

Report on Operations 1998

IV



- *Group sales increased to SEK 8,194 M (7,465)*
- *Operating income declined to SEK 1,381 M (1,586), including items affecting comparability of SEK -108 M*
- *Costs for restructuring and new Group organization are included in items affecting comparability – costs-savings of SEK 200 M annually*
- *Continuing strong growth for snuff*
- *Favorable trend of sales of cigarettes in second half following reduction of tax*
- *The Board of Directors proposes unchanged dividend of SEK 1:10 per share*

Report on Operations 1998

Group sales increased by 10 percent in 1998, to SEK 8,194 M (7,465), of which acquired units accounted for 7 percent.

Operating income declined to SEK 1,381 M (1,586), down SEK 205 M. Items affecting comparability in a net amount of SEK 108 M were charged against operating income.

The Group's strategic orientation was reviewed and the value of different product areas was analyzed from the shareholders' point of view. There will be a sharper focus on, and increased investments in, product areas in which the prospects for growth and profitability are deemed to be greatest. Parallel with the implementation of this strategy, a cost-saving program is being initiated in the Group. The full effect of cost-saving and restructuring measures, about SEK 200 M

annually, is expected in the second half of the year 2000. The expense for implementation of the cost-saving program were charged in 1998 and are included in items affecting comparability.

Operating income for Snuff continued to show growth and rose SEK 119 M to SEK 641 M, mainly due to a volume increase of 14 percent. Chewing Tobacco posted lower earnings, down SEK 89 M to SEK 331 M as a result of price pressure and volume decline. Cigarettes earnings fell SEK 99 M to SEK 438 M, attributable to sales declines caused by the tax situation during the first seven months of the year, high marketing costs for relaunching Blend and the export venture to Russia. Other operations posted a lower net of SEK 28 M.

Summary of Consolidated Income Statement

MSEK	1998	1997
Sales	8,194	7,465
Operating income	1,381	1,586
Income after financial items	1,198	1,558
Net income	726	1 045

Sales by product area

MSEK	1998	1997	%
Chewing Tobacco	1,068	1,149	-7
Cigarettes	1,468	1,546	-5
Cigars	902	691	31
Lighters	735	834	-12
Matches	1,573	1,299	21
Pipe Tobacco	218	166	31
Snuff	1,337	1,079	24
Other operations	893	701	27
Total	8,194	7,465	10

Operating income by product area

MSEK	1998	1997	%
Chewing Tobacco	331	420	-21
Cigarettes	438	537	-18
Cigars	117	131	-11
Lighters	18	53	-66
Matches	134	147	-9
Pipe Tobacco	38	28	36
Snuff	641	522	23
Other operations	-228	-252	
Subtotal	1,489	1,586	-6
Items affecting comparability	-108	-	
Total	1,381	1,586	-13

Chewing Tobacco



Chewing Tobacco operations are conducted exclusively in the North American market, mainly in the United States.

In recent years consumption of chewing tobacco has declined between 2 to 3 percent per year, with the rate accelerating to between 4 and 5 percent in 1997 and 1998. Swedish Match's share of the market amounts to just under 40 percent. The market has been characterized by stiffer price competition. In August, to meet this competition,

Swedish Match launched a new product in the low-price segment.

Sales amounted to SEK 1,068 M (1,149), a decrease of 7 percent compared with sales in the preceding year. Expressed in local currency, the decrease was 11 percent. The decline in sales was attributable primarily to the smaller total market and slightly lower market shares.

Operating income amounted to SEK 331 M (420), a decrease of 21 percent. Expressed in local currency, the decrease, which was due to smaller volumes of business and pressure on prices, was 24 percent.

Share of Group Sales, 13%



Share of Group Operating Income, 22%



Cigarettes



The Swedish market accounts for 75 percent of the Group's cigarette sales. Estonia and tax-free outlets, along with Great Britain (for filters and cigarette papers) are other markets.

The tobacco tax on cigarettes in Sweden was raised 63 percent in 1997. This caused a substantial increase in the illegal trade. Legal sales of cigarettes fell by about 25 percent in the first half of 1998, compared with the corresponding period of 1997. Against the background of the increased illegal trade, the Swedish Parliament voted to reduce the tobacco tax by approximately 30 percent from the prevailing level, effective August 1, 1998. In connection with this move Swedish Match also adjusted its prices. Legal sales in Sweden in both the third and fourth quarter of 1998 amounted to 1.6 billion cigarettes and total sales for the year amounted to 5.7 billion cigarettes, compared with 6.0 billion in 1997.

