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SWMA.ST - Q3 2014 Swedish Match AB Earnings Conference Call

EVENT DATE/TIME: OCTOBER 24, 2014 / 12:00PM GMT



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## PRESENTATION

**Emmett Harrison** - *Swedish Match AB - SVP of IR & Corp. Sustainability*

Hello. Welcome to the third-quarter 2014 results telephone conference for Swedish Match. With me today are Lars Dahlgren, our President and CEO, and Marlene Forsell, our CFO. After a brief results discussion we will be taking any questions you may have. For further information on the third-quarter results, please visit the [SwedishMatch.com](http://SwedishMatch.com) website.

During today's call there may be certain points which may constitute forward-looking statements. Because such statements deal with future events they are subject to risks and uncertainties. While management believes that these statements 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. Swedish Match assumes no obligation to update information concerning its expectations. A recording of this call will be available on the Swedish Match website. I will now turn the conference call over to Lars Dahlgren.

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

Thank you, Emmett, and good afternoon, everyone. You may have noted in our interim report earlier this morning, my commentary on our new vision at Swedish Match -- a world without cigarettes. In Sweden the percentage of adults using cigarettes is among the lowest in the western countries due in large part to the widespread use of snus as a much less harmful alternative to cigarette smoke.

In Norway we are now seeing a similar migration from cigarettes to snus. We believe that Swedish Match can play an important role in contributing significantly to improved public health by providing adult consumers, no matter where they live, a satisfying and viable alternative to cigarette smoking.

On that theme, we filed in June an application with the FDA in the US seeking modified risk tobacco product status for our snus. And during the third quarter Swedish Match became the first Company to have its modified risk tobacco product application accepted as complete by FDA. FDA acceptance of our application does not guarantee approval, but we believe that our products stand the best chance of any tobacco product to pass the [MRTC] approval process.



Based on extensive Swedish and international scientific evidence on the health effects of snus, we firmly believe that Swedish Match deserves to get permission to use warning labels that differ from mandatory warning labels on other smokeless tobacco products available in the US market. Our application is subject to an ongoing consultation process and we won't have a definite answer from the FDA for some period of time. But I am pleased to see that the application process is moving forward.

As you may also be aware, the (inaudible) period with Scandinavian Tobacco Group ended on October 1. We will touch on the performance of STG a bit later, but I did want to point out that we have no announcement on any potential change in ownership at this time and we will not -- this will not be a topic on this call.

Also, I am sure that you have been following the excise tax situation in Sweden. The latest budget presented for a vote is to increase taxes by 12% for snus compared to only 6% for cigarettes. In our opinion the proposed changes in relative taxation for snus and cigarettes are inadvisable both from a public health and a fiscal point of view. We will not comment on any potential price changes on our snus products till next year at this call.

Regarding the third-quarter financial performance, Swedish Match delivered increased sales and operating profit versus prior year. Some of the strongest growth in sales and operating profits coming from our other tobacco products area which includes US cigars and US chewing tobacco.

For cigars it is worth noting that the third quarter of the prior year was particularly weak as the market has become very competitive. The market has remained highly competitive, but Swedish Match has successfully responded to the new environment by adjusting our promotional mix and also by introducing our own deep discount brand. As a result our volumes on a 12-month volume basis ending September 30 this year were at an all-time high.

In the snus and moist snuff product area, our Scandinavian snus shipment volumes were flat with growth in Norway and small declines in Sweden travel retail combined. Sales for Scandinavia were also virtually unchanged. We did note however several positive trends underlying this relatively flat performance in Scandinavia.

Our overall market shares in Sweden have been stable for several months and in Norway we have maintained our market share over the last couple of months (inaudible) measures. The Swedish market remains highly competitive with the value segment's growth continuing to outpace the overall market growth.

Our stable overall market share in Sweden has been driven by a number of activities, especially in what we define as the value segment, where our market share reached its highest levels for two years. The price repositioning for the Kronan brand has achieved the desired results and we have just introduced new line extensions for both Kronan and Kaliber and we are also in the process of introducing a new more modern and refreshed packaging design for Kaliber.

