

# FINAL TRANSCRIPT

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**SWMAF.PK - Q2 2009 Swedish Match Earnings Conference Call**

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*Swedish Match - President and CEO*

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**Richard Flaherty**

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**David Hayes**

*Nomura - Analyst*

**Martin Sikorski**

*Credit Agricole Cheuvreux Nordic - Analyst*

**Eileen Khoo**

*Morgan Stanley - Analyst*

**Niklas Ekman**

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## PRESENTATION

**Operator**

Good afternoon, ladies and gentlemen, and welcome to the Swedish Match half year conference call. At this time all participants are in a listen-only mode until we conduct a question and answer session and instructions will be given at that time. (Operator Instructions). I would now like to hand over to the Chairperson, Emmett Harrison. Please begin your meeting, sir, and I will be standing by.



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**Emmett Harrison** - *Swedish Match - VP, IR*

Good afternoon. This is Emmett Harrison, Vice President of Investor Relations. Welcome to the second quarter 2009 results telephone conference for Swedish Match. Lars Dahlgren, President and Chief Executive Officer, is joined today by Joakim Tilly, Chief Financial Officer, Henrik Brehmer, Senior Vice President of Corporate Communications and myself.

The conference call should last about an hour and will include an overview by Lars Dahlgren and a review of the financials from Joakim Tilly. A question and answer period will follow. A shortened version of our investor kit accompanies this presentation via webcast and a complete investor kit is available in the Investor Relations section of our website [swedishmatch.com](http://swedishmatch.com).

During today's telephone conference we will discuss certain items which may constitute forward looking statements. Because such statements deal with future events they are subject to various risks and uncertainties. Although management believes that its expectations are based on reasonable assumptions, it can give no assurance that its expectations will be achieved. Risk factors are outlined in the latest annual report which is available on our website [swedishmatch.com](http://swedishmatch.com). Swedish Match assumes no obligation to update information concerning its expectation.

This conference call is being recorded and the recording will be published on the Swedish Match website.

I would now like to turn the conference call over to Lars Dahlgren.

**Lars Dahlgren** - *Swedish Match - President and CEO*

Thank you, Emmett. Today we reported Swedish Match returns for the period January through June 2009.

On July 2 the Company announced an agreement has been reached to sell its South African Pipe Tobacco and Nasal Snuff businesses to Philip Morris International. We believe that this transaction is a win-win for the buyer, for the employees and for our shareholders as we continue our focus on smoke-free products, cigars and lights. We expect the transaction to be completed prior to the end of the year, following all the regulatory approvals, and to generate a capital gain in excess of SEK500m. As a consequence, this business is from now reported as discontinued operations in our financial statement and also excluded from the business results I'm presenting here today.

During the second quarter there were a number of encouraging developments. Despite the significant Federal Excise Tax increases for tobacco products in the US, volume declines in our cigar business were much lower than expected, especially for small cigars and cigars with our new foil fresh packaging. For all products except for snuff we were able to adjust prices to reflect the increases in the Federal Excise Tax. At the end of the quarter we also adjusted our US snuff prices, taking the federal tax into account.

Margins in the US improved versus the first quarter for our US cigar businesses on better than expected volumes and cost control, in our US snuff business helped by restocking volume and in our chewing tobacco business on improved pricing and high volumes.

In Scandinavia, we experienced continued volume growth for snus, with volumes up in Sweden, Norway and our travel/retail classes of trade, bringing year-to-date volume growth, excluding estimated hoarding and destocking effects, to 4%. Overall Scandinavian sales and operating profit increased and our Scandinavian margins for snus improved from Q1 levels.

Our new improved packaging and presentation of our flagship snus General is showing a positive consumer reception and we continue our commitment to devote sufficient resources behind smoke-free initiatives, both in and outside of Scandinavia, as part of our strategy in being the global smoke-free leader.

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Swedish Match group sales from continuing operations for the quarter reached SEK3,666m, an increase of 16% versus the second quarter 2008. In local currencies, sales are up 2% driven by the growth of 8% for snus.

Operating profit showed solid gains up 30% in the second quarter and 13% in local currency terms. During the second quarter all product areas except for lights reported higher operating profits compared to prior year.

Now let me go into some details by product area. Beginning with the snuff and snus product line, Scandinavian snus sales were up 8% and operating profit was up 5% in the second quarter versus last year on 6% higher volumes. Production cost increased somewhat more than the net sales price per can.

In last year's first quarter we estimated there was a destocking effect of approximately 5m cans, which was not repeated in the first quarter 2009. Taking out these destocking effects, Scandinavian volumes were up by 4% in the first six months of the year. Margins in Scandinavia in the second quarter were higher than in the first.

Our price levels in Sweden remained unchanged from prior year levels for most of the quarter. On June 22 list prices in Sweden increased by around 4%, bringing net prices up by some 6% to 7%. Prices also increased slightly in our travel/retail class of trade during the quarter.

In the North American market snuff shipment volumes were extra strong during the month of April, reversing the tax related inventory depletions we saw in March. In total, for the second quarter, these effects resulted in a volume increase for Swedish Match of 21% for US moist snuff, while revenues increased by 13% in US dollar terms on lower average prices primarily due to a mix shift towards the lowest priced product, Longhorn.

For the first six months volumes were up by 8% and revenues increased by 7% in US dollars. Our US snuff operating margin increased during the second quarter versus both Q1 and year earlier levels, as higher volumes substantially offset reduced prices from the absorption of the increased Federal Excise Tax. During the third quarter net prices will be closer to Q1 levels again as we recently announced a price increase. On June 22, Swedish Match raised its prices by \$0.07 a can for Longhorn and \$0.10 per can for Red Man and Timber Wolf.

