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SWMA.ST - Q4 2013 Swedish Match AB Earnings Conference Call

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## PRESENTATION

### Operator

Thank you for standing by and welcome to the Swedish Match full-year report 2013. (Operator Instructions). I must advise you that this conference is being recorded today, Wednesday February 19, 2014 at 2 pm Central European Time.

I'll now like to hand the conference over to your speaker today, Emmett Harrison. Please go ahead.

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**Emmett Harrison** - *Swedish Match AB - Senior VP IR & Corporate Sustainability*

Good afternoon, this is Emmett Harrison, Senior Vice President of Investor Relations and Corporate Sustainability.

Welcome to the fourth-quarter 2013 results telephone conference for Swedish Match. Lars Dahlgren, President and Chief Executive Officer, is joined today by Tom Hayes, Acting Chief Financial Officer, 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 Tom Hayes. 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 conference call 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 expectations.



This conference call is being recorded and a 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 AB - President & CEO*

Thank you, Emmett, and good afternoon, everyone. In 2013 our operating profits from product areas declined by 6% in local currencies. Some of the factors behind the decline include things like increased investment for snus internationally and also negative currency transaction effects. However, the reduced profitability's also a reflection on changing Company dynamics in key areas like US cigars and Scandinavian snus.

As a Company we have practically addressed these challenges and, because of the hard work of our production and product development teams and our marketing and sales organizations, we ended 2013 with a more balanced and market-responsive product portfolio and a more efficient organization and way of doing business.

While I remain disappointed with the European Union regulatory developments for snus, which, in all likely events, entire prolongation of the EU dynamics except for Sweden and Norway, I am confident that over time both consumers and regulators will view snus as the key element in curtailing cigarette smoking.

Moving on to the fourth quarter, Swedish Match reported increases and a decline in operating profit from product areas of 5%, which was less pronounced than in previous quarters during the year.

There were several factors contributing to the lower operating profit, such as the currency effects, including a notably weaker Norwegian krone versus the Swedish krone, pricing and promotional effects for US cigars and mix effects for US moist snuff.

Operating profit, including share on our profit from STG for the fourth quarter, was SEK932 million compared to SEK986 million in the previous year and earnings per share for the fourth quarter amounted to SEK3.43.

Scandinavian snus sales declined by 2% compared to the fourth quarter of the prior year, on slightly lower shipment volumes. Sales were higher in Sweden and lower in Norway and travel retail.

The fourth quarter shipments versus prior year were impacted by hoarding effects in both Sweden and Norway and, on an underlying basis, adjusted for differences in hoarding effects between the years, Swedish Match estimates its underlying volumes in Scandinavia at being slightly higher than in the fourth quarter of the prior year.

Operating profit declined somewhat more in percent than sales, primarily due to the weaker Norwegian krone.

In Sweden, price mix effects were modest in the quarter versus a year ago, with small price adjustments in September largely offsetting higher share of low-priced products in the petroleum.

Q4 marked the finish of the year with a very healthy category growth for snus in Scandinavia. We estimate the underlying growth to be a bit more than 5%, both in the quarter and the year-to-date period, with strong growth in Sweden and Norway partially offset by declines at travel retail.

In Sweden the growth has, to a large extent, correlated to the continued intense price competition in the low-price segment, but we also saw a more resilient full-price segment in the fourth quarter.

Also, our market research data shows that the number of adult snus users continues to increase in both Sweden and Norway at a good rate. In both these markets, increased penetration in the female segment has been an important source of growth.

In Sweden our market share is highest in the full-price segment and lower in the value segments. And, despite only minor share movement for Swedish Match in each price segment, our overall share of the market declined versus the third quarter as a result of mix shift between segments.

At the same time, we note that our year-on-year market share loss was lower in the fourth quarter than in any other quarter during 2013.

In Sweden, using Nielsen data, excluding tobaccoists, our market share for snus in the value terms was 77.4% in the four-week period ending January 26, compared to 77.9% for the preceding four-week period and 79.6% in the corresponding four-week period last year.

Our market share in volume terms was 70.4% compared with 70.9% in the previous four-week period and 73.5% in the corresponding period last year.

We use Nielsen data to further segment the market by price segment. Based on our own segmentation for the four-week period ending January 26, Swedish Match had a volume share of 94.8% of the full-price segment and 36.6% of the combined value segments.

Our share of the full-price segment was down slightly from the prior year corresponding period, while our share in the value segment was virtually unchanged.

Value segment accounts for approximately 42% of the Swedish market in number of [accounts]; up from approximately 38% in the corresponding period last year.

In January 2014, weight-based taxes were virtually unchanged in Sweden and increased by 2.1% in Norway. As the tax movements were only modest, only minor adjustments were made in Norway, while there was no list price adjustment in Sweden.

As we enter into the first quarter of this year, it can be good to remember that in 2013 we raised the price of our low-priced product, Kaliber, in January, but brought that price back towards the end of the first quarter.

In Norway our market share in value terms in the latest four-week period ending January 26 was 62.2%; unchanged versus the previous period compared with 65.8% in the corresponding period last year. The total market increased by more than 8% in the latest six-month period versus the same period one year earlier, according to Nielsen.

Nielsen reports that over the same six-month period, Swedish Match consumption volumes are up close to 2% over the same period a year ago.