In the premium segment we have done a good job of maintaining our share position. In Norway Nielsen indicates that the market is still growing at a robust pace, up some 8% year on year in the quarter, with Swedish Match consumption up by 2%. We are actively focused on in region markets and have implemented a number of initiatives aimed at supporting volume growth.

In addition to our recent (inaudible) improvements for The LAB [fresh range] we have also launched other new projects including General G3 with a better mild feel and improved moisture balance in a distinctive and modern labeling.

For moist snuff in the US we are continuing to have good volume growth for our pouch and tub products. This combined with promotional facing meant that we had volume growth of some 4% in Q3 for moist snuff. The pouch segment in the US now comprises about 15% from the moist snuff market and has been growing considerably faster than the category over the past several years.

Consumption volume for General snus in the US continued to increase. Shipments and gross profits for US snus were higher than last year's Q3 and our rotation in stores have improved since the start of the year, supported by increased focus on consumer engagement, category awareness and brand building activities. Nielsen data, as well as market share data provided by distributors, indicates that General remains the second largest and fastest-growing snus brand in the US during this year.



The Lights product area operating profit and sales were down affected by lower lighter volumes in both Asia and Europe. This was only partially offset by slight growth in operating profit for our match business and a strong performance of our Brazilian complementary products business.

Late in the third quarter we began a limited test of e-cigarettes produced by a third-party and sold under the Cricket brand in the Russian market. Sales and expenses related to this test are included in the Lights reporting segment but were not material in the quarter. We are still only at the early stages on the learning phase of this project, but we are receiving positive initial feedback.

STG's performance during the third quarter improved significantly compared to the first half of the year. Volumes grew for cigars in general, but most strongly for handmade cigars. During the quarter STG announced the acquisitions of Verellen, a Belgian cigar company, and the brand portfolio of a US led [Peranio Familis] family cigar company.

These acquisitions strengthen STG's position within both machine made and handmade cigars. However, the effects from these acquisitions in the quarter on sales and profits were minor. Now I will hand over the call to Marlene for some more detailed comments on the financial performance.

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**Marlene Forsell** - *Swedish Match AB - SVP & CFO*

Thank you, Lars. On the Group level sales for third quarter were SEK SEK3.460 billion, up 6% from the prior year. Operating profit, including our share of the net profit from Scandinavian Tobacco Group amounted to SEK989 million compared to SEK924 million in last year's third quarter. Earnings per share in the quarter include the SEK3.5, up from SEK3.15 prior year.

The quarterly comparison is affected by a positive currency effect, restructuring charges in the prior year and the increased net cost for expansion of snus to markets outside Scandinavia. Currency translation had a positive effect of SEK77 million on sales and SEK24 million on operating profit, excluding STG.

In local currencies sales grew by 3% versus Q3 last year and our operating profit for (inaudible) areas grew by 2%. If we also adjust for restructuring charges of SEK28 million recognized in Q3 of last year and exclude the [mentioned] snus (inaudible) costs, our operating profit in local currencies for our product area also grew by 2%.

At the current stock rate we will see positive currency effects in the coming quarters. Note though that in the following product area comments I will generally refer to operating profit development on a local currency basis.

Within the snus and moist snuff product area sales were flat in Scandinavia but grew for both moist snuff and snus in the US. For US moist snuff the sales increase was attributable both to the 4% volume increase at slightly higher pricing and operating profit was up. In Scandinavia, adjusted for the restructuring charges in the prior year operating profit declined slightly as operating expenses were somewhat higher.

Regarding pricing in Scandinavia, you want to remember that in September 2014 there was a small price increase for most of our products in Sweden while there were price reductions for the [Kronan] brand this year. In Sweden our overall volume share of the Swedish market was just below 70% during the quarter, down from approximately 72% in the same period last year. For most of 2014 the Swedish Match share of the total market has remained at around 70%.

Since January we estimate that the Swedish Match volume share of the premier segment has been hovering around 94% while our share of the value segment has grown from approximately 36% to more than 38%. In Norway our market share during the third quarter was estimated to be approximately 59%, down from 63% during the same period last year.

