

THOMSON REUTERS STREETEVENETS

EDITED TRANSCRIPT

SWMA.ST - Q2 2017 Swedish Match AB Earnings Call

EVENT DATE/TIME: JULY 21, 2017 / 12:00PM GMT



JULY 21, 2017 / 12:00PM, SWMA.ST - Q2 2017 Swedish Match AB Earnings Call

CORPORATE PARTICIPANTS

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

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

Marlene Forsell *Swedish Match AB (publ) - CFO and SVP of Group Finance*

CONFERENCE CALL PARTICIPANTS

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

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

Charles Manso de Zuniga *Societe Generale Cross Asset Research - Director of Consumer Equity Research*

Kevin V. Dreyer *G. Research, LLC - Research Analyst*

Niklas Ekman *Carnegie Investment Bank AB, Research Division - Head of Consumer Discretionary and Staples & Financial Analyst*

Stellan Hellström *Nordea Markets, Research Division - Senior Analyst, Retail and Consumer Goods*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Swedish Match Half-year Report January to June 2017. (Operator Instructions)
I must advise the conference is being recorded today, Friday, the 21st of July, 2017.

I would now like to pass the conference over to your speaker today, Emmett Harrison. Please go ahead, sir.

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

Good day. This is Emmett Harrison. This is the Swedish Match Second Quarter 2017 Telephone Conference. And with me today are Lars Dahlgren, our President and CEO; and Marlene Forsell, our CFO.

In the Investor section of our swedishmatch.com website, you will find a Q2 presentation for today's call, which is intended to be viewed in conjunction with our prepared commentary. So we encourage you to follow along with that presentation. In that same Investor section, you will find copies of the interim report. 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 risk 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 the latest interim report and Annual Report, which is 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.

With that, I would like to turn the conference call over to Lars.

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

Thank you, Emmett, and good afternoon, everybody. Beginning with Slide 3 of the presentation.

We're pleased with the financial performance in the second quarter with both sales and operating profit from [product] areas up by 8% on a reported basis and by 4% in local currencies. While our U.S. cigar business was once again the major driver for growth, our snus and snuff product area also



JULY 21, 2017 / 12:00PM, SWMA.ST - Q2 2017 Swedish Match AB Earnings Call

performed well. And the exception financially was the Lights business, where the performance was notably weaker. Earnings per share for the quarter increased by 12%.

Turning to Slide 4. Starting up with the snus and moist snuff product area. Our shipment volumes in Scandinavia were up by a bit more than 1%, driven by higher pouch volumes in both Sweden and Norway. Calendar effects only had a limited positive impact on the comparability on our volumes during the quarter.

Net realized pricing per can was also up, both in Norway, where we took price increases in January; and in Sweden, where we raised prices in early May by a little bit more than the 2016 year-end excise tax increase.

For moist snuff, in the U.S., growth rates continued to be relatively modest in the category in the second quarter compared to historic levels. The pouch segment, however, continued to grow at a very healthy rate, and this was also the only segment that experienced volume growth within our own moist snuff portfolio in the quarter. We also reported an improved operating result for snus and ZYN nicotine pouches outside Scandinavia on increased volumes and higher average pricing.

On Slide 5, we have highlighted certain of our new product activities. We continue to leverage our consumer insight and innovation stream in order to capture and address the changing needs of adult consumers. Our activities help us to expand our market presence both in new markets and in existing geographies.

In Scandinavia, our modern snus products, including our G.3 range, are showing positive trends, which enable us to moderate our share declines for pouch products, particularly in Norway.

As noted on Slide 6, the market growth in Scandinavia has been in the range of 2% to 3% over the past 3 quarters. What is notable versus the first quarter is that we had both the somewhat improved volume growth and the stronger price/mix effect, the latter despite the weaker Norwegian currency.

Moving to Sweden, specifically, and Slide 7, which illustrates the trend in market growth, both in volume and value terms as reported by Nielsen. Volume growth had been slowing notably since the beginning of 2016 but rebounded a bit in the second quarter despite improved pricing in the category.

Year-on-year, our market share in Sweden has declined somewhat, both in the premium and the value segment. You can see on Slide 8 that in the shorter sequential period, our shares in the value segment have remained stable with the launch of Kaliber+ being a contributing factor. But within the premium segment, we have noted some increased competitive activity. With the premium segment representing a slightly larger share of the total market in Q2 compared to Q1, our overall market share remained relatively stable.