Sales in 1998 amounted to SEK 1,468 M (1,546), down 5 percent from 1997. Swedish Match's share of the market for the full year was slightly more than 48 percent.

Operating income amounted to SEK 438 M (537), a decrease of 18 percent. Lower sales, sharply increased marketing costs and the full-year effect of renegotiating the licensing agreement pertaining to Prince cigarettes had a negative impact on operating income, while rationalization of product had a positive effect. Marketing expenses relate to relaunching of Blend and the export venture to Russia.

Share of Group Sales, 18%



Share of Group Operating Income, 29%



Blend Gul Cigarettes (highest fixed price)

SEK	Before 8/1	After 8/1
Sale price Swedish Match	5:28	5:17
Retail sales margin	5:40	4:91
Sales and VAT	33:82	24:42
Price to consumer	44:50	34:50

Cigars



Swedish Match is one of the world's largest manufacturers of cigars and cigarillos. Western Europe is the most important market for the products.

Sales amounted to SEK 902 M (691), an increase of 31 percent during the year. Sales were higher in virtually all markets. Two new operations were consolidated during the year:

- At the end of 1997 Swedish Match acquired R. J. Reynolds' production of cigars in Finland, thereby gaining slightly more than 60 percent of the cigar market in that country.

- The Alexander Group in Australia was acquired during the year. The company has a comprehensive national distribution network for the sale of cigars and other tobacco and tobacco-related products.

Operating income amounted to SEK 117 M (131), a decrease of 11 percent. Income was charged with substantial marketing programs, notably in North America.

During 1998 production in the plant in Jakobstad, Finland was transferred to Swedish Match's production unit in Belgium.

Share of Group Sales, 11%



Share of Group Operating Income, 8%



Lighters



Swedish Match is the world's third-largest producer of disposable lighters. Western Europe, Eastern Europe, the United States and parts of Asia are the most important markets.

Sales amounted to SEK 735 M (834), a decrease of 12 percent. Volumes of lighters shipped declined slightly more than sales, primarily the result of a

substantial downturn in the market caused by the financial problems in Southeast Asia and Russia. Shipments to Russia virtually ceased in the third quarter but resumed toward the end of the year, although at a much lower level than before.

Operating income fell to SEK 18 (53).

Swedish Match has begun negotiations pertaining to closing the lighter factory in Lyon, France.

Share of Group Sales, 9%



Share of Group Operating Income, 1%



Matches



Share of
Group Sales,
19%

Share of
Group Operating
Income, 9%

Swedish Match is the world's only global manufacturer of matches. The Group sells its products mainly in Europe, South America and Asia, and also has large volumes of exports to more than one hundred countries. In its Swedish Match Arencio unit, equipment used to manufacture matches, is produced.

Sales increased by 21 percent, to SEK 1,573 M (1,299). The increase was attributable primarily to consolidation of newly acquired units.

During the year Swedish Match acquired additional shares of PLAM Bulgarski Kibrit JSCO in Bulgaria, increasing its holding to 92.5 percent. Swedish Match owns 60 percent of the Turkish company Swedish Match KAV. The company was consolidated as of May 1, 1998. Swedish Match's holding in Wimco, in India, amounts to 39 percent. Since Swedish Match has a controlling influence in the com-

pany, the business was consolidated as of April 1, 1998.

During the year Swedish Match also acquired the match, cigarette-lighter and fire-lighter business of Bryant & May, a distributor in Australia and New Zealand. Swedish Match gains access to important distribution channels as a result of the acquisition.

Operating income amounted to SEK 134 M (147), a decrease of 9 percent. Slightly smaller volumes in established markets contributed to the weaker earnings. Acquired units affected income marginally. Earnings-improvement measures are being implemented in these companies.

During the year the production of matches used for promotional purposes was transferred from Geraardsbergen in Belgium to the factory in Szegeed, Hungary.

Early in 1999 Swedish Match concluded an agreement to acquire 40 percent of Indonesia's largest match manufacturer, P.T. Java Match Factory.