In the US, Swedish Match moist snuff sales were down year on year in the fourth quarter, with volumes down by 3%.

Operating profit in the US for moist snuff was also lower from both the volume declines and from mix shift within the product portfolio. For the full year operating profit was also down in dollar terms versus 2012 for moist snuff.

Using factory shipments, we estimate that for 2013 the moist snuff category in the US was up by about 3.5% in volume terms, whilst Swedish Match volumes in can equivalents were down by almost 4%. Swedish Match estimates its volume share of the US moist snuff market to be in the range of 9% to 10%.

During 2013 we made good strides in developing our presence in the fast-growing pouch segment of the US moist snuff market, with our improved cans with the disposal lid as well as competitive everyday low prices.

The pouch segment in the US now makes up about 13% of the market and has been growing roughly three times the category growth rate over the past several years.

Another fast-growing segment is for larger packaging formats, and here we continue to see good growth for our Longhorn tubs.

Our snus activities in the US (inaudible) continue to grow and develop our presence in that category and during the fourth quarter we further expanded our store count and today we are in more than 22,000 stores. For 2014 we will focus on adding distribution in selected high-quality outlets, which means that the pace of store expansion is likely to moderate over the coming year.



With the current plans for consumer engagement and brand-building activities, the operating loss for 2014 is expected to be of similar magnitude as in 2013.

During the year we sold close to 4 million cans; almost twice the level in 2013. In the fourth quarter, however, we only saw small volume increases on a net basis as we faced some issues with product returns that we attribute to too high buy ins of temporary promotions earlier in the year.

We also foresee a fairly soft first six months this year for US snus versus prior year, due in part to these retailing monetary adjustments, but also due in part to rapid distribution gains in the first half last year affecting comparisons.

With regard to SMPM International, the joint venture company for smoke-free products, testing continues in Canada, Russia, Asia and Malaysia.

In our other tobacco products businesses, sales from mass markets cigars in local currency were in line with the fourth quarter of 2012, while volumes increased by 11%, with higher volumes coming from both our natural wrapper Game products by Garcia y Vega and our new Jackpot line.

In the fourth quarter operating profit for cigars was lower. This was anticipated and the result of an increased promotional and product mix.

For the full-year 2013 our overall shipment volumes for cigars were only slightly below last year's record level and, once again, surpassed the 1 billion stick mark.

For chewing tobacco we estimate the category to have declined by around 4% in volume terms for 2013. And our own volumes of Swedish Match brand declined about the same as the market rate. Contract manufacturing volumes, which can be volatile, declined at a faster rate.

For the fourth quarter and the full year, chewing tobacco sales and profits in local currency were above 2012 levels.

During the fourth quarter, the lights product area delivered another solid quarterly result, with sales in local currencies up by 6% and operating profits up by 5%. Sales in local currencies increased for both lighters and matches.

In local currencies, operating profit increased for lighters and were down only modestly for matches. For matches, the decline in operating profit was due to different factors, including country mix, currency and transaction effects and higher raw material costs.

With regard to our 49% holding of Scandinavian Tobacco Group, our share of net profit in STG was SEK97 million compared to SEK103 million in the prior year. Total Scandinavian Tobacco Group net sales for the fourth quarter amounted to DKK1.481 billion, whereas DKK1.610 billion in the corresponding period a year ago. Reported EBITDA amounted to DKK289 million.

Sales and EBITDA have been negatively affected by currency fluctuations and the previously announced one-off stock reduction at a major European distributor, which took place as planned during the fourth quarter of 2013. The fourth quarter of 2013 also included personnel-related restructuring charges of approximately DKK20 million.

Additionally, the comparison to prior years is distorted by the fourth quarter of 2012 volume recovery following the third quarter of 2012 backlog situation in the European cigar operations.

The decline in EBITDA was largely upset by a positive one-time adjustment to the tax line.

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



**Tom Hayes - Swedish Match AB - Acting CFO**

Thank you, Lars. For the fourth quarter the development of exchange rates continued to have a negative effect on our sales and operating profit comparisons.

Currency shifts relative to the Swedish krone were most pronounced with the Brazilian real and the Norwegian krone and, to a lesser extent, between the Swedish krone and the US dollar.

Overall, there was a negative translation effect on sales of SEK50 million for the fourth quarter. This consists of a negative SEK22 million for snus and snuff, a negative SEK13 million for other tobacco products and a negative SEK15 million for lights.

The total translation effect on operating profit was a negative SEK6 million.

At current exchange rates we would expect to see negative currency effects on sales and operating profit in the coming quarters and a notable impact on Scandinavian snus sales and profits, due to a weaker Norwegian krone versus the Swedish krone compared to year-earlier rates.

Net finance costs for the fourth quarter amounted to SEK128 million compared to SEK137 million in the previous year, due in large part to lower interest rates. As of December 31, 2013 interest-bearing debt was SEK10.5 billion versus SEK10.8 billion December 31, 2012.

For the year, the reported tax rate was 18.1%. Excluding one-time items, associated companies and joint ventures, the tax rate was 20.9%. The reported tax rate declined from the previous year largely as a result of reduced corporate tax rate in Sweden.

Our best estimate right now for the 2014 tax rate, once again excluding one-time items, associated companies and joint ventures, is around 22%.