Turning to Slide 9. In Norway, the market growth continued to be above Sweden, but when we sum up the first half of the year, it is clear that the growth in the market has moderated a bit from what we have seen in the past few years. The growth is still at the very respectable level, however, and Nielsen indicates that the volume growth this year has been in the range of 5% and that pricing has remained healthy. The volume growth is attributable to the pouch segment, while loose snus continued to decline at a fairly rapid pace.

On slide 10, you can see that despite the rapid decline in loose volumes, where Swedish Match has a share of more than 90%, our total share of the Norwegian market has been holding up fairly well more recently. It is also worthy to note that we have improved our share trend despite the positive share trajectory of the third largest player in the market.

On Slide 11, we can clearly see how the momentum with our more modern G.3 pouch product has helped our market share trends. The G.3 range has a broad appeal for both men and women and especially young adults. Our year-on-year share decline for our pouch products is now about half of what we experienced a couple of years ago. About 1/3 of the decline in overall share is because of our high share in the declining loose segment.



JULY 21, 2017 / 12:00PM, SWMA.ST - Q2 2017 Swedish Match AB Earnings Call

Turning to Slide 12, in the U.S. moist snuff market, our volumes were down by 8% or 6.6% on a constant trading day basis, which means that our share contracted in the quarter. Also sales and operating profit were lower as higher average prices could not compensate for the volume shortfall.

On the positive side, as you can see on Slide 13, our momentum within the strategically important pouch segment continued and our volume growth exceeded estimated category growth rate for pouches.

Next slide. As previously mentioned, our portfolio of snus and ZYN nicotine pouch products outside Scandinavia continued to perform well in the quarter. Looking at volumes on a rolling 12-month basis, annualized shipment volumes for these products are approaching 10 million cans. The growing volumes for ZYN did not only come as a result of wide distribution in the U.S. but also from a modest increase in turns per store.

Another positive development is that in stores where we sell both General Snus and ZYN, we can conclude that the cannibalization from ZYN on snus has been limited. To more fully capitalize on the progress of ZYN in the U.S., we recently decided to invest a larger-scale ZYN production capacity, a project that our sales and marketing and production teams are very excited about. This capacity project will expand our existing facility for smokeless products in the U.S., and we primarily cater for U.S. demand but potentially also -- could potentially also address future ZYN launches in other markets.

On the next slide that addresses the regulatory and scientific developments for snus, I would like to draw your attention to the first 2 bullet points. Swedish Match has taken legal action to challenge the plain packaging legislation in Norway, specifically for snus. We firmly believe that the proposed regulation is disproportionate considering the dramatically lower health risk for snus compared to cigarettes. Close to half of the Norwegian population still believe that snus is almost as unhealthy as cigarette smoking and imposing plain packaging on snus while making an exception for some other type of products, for example e-cigarettes, clearly sends misleading and potentially dangerous signals.

While the medical science in favor of snus is convincing, one of the few debated topics have been whether there is a correlation between snus and pancreatic cancer. This debate emanates not the least from a criticized Norwegian study published in 2005, which analyzed the effects of smokeless consumption back in the '60s. In April of this year, a larger-scale and higher-quality study was published in the International Journal of Cancer that should put an end to this debate.

The study, which was a pooled analysis of studies, determined that there was no association between the use of snus and increased risk of pancreatic cancer. This analysis, coming from the Karolinska Institutet in Sweden, pooled 9 perspective studies and involved 400,000 men, the largest study to-date. The lack of association between snus use and pancreatic cancer was seen for all durations and intensities of use. In our view, it's clear that the Norwegian government not only has ignored this study, but several other important publications that support the science of Swedish snus.

Within Other tobacco products, comment on the bottom of Slide 16. The cigar category continued to experience solid market growth in the quarter and Swedish Match outpaced category growth with double-digit increases in both sales and volumes.

Swedish Match has had its strongest position in the natural leaf cigar segment, and this segment continued to grow notably faster than the HTL segment in the overall market. Despite the softness in chewing tobacco volumes and the inclusion of FDA fees this year as well as a small operating loss related to chew bags, second quarter operating profit for Other tobacco products in local currencies increased by 9%.