Pipe Tobacco



Share of
Group Sales,
3%

Share of
Group Operating
Income, 3%

Swedish Match is one of the world's largest manufacturers of pipe tobacco. The United States, Sweden and the rest of Western Europe are the most important markets.

Sales increased by 31 percent, to

SEK 218 M (166). Operating income improved by 36 percent, to SEK 38 M (28).

The takeover of rights to market Borkum Riff in the U.S. had a positive effect on both sales and operating income.

Snuff



Share of
Group Sales,
16%

Share of
Group Operating
Income, 43%

The largest markets for Snuff are Sweden, the United States and the Nordic tax-free market.

Sales amounted to SEK 1,337 M (1,079), an increase of 24 percent during 1998. Swedish Match's share of the snuff market in the U.S., which is continuing to increase, amounted to 5 percent in 1998, compared with 3 percent in 1997. Volume-wise, sales in the U.S. rose 70 percent. As a consequence of sharp increases in taxes in

Sweden, tax-free sales in the Nordic region increased by 45 percent. Sales in the taxed Swedish market rose by several percent. The increase in volume for snuff as a whole amounted to 14 percent in 1998.

Operating income improved by 23 percent, to SEK 641 M (522) as a result of larger volumes of business and a changed product mix.

At the end of October 1998 the price of Timber Wolf, Swedish Match's low-price snuff in the U.S. was increased by 10 cents, to one dollar per can.

Other operations

The net of Other operations declined to SEK -228 M (-252). This amount includes a capital gain of SEK 45 M, costs of participating as a sponsor in the Whitbread Round the World Race, and other Group costs.

Items affecting comparability

Items affecting comparability amounted to a net deficit of SEK 108 M. This figure included a capital gain of SEK 266 M on the sale of Swedish Match's head office building in Stockholm. The building was sold at the end of the year for SEK 725 M; at the same time, Swedish Match signed a long-term rental agreement with the buyer. Items affecting comparability also included production restructuring costs of SEK 177 M, a write-down of SEK 97 during the year in the value of intangible assets, and cost of SEK 100 M in connection with implementation of a new Group organization.

Net financial expense

Net financial expense in 1998 amounted to SEK -82 M (-17). Interest expense was higher due to borrowing related to the redemption of shares. Other net financial expense amounting to SEK -41 M (-11) included costs of the share redemption program and exchange differences. In addition, a provision of SEK 60 M was made pertaining to the financial risk to which the Group is exposed in Southeast Asia.

Investments

The Group's direct investments in property, plant and equipment amounted to SEK 393 M (292). The investments pertain mainly to capital expenditures for replacement and rationalization. Straight-line depreciation totaled SEK 332 M (268). Investments in intangible assets amounted to SEK 213 M (249). In addition, SEK 157 M (60) was invested in acquisition of companies.

Financing

Group borrowing is financed principally through a Swedish short-term commercial paper program, of which SEK 1,382 M had been utilized at the end of 1998, and a Swedish bond program of which SEK 1,561 was utilized.

Increased emphasis is now being placed on increasing the percentage of the Group's long-term financing. In this connection, a facility has been established for the issuance of bonds in the euro market.

Net debt at the end of the period amounted to SEK 1,455 M, an increase of SEK 984 M since December 31, 1997, due mainly to redemption of shares amounting to SEK 1,216 M during the year.

Liquidity

As of December 31, 1998, cash and bank deposits, including short-term placements, amounted to SEK 2,876 M, compared with SEK 563 M at the beginning of the year. The December figure included SEK 725 M from the sale of the head office building at the end of the year.

Liquid funds are placed with banks and in short-term negotiable Government securities.

Taxes

Income for the year was charged with income taxes amounting to SEK 482 M, equal to 40 percent. The tax rate has increased as a consequence of none tax deductible restructuring charges during 1998 in some countries. The tax rate in 1999 is expected to be 32%.

Tobacco tax

During 1998, total tobacco tax and value-added tax for cigarettes and other tobacco products paid by Swedish Match in Sweden amounted to SEK 9,266 (9,387).

Acquisition

In addition to the acquisitions described in the sections dealing with each product area, Swedish Match acquired M. Beraha & Co. Ltd., a distributor of tobacco products in Hong Kong and Macao.