Some brief comments on cash flow and balance sheet. Cash flow from operating activities for the year amounted to SEK2.500 billion compared to SEK2.805 billion for the previous year.

The cash flow from operations decreased compared to the prior year as a result of lower operating profit and higher taxes paid.

Net cash used in investing activities for the year amounted to SEK240 million and includes investments in property, plant and equipment of SEK306 million compared to the SEK251 million in the prior year.

In addition, investments in intangible assets amounted to SEK35 million compared to SEK48 million in the previous year. We expect that investments in tangible and intangible assets for the full year of 2014 will be at a similar level, around SEK300 million to SEK325 million.

During 2013 we also received net proceeds from investing activities of SEK158 million, primarily related to additional payments of SEK161 million from the sale of land in 2007.

During Q1 of 2013 Swedish Match received a dividend from STG of SEK224 million. In 2012 Swedish Match received a dividend from STG of 204 million.

During the year SEK1.8 billion has been transferred to the shareholders by means of share buybacks and dividends. At December 31, 2013, Swedish Match held 2.95 million shares, corresponding to 1.5% of the total number of shares outstanding. The number of shares outstanding net at December 31, 2013, amounted to 199 million shares.

The Company has issued call options, for which amounts corresponding to 1.1 million shares exercisable in stages from 2014 through 2015 were outstanding as at December 31, 2013.

The net debt declined to SEK8.388 billion from SEK9.289 billion at the end of 2012. And the net debt in relation to EBITA, excluding share profit in STG, was 2.5 for the period ending December 31, 2013; consistent with the 2012 measure.

We had during the year issued new bonds of SEK1.225 billion and repaid loans of SEK1.491 billion. In 2014, SEK948 million of loans fall due for repayment, with SEK488 million of that due for repayment in the first quarter.

The average maturity duration of the bond portfolio is now 4.0 years and the weighted average interest rate on the bonds is 4.67%, with about 93% of the portfolio at fixed interest rates.

The Board will propose to the annual general meeting in May 2014 a renewed mandate to repurchase shares up to a total holding in treasury not to exceed 10% of the number of registered shares in the Company until the next annual general meeting in 2015.

The Board of Directors will also propose to the annual general meeting in May a dividend of SEK7.30 per share.

I will now turn the conference call back to Lars.

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**Lars Dahlgren** - *Swedish Match AB - President & CEO*

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

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). Stellan Hellstrom.

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

Firstly a question on Norway, where you've made moderate price changes. I'm just curious whether you raised your prices more or less than the tax increase.

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**Lars Dahlgren** - *Swedish Match AB - President & CEO*

On average we have basically a manufacturer's take; you can count on around 2%. There are little bit differences within the portfolio, where it's actually some absorption of the tax increase on loose snus, given the high price levels in the Norwegian market and an exceptionally high tax.

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

Okay. Then also question on pricing in Sweden, what you can say at this point on 2014. I saw some comments that could be maybe interpreted as a bit cautious on the potential for raising prices. But, given that we are seeing stable volumes for full-price snus, wouldn't that be a good environment for raising prices?

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**Lars Dahlgren** - *Swedish Match AB - President & CEO*

Well, we don't communicate price changes until we make decisions. And when we took some small price adjustments in September of last year, there was virtually zero movement on the excise tax in Sweden around New Year, and we didn't adjust any list prices. And we also haven't seen any competitors, to our knowledge, that we can see that have changed their prices over a year.



And then, as usual, these type of business decisions are things that we continue to analyze as time progresses. And when we have news to communicate, we will communicate.

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

Sure. But there is nothing then that indicates any movement in either direction. You seem to be commenting on the general inflation level that that would have an impact on your decisions.

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**Lars Dahlgren** - *Swedish Match AB - President & CEO*

I think that goes for all companies, that one has to factor in. But in Sweden we are in an exceptional low interest -- or inflation environment. That's also why the tax was unchanged last year, that we had zero change in CPI.

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

Also if you can give some further comments on the returns that you're seeing in snus in the US and why this is coming, and how much we'll see in the first half 2014.

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**Lars Dahlgren** - *Swedish Match AB - President & CEO*

Yes. What we did do, during the rapid expansion in 2013, as a standard model with new outlets, we ran for a limited period, and I think it was eight weeks, Tom, a temporary price model, basically to generate trial among consumers and help them discover General, which we feel is a superior product in the US market.

And, as I say, that was definitely successful in the sense that we saw -- when we measured cans per store per week, prior to the TPR, and then, of course, it spiked during the TPR. So it tended to exit (inaudible) post that promotion, tended to be slightly higher. But, in retrospect, it's clear to us that some of the distributors and trade got too excited and ordered too much snus so that we had to accept returns of all the outdated products.

And, quite frankly, we do, of course, try to analyze exactly the underlying trends and see when were these shipped and so forth, but it is a cloudy exercise since you have not all the products are shipped directly from the factory to a retailer. So it's a little bit hard to get transparency on exactly what were the true sales volumes in the second quarter versus the fourth quarter, as it were.

But we have a small growth in the fourth quarter, but we had a pretty significant product return. So the gross sales were up quite a bit more than the net sales, I guess, on volume basis.

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

Okay. Thanks.

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**Operator**

Anders Hansson.

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

First of all, coming back to the questions on Sweden, if you -- since a lot of things have happened, BAT terminated their G20 brand, Imperial launched a new brand, premium, more stable and so forth, what's your gut feeling on Swedish market now compared to after Q3 or after Q2?