Stabilizing Norwegian market share development is a key objective and we are encouraged to see that the flat development in the last couple of months (inaudible). Our (inaudible) to expand snus outside Scandinavia was up versus last year by SEK27 million during the quarter. With the current plans of expanding consumer engagement and brand building activities the operating loss for our snus expansion out of Scandinavia is anticipated to be somewhat higher than 2013 also in the fourth quarter.

For other tobacco products, sales increased by 9% in US dollars while operating profits increased by 6%. Sales in operating profit increased for both cigars and chewing tobacco and was most pronounced in cigars. Our successful response to the changes in the competitive landscape with cigars resulted in continued solid volume development in the third quarter and against the third quarter of the prior year volumes were up by 22%.

Volumes were unusually low in the third quarter last year as a result of increasingly competitive market. While volume grew significantly the changes to our promotional and product mix have resulted in a lower selling price for cigars which is in the recent why sales and operating profit increased less than volumes in percentage terms in the quarter.

Chewing tobacco -- chewing tobacco shipments, excluding contract manufacturing volumes, were down by 4%. But sales and operating profit in local currency were slightly higher in local currency due to favorable pricing.

From October 1 of this year Swedish Match is no longer required to make payments in the US as part of a tobacco quota buyout arrangement between farmers and the government. This means that approximately \$2 million in fees for the quarter will not be incurred for these payments.

However, we do expect to begin paying fees to the FDA for cigar regulation sometime during the next year which will likely be on a similar order of magnitude. Result of this is that for the next quarter or few quarters we will have a benefit to our P&L mostly affecting other tobacco products in the range of \$2 million per quarter.

For Lights, operating profit was down 14% in local currencies versus prior year on 8% of sales. For matches year-on-year sales and operating profit growth came from improved pricing and a more favorable currency situation compensating for volume decline. Sales and volume growth for complementary products were particularly strong in the quarter.

Our complementary products (inaudible) in Brazil which consist of (inaudible) branded razors, high-efficiency light bulbs, batteries and toothpicks has been growing in importance in the Lights portfolio. And makes up close to 10% of sales from the Light product area in the quarter.

For lighters sales and operating profit declined on lower volume (inaudible) Asia and Russia. And in Asia the declines were partly due to a difficult comparison to the prior year. The Russia market has been affected both by the new more stringent tobacco legislation and the development of the Russian economy.

The Swedish Match share (inaudible) profit in STG in the third quarter amounted to SEK150 million, up 30%, benefiting from higher earnings from all product areas, except machine made cigars as well as positive tax and currency. STG sales were up 4% and were 3% higher in local currency from third quarter.

The reported EBITDA amounted to DKK364 million versus DKK335 million in the prior year. This improvement in EBITDA was due to a positive development in handmade cigars, tied tobacco and fine cut tobacco combined with lower operating expense. The underlying EBITDA was up by 9% adjusted for currency, onetime items and the Verellen acquisition. On a year-to-date basis underlying EBITDA increased by 3% compared to the prior year.

And now I will give some comments on tax, cash flow and financing and we will then reference the first nine months of the year. The net finance cost was lower during the first nine months of 2014 compared to the first nine months of 2013.

The reduction of SEK38 million is primarily due to lower average debt level during the period and the tax rate, excluding one-time items (inaudible) companies and joint ventures, were 22% which is the same as in the first nine months of 2013. For the full year we estimate that this tax rate will remain (inaudible).

In 2013 the reported tax rate was 18.8% and was positively affected by the nontaxable capital gains from the sale of a parcel of land. The reported tax rate for the first nine months of 2014 is consequently higher and amounted to 20.1%. The cash flow from operating activities increased to SEK2.5 million from prior year SEK2.1 million. This increase is mainly coming from lower tax payments and timing and working capital.



During the period investments in property, plant and equipment have been lower than in the same period in 2013. Still the cash outflow from investing activities is higher due to the proceeds received in 2013 from the sale of the parcel of land.

In total the cash generated from operating activities, net of cash flow from investments, amounted to SEK2.3 billion. Of this SEK1.8 billion have been distributed to shareholders as dividend and via share buybacks. At the end of the period as of September 30, 2014 Swedish Match had SEK9.8 billion of interest-bearing debt excluding retirement benefit obligations compared to SEK10.5 billion at December 31, 2013.