New President and Chief Executive Officer

On August 10, 1998, the Board of Directors named Lennart Sundén the new President and Chief Executive Officer of Swedish Match, effective November 1, 1998.

New organization

Effective in February 1999, Swedish Match has a new organization and new Group Executive Committee. Group operations have been organized in six divisions: North Europe, Continental Europe, North America, Overseas, Matches and Lighters. Division managers report directly to the President and are members of the Group Executive Committee.

The aim of the reorganization is to achieve a more market-oriented organization with distinct profit responsibility and to link Group management directly to the operating units. The new organization focuses on Swedish Match's most important markets and products. It will improve conditions for higher profitability and value growth and it cre-

ates distinct responsibility at all levels, with clear and measurable goals and at a lower cost than in the previous structure.

Average number of Group employees

The average number of employees in the Group during the year was 10,314, compared with 6,467 in 1997. Wimco, in India, with 3,099 employees, is included in the 1998 figure. The average number of employees in Sweden in 1998 was 1,430, compared with 1,485 in the preceding year.

Redemption of shares

On July 7, 1998, a Special General Meeting of Swedish Match shareholders approved the redemption of 34,752,689 shares at a price of SEK 35 per share. The total redemption amount, SEK 1,216 M, was paid at the end of July to shareholders who had tendered shares for redemption. The Special General Meeting also approved a bonus issue of shares, effected by raising the par value of Swedish Match shares from SEK 2.00 to SEK 2.20. In connection with the redemption of shares, new shares amounting to SEK 69.5 M were issued and placed directly. Following these transactions, Swedish Match has 431,339,663 shares outstanding.

Preparation for the year 2000

Swedish Match has been working since the beginning of 1997 to ensure that the Group's data systems will be able to handle the transition to the new millennium. A seven-step overhaul of more than 250 systems is being made. At the end of 1998, 95 percent of the systems had been subjected to the greater part of the overhaul, and 50 percent had been fully examined. All systems are scheduled to have been tested and in production in September 1999. The Group is believed to be well prepared for the transition to the new millennium.

Board of Directors' dividend proposal

Profit per share was SEK 1.59 (2.20). The Board of Directors has decided to propose that the Annual General Meeting approve payment of a dividend of SEK 1:10 per share (1.10), or a total of SEK 474 M (510) to the shareholders. The proposed dividend amounts to 69 percent of income for the year.

Additional information

The Annual General Meeting will be held in Stockholm on April 26, 1999. The 1998 Annual Report is expected to be released and distributed during the week beginning Monday, March 22, 1999. The interim report covering operations during the first three months of 1999 will be released April 26.

Stockholm, February 12, 1999

Board of Directors

Key data

	1998	1997
Operating margin, % *	18.2	21.2
Return on operating capital, % *	33.2	42.7
Return on shareholders' equity, %	28.3	39.5
Interest coverage ratio, times	7.6	24.9
Debt/equity ratio, %	63.0	15.7
Equity/assets ratio, %	21.9	41.9
Investments in tangible assets, SEK M	393	292
Average number of employees	10,314	6,467

Share data**

Income per share after full tax, SEK		
Before items affecting comparability	1:96	2:20
After items affecting comparability	1:59	2:20
Dividend, SEK	1:10 ***	1:10
Market price at year-end, SEK	29:50	25:90
Shareholders' equity per share, SEK	5:00	6:26
P/E ratio after tax	18.7	11.8
Number of shares outstanding	431 339 663	463 558 252

* Before items affecting comparability

** In certain cases adjusted for the bonus issue component in the redemption of shares in 1998. The average number of shares during 1998 was 450,133,840. For full-year 1997, the average number of shares was 463,558,252.