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**Lars Dahlgren** - *Swedish Match AB - President & CEO*

Well, first of all, as I said, it's very positive to note that there is definitely strong category growth, not only driven by increased consumption as when people have traded down.

And then obviously the -- exactly what competition do, the answers there need to come from them in terms of which product they introduce or take off the market and so forth. But I think what you're referring to is a general picture of where you see very dynamic market condition, or market activity, in the low-price segment.

So we continue to expect that you will see high level of activities and that can include new product introductions. It can include removal of non-performing SKUs. It can include changes in distribution set up and it can also include changes to discount structures.

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

Okay. One other thing on mass market cigars, price mix is going to be a negative, as it was in Q4. Can you discuss a bit on the margin impact in 2014 from the changed mix?

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**Lars Dahlgren** - *Swedish Match AB - President & CEO*

Obviously we do everything we can to compensate for a lower average price on cigars. We continue to work effectively with rationalizations in the supply chain. They've done an excellent job there over the past few years.

And while our ambition is to have as strong a volume component as possible, it remains very competitive and we're not in a position to give a volume forecast for this year.

But one thing that we are happy with is that when we enter this year we feel that we have secured very good distribution, as we have revised our promotional offerings. And for 2013 for natural cigars we actually had very good growth. For lights, though, we did not have good growth but we feel that we secured good distribution in chains, whereas in 2012 we were more dependent on this type of very large distributor that we sometimes refer to as metro accounts where we have seen significant volatility.

We enter 2014 with, I'd say, a better, more stable quality in the convenience channels, including national accounts, and, therefore, being part of more firm planograms and so forth with a wider product range from Swedish Match.

So we feel good about that but then, having said that, the difficult thing is how big exactly will be the price mix component because, effectively, in the end the consumers will decide what they buy.

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

Yes, but also on -- how big impact on margins will the negative price mix effect have? Since we didn't see that much of it in Q4, given how big it was.

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**Lars Dahlgren** - *Swedish Match AB - President & CEO*

We don't go into margins between cigars and chewing tobacco, apart from directional, and you know that the whole of 2013 was a very strong chewing tobacco year.

And it is, as I said, at the end of the day, consumers decide and it is difficult to assess where we end up because while, for example, Jackpot does have slightly lower production cost, it's not enough lower to compensate for the difference in price; also on the promotional White Owl product.

So it depends on the mix and we are in all segments. We are in deep discount HTL with Jackpot. We are in more regular or premium HTL and then we are definitely having good traction also in the natural cigar segment.

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

Just one short one. US snus cost for 2014 and when do you think the peak for losses in the US will be?

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**Lars Dahlgren** - *Swedish Match AB - President & CEO*

If we looked -- this is true both for US and if we look at the totality of international snus investments. First of all, we're at the beginning of the year and clearly we adopt our plans and may decide on new initiatives and may exclude initiatives we have in our plans and so forth.

But when we look at our financial plans for 2014, right now, and this can change, it looks like any spending on the net -- or the operating profit impact from international snus ventures will be of similar magnitude as in 2013. And it was SEK294 million for the full year 2013.

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

Yes, thanks.

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**Operator**

Andreas Lundberg.

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**Andreas Lundberg** - *ABG Sundal Collier - Analyst*

Can I ask on your low-price products in Sweden, what's your take there on the recent market data?

And also what's your strategy in that category to defend your position? Or is to be number 1 in that category? Thank you.

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**Lars Dahlgren** - *Swedish Match AB - President & CEO*

When you look at the low price and Kaliber after Q3, that was relatively recent after the September price adjustments, and we did see a setback in the market share for our Kaliber brand. Since then, the picture has been that it's relatively stable. It goes a little bit up and down because, as I was referring to before, it is a very dynamic price segment.

When we look at our ambitions in terms of market share, our key objective is to compete effectively in all price segments of the Swedish market. When we look at our total market share, as I said earlier, our year-on-year loss was actually the lowest in the fourth quarter. However, it was still too high.



And when we look forward, we do think that the value segment, the low-price segment and the mid-price segment combined, will grow at a faster rate than the full-price segment. And we have an ambition to defend our overall market share as well. Although we do things within the different price segments, that's where we make the firm decisions on exactly on what we do.

Our overall objective is to defend better our market share of the total market and, given what I said about that we do think that the value segment will grow at faster pace, that implies, if we're going to be successful, then that we have an ambition of rather taking a little bit of market share in the value segment.

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**Andreas Lundberg** - *ABG Sundal Collier - Analyst*

Okay, thank you. And also maybe for Tom. Saw you had some working capital buildup in the fourth quarter. Any specific reasons for that? Thank you.

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**Tom Hayes** - *Swedish Match AB - Acting CFO*

I think our fourth quarter can, at times, be somewhat volatile on working capital movements, both on the receivable side for our distribution business and the timing of when a period ends relative to cash collections. But also we see volatility from time to time on the phasing of yearend inventory purchases and the payments of those inventories.

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**Andreas Lundberg** - *ABG Sundal Collier - Analyst*

Okay, great. Thanks.

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**Operator**

Niklas Ekman.

