this year being soft on Norwegian volumes as those reverted in January of '21 following virtually no shipments in December of 2020 ahead of the tax cut. And then, of course, pricing will play a part of the mix, but we don't comment on future pricing.

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

And then in terms of other markets, we are pleased that we've been able to increase our activities in 2021 compared to 2020. It's fair to say that there has still been some clear limitations. And we do see long-term opportunities. So we will continue to invest behind those opportunities. And our investments will be geared in existing markets where we already are and the core markets, so to say, will be prioritized. But we also -- we are also evaluating opportunities in exciting other geographies, which type of geographies we will get back to and we are in those markets.

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**Anders Larsson** - *Swedish Match AB (publ) - CFO & Senior VP of Group Finance*

And just to complement there on the first question on Scandi, of course, with the growth prospects for nicotine pouches, we do invest to improve our positioning in Scandinavia as well, of course.

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**Fredrik Ivarsson** - *ABG Sundal Collier Holding ASA, Research Division - Research Analyst*

Got it. A follow-up on the second question there, Lars, should we expect you to move closer or beyond breakeven already in 2022? Or should we see 22% as another big investment year for especially nicotine pouches, obviously?

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

I think it's more prudent to view it as an investment year. And then, of course, our ambition is to continue to grow the top line and the gross profit as well.

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**Operator**

Our next question comes from the line of Rashad Kawan of Morgan Stanley.

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**Rashad Kawan** - *Morgan Stanley, Research Division - Equity Analyst*

Congrats on a strong set of results. My question is related to your '22 outlook. You mentioned plans to increase investments in the U.S. and Scandi mostly related to nicotine pouches. Can you contextualize that a little bit more, if you can? I mean how should we think about margins for '22? And how much of that is driven by an expectation that your peers will continue investments in promotional activity versus expanding into new growth areas over the year?

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

It's, of course, difficult to predict competitive activity and what's going to happen on the pricing side, we're at the beginning of the year. This is more of a general statement that we are continuing to gear up our investments and -- our investment spends across a broad spectrum of activities. It includes fixed capital, such as capacity enhancements, it includes loyalty programs with the trade. It includes loyalty programs and awareness building activities with consumers, and it includes digital marketing and the strengthening of -- building of the brand that way. So it's across a broad toolbox.

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**Operator**

Our next question comes from the line of Owen Bennett at Jefferies.

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

I just had a question on the margins. So margins in Smokefree much higher than expected and recovery back towards the 2Q levels and that was despite higher marketing spend. I was just wondering how should we be thinking about those margins in the U.S. business into 2022?



**Anders Larsson** - *Swedish Match AB (publ) - CFO & Senior VP of Group Finance*

Owen, Anders here. But of course, I mean, margins vary from quarter-to-quarter and you're right that we did spend at the same level as we have had in Q4 -- Q3, which was a ramp-up from previous quarter. And then -- of course, we had very strong volumes in the quarter and that you have the leveraging effect of higher volumes, which helps margins. So we will continue to invest and margin will partly be dependent on our success to grow volumes.

**Emmett Harrison** - *Swedish Match AB (publ) - SVP of IR & Corporate Sustainability*

In the Smokefree area, we also have chewing tobacco, moist snuff, snus and so forth. And you'll recall that Q3 was a rather tough comp versus the COVID period count for chewing tobacco and for moist snuff. So we saw improvements for profitability in many of our areas in Smokefree as well. So one should consider the entire portfolio in the U.S.

**Anders Larsson** - *Swedish Match AB (publ) - CFO & Senior VP of Group Finance*

Yes, and Q4 of 2020 was a low point in terms of margins for the U.S. business in the prior year.

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

Okay. Great. And just one quick follow-up on the very strong Scandi industry volume growth. I mean how do you see this kind of progressing? Do you think it can maintain those kind of high single-digit, double-digit levels?

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

I mean if you look at the demographics, Smokefree products, in general, and nicotine pouches in particular, the penetration and the incidence level is growing among young adults, which is helpful for growth, of course. And we can look back and reflect on the Norwegian market, where we've had very good growth for many years. And where we have seen that once it got popular in kind of the 18 to 29-ish bracket, we have seen those incident rates roughly move up as those people have become older and, so of say, reached the next age bracket. So there is a natural -- all things equal, there is a natural support for growth. But then, of course, the consumption patterns can shift over time. But in the recent history, in the past few years, the broad picture is that the tobacco variance have remained stable to show a slight growth and then you've had a significant incremental growth coming on top of that from nicotine pouches. And much of that is also driven by much faster penetration among female consumers. So that's very encouraging. And particularly, since what I referenced in my opening remarks that if anything we've seen in -- among young adults and acceleration of the decline in cigarette smoking as well, which is, of course, very positive not only for us and the industry, but -- the Smokefree industry, but also from a public health point of view.