*** Board proposal

Consolidated Income Statement in summary

SEK M	1998	1997
Sales, incl. tobacco tax	15,915	15,231
Less tobacco tax	-7,721	-7,766
Sales	8,194	7,465
Cost of goods sold	-4,096	-3,615
Gross profit	4,098	3,850
Sales and administration costs, etc.	-2,620	-2,281
Share in earnings of associated companies	11	17
	1,489	1,586
Items affecting comparability	-108	-
Operating income	1,381	1,586
Net interest expense	-82	-17
Other financial items, net	-41	-11
Items affecting comparability*	-60	-
Net financial items	-183	-28
Income after financial items	1,198	1,558
Taxes	-482	-512
Minority interests	10	-1
Net income	726	1,045

* See page 4

Consolidated Balance Sheet in summary

SEK M	Dec. 31, 1998	Dec. 31, 1997
Intangible fixed assets	895	757
Tangible fixed assets	2,423	2,226
Financial fixed assets	279	308
Current operating assets	3,774	3,125
Current financial receivables	315	153
Current investments	1,386	-
Cash and bank	1,490	563
Total	10,562	7,132
Shareholders' equity	2,160	2,972
Minority interests	148	20
Provisions	1,165	656
Long-term loans	2,098	209
Other long-term liabilities	26	27
Short-term borrowings	2,233	825
Other current liabilities	340	290
Current operating liabilities	2,392	2,133
Total shareholders' equity, provisions and liabilities	10,562	7,132
Operating capital	4,700	3,975
Net debt	1,455	471

Consolidated Cash Flow Analysis in summary

SEK M	1998	1997
Cash flow from operations	794	773
<i>Investments</i>		
Investments in property, plant and equipment	-393	-292
Investments in intangible assets	-213	-249
Acquisition of companies	-157	-60
Sales of property, plant and equipment	849	40
Other	-4	-91
Cash flow from investments	82	-652
<i>Financing</i>		
Changes in loans	3,084	-21
Dividends to shareholders	-510	-510
Share redemption, net	-1,147	-
Cash flow from financing	1,427	-531
Translation differences attributable to cash and bank balances	10	31
Decrease (increase) in cash and bank balances	2,313	-379
Cash and bank balances at January 1	563	942
Cash and bank balances at December 31	2,876	563

Quarterly data

SEK M	Q397	Q497	Q198	Q298	Q398	Q498
Sales, incl. tobacco tax	4,173	3,883	3,741	3,978	4,155	4,041
Less tobacco tax	-2,219	-1,998	-1,902	-2,003	-1,932	-1,884
Sales	1,954	1,885	1,839	1,975	2,223	2,157
Cost of goods sold	-959	-881	-894	-992	-1,162	-1,048
Gross income	995	1,004	945	983	1,061	1,109
Sales and administration costs, etc.	-540	-622	-596	-640	-669	-715
Shares of earnings in associated companies	5	3	3	3	3	2
	460	385	352	346	395	396
Items affecting comparability	-	-	-	-48	-	-60
Operating income	460	385	352	298	395	336
Net interest expense	-6	-4	-4	-13	-39	-26
Other financial items, net	-17	-18	-7	-6	-22	-6
Items affecting comparability	-	-	-	-60	-	-
Net financial items	-23	-22	-11	-79	-61	-32
Income after financial items	437	363	341	219	334	304
Income taxes	-155	-131	-111	-95	-118	-158
Minority interests	2	1	0	2	6	2
Net income for the period	284	233	230	126	222	148

Sales by product area

SEK M	Q197	Q297	Q397	Q497	Q198	Q298	Q398	Q498
Chewing Tobacco	295	261	312	281	267	265	280	256
Cigarettes	349	430	414	353	328	362	401	377
Cigars	151	186	161	193	187	225	230	260
Lighters	211	226	210	187	196	184	177	178
Matches	303	349	297	350	324	343	473	433
Pipe Tobacco	37	41	44	44	48	57	55	58
Snuff	238	267	281	293	295	330	346	366
Other operations	100	182	235	184	194	209	261	229
Total	1,684	1,942	1,954	1,885	1,839	1,975	2,223	2,157

Operating income by product area

SEK M	Q197	Q297	Q397	Q497	Q198	Q298	Q398	Q498
Chewing Tobacco	104	93	123	100	86	94	73	78
Cigarettes	94	144	175	124	92	92	141	113
Cigars	30	27	39	35	31	32	32	22
Lighters	10	13	16	14	14	3	-3	4
Matches	26	43	40	38	30	35	28	41
Pipe Tobacco	5	9	9	5	12	9	8	9
Snuff	115	117	138	152	149	152	182	158
Other operations	-50	-39	-80	-83	-62	-71	-66	-29
Subtotal	334	407	460	385	352	346	395	396
Items affecting comparability	-	-	-	-	-	-48	-	-60
Total	334	407	460	385	352	298	395	336



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