During the third quarter the US will be launching two new varieties of Longhorn pouches. This follows the successful line extension of Timber Wolf packs in 2008. Our market share, for the year-to-date in volume terms, according to ACNielsen, was 12.9% up from 12.0% for the same period in 2008. ACNielsen reported the overall US snuff market being up by 2.3%, with Swedish Match volume up by 9.2%. For the latest four-week period ending June 13, Swedish Match holds 12.9% of the market in volume terms with Red Man holding 1.8% of the market, Timber Wolf 6.2% and Longhorn 4.9%.

In our cigar business, sales in local currencies were flat versus the second quarter 2008, which was better than we had anticipated. During the first quarter there was exceptionally strong sales growth from hoarding by wholesalers and retailers in the US, most notably for our machine-made cigars but also for premium hand-rolled cigars by some larger accounts.

This hoarding was due to lower tax exception in the Federal Excise Tax increase for cigars. While volumes were down due to anticipated destocking of larger cigars in the second quarter, volumes for small cigars and cigars with our foil fresh packaging continue to be very strong in our US machine-made cigar business as we gained market share.

In anticipation of major destocking in the second quarter, costs in factories as well as marketing were adjusted to lower than normal levels, which together with the better than expected volumes and price increases resulted in very strong operating margins and sharply increased operating profit in the US mass market year on year.

In Europe, sales and operating profit declined in local currency on lower volumes, especially in Belgium, Netherlands and France. As margins in the US are generally higher than for our European business for cigars, the combination of a stronger dollar in the relatively larger US business during the second quarter helped the reported operating margin for the product area as a whole.



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Our position in the chewing tobacco market is stable and our market share year-to-date stands at 45.2%, according to ACNielsen. Sales in the second quarter were up by 39% to SEK314m, aided by the strengthened US dollar. In local currency, US sales were up by 5% despite lower volumes due to price increases. Operating profits in SEK in the first quarter was SEK129m, up 67%, and operating margin reached 41% in the quarter. In US dollars, operating profit grew by 23%. We should note that the volume decline in the second quarter year on year was more moderate than what we normally experience for this product line.

Our lights business also continued to perform well in the second quarter with sales and operating profit close to year earlier levels. Sales increased by 4% while operating profit declined by 2% to SEK62m. Our lighter's business noted some weakness in Eastern Europe primarily tied to some currency issues.

Now I will hand over to Joakim for some more comments on the financials.

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**Joakim Tilly - Swedish Match - CFO**

Thank you, Lars. During the second quarter the development of exchange rates had a continued strong positive effect on our sales and operating profit comparisons, brought on by the strengthening of the dollar since last September. The total translation impact on sales from continuing operations in the second quarter is positive SEK425m, of which SEK227m for cigars, SEK83m for snuff, SEK77m for chewing tobacco, SEK32m for lights and SEK6m for other operations. For operating profit the total translation impact was a positive SEK160m for the second quarter. For Q3 2009 the currency situation continues to look favorable compared to the third quarter of 2008.

Net finance costs for the second quarter amounted to SEK108m compared to SEK117m previous year, as lower interest income from our cash positions are more than offset by lower interest expenses on our financing. As of June 30 Swedish Match holds net SEK8.8b worth of bonds due for repayment under global and domestic MPN programs. The average maturity duration of the bond portfolio is 3.4 years and the average duration of the interest binding is 3.0 years.

In the second quarter, maturing loans of SEK126m were repaid and during the rest of 2009 a total of SEK224m worth of loans will come due for repayment, of which SEK182m in the third quarter. The weighted average interest rate on bonds issued, including derivative effects, is currently 4.16% and about 25% of portfolio is exposed to variations in interest rates.

For the first half of the year the tax rate was 22% and we now estimate the full year tax rate from continuing operations, excluding onetime items such as the tax free capital gain from the sale of the South African business, to be around 22%.

Some comments to the cash flow. Cash flow from operating activities for the first six months of the year was SEK1.3b compared with SEK578m in the first six months of 2008. The improvement is mainly related to the increased operating profits but also to lower tax payments and better cash flow from changes in working capital. Net investments were SEK258m for the six month period compared to the investments of SEK90m for the first half of 2008. Investments in property, plant and equipment amounted to SEK231m compared with last year's level of SEK133m. As previously indicated, investments for the full year of 2009 are expected to be above SEK500m due to the announced capacity investments in the Kungälv snus plant.

Swedish Match made no share repurchases in Q4 '08 or in Q1 '09. Due to the high cost of new financing during that time we prioritized using available funds for needs in operation, upcoming maturities and dividends. In May, SEK1b of new bond funding was secured, maturing in 2015 at a fixed interest rate of just below 6%. At the same time, SEK900m of bonds maturing in 2010 and 2011 were repurchased, which allows us to reduce our cash position without increasing refinancing risk.

After having secured new financing, share buybacks were resumed and during the second quarter a total of 4,087,442 shares were repurchased for a total amount of SEK496m, or at an average price of SEK121.45, while 115,000 treasury shares were sold as a result of option holders exercising their options.



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The net debt was SEK7,770m as per June 30 and the net debt in relation to EBITA was 2.1 for the period ending June 30, 2009. This figure includes discontinued operations. Total dividends paid during the first six months of the year amounted to SEK1,024m, this is equivalent to 46% of the earnings per share for 2008.

We expect to receive the ZAR1.75b, equivalent to about SEK1.65b, as the consideration for the sale of our South African operations before the end of the year. Our financial strategy remains intact, our net debt/EBITA ratio should be below 3 and funds not needed in operations should be returned to shareholders.

I will now hand over to Lars for any other remarks before going into Q&A.

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**Lars Dahlgren** - Swedish Match - President and CEO

Yes, thank you. I think, operator, we can go ahead and open the floor for questions and answers.

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## QUESTIONS AND ANSWERS

**Operator**

Thank you, sir. (Operator Instructions). The first question comes from the line of Anders Hansson. Please go ahead with your question.

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**Anders Hansson** - Danske Bank - Analyst

Thanks. Anders Hansson, Danske Bank. First of all a question on snuff, you had 6% volume growth in Scandinavia in Q2, which seems to be the highest number for at least five, six years, if we exclude trade loading quarters. Any reason for this, anything exceptional that I missed, or why is the market so strong?