Chew bags, a modern form of chewing tobacco available in small pouches, represents a very interesting opportunity for us as it has proven to be a viable smokeless alternative in some markets outside Scandinavia and the U.S. In June, we launched chew bags in Germany on a limited scale and we also had some presence for chew bags in Denmark, Slovenia and the Czech Republic.

Slide 17 summarizes the quarterly trend and performance of our cigar shipment volumes by segment. In the first quarter of this year, HTL cigars outperformed natural leaf cigars due to trade destocking on natural leaf cigars following strong shipment levels toward the end of 2016. As the trade has adjusted their inventories, sales in natural leaf cigars picked up again in the second quarter and the portfolio mix rebounded. With strong natural leaf volumes, sales grew somewhat more than overall volumes during the quarter.



JULY 21, 2017 / 12:00PM, SWMA.ST - Q2 2017 Swedish Match AB Earnings Call

In the next slide, the relatively soft performance for chewing tobacco with a volume decline on 9% in the quarter should be seen in the light of both the steep excise tax increase in Pennsylvania in October last year and the fact that this year, second quarter had 1 less shipping day than the prior year. We estimate that our volume declines was in line with the trend in the overall market.

As you can see on this slide, the volume decline for Swedish Match brands on a year-to-date basis was 5%, but it's worth noting that our year-to-date performance was favorably impacted by easy comps in the first quarter.

For Lights, the softer performance followed the relatively strong first quarter. But in Q2, volumes were down double-digit levels for both matches and lighters. The drop in operating profit was primarily an effect of the lower volumes with reduced sales and poor cost absorption as a result, but also operating expenses were higher. However, complementary products continued to grow and delivered improved results.

The complementary products business has been benefiting from a strong Brazilian real as the majority of our complementary products are imported to and sold in Brazil. It is important to note that the Lights business often has quarterly variability. And with regard to comparison between the years, I'd like to point out that the second half of 2016 generally was strong for this product area.

With that, I will leave the word to Marlene.

Marlene Forsell - Swedish Match AB (publ) - CFO and SVP of Group Finance

Thank you, Lars. And for those of you following the presentation, we are now on Slide 20.

As you note from the graph, the net finance expense for the quarter was unusually low. The dividend we received from STG during the second quarter of this year amounting to SEK 65 million was recognized as finance income, thereby significantly reducing our reported finance net. The net interest expense, excluding cost on repurchased bond, has been relatively stable. The second quarter interest expense remained in line with the prior year as lower average interest rate offset the effect of a higher interest-bearing debt. The higher interest-bearing debt is, to a large extent, the consequence of us securing the refinancing of a larger maturity falling due in November of this year.

Turning to Slide 21. You see this larger maturity of approximately SEK 2 billion illustrated. During the quarter, Swedish Match has issued new bond loans of SEK 500 million, and bond loans of another SEK 600 million were issued after the close of the period. These new bond loans have a tenure of 5 years and are illustrated with stacked bars in the graph.

The interest rate of the bonds falling due in November is approximately 5%, and the interest rate of the newly issued bonds are both approximately 1.4%. As you noticed, the weighted average interest rate in our bond portfolio was 3.3% compared to 4.1% for the same date 1 year ago.

On Page 22, we have summarized cash flow highlights for the first half of 2017. I would like to point out that cash flows from operating and investing activities between the periods are affected by a shift in the reporting of dividends received from STG. In the prior year, the dividend was reported as cash flow from operating activities, whereas, it is reported as cash flow from investing activities in 2017.

On a like-for-like basis, cash flow from operating activities increased SEK 100 million due to improved EBITDA, partially offset by negative changes to working capital in the period. The free cash flow for the first 6 months were very strong, positively impacted by the proceeds received from the sale of shares in STG and the final proceeds from divestment of that.

In line with our financial policy, Swedish Match distributed SEK 4,300,000,000 to its shareholders in the form of ordinary and special dividends and share repurchases during the first half of 2017. Of this amount, SEK 3.6 billion was distributed during the second quarter.