The average maturing duration of the bond portfolio was 3.5 years and the weighted average interest rate was 4.7%. Approximately 94% of the debt has [fixed interest]. The net debt in relation to EBITDA -- EBITA, sorry, excluding share of profit in STG, was [2.3] for the 12 month period ending September 30, 2014. In the fourth quarter of this year at SEK230 million of loans were due for repayment. And I will now turn the conference back to Lars.

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

And I will turn to the operator who please can go ahead and open up the floor to questions and answers.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). Erik Bloomquist, Berenberg.

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**Erik Bloomquist** - *Berenberg Bank - Analyst*

Lars, I was hoping you could comment on what you see as the likely evolution of the Scandinavian snus market over the next few years, taking into account the Swedish tax increase. And then more broadly related to your comments on snus, what you see as the opportunity globally in key markets where you see the most near-term upside.

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

Good afternoon, Erik. I mean when it comes to the very short term we have the tax increase coming most probably January 1. There is still a little bit of uncertainty on the political situation in Sweden. But we count on the 12% coming into effect January 1. But of course we don't know what the competition will do and we don't comment on our own pricing.

Generally speaking if we go back to look historically on the year we had steep tax increases and sooner or later they should come -- we pass those to the consumer. Then what we have seen is a slowdown in the migration from cigarettes to snus, but after some time the snus market has rebounded and started to grow much faster again.

If we look at the category growth (inaudible), we have throughout this year and the last year very solid the category growth in the Scandinavian market. It was ever so slightly lower as far as we can estimate that in the third quarter, based on year-on-year growth, has compared to the first six months.

But quite frankly I think it is a bit early to say that that is a change to the trend. And the demographics continue to be favorable, especially in Norway but also in Sweden. So we think that's very good reasons why over a longer period of time the snus market in Scandinavia should continue to grow.



**Erik Bloomquist** - *Berenberg Bank - Analyst*

Okay. And then --.

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

Sorry, on your international --.

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**Erik Bloomquist** - *Berenberg Bank - Analyst*

Yes.

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

-- On that one. I want to say first of all we are then in the US of course where we put most of our investments, and then through SM/PMI our markets are still Canada, Israel and Russia. And within those markets I'd say there is a slight growing trend in Canada this year, albeit it a little bit slower.

And there have been some rather steep tax increases, but when we look at the market share within the smokeless category we continue to trend upwards. But it is rather slow growth, but over the long term I think that Canada has a potential.

The Russian market have been a bit more volatile and especially initially difficult quite frankly. But we are pleased with the extension of our offering there where we have introduced the Chesterfield brand. We are in not so many more stores, more specific niche stores, but in more geographies. And we see some positive trends during this year although from a low level.

And Israel we see some growth. As far as potential new markets, we comment on those after the fact, so to say.

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**Erik Bloomquist** - *Berenberg Bank - Analyst*

Okay. And then with respect to the US, I was just wondering if you could update us on the alignment or synergy between the sales force selling your OTP products and snus. And are you in the same points of sale and you just have to go to more of the points of sale you are already in with cigar with the snus product?

And then related to that, are sales incentivized the same way to sell the snus product? In other words, are they just as happy selling snus as they are cigars, particularly given your emphasis on a world without cigarettes or by extension without combustion?

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

When it comes to the retail landscape for snus we have one set of stores that are very successful in snus and very important, we believe, also for the brand building and the category awareness. And that is more premium and specialist outlets where we continue to enjoy very strong volumes and terms. And they are specific, so to say.

Apart from that, as you know, most of the tobacco is sold in the convenience channel in the US market and there we have a very big overlap between our categories, snus, moist snuff, chewing tobacco and cigars. And then there are some regional differences, so cigars are a little bit stronger northeast than chewing tobacco, for example. And snus is actually relatively strong up north as well.

So some regional differences, but generally there are largely overlaps and good synergies. And then typically the sales force, they have different type of measures and we try to optimize and run our entire business as professionally and successfully as possible. And that can also be for a longer



period of time or for a year so to say. But it can also be on a shorter note if there are specific actions that we want to incentivize and that depends on the priorities within the various categories.