**Emmett Harrison** - *Swedish Match AB (publ) - SVP of IR & Corporate Sustainability*

Also, one should look over a few years and not just one single year period from time to time. There were some effects in 2020 versus 2019, 2021 versus 2020, as was outlined earlier in the conference call in terms of the differing growth rates.

**Operator**

Our next question comes from the line of Gaurav Jain at Barclays.



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

So I have a few questions about ZYN on revenue and margins. So on a full year basis, your margins in Smokefree have gone up in the U.S. And that can only happen if your ZYN margins are higher in FY'21 over FY'20, which was anyway a very strong year. And that is despite competition, investment, high level of promotional intensity, and now we know BAT is pulling back. And I think your Q4 revenue per can is almost 10% higher versus Q3. So how -- why shouldn't your margins now keep on expanding from here? Because competition is reducing and pricing is coming in the category. So why would there be a step down in margins?

**Emmett Harrison** - Swedish Match AB (publ) - SVP of IR & Corporate Sustainability

First of all, just a small point, I think, is that we have seen a notable improvement in the profitability of snus for 2021 versus 2020. Moist snuff also has had improving margins in recent periods, and chewing tobacco margins have held up very well as well. So one should not assume that all of the margin movements are only due to nicotine pouches in the U.S. We also took a [\$0.10] price increase on nicotine pouches. Now much of that was offset by some of the promotional and other activities that we have had. But we also took pricing along with the industry in our moist snuff business as well. So it's -- the pricing environment, at least, at the list price level, is going well. But we have increased investments behind nicotine pouches, and we will continue to increase -- I'm sorry, we will continue to invest behind nicotine pouches where we see that the growth opportunities are right for that level of spending.

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

Sure. That's very helpful. Now coming to the cigar business and the spin-off later this year, so your cigar business didn't have a good Q4, and you're highlighting supply side challenges, and then we will get a flavored cigar ruling from the FDA probably in the next few months. So do you think that will complicate your attempts to spin off the cigar business later this year?

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

You're correct in saying that the fourth quarter was financially relatively weak for the cigar business. And it's clear that supply-related issues has had an impact. At the same time, I think, again, need to take a little bit of a longer view, and it's a strong year. We grew sales, we grew volumes, and we grew profit at double-digit levels. And we have a more -- for Swedish Match more normal composition of our product portfolio towards the end of the year with more than 60% being natural leaf cigars. And if you look at that slide, we showed you that segment has showed compounded annual growth rates in excess of 20% over the past 10 years. It's a very attractive segment. And while we have the deepest respect for the current challenges and may take some time to address because they involve some significant capacity enhancement on the supplier side and installations that are not built overnight, so to say, but they will be addressed. And we're confident that the long-term prospects are very good for that business. And as regards for the potentially coming proposed rule, that I assume you're referring to the communication on the Twitter from the FDA, that is to be expected in April. As you know, and as we pointed out many times, it goes back to 2016. So this is something that we and the industry, I would say, is well prepared for and we have consciously worked to ensure that we have a very broad portfolio. And I think that the likely scenario is that even post-April, if that is the time line for a proposed rule, even post that date, there will be a period of uncertainty exactly on what will make it into a final rules and when that will be implemented and how definition should be interpreted and so forth. And that period can take several years.

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

Okay, sure. And if I could sneak in a last question on the comments you made around the nicotine pouch regulation in Sweden. Could you just help us understand in more detail what you are expecting there?

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

Yes. We -- there's been a (inaudible) inquiry report, which most often contains a lot of the proposal that is going to be put forward by the government. But there may be changes to that one. But the proposal -- simply put, proposal is to implement marketing restrictions for nicotine pouches that are similar for tobacco products. There are nuances. It's actually even closer to alcohol in Sweden from some respect. It does not include any changes to the excise tax. So the excise tax, that can, of course, be changed separately, but it will not change with this proposal. So it -- for now, at least, it will remain to be less than half than that of tobacco snus. But it will eliminate the possibility to sample products -- to encourage -- with direct encouragement encourage consumption and so forth, similar as for snus. And then obvious things that's age limit and so forth, but that's something that the industry has already implemented on its own. And as I mentioned, we have been in direct discussions with the Swedish government for 5 years now advocating that we need responsible regulations in this area. So while we haven't seen the final regulations, we are pleased to see it coming.

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**Operator**

We currently have one further question in the queue. (Operator Instructions) And that next person is Richard Felton at Goldman Sachs.

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**Richard Felton** - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

My first question is about your retailer loyalty program for ZYN in the U.S. So I think around Q3, you were talking about increasing the off-invoice rebates to retailers that you offered in exchange for more shelf space and a fuller assortment of SKUs. So my question is how is that being received by retailers? Have you seen any noticeable impact in the velocity of those retailers, you take the full rebate and give you that matched shelf space? That's my first question.