After the close of the period, Swedish Match has continued to repurchase shares. In June, Swedish Match initiated the share repurchase program of up to a maximum of SEK 250 million for the period June 20 to July 21 under Safe Harbor Regulation, which enabled Swedish Match to repurchase the shares during closed periods caused by quarterly reporting cycles and thereby expanding the window for share repurchase.



JULY 21, 2017 / 12:00PM, SWMA.ST - Q2 2017 Swedish Match AB Earnings Call

Following the shareholder distributions during the second quarter, Swedish Match's gearing measured at net debt to EBITDA increased to 2.2x from 1.6x at the end of March.

Following the development in the first 6 months, we have updated our outlook. The revised outlook can be read on Slide 23. Updates are made for cigars in the U.S. and snus and nicotine pouches outside Scandinavia as highlighted with italics.

In the outlook for the year, we have previously stated that the operating profit development in 2017 for Other tobacco products was expected to be impacted by FDA user fees and also by higher raw material costs, especially towards the second half of the year. While we have experienced increases in raw material costs on a year-to-date basis, we currently do not expect raw material costs to materially differ from the cost levels already incurred. The outlook has, therefore, been updated to reflect our change in expectations.

We also would like to clarify that FDA user fees will only impact the year-on-year comparison up to and including the third quarter as FDA user fees for cigars started to be expensed from the fourth quarter of 2016. I also like to reiterate that these volume-based fees are ongoing and will continue to be paid also beyond the third quarter.

Finally for cigars. We remind you that the second half of 2016 was strong for cigar shipments. As you recall, this was evidenced in a somewhat softer performance for natural leaf cigars in the first quarter of this year.

For snus and nicotine pouches outside Scandinavia, we have updated the outlook to reflect expectations of lower operating losses for the year. The gross profit continues to improve and total marketing investments for snus and nicotine pouches are expected to be on a more similar level between the first and the second half of 2017 than was experienced in 2016.

In 2016, marketing activities were more intense in the second half than in the first half of the year. The ZYN production project, as has already been mentioned, has just been initiated and will run through the whole of 2018. We, therefore, expect capital expenditures in support of this project to primarily be incurred during the course of 2018. For this year, we expect group-wide capital expenditures to be in line with 2016 while capital expenditures in 2018 will likely exceed 2017 and 2016 levels primarily as a consequence of the ZYN capacity project.

Finally, currency developments are another area to keep in mind. For the first 6 months, the currency translation effects have been positive. However, I would like to point out that the U.S. dollar, the Norwegian krone and the Brazilian real all were at lower levels at June 30 than during the latter half of 2016 and the beginning of this year. And at the current spot rates of relevant currencies versus the Swedish krona, we expect the effects to be negative for the second half of 2017.

Operator, we can now open the floor to questions and answers.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question is from Stellan Hellström from Nordea.

Stellan Hellström - *Nordea Markets, Research Division - Senior Analyst, Retail and Consumer Goods*

First, I had a question on the quite high growth of snus and nicotine pouches in the -- in markets outside of Scandinavia. If you can just share some light on how much of this growth is related to expanded distribution and how much is selling in existing outlets?



JULY 21, 2017 / 12:00PM, SWMA.ST - Q2 2017 Swedish Match AB Earnings Call

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

Stellan, this is Lars. I'm always impressed with the speed of your fingers. You're always the first one to ask [again] a question. Regarding the growth, for obvious reasons, when you look at the numbers in the report with ZYN being relatively new in the market (inaudible) pay too much attention to the percentages, so to say, so there's definitely an element of the new initiatives around ZYN in that growth number. But the important thing is that we do see good traction for both ZYN and snus in those numbers, and we also see some growth in -- for snus in markets outside of the U.S.

Stellan Hellström - *Nordea Markets, Research Division - Senior Analyst, Retail and Consumer Goods*

Good. Also noticed that you commented here that you've seen some increased prices in snus in Sweden from your competitors. Could you give some idea on how many of your competitors have raised prices? And maybe also if your -- the largest brand among your competing brands, so to say, has increased prices? It will be helpful.