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**Niklas Ekman** - *Analyst*

I want to start with a question on STG. You mention here that you have appointed advisors to help you in your future strategy for that company. Can you elaborate a little bit on your thoughts here and then, timing wise, what you think could happen here?

And particularly, I guess, in light of the sales and earnings development, do you think it's likely that we could see some kind of transaction in STG from your point of view in 2014? Or is this more a 2015 issue?

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**Lars Dahlgren** - *Swedish Match AB - President & CEO*

Since the inception of STG, we have been clear that what we wanted to do here is to trade a very strong -- the world's largest manufacturer of cigars and pipe tobacco with an excellent brand portfolio. And we saw a lot of value creation in that combination. And, as far as we are concerned, we want to maximize the value on that investment and that follows that it's not at all impossible that that value is monetized one day.

And then we do have a stand-still agreement that expires in October and that's a new situation. And, in relation to that situation, as we wrote in the report, we have appointed an investment bank to review the options. And that doesn't mean that necessarily something happens in October 2014. And there are no firm decisions on what we or the other shareholders or what we would do in concert, because that's effectively why we appoint an investment bank to evaluate the options.



And so we will communicate more when we have something to communicate, but don't look at October 1, 2014 as a fixed date.

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**Niklas Ekman** - - *Analyst*

Okay. No, that makes sense. And can you just tell us a little bit about the outlook here for STG, as far as you know? Obviously 2013 has been a bit of a challenging year with some headwinds. What do you see going into 2014? Should we expect similar headwinds or do you see the market improving? Is there a chance of earnings recovery for that business?

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**Lars Dahlgren** - *Swedish Match AB - President & CEO*

In 2013 there have been a combination of factors, including market conditions, but also some things of a more one-time nature that, like in the fourth quarter, both the restructuring cost and also the adjustment of inventory levels at distributor level. Those type of one-off effects are one-off by nature.

The cigar markets in Europe showed, from a historic perspective, there were steep declines in 2013. It's hard to say where it will go, but I can say that 2013, if you take an historic trend, was a relatively steep decline. So if, I say if, we would revert to more a historic trend that would imply an improvement versus the trend that we saw in 2013.

And then also STG, the way STG is run, is a company that invests for the future in terms of new initiatives and brand-building activities. That includes on the cigar side, that includes on the fine-cut side and so forth, including capital expenditure, is the position for the future. And I think a lot of good things are being done there and they have good plans. So then we'll have to see how it plays out.

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**Niklas Ekman** - - *Analyst*

Okay, excellent. And then turning to US snus, can you just clarify when you're talking about returns of cans, are you actually seeing retailers returning fridges and then terminating contracts? Or is this really just return of cans we're talking about?

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**Tom Hayes** - *Swedish Match AB - Acting CFO*

I would say that, as referenced by Lars, we're talking about the impact of product returns during the quarter that had an impact on our noted growth for snus volumes in the quarter.

When we talk about our store expansion and that we are now currently in 22,000 stores, there is a natural churn. That's not to say that every store that we place a chiller, or have ever placed a chiller, is a current seller of snus. So there is a natural churn that takes place in our distribution efforts, but it's not significant to the level of the product returns that we experienced as a result of the ambitious buying efforts by trade following the second quarter and early third quarter TPR efforts.

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**Niklas Ekman** - - *Analyst*

Okay. Sorry just to clarify, did you say 22,000 was the gross number of stores? So you mean that actual number is lower?

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**Tom Hayes** - *Swedish Match AB - Acting CFO*

That's where we're currently selling product in the US. I'm saying that arriving at that number we may have introduced snus at more than 22,000 stores over the course of 2013 and there is a natural turnover or churn rate, where not all stores where you place a chiller remains a snus seller today.



**Niklas Ekman** - - *Analyst*

That makes sense. Thanks. And finally, can you say something about your buyback plans for 2014? You were very limited buybacks in 2013. Do you expect that pace to pick up a bit? And should that be maybe more skewed towards the second half of the year than the first half of the year? Any comments here would be appreciated.

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**Tom Hayes** - *Swedish Match AB - Acting CFO*

I would say we don't provide firm guidance on the pace of buyback. We do comply with our financial policy on net debt to EBITA and, in that respect you can run your own models. We have historically steered toward that metric of 2.4 times to 2.5 times, so that should give you an indication of expectation based on your model for full-year buyback.

I will say that Q2 historically is a very silent quarter for buyback activity because of the dividend that takes place during that quarter.

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**Niklas Ekman** - - *Analyst*

Okay. Thank you very much.

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**Operator**

Owen Bennett, Nomura.

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**Owen Bennett** - *Nomura - Analyst*

Just a couple of questions, please. Firstly I just wanted to get an idea of the price differentials at the value end now with JT, assuming obviously you've done some discounting back from the price increases you took. I just wanted to know what that differential is with what JT is selling at at shelf.

And secondly, I just wanted to know what was the incremental spend on US snus in 2013? And what is the likely incremental spend in 2014? And what do you see a realistic target in terms of cans? Obviously 4 million this year, do you think you can double that again? That's all. Thanks a lot.

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**Emmett Harrison** - *Swedish Match AB - Senior VP IR & Corporate Sustainability*

We're looking at national averages based on Nielsen's so, of course, the numbers can fluctuate from shop to shop and this isn't an exact science on the pricing.