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

The answer is, yes, on the latter part of your question, we generally see these trade programs, they contain several elements. And it's like an elective list. So to qualify for a good enhancement of trade margin or even the maximum one. There are several pieces that go into that. And there are clear indications that not only is it good for ZYN, it's also good for the category and the retailer when they sign on to several elements of the Swedish Match trade program. And that, in itself is, of course, helpful when we discuss with retailers. So we expect to see broader acceptance in 2022 compared to 2021 and more electives. So the trend is pointing in the right way there.

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**Richard Felton** - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

And can you give us any sort of idea on how widely adopted that has been?

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

I don't have those numbers in front of me. But the trend is going the right way, and it's meaningful. And if you have the chance to travel to the U.S. nowadays, after all the restrictions are eased, I encourage everybody to do so because it's an insightful experience to travel around in the U.S. and visit retail outlets, and you'll see that ZYN typically has very good shelf presence and strong support from retailers and that goes for retailers that participate in the program that generally actually also goes for other retailers because the product is doing very well.

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**Richard Felton** - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Great. That's very clear. And my second question is on cigars. Are you able to offer any visibility on the timing of when those temporary supply constraints might be relaxed? And so just to understanding this correctly, is this an issue just facing Swedish Match or is it industry-wide?

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

Of course, we don't have perfect insight into the supply situation of our competitors, but -- so if you take this as a qualified guess, to say, or an assessment from our side with limited information, I would say that there are some impacts in the industry. There certainly have been supply disruptions in the industry, but this particular issue -- but it's fair to say that -- or our assessment is that we are at a competitive disadvantage in this case to some of our main competitors. And in terms of timing, as I said, it takes some time to address this, working hard, working on some temporary solutions as well. But I think realistically to expect to live with this theme for a good part of this year, but we hope that it will be to a lesser and lesser extent. But it's certainly something that's going to impact the performance in the first and the second quarters.

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**Operator**

And we've had one further question come through. That's a follow-up from Gaurav Jain at Barclays.

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

Sorry. Sorry, I was on mute. So just a question on ZYN shipments in Q4. Was there any inventory buildup or restocking at either the wholesaler or the retailer level?

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**Anders Larsson** - *Swedish Match AB (publ) - CFO & Senior VP of Group Finance*

Yes, there were some ahead of some activities that we carried out in January and February.

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

We had a few right before Christmas, some of these days were -- for the holidays. There were some very strong shipping days. So the delivery volumes exceeded our own forecast a bit in the fourth quarter and -- but then the first week of January started a bit slower then.

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

How much would that number be, in your estimate?

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

We don't go into details, but it's -- we're talking things that we saw in the very last week. So it's not material for the overall...

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**Anders Larsson** - *Swedish Match AB (publ) - CFO & Senior VP of Group Finance*

One should keep in mind that it's always tricky with those shipping days at year-end, so to say.

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

Okay. And like how will your shipping base change this year, every quarter?

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**Anders Larsson** - Swedish Match AB (publ) - CFO & Senior VP of Group Finance

Sorry, how many shipping days?

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

Yes. (inaudible)

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

(inaudible)

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**Operator**

And we have one further question coming through. That's from the line of Andreas Lundberg at SEB.

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**Andreas Lundberg** - SEB, Research Division - Analyst

Maybe a question for Anders about the financial figures with the balance sheet, 1.7x gearing now. What do you think is a reasonable level?

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**Anders Larsson** - Swedish Match AB (publ) - CFO & Senior VP of Group Finance

I mean we don't comment specifically on kind of how we look upon the gearing future wise. But if you look at the history, we have been around 2x. So from that perspective, it's a bit lower, but it can go up and down, and one should also bear in mind that we actually did a record number of buybacks in the fourth quarter. So it depends a bit on timing of cash flows and so forth. And as you might have noted, we have also a quite good increase in the upcoming dividend proposal.

And then you need to manage liquidity with bonds and so forth with maturities.

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**Andreas Lundberg** - SEB, Research Division - Analyst

No impacts from the intended cigars operation in how you think about the financial gearing at the moment?

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**Anders Larsson** - Swedish Match AB (publ) - CFO & Senior VP of Group Finance

No, not from the current level of gearing.

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**Andreas Lundberg** - SEB, Research Division - Analyst

Okay. And lastly, also status on the working capital. Is there any specific things to think about there here now?

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**Anders Larsson** - Swedish Match AB (publ) - CFO & Senior VP of Group Finance

There are some -- we see some inventory build over the course of 2021. And partly, that's intentional to have some more safety stock at hand. And then comparing to the cash flow development of the prior year, that was more a (inaudible) year because we have favorable working capital movements and positive cash flows. So -- but it's slightly higher from -- mainly somewhat higher than normal inventory levels.