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

I mean, first of all, let me be clear that I don't know exactly what the competitors do in terms of their pricing, but what we have is the Nielsen data where we get average prices. And Nielsen in Sweden covers about 60% of the market, so there can be other things going on. But when we look at Nielsen data and compare year-on-year prices, and remember, there has been a small tax increase as well, but on top of the price increase, prices have generally gone up a little bit, not much, but a little bit for all of our 3 main competitors. But for the smallest one, relatively little. But for the other 2, you see a small average price increase, which I would say to the consumer is similar to the ones that you see in our portfolio, and then the timing is a little bit spread out over time, so to say.

Stellan Hellström - *Nordea Markets, Research Division - Senior Analyst, Retail and Consumer Goods*

Right. Also I was just wondering if you could also comment on how you are in terms of the launch of Kaliber+ maybe relative to the phasing out of Mustang?

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

Yes, I can. Referring to Nielsen data then, if you look at the 2 varieties of Kaliber+, after 24 weeks in the market, they had 1.3% market share. And for the pouch product or Mustang, they had collectively 0.8% and was starting to decline. So Kaliber+ is performing better. But then you should remember that the cannibalization is probably bigger within the Kaliber family. But when we look at total Kaliber, it has improved, and there is no doubt that Kaliber+ has been a good initiative in support of the Kaliber brand.

Stellan Hellström - *Nordea Markets, Research Division - Senior Analyst, Retail and Consumer Goods*

Good. Then just a final question on your comments on raw material, particularly in cigars. Did I understand you correct that you did see still higher raw material costs, but you didn't expect those to affect the results until next year? Or how is that?

Marlene Forsell - *Swedish Match AB (publ) - CFO and SVP of Group Finance*

No. The way you should interpret that is that, I mean, what we have seen already in the numbers in the beginning of the year here is that we've seen some increases on raw material cost. So the level at which we procure them are a bit higher than they were a year ago. But having that said, it's not material difference. So we don't expect any comparison done to the first -- 6 months of last year. In comparison to the second half of this year, there won't be material difference.



JULY 21, 2017 / 12:00PM, SWMA.ST - Q2 2017 Swedish Match AB Earnings Call

Stellan Hellström - *Nordea Markets, Research Division - Senior Analyst, Retail and Consumer Goods*

Okay. But we might expect that in the beginning of next year. Is that correct?

Marlene Forsell - *Swedish Match AB (publ) - CFO and SVP of Group Finance*

I mean, of course, this is -- whenever we procure the raw tobacco, there's a risk of a supply shortage. But as of the -- for the moment, we don't see that risk as overwhelming.

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

When we were at the beginning of the year, we thought that we would have higher raw material costs than we currently see for the second half.

Operator

Your next question is from the line of Andreas Lundberg from ABG.

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

Back to this ZYN U.S. snus business. How would you say the typical ZYN user differ from your typical snus user in the U.S. on the demographics?

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

I would say that it's early days to conclude on that. And we are performing more or less as we speak more in-depth market research, but I think it's fair to say that ZYN, maybe because the way it's presented in the stores as well and maybe because it doesn't contain tobacco, it has -- or it lends itself easier to trial for nicotine consumers in general compared to snus, which -- or some people, sort of, don't consider snus because they may have an aversion against smokeless tobacco as such. But we're definitely seeing so to say core smokeless tobacco users appreciating ZYN based on incoming calls to our customer service.

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

Okay. Got it. And what is the average price on the ZYN product versus General [old] can in the U.S.?

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

I believe it's fairly similar, but I don't have those numbers on the top of my head. But they're both premium priced.

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

Okay. Lastly on cigars, okay, give us an update on the progress for your Night Owl products in the U.S.

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

I wish I could, but the honest answer is that there's not much progress to report. It hasn't been doing particularly well.



JULY 21, 2017 / 12:00PM, SWMA.ST - Q2 2017 Swedish Match AB Earnings Call

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

You haven't scale up? It's still in a few states or...

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

Yes. And it's something we will have to monitor going forward. It's still a very interesting segment, obviously, but we also know that there are other very, very strong competing brands there.

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

And that's the reason for not taking up or...

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

I mean, at the end of the day, it's the consumer that decides.

Operator

There appears to be no further questions at this time, sir.

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

Okay. Very few questions.

Operator

Just had another question, in fact. It's just come through from Kevin Dreyer.

Kevin V. Dreyer - G. Research, LLC - Research Analyst

I guess, maybe just bigger picture than the details. Strategically, STG, which you had IPO-ed. You sold that down now. I'm just curious, from the perspective of management and the board, any further thinking that this could be -- you could use financial engineering for any of your businesses in the future? Is that something that you're contemplating at any level?