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**Erik Bloomquist** - *Berenberg Bank - Analyst*

Okay, thank you.

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**Operator**

Owen Bennett, Nomura.

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

A couple of questions please. Firstly, obviously spend on international snus picked up in the quarter and earlier in the year I believe you got it to full year spend similar to prior year. I was just wondering what has driven the pickup and what is it being spent on.

And secondly, could you give some updated guidance to the likely incremental investment for the full year based on this? I know you said operating loss should be somewhat higher, but I was hoping you could be a bit more specific.

And secondly, what sort of cans per store per week in US snus are you seeing now and how does this compare to a year ago? And finally, I was hoping you could be more specific in terms of when you would expect a decision regarding your modified risk application. Thank you.

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

Okay. Hello, this is Lars here. When it comes to the spending on our expansions outside Scandinavia, you are right that we've been talking about a similar magnitude and now we are pretty clear that it is going to be above. But it is not dramatically above. And already at the beginning of the year we said that the magnitude is a rather broad range.

And the pickup is really that we adjust our activity plans on a more detailed level as we learn and see what works and so forth. And with the increased focus on brand building and the consumer engagement activities we have seen some opportunities that we've decided to invest slightly more than you can say what was in the original desktop draft.

And then there is also a factor naturally from the strengthening of the dollar in the second half year versus the Swedish [kroner] that comes into effect. And also -- in our joint venture we have also based on good suggestions from the organization decided to approve some additional activities. But just to be clear, the main increase is really coming from our efforts in the US market.

When it comes to the progression on consumption and store rotation, the important thing here is that we see our shares growing in the market, we have added relatively few stores, we are talking a couple of hundred, I think Emmett has the exact number between Q3 and Q2. And we don't go into the detail.

I know that we have provided those numbers sometimes in the past, but we have found it difficult to use them to explain the broad picture, so we don't comment on the cans per store per week and it can vary quite dramatically also between the types of outlets if you, for example, compare these tobacco (inaudible) that I was previously talking about and the trends we can see in convenience stores.

But generally the trends are pointing in the right direction, as you would expect, with a few additional amount of stores and growing market share. When it comes to the spending for Q4, we forecast that they will be above the prior level -- prior year level also.





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

Okay. And then just more specific timing for the modified risk application?

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

On that one, it is very hard to say. So first of all, let me just reiterate that we are very pleased with the fact that our application has been assessed as complete by the FDA. There is an enormous amount of work and data that has gone into this process also after we filed the application until the completion date, so to say.

FDA have themselves said that they intend to review this application in 360 days. That is not a legal requirement, but we understand it as their ambition. And that is -- that should be thought of then as past the date of when they consider the application complete.

However, what we do think is not unlikely is that they would, in their review and their answers so to say to the application, that they could very well ask for some additional date at the time or during the meantime as well. Which means that quite frankly we don't count on a, so to say, final approval or disapproval of the application 360 days after the effective or the August date when the applications were deemed complete.

But it could potentially happen, but I think the likely scenario is that there will be an extended review process for some time after that and quite frankly it is very difficult to assess that one.

But I must say that we are encouraged with the professionalism at the FDA. We are encouraged by how the scientific community also reaches out to us. And we do encourage scientific community and other stakeholders to comment on our applications.

And I think it is fair to say -- I think the FDA is catching up on the substantial equivalence filings, but they have a very high burden there. But it's important to understand that this application is a separate process and here we feel that it's dealt with from day one when we first filed. So that is very positive I must say.

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

Okay. Thanks very much.

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**Operator**

Andreas Lundberg, ABG.

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

To a different subject -- given the low interest rates you are seeing now what kind of potential do you see to refinance part of your debt going forward? Also if you could give some flavor on how we look at the tax rate in general after 2014 and 2015? Thank you.

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**Marlene Forsell** - *Swedish Match AB - SVP & CFO*

Yes, it is Marlene talking. If we start with the tax rate, I mean normally we don't give any guidance on the tax rate before we're kind of entering the year. And that is what we are planning doing this year as well. So when we're getting into next year with our Q4 release we are going to commenting on next year tax rate. After this year, as we stated was in the report, we're expecting that 22% level.