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**Andreas Lundberg** - *SEB, Research Division - Analyst*

Okay. Cool. Lastly, about other markets for Smokefree. Is there any particular country you would like to highlight that is doing very well?

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

I mean we've seen good growth in several geographies from small base. But if you take 1 country that sticks out a little bit in our portfolio, it's Austria has done well lately with a nice volume development?

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**Andreas Lundberg** - *SEB, Research Division - Analyst*

Do you think that relates to, let's call it, distribution advantages or due to the product itself?

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

We've been active with the priority assortment there, but then also been active with our go-to-market model a bit. So it's good to see that pays off.

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**Operator**

We've had a couple more questions come through. The next is from Nik Oliver at UBS.

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**Nik Oliver** - *UBS Investment Bank, Research Division - MD, Head of European Consumer Staples Team & Analyst*

Just one left for me. Back to U.S. then, you mentioned velocity is obviously driving the growth. But in the past, you've given a store count number, and I saw your main peer was talking about 117,000 stores as of the last quarter. Is there anything you can share with us on that?

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

Yes. Thank you for the question. Our presence is a bit more than 120,000 stores. That is, we have done a retake at the database in terms of what we include in the number of stores. And when it comes to store count, to become a little bit technical with the risk -- to avoid any risk of overstating growth, we have been omitting recent ads on all metrics, historically, when we were in fast expansion. That little cautionary adjustment, given where the category is now, is no longer needed. And therefore, the most accurate one is to look exactly at all stores that are in the MSA database and then we are a little bit more than 120,000 stores, and it's up about 4,000 stores from Q3, and it's up about 15,000 stores from Q4 of the prior year.

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**Emmett Harrison** - *Swedish Match AB (publ) - SVP of IR & Corporate Sustainability*

And those are the stores that we've shipped to over the last...

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

26 weeks.

**Emmett Harrison** - *Swedish Match AB (publ) - SVP of IR & Corporate Sustainability*

26 weeks. So it's not a total universe store count. It's where we've actually shipped over the last 6 months.

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**Operator**

We have one further question in the queue. That's from the line of Jared Dinges of JPMorgan.

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**Jared T. Dinges** - *JPMorgan Chase & Co, Research Division - Analyst*

A couple of questions from me, please. Just to follow up on that last one. You've clearly been able to continue to expand your store count at a pretty good rate. Can you comment on how much headroom you think you have left there? And maybe for 2022 in particular?

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

It's a moving target, I would say, in terms of -- we don't have big white spots when it comes to ZYN. It's more as the category continues growing, so does, what I would call, the addressable retail universe. I mean I get different numbers and you may have your own set of numbers. But a round number that I use for cigarettes, it's around 200,000 outlets, but then you start to include some very small kiosks and stuff in certain cities. But as the category continues to evolve, we don't see why nicotine pouches should be available in just about every outlet in the U.S. that sells nicotine products.

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**Emmett Harrison** - *Swedish Match AB (publ) - SVP of IR & Corporate Sustainability*

And there are 2 components to distribution. There's -- of course, you have store count distribution, but you also want to ensure that in each of those shops, you have the appropriate range of products for the consumers. And as our velocities grow, we also see that we need to have a little bit more space as part of the merchandising program. As their own sales grow, they need to make sure that their own weeks of supply corresponds with that. So that also impacts retail levels as well. So it's not only just store count, it's the assortment of products, having menthol in there, for example, as well and some unflavored varieties, which have done well in the expansion.

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**Jared T. Dinges** - *JPMorgan Chase & Co, Research Division - Analyst*

Got it. That's clear. And the second one for me. Can you guys talk a bit about competition in Scandinavia nicotine pouches? And in particular, do you expect a further step up, let's say, in competitive intensity before those new regulations come into effect in Sweden. Maybe related to that, do you expect any impact to the Nordics from the entry of Philip Morris?

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

I mean there are several competitors. I will -- I don't think -- they're not our main competitors. I will refrain from specific comments on Philip Morris. But as most of you heard on their call, they are present with their product now, and they were present in small scale before the acquisition as well. What we are seeing a lot of competitive activity and have seen for some time, including several additions of small players with brands that you only find online and so forth. So it's -- while there is -- big competitor of ours is the clear market leader. Still it is very fragmented below the #2, #3 player in the market. And I think it's a reasonable assumption that the ongoing very intense campaigning and so forth, is a direct reflection of that all industry participants understand that there is a limited time available to be able to conduct those type of activities. So whether it will further increase in the coming months, that remains to be seen.

**Operator**

As there are no further questions in the queue at this time, I will hand back to our speakers for the closing comments.

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

Okay. Thank you everybody for listening today, and I'd like to take this opportunity to inform you that the release of our first quarter results will be on May 11. Thank you very much.

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