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

Sorry, I'm not completely sure I understand your question there, Kevin. Sorry for that. Can you...?

Kevin V. Dreyer - G. Research, LLC - Research Analyst

Just saying that you took a business and combined it with somebody else and have since taken it public and monetized it. Any further thinking of that kind of mentality with any of your other businesses?



JULY 21, 2017 / 12:00PM, SWMA.ST - Q2 2017 Swedish Match AB Earnings Call

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

Never say never. But generally speaking, I'd say, now we have our portfolio businesses, we think we have a good structural setup in a very competent organization. In the case of STG and our former cigar business, there, there were very clear synergies and the benefit of an improved scale in that relatively complex business. So the logic was very obvious. I'm not ruling out that there can't be other type of combinations and structural opportunities in the future. But I'd say generally speaking, we're happy.

Kevin V. Dreyer - *G. Research, LLC - Research Analyst*

And then maybe just on the tobacco industry, generally, I mean, we've continued to see further consolidation happen. Does that impact you on any level?

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

I guess that remains to be seen. We focus on running our business as well as we can.

Operator

The next question is from Niklas Ekman from Carnegie.

Niklas Ekman - *Carnegie Investment Bank AB, Research Division - Head of Consumer Discretionary and Staples & Financial Analyst*

Yes, I was just curious about the price action of peers you were talking about in the Swedish snus market. If you could comment at all how significant these price hikes have been in comparison to your price hikes. I think that last year, you saw your largest competitor raise prices, basically, in line with the price hikes you made. Is this a similar move you've seen this year? Or is it much less tangible price hikes?

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

Hi, Niklas. I would say if you look at the Nielsen data, it's fairly similar on average for our 2 largest competitors. And one of those, they have actually reduced their premium pricing, but their value-priced products have come up a little bit. But let me just make sure it's 100% clear to everybody that what I'm looking at is Nielsen average prices, which means that it could be, for example, the trades changing margins and so forth and not necessarily the manufacturers themselves. But at the end of the day, I'm looking at the good sample of what the consumers are paying for the assortment.

Niklas Ekman - *Carnegie Investment Bank AB, Research Division - Head of Consumer Discretionary and Staples & Financial Analyst*

So you're not -- you haven't seen any list price changes? It's just the trade that has raised prices.

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

That I don't know. All I can say is that the Nielsen prices have gone up a little bit and roughly in line with ours.

Niklas Ekman - *Carnegie Investment Bank AB, Research Division - Head of Consumer Discretionary and Staples & Financial Analyst*

Okay. And I was curious, shifting to your non-Scandinavian snus and nicotine pouch volumes, how much of this roughly is the U.S.? I assume that, that is -- the vast majority is U.S. related, but can you give an approximate number?



JULY 21, 2017 / 12:00PM, SWMA.ST - Q2 2017 Swedish Match AB Earnings Call

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

You're correct. It's a large part, very large part is the U.S., but we don't give a country split. But, I mean, the rest is -- what it is, is really a little bit to Malaysia, a little bit to Canada from -- directly from us, so to say, but we are distributors. And then the international sales from e-comm retailers of Swedish snus is also growing.

Niklas Ekman - *Carnegie Investment Bank AB, Research Division - Head of Consumer Discretionary and Staples & Financial Analyst*

Okay. Can you say anything about your path towards profitability in this business? Or will you, at some point, start reporting this separately how the profitability looks like for your international snus business?

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

We'll have to see in the future. For now, you get the numbers since we're running it at a loss for the moment, but we're pleased with the improvement this year and the reasons why we have to revise our expectations there. And it's basically, to a large extent, it is volume and gross profit driven.

Niklas Ekman - *Carnegie Investment Bank AB, Research Division - Head of Consumer Discretionary and Staples & Financial Analyst*

Okay. Very good. Also I was curious about the buybacks that you made in the closed period. What was the thinking behind making buybacks in a blackout period. I don't think you have done this in the past. So just curious to hear your thoughts on choosing this strategy this time around.