I agree with you that interest rates are low and of course we do have maturities coming in next year of around SEK2 billion. And we are I mean -- but (inaudible) based. I mean, you know that we have our financial policy which is guiding us. And we kind of [balance that]. We have our financing decisions. But of course we're looking into opportunities as we see them coming. But I don't give any guidance right around kind of refinancing of that debt.

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

Okay, thank you. And then lastly on US snuff. Have been a while there with falling volumes. Do you now see a trend shift and that you were pouch products or getting traction in numbers as well? Thank you.

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

I would say that if you look at our volume development for the first six of the month -- six months of the year, it is reported they were probably a little bit too negative. And when it comes to the third quarter they are a little bit too positive so to say and relative to the true consumption and then partly related to some timing of promotions and so forth.

But it is definitely the case that the pouches and the tubs on a can equivalent basis then are becoming a larger and larger part of our portfolio. And we think that we have better chances to grow the moist snuff business within those segments. But I think it is too early to talk about trend shift.

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

Okay, thank you.

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**Operator**

Stefan Nelson, SEB.

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**Stefan Nelson** - *SEB Enskilda Equities - Analyst*

Just a few questions. First a follow up on the modified risk. Could you just give us an idea what -- if you get this approved, will this change your strategy and what kind of doors does it open up? Just your view how this changes things for you.

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

Yes, I think the bottom line answer is that it is too early to tell exactly what it will mean. But just to be clear what we have applied for is that we should be allowed to use a different warning label that explains why the tobacco product is addictive.

It is significantly less hazardous than cigarettes, which is quite different from the mandatory rotating warning labels on the smokeless products today. And that we, particularly for snus, I think is not reflective of the scientific evidence. And that's what this application them treats.

I could very well envision that if approved that we continue dialogue with FDA and that, based on providing data on the potential effects and so forth, have a discussion with them on how we are allowed to convey that message. But I think just the fact that the warning labels are changed would be a very important milestone.



And if we look at the Scandinavian experience, I think it's fair to conclude that the relative risk between snus and cigarettes has been a very important driver for the very strong category growth. And migration from cigarettes to snus that we have seen over the past 40 years in Sweden and particularly over the past 10 to 12 years on the Norwegian market. So it is definitely a positive.

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**Stefan Nelson** - *SEB Enskilda Equities - Analyst*

Great. Then a completely different thing, over to Norway. You're talking about launching lots of new products. Just to understand how -- in that environment with legislation, how do you promote them so those new products get widespread among the consumers?

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

We don't promote them as such, we put products on the market and, just to be clear also, we are not overloading the Norwegian market with new products. We have made some -- there are some new products, like for example the G3, but we are also changing, upgrading I will call it, some existing products both on the product as such but also in terms of design and so forth.

But it is a good question, but as a general rule of thumb, if you go back a couple of years, I think it is fair to say that it's been significantly easier to get traction with new products on the Norwegian market than if we took the premium segment and then the Swedish market despite the Norwegian market then having been a so-called black market for a period of time.

So somehow -- somehow consumers find out and they speak to each other about their experience with different type of product. So it is not impossible to launch a new product on the Norwegian market.

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**Stefan Nelson** - *SEB Enskilda Equities - Analyst*

Great. And then just finally on STG, which shows some good improvements. How much of the EBITDA is driven by kind of underlying sales performance and how much is the synergies that are kicking in on efficiencies on the EBITDA?

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

The sales were up in local currencies -- Emmett is looking here --.

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**Stefan Nelson** - *SEB Enskilda Equities - Analyst*

I just have -- I remember that cost synergies that were going to kick in also in the second half of this year if I am not mistaken.

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

If you look at the sales, they are up 3% and the underlying EBITDA is up 9% and the difference there is, generally speaking, cost improvements and then doing things smarter. But they are not so much synergies I would say from the original merger that is now coming, it is a little bit on the supply chain. But there is -- STG has done a good job this year in optimizing their activities and costs across the various markets.