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**Joakim Tilly** - Swedish Match - CFO

Well, first of all, as you point out, it's very encouraging to see that the Scandinavian market is now showing growth again and we've been focusing on the category. We've been coming out with new products and new designs and we believe that has helped. But then also we should note that we are only talking about one quarter here and so year over year 6% volume growth is very strong. I would say that the year-to-date period is a longer time period and we still believe that the 4% that we see there, if we exclude the hoarding effect, is a good growth in the total market.

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**Anders Hansson** - Danske Bank - Analyst

Yes, because also the 4% it's a market pick-up compared to the past five years or something. Is that anything you feel has changed in recent months?

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**Joakim Tilly** - Swedish Match - CFO

What of course has changed is that, as we all know, in 2007 and 2008 we got a very blurry picture because of these very high excise taxes increases on the Swedish market and this year we don't have that, so it means that the category is behaving much more normally.

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**Anders Hansson** - Danske Bank - Analyst

Sure, thanks. On cigar side, in Q1 mass market volumes were up some more than 50%, premium up 28%, quite low volume drops in Q2, premium is almost flat and mass market was down 6%. Should we expect to see more destocking in Q3 or is it just mass market trade gains in mass market and also premium that explains why you sustain volumes?

**Joakim Tilly** - Swedish Match - CFO

It's of course very hard to know down to the last decimal what's left there on the shelves, but I'd say mass market cigars is a relatively fast category and it should be completely out of the system and we like to think that's also the case for premium cigars. But there could be some SKUs, some brands where people still are a little bit overstocked, but I wouldn't -- no significant impact.

**Anders Hansson** - Danske Bank - Analyst

Okay, also I saw on Reuters that you were talking about normalizing cigar EBIT margins in the second half of this year. I was just wondering what is normalizing EBIT margins in a division where you've seen massive market gains in the last two quarters?

**Joakim Tilly** - Swedish Match - CFO

I'd say it's in the direction of historic margins.

**Anders Hansson** - Danske Bank - Analyst

Okay, so down towards 20% but not all the way or something like that?

**Joakim Tilly** - Swedish Match - CFO

It's very hard to predict the cigar margin, but what we can say is that during the second quarter it was a little bit unusually strong because of the fact that the volumes were so strong, and stronger than we anticipated ourselves.

**Anders Hansson** - Danske Bank - Analyst

Okay, thanks.

**Operator**

The next question comes from the line of David Hayes. Please go ahead with your question.

**David Hayes** - Nomura - Analyst

Thank you. Hi, it's David Hayes from Nomura. Just firstly on going to the South African sale, I just wondered whether you can talk about whether that's a new theme or focus for the business, in terms of rationalizing some of the operations, some of the divisions? And I guess, in terms of the cash inflow, is the plan just to put that into the whole returning cash to shareholders that you mentioned earlier or are there places for that money to be invested, do you think, in the core businesses?

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And then secondly, in terms of the results, you talk about production costs in Sweden going up in the quarter, can you just talk a little bit about what's driving that? I'm guessing some of it's the FX transactional impact. If it is can you maybe quantify how much impact that had and whether that falls away in the second half with currency movements? Thanks very much.

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**Lars Dahlgren** - Swedish Match - President and CEO

Yes, thank you, it's Lars here. I wouldn't call it a new theme, but we are constantly evaluating how we create most value for our shareholders. And having said that it's in line with our strategic direction to focus on growth for smoke-free, to focus on developing the cigars to be best in class and improved profitability. At the same time operational excellence for lights and pipe tobacco, and in this case when it comes to pipe tobacco we have concluded that it's most value creating to divest it to another player who can develop the business more than we can ourselves.

When it comes to the cash proceeds, clearly SEK1.65b in cash in is quite an inflow and we are already today well below the ceiling of our financial policies. So although we will not hesitate to invest part of the proceeds in operations as we deem appropriate, it's a very sound and likely assumption that we will see some return to shareholders and some increased buybacks following when we have received those proceeds.

And finally, I just go on there, when it comes to the snuff in Scandinavia and the cost of goods increases, it's nothing dramatic, it's more pointing out as we write in the report the sales were up 8% and the operating profit in Scandinavia was up 5%, so clearly that is a slight margin deterioration year on year. And we just want to make people aware at this time it comes from the cost of goods increasing slightly more. And I think you should see this as the more normal development in the production costs, in inflation, etc. and against a background that we haven't moved prices on the Swedish market for 18 months, until June 22.

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**David Hayes** - Nomura - Analyst

Okay, so there's no big swing in terms of the FX transaction or costs of inputs?

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**Lars Dahlgren** - Swedish Match - President and CEO

No, that's relatively marginal. We have seen some impact on plastics and so forth, but there's no dramatic thing.

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**David Hayes** - Nomura - Analyst

Okay, thank you. Thank you very much.

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**Operator**

The next question comes from the line of Martin Sikorski. Please go ahead with your question.

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**Martin Sikorski** - Credit Agricole Cheuvreux Nordic - Analyst

Good afternoon, gentlemen. Thank you for taking my questions. Just a quick one on cigars for you, I think like many others I was positively surprised by the margins in the second quarter, and in the report you did mention something about cost controls. Can you give us a bit more flavor on what you've done to keep costs in control in second quarter in cigars?



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**Emmett Harrison** - *Swedish Match - VP, IR*

Yes, don't think of it so much as a major cost saving program or cost control, think of it as we were expecting pretty low volumes going out of the system in the US following the significant hoarding in the first quarter going into the second quarter. And we looked under every rock to find ways that we could cut costs on the production side and some on the marketing side as well. And a lot of that was of a temporary nature to abnormally low levels of costs, so a lot of those costs will revert back over time. During the third and fourth quarter a lot of those will come back, we're going to come back to more normal levels of production costs and marketing activity and so forth.