Marlene Forsell - *Swedish Match AB (publ) - CFO and SVP of Group Finance*

It's something that we've been discussing as you'd seen. I mean, during first 6 months here of the year, we've had relatively significant share repurchases. And also then in order to be able to even them [after we're time], it's good to have the window for repurchases sort of broader. And so that's the reason for using also the blackout period (inaudible) so now that you know.

Niklas Ekman - *Carnegie Investment Bank AB, Research Division - Head of Consumer Discretionary and Staples & Financial Analyst*

And this mandate then expired -- or expires today, basically, but I assume that after that you go back to normal buybacks. You could, in theory, continue to buy back shares tomorrow.

Marlene Forsell - *Swedish Match AB (publ) - CFO and SVP of Group Finance*

Yes. In theory, I mean, we could run with sort of normal way of doing -- that we have been doing it in the past between closed periods and having then safe harbor programs during the blackout period.

Operator

Your next question is from Chas Manso.

Charles Manso de Zuniga - *Societe Generale Cross Asset Research - Director of Consumer Equity Research*

Just a question on Slide -- what slid is this -- Slide 6, the underlying volumes and Swedish Match price/mix effect in Scandinavia. I mean, it's nice to see, well, both volume and price/mix sequentially improving. And I came in later. I may have missed some -- your color around this, but I was



JULY 21, 2017 / 12:00PM, SWMA.ST - Q2 2017 Swedish Match AB Earnings Call

wondering whether you've now anniversaried the XRANGE impact, and we can get back to more sustainable price/mix in Scandinavia. Clearly, the price increase in May helping there, but I was just looking at the tougher comps coming up in the back half of the year and was wondering whether all this was sufficient to, to overcome those tough comps or not in terms of Scandinavian price/mix. That would be the first question.

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

Yes. This is Lars here. We haven't given any forecast for pricing for the second half, but I think you're on to some of the relevant variables, so to say. First of all, of course, in the quarter where there has just been a price increase, you have, you can say, the full effect of the price increase, but a mix effect that tends to be gradual to the standard negative -- the further away you get from your price increase the more of the mix impact you have if you have continuous changes within your portfolio. But the mix in our portfolio, in the Swedish market, the mix effect is actually very limited to the negative side in the second quarter. And the reason for that is, to a large extent, what you mentioned that since we now anniversaried XRANGE, we have growth of XRANGE, but we don't have the type of growth that we saw last year. So our premium volumes overall have done well. And another thing to keep in mind is, if you were late coming into the call is that the 2.2% that you see there, it does include roughly 1 percentage point tailwind from the stronger Norwegian currency compared to the prior year. And as Marlene pointed out, based on current spot rates, one shouldn't count on that one going forward. And then while I give you some cautious things to think about, I might as well -- and the final one is that, generally speaking, second quarter with summer months, the premium segment tends to be a little -- do a little bit better. So versus prior year's second quarter, you should have the same thing. But if you compare sort of the fall and maybe the first quarter, then historically, we've seen a little bit more growth in the value segment in the market compared to premium.

Charles Manso de Zuniga - Societe Generale Cross Asset Research - Director of Consumer Equity Research

Okay. And my second question is on sort of competitive situation in Swedish snus, I guess. I mean, there does seem to be a lot of brand activity, a lot of new brands, brand extensions, not just by yourself, but by your competitors, and yet, you're pointing out that average prices, albeit on limited Nielsen data, appears to be improving. So it feels as if competition may be shifting from price-based competition to more sort of innovation-based competition, maybe. I was wondering what your thoughts were on that and what that -- what implications that might have for industry volumes and mix going forward?

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

Yes, it's a good question. I mean, it is -- it remains very competitive in both the Swedish and the Norwegian snus markets, but the pricing component is more of an issue in the Swedish market, and I think quite frankly, you see a bit of -- you do see price competition clearly from competition in the Swedish market. And I commented earlier that you might have missed, if you take one of our competitors, they have done a relatively big price cut within the premium segment. But on the other hand, they have raised prices or the trade then to the consumer. Whoever has done it, the prices have gone up a bit in the value segment, plus that the value segment has grown quite a bit. So when you look at their average price, it's up. But -- so I'd say there's a combination because it's definitely the case that if we compare this year -- compare over the last 12 months and you go back to 24 months, I'd say you see more activity other than pricing as well in terms of pushing new products and pushing distribution and visibility and so forth. Some of you might have been to [Bosta] during this week, and I was just told that one of our main competitors have a very large display there, just to give you an example.