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**Stefan Nelson** - *SEB Enskilda Equities - Analyst*

Okay, great. Thanks so much.



**Operator**

James Bushnell, Exane.

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**James Bushnell** - *Exane BNP Paribas - Analyst*

I have two questions please. The first is on how you are thinking about the Swedish markets. Clearly there is a trade-off between prioritizing share versus prioritizing profits. And certainly in recent times share has obviously been a big focus. I just wonder if you could you sort of remind us how you tend to think about that philosophically, if you like.

And then my second question was around snus in Russia. So you now mention you are rolling out the Chesterfield brand. I just wonder if you could describe in a bit more detail how that links or otherwise with the Parliament product which is on the market already. Thanks.

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

If we start in Russia, we see them as complementary. Chesterfield is, if you are familiar with the PMI cigarette business in Russia, Chesterfield is more of a mass market and Parliament is more of a premium brand. And that is also how the two variants on the snus are positioned. And it was an intentional strategy to go first with Parliament as sort of a category opener and now the positioning of Chesterfield is more mass and it is at a lower price than Parliament.

When it comes to the Swedish market, I'd like to first of all say that in the longer-term I think there is very strong correlation between share and profitability. It is important for us to not have the type of share declines that we have had for the past couple of years, year on year if you want to grow our profitability over time. So I don't really see a contradiction in the two objectives.

But I'd say we do think that it is important to have a much more stable environment than what we have had the last couple of years. And that is why we continue to believe that for us with our strong premium position to achieve that that we need to invest in the value segment and grow our share of that.

Having said that, it is important to note that there are a lot of means that we use to try to achieve that and I think we have done a good job that spans beyond pricing. We have, as you know, introduced new SKUs, we have worked a lot on visibility and filling some distribution gaps for the more fringe varieties and.

We work very consciously on product quality in all price segments to make sure that we really have the best not only in the premium segment but also in the value price segment that we really give the consumers the best experience. So bottom line I guess the short answer to your question is that it continues to be important for us to stabilize our share.

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**James Bushnell** - *Exane BNP Paribas - Analyst*

Okay, great. Thank you very much.

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**Operator**

Stellan Hellstrom, Nordea.

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

Unfortunately my call was disconnected, so I hope I am not repeating questions here. But first I wanted to ask on the US mass-market cigars here where you still had quite negative price mix effect in the third quarter.

It would seem that you now have analyzed much of the negative effects on the promotional price mix here in this quarter. Would you agree with this? And will you recent launches and growth in natural leaf help the price mix going forward?

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

You are correct in pointing out that between the third and the fourth quarter the prior year there was a price mix component as we so to say started to respond to that new environment. Then the market has remained very competitive and there could well be continued some negative pricing in that category.

But having said that, if everything would stay the same, just roll things forward, it would be less pronounced than you see now in the third quarter. But I must say we are very pleased with how we have succeeded in responding to this new environment that is demonstrated by our solid volume performance also if you extend it for a little bit longer period of time this year.

And if you look at the profitability in the OTP segment you see that we are not doing this at very low profitability -- still a very healthy business model. And then having said that, it is a category that historically has proven to be rather volatile and sometimes even unpredictable more so than what characterizes most other tobacco categories.

So it is very difficult to tell you how next quarter and especially the quarters beyond that are going to look in the cigar business. But I'm very pleased with what we have accomplished this year.

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

Thanks. Then also a question on Scandi volumes here. You had a slightly downward volume trend in -- or volumes in Sweden and travel retail. And it seems by Nielsen numbers that you should have had some growth. So it suggests sort of normal volatility in the travel region segment or is there something else happening there that is slightly different?

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

Yes, that is a good question because there is one element in the travel retail. And as you know, the travel retail volumes are basically consumed in Finland and Sweden and Norway, the majority of it. And then of course as more people internationally learn about snus that increases. But the bulk of the volume are Finnish, Swedish and Norwegian.

And then we've had this distortive effect between the Swedish market and the Baltic Sea related to the tax-free labeling and we saw a recovery in the second quarter in tax-free with growth attributable to the anniversary effect of the tax-free labeling.