But if we take the white pouch product as an example, Nielsen is showing us an average for the stores to be looked at, including tobacconists, of general white pouches being just over SEK45. For the mid-priced products there's a bit of a range there, but, let's say, mid-priced products around the SEK35 level; again there's some variances.

And then for the lowest price products there's quite a range and a lot of that has to do with the weight of the product. As you will recall, one of the large competitors, or a major competitor, had a big price cut for one of their smaller brands back after May 2013. But the range you could say is in the range of SEK20 to SEK26, depending on weight.



If you take our own Kaliber products, because we have to put a weight to the product, again there's a variance there, but we did see the price increase that went through in September, but there was a gradual dip in the average price going into the September price increase, and then the price increase went in.

So a very long answer to your question, but if I give you three different -- just three numbers I think it's not quite the best way to look at it.

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**Owen Bennett** - *Nomura - Analyst*

Okay, cool. Thanks a lot.

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**Lars Dahlgren** - *Swedish Match AB - President & CEO*

And when it comes to US snus, I said earlier that total spending for us in US (inaudible) was SEK294 million in 2013 and, right now, our plans point similar magnitudes for 2014 and the vast majority of that money is spent in the US market.

When it comes to volumes we don't disclose our volume targets, but we have clear ambitions to grow in share, both on a national level and in same-store basis on the US market.

And, as I said, while we plan to add some additional distribution, our volume targets are higher, as we will divert some of the spending more to building the category and the brand (inaudible) the consumers and that can buy it in existing stores as well.

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**Owen Bennett** - *Nomura - Analyst*

Okay. Thanks a lot.

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**Operator**

Stefan Nelson.

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**Stefan Nelson** - *Analyst*

If I return to the Swedish market, the premium segment volumes look to be stabilizing, which is good. Just trying to understand, how much of this is positively impacted by the travel segment decline? Or do you see the underlying trends different in any way than what we see in the report that Nielsen did and so forth?

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**Lars Dahlgren** - *Swedish Match AB - President & CEO*

It is impacted. The underlying trend throughout 2013, if you look on a year-on-year comparison, is definitely positive in the sense that full-price volumes have been -- and the whole market has been very strong. So full-price volumes have been holding up better, even if you account for the tax-free effect. But there is a clear impact. So it would be a mistake to look exclusively on what Nielsen reports as the growth of full-price volumes, because part of that volume are now taxed [accounts].

So when we look at -- and it is a little bit cloudy to say exactly what is what here, but when we look at our deliveries and we combine the two, we have a very small decline on full-price volumes in the fourth quarter when we combine tax free and the Swedish market.

**Stefan Nelson** -- Analyst

Okay, good. Then also if you could talk me through the margins for the Scandinavian snus business. I think I remember that you've discussed some costs in 2014 for change in refrigerators in Norway and potentially increased marketing spend. If that's still correct, then if there are other things that will positively impact or negatively impact on profitability, going forward.

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**Lars Dahlgren** - Swedish Match AB - President & CEO

Yes, there are a bit ups and downs there, I'd say. As you know, we have also reorganized our Scandinavian operations, with effective to do things both smarter and better. So there is definitely a strong focus on costs in the Scandinavian operations.

But then you're right to pointing into certain factors that, I'd say, naturally drive costs the other way, if you want to compete effectively in today's market.

So while we focus on costs, I'd say we're even more focused on top lines and there are savings for this year, but there are also costs, underlying cost increases. So it would be wrong to think that value creation is going to come from some kind of massive cost restructuring, or cost-cutting programs this year.

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**Stefan Nelson** -- Analyst

Okay. But just given that you were able to keep margins quite stable in 2013, despite weak volumes in the beginning of the year and so forth, what -- going forward, if we have a more favorable volume trend than a year ago, should margins be able to at least be stable or up, versus (inaudible) let's say?

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**Lars Dahlgren** - Swedish Match AB - President & CEO

As I say, we don't give any margin guidance but we would try to be smart with our costs. We will take necessary investments over the P&L, as I say, and, given our ambitions to defend our overall market share better, we do anticipate certain negative mix effects. And everything else equal, of course, negative mix effects are not helpful for margins. So let's see how that plays out.

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**Stefan Nelson** -- Analyst

Okay, great. And then just finally, given the Swedish Government talking about tax increases specifically for snus, do you have any idea what magnitude is being discussed, and how this could impact the pricing in the market?

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**Lars Dahlgren** - Swedish Match AB - President & CEO

I think it's a bit premature to discuss how it will impact pricing and so forth. And, for the benefit of the international listeners, this is recent news where the Minister of Finance went out in an interview last Saturday and mentioned a number of means to finance reforms to improve the Swedish educational system, primarily. And this is in an election year, so this has to be viewed through those glasses. And Swedish educational system is an extremely hot potato at the moment.

And we'll have to see what finally comes in any budget proposals and so forth, but also we have to realize that there is great uncertainty in terms of outcome of the September elections in Sweden.

The current Government is very far behind the opposition in the opinion polls. So if you would listen to those people -- or people actually consider it less and less likely that they will be reelected, but things can change. And I'm sure we will see a lot of news flow during this election year.

Having said all that, what he mentioned was SEK2 for a can of snus and, as you all know, a can of snus varies in weight and so forth. So exactly what he meant by that in terms of per kilo and so forth, is not clear.