**Martin Sikorski** - *Credit Agricole Cheuvreux Nordic - Analyst*

Okay, thanks, and just one more question if I may, relating to the South African divestment and the proceeds from that. Have those been hedged into Swedish kronor?

**Emmett Harrison** - *Swedish Match - VP, IR*

Yes.

**Martin Sikorski** - *Credit Agricole Cheuvreux Nordic - Analyst*

Thank you.

**Operator**

The next question comes from the line of Eileen Khoo. Please go ahead with your question.

**Eileen Khoo** - *Morgan Stanley - Analyst*

Hi. Two questions, please. First of all, in the US can you comment a little bit on who you've been gaining share from with -- within mass market cigars and comment a little bit about maybe cross-product movement?

And the second question is on the competitive environment in the second quarter. Do you feel that it's gotten more competitive or the same? If you could give us a bit of color on that, that would be great. Thanks a lot.

**Richard Flaherty** - *Swedish Match - President, North America Division*

Sure, when we look at the mass market cigar side the gains really have been coming from, at least according to ACNielsen, all other manufacturers. So those are the ones that have been dropping a bit in terms of market share, not so much the big players. And it really depends upon the product line. Little cigars in general have been declining, small cigars in general have been growing, our White Owl has been growing. But again for us, we're a fairly small player, we went from -- we're 5.4% year-to-date, we're 5.8% for the latest four-week period and we were below 5.3% prior to March, so we've gained about 0.05%. To say where did that 0.5% come from specifically, it's really tough to say, but what has declined are more of the smaller manufacturers.

**Eileen Khoo** - *Morgan Stanley - Analyst*

Okay, so it's a bit of up-trading or movement from little cigars up to more small cigars.

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**Richard Flaherty** - Swedish Match - President, North America Division

We're not exactly sure. What we can say is little cigars have gone down and small cigars, for us, have gone up.

**Eileen Khoo** - Morgan Stanley - Analyst

Okay, and on the competitive environment in the second quarter?

**Richard Flaherty** - Swedish Match - President, North America Division

Well, there were some pretty significant price increases that came through in February and again in April in anticipation of and along with the Federal Excise Tax increase. The overall market's growth rate year-to-date is -- again it's a lot of different factors in there but the market is flat to slightly down, excluding little cigars, but no major shifts going on.

One of the big competitive things that has happened is we have done very, very well with our foil fresh cigars. We've launched quite a few products in the new packaging formats and that's been very successful, so we've done a lot on the competitive side.

**Eileen Khoo** - Morgan Stanley - Analyst

Okay. And sorry, were these products launched in the second quarter itself?

**Richard Flaherty** - Swedish Match - President, North America Division

No.

**Eileen Khoo** - Morgan Stanley - Analyst

No.

**Richard Flaherty** - Swedish Match - President, North America Division

There was some in the second quarter, there was some in the first quarter, there was some in the third and fourth quarter last year, so we're continuing to roll out foil fresh cigars.

**Eileen Khoo** - Morgan Stanley - Analyst

Okay, so should we still expect that sort of growth rate then in the remainder of the year?

**Richard Flaherty** - Swedish Match - President, North America Division

Again, we'll have to see whether the trends continue, but it was very encouraging to see that we maintained the 5.8% share of market that we reached in May again in June, so we'll have to wait and see.



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**Eileen Khoo** - Morgan Stanley - Analyst

Okay, thank you.

**Operator**

The next question is from the line of Niklas Ekman. Please go ahead with your question.

**Niklas Ekman** - Carnegie - Analyst

Hi, a couple of questions if I may. First, a follow-up on cigars, I'm just wondering, and this might be difficult to answer, but if you also saw a strong underlying trend in the first quarter? I guess hoarding issues you would see towards the end of the first quarter and if you actually saw a decent volume growth in the first quarter as well? I'm just trying to get some flavor of how much of the strong growth in Q2 and how that was exceptional or just to see the trends here, if you could help us here?

**Richard Flaherty** - Swedish Match - President, North America Division

It's very difficult to get full transparency as we are relatively small, so that it's a big error of margin in market shares and so forth. But I think it's fair to say that we did see that the foil fresh was very well received by consumers but also we a little bit, ourselves, underestimated the power in that business.

**Niklas Ekman** - Carnegie - Analyst

How big a part of your US business is that, of your US cigar business? Just to give us some kind of indication.

**Richard Flaherty** - Swedish Match - President, North America Division

I don't have that. In terms of what the percentage of the business in mass market cigars is foil fresh, I don't have that.

**Niklas Ekman** - Carnegie - Analyst

Okay, turning to chew tobacco, and we don't talk too much about that usually, but since long now you've seen a significant improvement in margins. And they were above 40% now in Q2, and I guess a lot of this was due to not hoarding but the opposite here now in Q2. But I'm just wondering what do you see as the best run rate for these businesses? Are these margins now at 35% plus, is that sustainable or are these exceptional levels we are at now?

**Richard Flaherty** - Swedish Match - President, North America Division

We are at exceptional levels where we are right now in the second quarter. Volumes normally decline in the range of 6% to 8% per year. And what happened was in the first quarter there was a little bit of destocking and a little bit of, we can call it, restocking which created a much slower than normal volume decline during the second quarter of the year. So your allocated costs, your allocated fixed costs, you had some positive factory variances and so forth going on, on the chewing tobacco side. So that lifted the margin somewhat.

Also there is seasonality in chewing tobacco margins, they bounce around quite a bit. Generally what you see is, right after a price increase, the margins do go up for a few months. But you are always having the volume declines going in there, which

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puts a little pressure on the margins over time. So you have those two effects in there, both of them would indicate the margins would be coming down a little bit from the second quarter levels.

What I can say is prices are up about 4% above the FET from April 1. If you take a look at the margins last year and assume that we've had somewhat better price increases that supports those kind of margins.

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**Niklas Ekman** - *Carnegie - Analyst*

Okay.