And we saw a slight decline there in the third quarter, but then we also incurred some declines on tax-free specifically Norway outlets. And that we actually attribute to a new law in Norway where -- from July 1. And if you purchase tax-free for example at the Norwegian Oslo airport you are allowed to bring into the country more alcohol if you don't buy tobacco.

And it is relatively clear that that has had some impact during the quarter. And then whether that is a timing effect that will be translated into support domestic growth I think remains to be seen. But that is an element of the decline in travel retail in the third quarter.

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

Okay, very good. Do you have any estimate on potential hoarding with the tax increase?

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

No. I don't at this stage.

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

Okay, thanks.

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**Operator**

(Operator Instructions). Chas Manso, Societe Generale.

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**Chas Manso** - *Societe Generale - Analyst*

Again apologies if these have been asked. Okay, two questions. One on US snus. You are putting in a lot of investments for a category that remains quite small at sort of 40 million to 50 million cans for the entire category per year.

The question is are you happy to continue to invest into this category if it stays at more or less this kind of size level? Or perhaps better put, what size does the US snus market have to get to until it is really a viable category to invest behind on a permanent basis? That would be question number one.

And question number two is sort of a margin question. Just looking at the difference between your gross margin and your operating margin. I mean last year your gross margins were going down sort of 300 to 400 basis points, which I guess was the mix effect in Scandinavia, but I'd be interested to hear if it's something else. And your operating margin was going down less. So you are making savings at the OpEx as a difference.

This time round, this year your gross margins are much stronger. I mean Q3, the one -- today's gross margin is (technical difficulty) same as it was last year. And yet now the operating margin is the one that is kind of slipping. So could you just perhaps explain, give more color why there has been this flip around from the gross margin pressure to more the kind of operating margin pressure?

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

Which pages in the report are you referring to? Because we typically look more within the product areas when we analyze the business.

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**Chas Manso** - *Societe Generale - Analyst*

Oh, no, this is as a group -- as a group.

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

Okay. I'll take the first question while Emmett (inaudible), try to understand exactly where the question is coming from on the margin there.

When it comes to the US category for snus, let's first of all remember that we are basically talking not in Norway, but of course spread out on a much wider population. So we think that the category has quite a bit of potential to grow from here and that it will, quite frankly.

And while the category growth has been a bit disappointing I would also recommend people to look a little bit deeper in the category. And since there are some brands that have scaled back quite significantly on their [presses], not only in terms of marketing support and so forth, but even as a consequence of -- or well, I don't know exactly why but distribution is scaled back.

If you look at the two biggest brands in the category you see quite a bit healthier trends. That over time is indicating that things are pointing in the right direction. But if the category -- if your question is if the category stays at this level, is it worth investing in, certainly not at this level then of course.

Although we think that we can still grow within the category, the investment that we incur is because we think we can both grow as a share of the category and also that the category will grow.

If the category would not grow I think it's important to understand that we have a critical mass volume now and we have -- if you take our let's say 5,000 best performing stores, I would say that that is a healthy profitable business there that could be maintained at -- with much less support and be a viable business. But of course then with a lot less potential.

So the fact that we continue to invest the way we do is because we do think that the potential is ahead of us.

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**Chas Manso** - *Societe Generale - Analyst*

(Inaudible) Okay.

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

On the margin side --.

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**Marlene Forsell** - *Swedish Match AB - SVP & CFO*

Yes, on the margin side here, I mean since Lars was saying -- I mean we look more at the product groups and such and I was trying now to look in the income statement (inaudible) the interim report. Are you looking at the year-to-date numbers or are you looking at the (multiple speakers)?

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**Chas Manso** - *Societe Generale - Analyst*

No, the quarterly numbers year on year.

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

Why don't we get back to you directly with an answer on that one?

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**Marlene Forsell** - *Swedish Match AB - SVP & CFO*

Yes, I didn't see that much change, but okay. We will get back to you.

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**Chas Manso** - *Societe Generale - Analyst*

Great.

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**Operator**

(Operator Instructions). There are no further questions at this time. Please continue.

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

Okay. Thank you, everyone, for listening today and the release of our full-year report will be on February 18. Thank you.

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**Operator**

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

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