And then he mentioned SEK1 for cigarettes. And, obviously, we consider this very irrational from a public health point of view, in terms of we have seen very positive effects on the Swedish public health with migration from cigarettes to snus. And everything else equal, you would expect cigarette smoking to be higher with such a tax movement than it otherwise would have been.

And this is something we know that some people are telling the Government that financially also, it is maybe not a smart decision, given the increased healthcare costs that are associated with the cigarette smoking.

So I think we should expect this -- it's not the only thing that's going to be debated during the election year, that's very clear. But I don't think it's the end of story, so we'll have to see how this plays out. It's a relatively long answer, but I try to bring all the international listeners in a little bit to the Swedish political debate here.

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**Stefan Nelson** -- Analyst

Thank you, Lars.

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**Operator**

Gabriela Malczynska.

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**Gabriela Malczynska** - Barclays - Analyst

I still have just two questions. One is on essentially snus and snuff, and you -- sorry, and the other tobacco products. How much visibility do you have into EBIT, going into 2014? Is it actually going to increase in absolute terms?

And then my second question is on the interest expense. Do you expect any changes in 2014?

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**Lars Dahlgren** - Swedish Match AB - President & CEO

In terms of the EBIT, this is early in the year and we give an outlook in the interim report, in terms of the market conditions and also pointing to the competitive dynamics that we see out there in the market. And then we try to explain how we compete. And I think the question's more broadly, so we don't give specific EBIT guidance.

And, Tom, do you want to comment on the financial net --?

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**Tom Hayes** - Swedish Match AB - Acting CFO

Yes, I would just say, as I mentioned, in the third quarter there were some costs in Q3 that were somewhat more reflective of extinguishment of certain indebtedness that we had at that point. But I would say using Q4 as a run rate would not be a bad proxy for an expectation for finance costs for the full of 2014.

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**Gabriela Malczynska** - Barclays - Analyst

Okay, thank you.





**Operator**

Casper Blom.

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**Casper Blom** - *Handelsbanken Capital Markets - Analyst*

First of all, a question regarding e-cigarettes, which seems to be where a lot of the tobacco makers are putting their efforts at the moment. How do you look upon that?

Is that a competitor to your smoke-free products? Or is an ally to help consumers get away from traditional smoking tobacco? I'm thinking especially about the US market.

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**Lars Dahlgren** - *Swedish Match AB - President & CEO*

Yes, it's a good question and, quite frankly, I think there is a little bit of both. And at longer term, I think this phenomenon is a net positive also for snus, in that there is an element of substitution effect in the sense that it's a product that also caters to cigarette smokers who are looking for an opportunity.

And that could potentially imply that people try e-cigarettes instead of snus when they're going to quit smoking and so forth. And I think we've seen very high trial rates in -- or we all know that we have seen very high trial rates in, for example, the US market.

At the same time, though, e-cigarettes and the phenomenon, in my opinion, really helps putting alternatives on the radar screen and on the mind of consumers to start with, but also in terms of regulators, because there is more ground to discuss the harm reduction, which, as you know, in essence, in a tobacco field is offering consumers a less hazardous alternative to cigarettes.

And I think that we already feel that there is an increased interest generally to discuss harm-reduced alternatives.

And certainly an important element for us, as part of our snus strategy, is the health aspect, which is a key criteria for triers of e-cigarettes and, as we informed you previously, during 2014 it's our intention to file our modified risk products application for Swedish snus with FDA. Then it will take time before we have a final outcome of that application.

But there are some synergies, so to say, there from the e-cigarette phenomenon.

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**Casper Blom** - *Handelsbanken Capital Markets - Analyst*

And entering the segment yourself, is that something we could expect at some point in time? Or is that too early to talk about?

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**Lars Dahlgren** - *Swedish Match AB - President & CEO*

We never sort of comment on the new type of initiatives before there are any decisions, but, as you would expect, we follow the development of e-cigarettes very closely. And we do run our own market research, things like that, to understand the consumer dynamics, because it is also an alternative to cigarette smoking.

And I think it's fair to say that what we see in the trial rates in the US market it is clear that e-cigarettes, there is something interesting with the ritual and its proximity to cigarettes.

At the same time, I'm convinced that we have in snus a very, very good product as an alternative with a proven epidemiological and scientific platform that has been used by hundreds of thousands of Scandinavians to either quit smoking or using instead of smoking.

So we are extremely confident in our own product, and then we recognize that consumption patterns and consumer preferences varies there and we need to educate consumers. But we follow the developments.

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**Casper Blom** - *Handelsbanken Capital Markets - Analyst*

Okay. Just a second question then on the Swedish snus market. The mid-price segment really seems to be where there's the most pressure. First of all, what do you see happening here in 2014 in terms of launches etc.? And how would you look upon that segment, let's say, three years down the road? Do you think it will still be there?

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**Lars Dahlgren** - *Swedish Match AB - President & CEO*

That's also a good question, because, as you point out, the low-price segment has grown. It is clear that, on a relative basis, the mid-price segment has shrunk the most.

We are not inactive in that segment and, for example, in 2013 we launched an additional line extension to our Kronan brand, Kronan Strong. That product has so far not done great, but then I think that shows that it is a segment that price position-wise is hard to attract the attention of the consumers.