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**Lars Dahlgren** - *Swedish Match - President and CEO*

That -- for the second half of the year, although we're a little more cautious about our so to say own volumes, Red Man and so on, we have the addition of subcontracting volumes for National Tobacco. But this comes in then at a lower margin because it's mainly the benefit of factory absorption. So that's affecting margins a little bit. But it's obviously good business

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**Niklas Ekman** - *Carnegie - Analyst*

Okay, thanks. Turning to US snuff. I'm wondering if you've seen any impact in terms of volumes from Altria UST and the price cuts that they made. Is there any signs that the premium segment is starting to see growth? Or is it too soon to tell?

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**Richard Flaherty** - *Swedish Match - President, North America Division*

Yes, if you compare the Q1 investor kit to the Q2 investor kit you'll see that we lowered the market growth projection from 6% down to 4%. But we maintain the market growth projection for the low priced segment. We're still looking at a 9% or so growth in that low price segment. But now we're assuming that the premium segment declines a little bit. We have not seen any pickup in the premium snuff segment since -- over the past several months.

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**Niklas Ekman** - *Carnegie - Analyst*

Okay. (multiple speakers)

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**Lars Dahlgren** - *Swedish Match - President and CEO*

-- short periods.

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**Niklas Ekman** - *Carnegie - Analyst*

Yes. Certainly, yes, certainly. And turning to Scandinavians now, or Swedish snuff, have you -- have competitors raised the prices a similar amount as you have in the Swedish market?

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**Richard Flaherty** - *Swedish Match - President, North America Division*

Yes.

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**Niklas Ekman** - *Carnegie - Analyst*

Great. Final question, in a recent interview you, Lars, said that on the issue of buybacks that you were looking at potentially additional financing later this autumn to make additional buybacks. And I was just wondering if the pipe tobacco transaction, if that replaces these, looks at additional bonds or what your view here is on bonds and buybacks?

**Lars Dahlgren** - *Swedish Match - President and CEO*

We will look over in our financing continuously. And one part of it is to manage the maturity profile and to make sure that we are far out on the curve, so to say. But obviously now we have a large cash inflow so we don't -- we can afford to be more picky when it comes to prices on financing and so forth. But it's not a given that we will not go to the credit markets after the summer.

**Joakim Tilly** - *Swedish Match - CFO*

And as Lars said, this is Joakim here, we also want to make sure that we manage our refinancing risk and the maturity of our debt portfolio and so on. So it is not at all impossible that we will try to seek some more bond finance despite the cash inflow from the South African operations sale.

**Niklas Ekman** - *Carnegie - Analyst*

Okay. Thanks. Thanks a lot, that's all for me for now.

**Operator**

The next question comes from the line of Stellan Hellstrom. Please go ahead with your question.

**Stellan Hellstrom** - *Nordea - Analyst*

Hi, I was wondering on the Longhorn pouches, when did you -- I missed when you said when it was going to be launched.

**Richard Flaherty** - *Swedish Match - President, North America Division*

During the third quarter we'll start a phased rollout of the launch.

**Stellan Hellstrom** - *Nordea - Analyst*

So that haven't really affected your shipments already in the second quarter? Or has it?

**Richard Flaherty** - *Swedish Match - President, North America Division*

No. No. It starts later on this month.

**Stellan Hellstrom** - *Nordea - Analyst*

All right. And I would assume that the launch will be accompanied by the usual promotional activities?

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**Richard Flaherty** - Swedish Match - President, North America Division

Yes, we'll spend behind the launch. But this is a line extension not a new brand.

**Stellan Hellstrom** - Nordea - Analyst

All right. Also with regards to your strong Scandinavian snuff volumes, did you see any trade stocking ahead of your price increase at the end of June?

**Lars Dahlgren** - Swedish Match - President and CEO

Yes, a little bit, but nothing material because you're talking about a week here. And then we had one week after the price increase. But maybe the net was very marginally positive. But it's nothing that distorts the overall picture.

**Stellan Hellstrom** - Nordea - Analyst

So one or two percentage points over the quarter?

**Lars Dahlgren** - Swedish Match - President and CEO

Less. Less. Immaterial.

**Stellan Hellstrom** - Nordea - Analyst

Maybe you could just also maybe comment a little bit on the lights division which seemed a little bit weaker than it was in the first quarter. Is it the currency effect that you were talking about previously, or --?

**Lars Dahlgren** - Swedish Match - President and CEO

This is something -- what happened in the first quarter was that we did have some issues on export to Eastern Europe because of the depreciation over there, and lower volumes. But this was more than compensated by very strong volumes in Western Europe.

In the second quarter we had more normal development in Western Europe so we did see the effect. But overall we're very pleased with continued solid lights result at this level and with this kind of margin. But it can be good and I just point out, the third and fourth quarter and particularly the third last year, those were very strong lights quarters. So people shouldn't necessarily, they should look more where we are now rather than look at the prior year properly when they do their modeling.

**Stellan Hellstrom** - Nordea - Analyst

You have positive one-offs around SEK9m in each of the two last quarters, I would assume last year?

**Lars Dahlgren** - Swedish Match - President and CEO

Yes, I believe, think that's correct, yes.



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**Stellan Hellstrom** - *Nordea - Analyst*

All right, thank you very much.

**Operator**

The next question comes from the line of Charles Manso. Please go ahead with your question.

**Charles Manso** - *Dresdner Kleinwort - Analyst*

Yes hello. Some more clarification on the cigars, if we can. Firstly, you were saying earlier on that you yourselves were anticipating much lower volumes, or much greater volume decline, should I say, in Q2. I understand what really came through quite strongly was your mail order and Internet business on US cigar side. Could you tell us now how big that side of the business is and in particular why that side of the business was so unexpectedly brisk in Q2?