Charles Manso de Zuniga - Societe Generale Cross Asset Research - Director of Consumer Equity Research

Okay. And my final question would be on U.S. moist snuff. It just seems to be an area where it's tough. It's difficult for you to gain share on an overall basis. So just wondering just to have an update on your strategy really in U.S. snuff, whether you -- what your ambitions are really in that category?



JULY 21, 2017 / 12:00PM, SWMA.ST - Q2 2017 Swedish Match AB Earnings Call

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

Yes. It is a challenging category being a relatively distant #3 player, but our strategy, quite frankly, is quite clear and that is the focus on the segments where we see better potential, so gradually, we think we're improving the composition of our portfolio. Where if you look on a 12-month basis, we have very good growth, both for pouches and for tubs. And those are segments that been showing better growth rates than the traditional loose products. In the second quarter, our tubs did not grow, but we attribute that more to normal quarterly fluctuations. So we continue to believe that we have good prospects for growing volumes within the tubs as well. But at this point, tubs and pouches still represent a minority of our portfolio, and that's why we see this overall share pressure.

Charles Manso de Zuniga - *Societe Generale Cross Asset Research - Director of Consumer Equity Research*

So do you have any activity on the -- sort of the -- heritage of can business to improve momentum there?

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

Sorry, to what, the heritage of cans?

Unidentified Analyst

Yes. In the nontub, nonpouch, the can side of the business.

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

Yes. We definitely do. We -- in the sense that we work with our products as an example and we continue to make some improvements. But we do have FDA lead times there. So we have some improvements that we would like to get out to the consumer imminently but where we have to respect the regulatory regime as well.

Operator

No further questions at this time, sir. We just have one from Adam Spielman from Citi.

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

Can I ask a question or a couple of questions around cigars? First of all, in the outlook statement, you mentioned that the second half will have tough comps. But that's hardly new. We knew that before. So I suppose the question on that is are you flagging that actually the second quarter volumes had a little bit of volume shifted into it from the third quarter? What are you trying to indicate about cigars bearing in mind that you changed your outlook statement? And just more generally, how do you see the growth path of cigars now that we're well into the regulation by the FDA? If you can just talk a little more broadly about how you see cigars panning out, that will be helpful.

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

Adam. If we start with the latter question. We discussed this a little bit after the first quarter. We, as I believe, other players, we have been mindful to make sure that we have a good pipeline of interesting products out in the market that we can push in wider distribution and so forth and, therefore, have a nice impact of novelty in the marketplace. So for a foreseeable future or for the sort of short- to medium-term period, we feel actually very -- relatively good about our launch plans when it comes to -- you can call it launch plans, although they've been in the market in the sense that they've gone wider for cigars. Longer term, it is difficult to assess, but it is a fact that, in the cigar business, it is a little bit more wheeling and dealing and new products seem to be important. So it could be the case that growth is hampered a bit in the category. On the other hand,



JULY 21, 2017 / 12:00PM, SWMA.ST - Q2 2017 Swedish Match AB Earnings Call

one can speculate then whether that would mean that manufacturers would focus more on their average price instead, which has not been the case the last few years. And when it comes to the guidance, I wouldn't read too much into it. As you say, it's been known out there, but if you look at one of the slides in our presentation here, where you see the quarterly cigar shipments, you can see that we did have very strong shipments in the second half. And if anything, we concluded at the beginning of this year that there were some volumes that, so to say, probably more belong to this year than last year, and this was based on buying patterns from the trade as we were getting out of capacity constraints. So I would more say that, potentially, so to say, the second quarter -- or second half of last year was a little bit inflated on an underlying basis. But we continue to have high ambitions when it comes to the cigar business, but we're meeting a little bit tougher comps.

Operator

There are no further questions at this time.

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

Okay. Then, we thank everybody for listening and like to remind you that the release of our third quarter results will be on October 27. And by that, we'd like to wish everybody here happy summer. Thank you.

Operator

Thank you. That does conclude the conference for today. Thank you all for participating. You may now disconnect.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2017, Thomson Reuters. All Rights Reserved.