So, as I say, that's also one of the things that we monitor very closely. And, for us, it is a clear objective when we look at the market, if we look at the full-price segment, we look at the mid-price segment and the low-price segment, but I think one thing is the full-price segment on one side and then it's really the value segment, because people who have opted to use those brands are willing to compromise a little bit on quality and price is the more important factor.

So we look at that segment combined and, as I said, it is our ambition to grow our overall share of that segment somewhat.

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**Casper Blom** - *Handelsbanken Capital Markets - Analyst*

Thank you.

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**Operator**

Adam Spielman.

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**Adam Spielman** - *Citi - Analyst*

In fact my questions have been asked and answered, so thank you.

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**Operator**

Henry Davies.



**Henry Davies** - *BofA Merrill Lynch - Analyst*

I have three questions, please. Firstly on snus/snuff margins in the fourth quarter, I see they were down 130 bps, having been quite much more resilient in the first nine months, and that's despite top line trends in Scandi being a bit better.

If you could speak about what changed there, and whether that margin contraction should spill over into 2014.

Second, on cigars, again in the fourth quarter, backing out chewing tobacco, it looks like EBIT fell around 10% to 15% in the quarter. It sounds like you're hoping to do quite a bit better next year.

If you could just talk about what the change is. Is it your new innovations coming through? Is it something in the 4Q 2012 comp that will allow you to improve that trend?

And thirdly, apologies if I missed it, but on US snus investment now expected at a similar level to 2013, I think you'd previously talked about quite a material step up. So what is it that's changed in your thinking there?

And maybe while we're on US snus, if you could give us an update of how the overall category is trending in volume terms. Thank you.

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**Lars Dahlgren** - *Swedish Match AB - President & CEO*

If I start with the last question on the US snus and I'll leave the other questions to Emmett and Tom here.

I don't know that we have spoken about significant step ups in investments there, and our plans are never -- not even now they're rock solid.

They may have come down a little bit as we fine tune the numbers, and that is really related to, I'd say -- we have been clear that the store expansion we saw in 2013 is not going to be as big in percentage terms for sure in 2014.

When we are focused on quality and stores that sell a lot of smokeless and preferably even over skew on snus, and when we have run those analyses in detail and identified our target universe for this year, we have a target that is slightly lower in the number of stores than what we had two, three months ago. So that's basically fine tuning our plans.

And the spending levels is -- there are no dramatic differences from if I look back three, four months, but they come down a little bit and that's really related to the number of stores.

In terms of the category, it is growing. If we look to Nielsen data it is not growing as much as we would hope for, but when you dissect it also you have to realize that there are some competitor products there that, according to Nielsen, are doing very poorly in the sense that also with their removed distribution that drags down the category number.

But even adjusting for that, there is no dramatic growth in the Nielsen-reported snus category, but there is some underlying growth. And that's also the reason why we think that we have an important job to do in terms of brand building and category building activities that is going to be important during 2014.

Could this trend have to do with e-cigarettes? Potentially on the margin, as I said, there are some mixed trials of snus that have opted to try e-cigarettes instead. That's not at all impossible to rule out in the shorter term.

But I think the interesting thing there and, as we discussed before in relation to e-cigarettes, is the longer term effects; opening up the mind of the consumers and the regulators to alternatives and harm-reduced products.



**Emmett Harrison** - *Swedish Match AB - Senior VP IR & Corporate Sustainability*

And then if we look at the profitability of the snus and snuff segment, and then touching a little bit on the cigar segment, we did have the Norwegian krone effect clearly affecting the Scandinavian side. But I would say that the bigger hit on profitability really was more on the US side.

We've seen good growth from the pouch products, which generally have a lower price, and also the tub products. And both of those, if you look at it on an equivalent sales and profit per unit, and I could say a bit on the margin side as well, they're a little bit less sales per unit, profit per unit and profitability per unit.

And we did see some declines for our higher priced loose moist snuff products, okay. The spend behind snus in the US was really not all that different in the fourth quarter this year versus last year. So the hit on the margin, you would say, was more impacted by the US moist snuff side in terms of margins. A little bit on the Scandinavian side as well, but the Norwegian krone had an impact on that.

For cigars, I think we've touched upon that. We had indicated that we were hopeful that volumes would increase in the fourth quarter and they did by about 11%.

But one should remember that the mix in the fourth quarter of this year is different from the mix that we had in the fourth quarter last year, with not only the Jackpot-type of product, but also in the portfolio more of the two for \$0.99 type of products and much less of the single stick and gentler promoted products.

You will recall that in the first quarter we were pretty upbeat because I think we had an expectation of our promotional mix that was different than what played out, and we had to launch our product there. It's also good to remember that in the first quarter last year we did have quite a big launch of the Gold cigar products.

So going in to 2014, not only will you have the full-year effect of the promotional mix with, one would expect, Jackpot volumes, the effect of a full year of those type of volumes, but one should remember that there were some fairly large product launches in the first quarter last year.

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**Henry Davies** - *BofA Merrill Lynch - Analyst*

Okay. Thank you.

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**Operator**

You have no further questions at this time. Please continue.

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**Lars Dahlgren** - *Swedish Match AB - President & CEO*

Okay. Thank you for listening today and, finally, just to inform you that the release of our first-quarter results in 2014 will be on May 9. Thank you.

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**Operator**

That does conclude this conference for today. Thank you for your participation. You may all disconnect.

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