**Lars Dahlgren** - *Swedish Match - President and CEO*

I think what really -- the part of the US business that was sticking out the most was really their machine made business where we referred to the decline of 6% volumes during the quarter which was much more moderate decline than we had anticipated. On the premium side we were very pleased to see that we could limit the revenue decline to less than 1% in US dollar terms. And it's correct that we continue to see a more challenging environment in the brick and mortar part of the business while the mail order Internet business is delivering in line with historic growth trends, basically. Exactly how big it is now, we don't go down into that detail.

**Charles Manso** - *Dresdner Kleinwort - Analyst*

Right. And at the sales level, obviously the margins were very rich in Q2, but going up to the sales level, given that Q2 is less bad than expected, shall we put it that way? Is this now a reasonable sales base for the remaining quarters of the year?

**Lars Dahlgren** - *Swedish Match - President and CEO*

It's a very hard to estimate exactly. But we don't -- you're right in pointing out that the exceptionally strong margin is more attributable to very high efficiencies and low costs that probably cannot be repeated. And we continue to see good momentum in our machine made business and so forth. But we refrain from giving a more exact top line projection for the second half.

**Charles Manso** - *Dresdner Kleinwort - Analyst*

Right, okay. I think you were intimating a bit earlier that some of your short term cost management, you're saying a lot of it will revert. But it kind of leaves some space for you, for some of it not to revert? Was there any lessons learned while you were looking under rocks that you can reduce some of those costs permanently?

**Lars Dahlgren** - *Swedish Match - President and CEO*

Yes, what's not reverting is that of course we have a very nice pricing situation in the US mass markets. And so we have taken up prices more than the tax. Then we will have to see. It is a very competitive market, and not all competitors have raised prices

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to fully reflect the tax increase so it could be that we need to be back with a little bit promotions here and there. But the price factor should be very positive for the second half compared to prior year.

And then of course, we are running the factory at a very good utilization since we have good volumes.

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**Joakim Tilly** - Swedish Match - CFO

This is Joakim. I guess I can add also that as we have talked about in the past, we have changed our strategy a bit on the cigar side to be one of focusing more on profitability than on growth. And of course that means as we're already looking at those rocks and turning those rocks. So these were more of a temporary basis that we saw in Q2, the cost reductions.

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**Charles Manso** - Dresdner Kleinwort - Analyst

Fair enough. And moving on to US snuff, on the consumption side, the ACNielsen data side, I think in Q1 the year-to-date was [11%] and the first half was [9%]. That assumes it was [7%] in Q2, something like that. So are you seeing some kind of slowdown, a progressive slowdown on the consumption side in US snuff?

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**Richard Flaherty** - Swedish Match - President, North America Division

There is a bit of a slowdown in the category growth rate. Year-to-date the growth rate is about 2.3%. During the quarter there's no real big trend, but a slight slowing down of the growth rate, mostly coming on the premium cigar side -- premium snuff side.

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**Charles Manso** - Dresdner Kleinwort - Analyst

Okay. And you've been talking about that you've been looking at your strategic growth opportunities. Could you share with us some of those conclusions? You mentioned focusing on profits over growth in cigars. What about your conclusions on the snuff side?

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**Lars Dahlgren** - Swedish Match - President and CEO

Snuff is part of -- that's at the core of the smoke-free business. And we believe that long term we have excellent growth prospects for our smoke-free products. And we believe that although inflation is very high in Scandinavia that we will continue to focus to develop that category. And we believe that the US market has very good prospects long term. And we actually think that this slow category growth that we're seeing right now in (inaudible) in some periods we think that that will revert over time. And not the least for the fact that relative pricing makes it much more economical to use smoke-free products compared to cigarettes nowadays in the US.

And then of course we are optimistic about what we can produce together with PMI in our joint venture. But again we're talking long, long term and a lot of hard work before we see tangible results.

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**Charles Manso** - Dresdner Kleinwort - Analyst

Great, thank you very much.

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**Operator**

The next question comes from the line of Rolf Karp. Please go ahead with your question.



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**Rolf Karp** - *Ohman Securities - Analyst*

Hi, Rolf Karp here. To begin with, from the capital gain from the South African business, is there anything out there to acquire? And if so, are we talking about cigars only?

**Lars Dahlgren** - *Swedish Match - President and CEO*

I'll take that. Capital gain doesn't change that, really. We have enough financial flexibility to look for complementary acquisitions. But having said that, the focus for the cigar business is more on increasing profit. It doesn't preclude that we do good acquisitions, but we will scrutinize them very hard.

**Rolf Karp** - *Ohman Securities - Analyst*

Okay. My final question, regarding the tax rate. You've given us a guide of 22% excluding this capital gain. What about 2010? What will the tax rate look then?

**Joakim Tilly** - *Swedish Match - CFO*

I will not really going into what it will look like for 2010. What we're saying right now is with the rules that we have right now in our businesses around the world and with what we can see right now, we believe that for the year we will have 22%. And then what will happen with tax legislation in 2010 is very hard to predict.

**Rolf Karp** - *Ohman Securities - Analyst*

Because you've given previously a guidance of 22% to 24% and more likely to be on the higher end. And when you got this gain out of the picture, you get the conclusion that it might be higher than the 22%. Is that correct?

**Joakim Tilly** - *Swedish Match - CFO*

No, what we have said in the past is that we believe the tax rate for the year to be in the range of 22% to 24%. And we said it earlier in the year when we for one thing expected a slightly higher US dollar rate than what we have right now. And that's a large impact. And on that round also had much larger uncertainties. Now we're half into the year so we know a bit more firmly where it's going to end up. And we believe in 2010 we can be a bit -- can have a smaller range, so to speak.

**Rolf Karp** - *Ohman Securities - Analyst*

Okay, thank you.

**Operator**

The next question comes from the line of Anders Hansson. Please go ahead with your question.

**Anders Hansson** - *Danske Bank - Analyst*

Hi, short follow-up question. First of all, on the FDA regulation we'll see in second half of this year, do you have any estimates on what sort of costs that will incur?



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**Lars Dahlgren** - Swedish Match - President and CEO

Yes, they are not material, especially not for this year.

**Anders Hansson** - Danske Bank - Analyst

Okay, thanks. Also just on the tax rate for the capital gain from the pipe tobacco business, is that zero or -- do you know how much tax you will pay on the capital gain?

**Lars Dahlgren** - Swedish Match - President and CEO

It will be very close to zero.

**Anders Hansson** - Danske Bank - Analyst

Okay. And finally, previously we talked about bonus dividends that could be used in terms of extraordinary events such as divestments of operations. Now we have a divestment of operation. How do you reason when it comes to deciding on buybacks versus dividends? Or especially bonus dividends?

**Lars Dahlgren** - Swedish Match - President and CEO

I'd say now we have -- because of the credit markets, as Joakim pointed out, we have been relatively modest on buybacks at the beginning of the year. So I would suggest we have ample room within the mandate of the AGM of SEK3b to adjust our capital structure.

**Anders Hansson** - Danske Bank - Analyst

Okay, thanks.

**Operator**

The next question comes from the line of Thomas Russo. Please go ahead with your question.

**Thomas Russo** - Robert W. Baird & Co. - Analyst

Hi, good morning, gentlemen. A couple of quick questions. First in the US market, can you give a sense of how the snus product line is faring?

**Richard Flaherty** - Swedish Match - President, North America Division

This is still really, really going when it comes to snus overall. But just to give you an idea of maybe the market, at the beginning of 2008 it was probably about a 1m can market. At the beginning of 2009 it was probably round a 3m can market. And right now it's probably double that in terms of annual sales there. Got a lot of activity going on from Reynolds with their Conwood product. We also are doing quite a bit with our General, our Swedish product, where we're now getting close to in -- I don't know the exact number but let's say 400 stores in premium cigar outlets as well as the tobacco friendly chain of stores there. And the numbers look pretty encouraging on that business as well. We don't talk really about the joint venture with -- for the



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Triumph type product, but we're in two states there, we're in Ohio and Georgia on that. So it's growing, a lot of interest in the category on smoke-free product and it has a lot of room to grow.

**Thomas Russo** - *Robert W. Baird & Co. - Analyst*

Thank you. Thank you, and Lars, the international JV with Philip Morris International, what type of early steps are being taken? And any (technical difficulty) of uptake by the government which need to apply after your joint venture's launch?

**Lars Dahlgren** - *Swedish Match - President and CEO*

Sorry, I had a little hard time hearing what you said. What did you say about the government?

**Thomas Russo** - *Robert W. Baird & Co. - Analyst*

No, I'm sorry. It's the PMI joint venture, what early steps are being taken and is there any kind of indication that governments will start to yield on their restriction on smokeless?

**Lars Dahlgren** - *Swedish Match - President and CEO*

The early steps that are taken are the expected ones, so to say. The team is in place, it's operational, and they are busy preparing and basically scanning the world for opportunities. And then when we have more tangible initiatives to communicate, we'll do so.

When it comes to the -- when you talk about governments, I guess you're referring to the ban in the European Union and let's say the joint venture (multiple speakers). There's no change in that. It's basically nothing material has happened since the first quarter call. But the debate continues to be sound, I'd say, and focused on the principles of free trade and so forth within the Union.

**Thomas Russo** - *Robert W. Baird & Co. - Analyst*

Thank you. Last question in the US market, what developments are occurring at the state level for excise taxes?

**Richard Flaherty** - *Swedish Match - President, North America Division*

Texas is moving over to a weight-based tax. You are seeing movements. There are a few other states in there that are moving to a weight-based tax. But Texas is by far the biggest there. So a gradual movement over. And also too you're seeing some proposals for increases as well in terms of the more traditional types of tax structure. General, they're -- states are looking for every way to get some additional revenue. And the cigarette business is quite a bit bigger than the smoke-free business, so there's a lot more revenue to be gotten there. But there are some movements towards more weight-based taxes.

**Thomas Russo** - *Robert W. Baird & Co. - Analyst*

Thank you. Congratulations on great numbers.

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**Richard Flaherty** - Swedish Match - President, North America Division

Thanks.

**Lars Dahlgren** - Swedish Match - President and CEO

Thanks.

**Operator**

The next question comes from the line of Rogerio Fujimori. Please go ahead with your question.

**Rogerio Fujimori** - Credit Suisse - Analyst

Hi, everyone. My question is on the phasing of A&P this year. Do you see the overall A&P spend in the second half materially different than the first half? Thank you.

**Richard Flaherty** - Swedish Match - President, North America Division

In terms of A&P spending, Rogerio?

**Rogerio Fujimori** - Credit Suisse - Analyst

Yes.

**Richard Flaherty** - Swedish Match - President, North America Division

We have -- we don't talk about new product launches until they happen. We mentioned today the Longhorn pouches that we'll be launching in the US. Market environment stays competitive. We still have to see how things go on the snuff side in the US to see -- we have to react as necessary there. But other than the Longhorn pouch launch, we don't have any major, other new, significant launches to talk about right now that would significantly change the overall A&P environment.

**Rogerio Fujimori** - Credit Suisse - Analyst

Thank you.

**Operator**

The next question comes from the line of Virginia Heeribout. Please go ahead with your question.

**Virginia Heeribout** - Natixis Securities - Analyst

Hi, good afternoon, everyone. Several quick follow-up questions on the cigar side, especially on the mass market. Do you see, some of your competitors have spoken about brand repositioning. And do you see some stress from that on your business?

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**Lars Dahlgren** - *Swedish Match - President and CEO*

There's always some fight with the competitors I'd say in the mass market cigar business. It's a very dynamic category. And what we are seeing now is an example again where we have been very flexible and early. And we are far ahead on the curve and there's a strong demand for our foil fresh. I don't expect competitors to sit entirely still in the boat, so to say, and that's never been the case in the history of mass market. It is very dynamic. But we continue our own development as well. Even though we are sailing on nice waters at the moment, we don't sit still as well.

**Virginia Heeribout** - *Natixis Securities - Analyst*

And if you -- should we expect some also state excise tax increase on the cigar side? And do you still have flexibility to increase prices? Or should we expect the pricing effect to lower [EBIT] in the second half in this market segment?

**Richard Flaherty** - *Swedish Match - President, North America Division*

Again, I think you should just go under the general assumption that states are going to be looking for ways to find revenues and sometimes cigars is included and sometimes cigars isn't included. You're not seeing -- as far as I know, you're not seeing any major proposals for really big increases on cigar taxes. But I need to follow up on that.

**Virginia Heeribout** - *Natixis Securities - Analyst*

Okay. A question also on the premium cigar side. You talk about improved product mix in your press release, which seems a bit -- you are not expecting an improved product mix regarding the market environment. So could you expand on that?

**Lars Dahlgren** - *Swedish Match - President and CEO*

The premium cigar business is -- it has a lot of variety in the portfolio in terms of the different offerings. And this quarter we had reasonably good mix. That can vary from quarter to quarter.

**Virginia Heeribout** - *Natixis Securities - Analyst*

Okay. And on the European side, should we expect cost reduction to come already in the second half due to your focusing on profitability and reorganization you've made in the management of the European activity?

**Lars Dahlgren** - *Swedish Match - President and CEO*

When we focus on profitability it's not always about incurring cost. It's about looking over the processes and assortments. And basically as Joakim said, we try to turn every stone. If there are some activities that will drive some one-time costs, we will speak about them when that is the case.

**Virginia Heeribout** - *Natixis Securities - Analyst*

But should we expect benefit from this focus on profitability already in H2? Or it's more a long term impact?

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**Lars Dahlgren** - *Swedish Match - President and CEO*

I'd say it's probably a little bit longer, but I'd say the second half of the year, we think we're going to improve profits in Europe slightly from the first half. It has been relatively weak in Europe during the first half.

**Virginia Heeribout** - *Natixis Securities - Analyst*

And last question on the snuff side. The Scandinavian market is really good in terms of volumes. But we see the value price share increasing month after month now. So is it a concern for you? And do you confirm your guidance for the full year of approaching or not far from the 44% registered last year?

**Lars Dahlgren** - *Swedish Match - President and CEO*

The fact that the value segment has grown somewhat this year it could partially be explained by maybe the economic conditions, also in Sweden around unemployment and so forth is going up. And clearly we would like to see all the growth attributable to the premium segment. Having said that, we also concluded that our low price brand Kronan could tolerate a little bit higher price adjustment than the rest of the portfolio. For the second half we will have on the low price segment, we will have better margins than we had in the first half.

**Virginia Heeribout** - *Natixis Securities - Analyst*

Okay. So you can confirm now that you have the price increases you needed in the US that you could reach the 44% level?

**Lars Dahlgren** - *Swedish Match - President and CEO*

It's very -- what we have been saying is it's very hard to predict exactly with the relative sizes, the currencies and timing of launches and so forth. But what we said at the beginning of the year that what we then reported as a full year operating margin of 44% is a good indication of what we expect with the full year of 2009. And now we had a bit of a pricing issue in the second quarter in the US since we absorbed the tax increase. Now that has reverted. It may mean that since that happened in June that there is no further price increase in the US for the rest of the year. We'll have to see. But apart from that it's reverted to Q1 levels. So we have lost one quarter you can say on the pricing side there.

But this means that we think that the indication that we gave in the beginning of the year is still valid, that we should be able to approach the full year margins of 2009. But it's an indication, it's not a definite guidance by far.

**Virginia Heeribout** - *Natixis Securities - Analyst*

Okay. Thank you very much.

**Operator**

(Operator Instructions). The next question comes from the line of Niklas Ekman. Please go ahead with your question.

**Niklas Ekman** - *Carnegie - Analyst*

Hi, just a quick follow-up on this issue of weight-based taxes in the US. I'm just wondering how big an impact this has had if you can put it in relation to the federal taxes. Is this much smaller or what kind of impact has that had on retail prices?



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**Richard Flaherty** - Swedish Match - President, North America Division

It's much bigger.

**Niklas Ekman** - Carnegie - Analyst

It's much bigger?

**Richard Flaherty** - Swedish Match - President, North America Division

Yes, yes. On the federal tax, federal excise tax increase in the US, you're talking about \$0.07 a can. But the increases on the state level are, in some cases are significantly higher than that, depending on the state.

**Niklas Ekman** - Carnegie - Analyst

And can you give some examples? You mentioned Texas, for instance?

**Richard Flaherty** - Swedish Match - President, North America Division

Yes, Texas was one of the latest ones. You have in Texas it went from 40% of the wholesale price up to \$1.10 an ounce. In Kentucky it went from \$0.10 an ounce up to \$0.19 an ounce. It's a little bit all over the place in terms of what the changes are. In Arkansas it went from 32% of the wholesale price up to 52% of the wholesale price. So it can be rather significant depending on the state.

**Niklas Ekman** - Carnegie - Analyst

And this is a tax that's added, this is like a VAT, it's not something added on top of your wholesale price, right?

**Richard Flaherty** - Swedish Match - President, North America Division

Sometimes it's added on top of the wholesale price, but when it's a weight-based tax, it's just added on.

**Niklas Ekman** - Carnegie - Analyst

Has it -- so far, has it been market neutral? Or are you forced to adjust your prices to adjust for this tax?

**Richard Flaherty** - Swedish Match - President, North America Division

We add on the -- the tax is added onto the list price.

**Niklas Ekman** - Carnegie - Analyst

Okay, thanks. Thanks a lot.



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**Operator**

We appear to have no further question at this time. I hand the conference back to you, sir.

**Lars Dahlgren - Swedish Match - President and CEO**

Okay, thank you very much and just as a concluding remark, I remind people that the release of our results for the third quarter will be on October 27. Thank you.

**Operator**

Ladies and gentlemen, thank you for your participation. This concludes today's conference. You may now disconnect your line, thank you.

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