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PRESENTATION

Operator

Thank you for standing by, and welcome to the Swedish Match half-year report January to June 2016 conference call. (Operator Instructions). I must advise you this conference is being recorded today, Friday July 22, 2016.

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

Emmett Harrison - *Swedish Match AB - SVP, IR and Corporate Sustainability*

Thank you. This is Emmett Harrison. This is the Swedish Match second-quarter 2016 telephone conference, and with me today are Lars Dahlgren, our President and CEO, and Marlene Forsell, our CFO. After providing a prepared commentary, we will be taking questions. For further information on the second quarter's performance, visit the Swedishmatch.com website.

During today's call, there may be certain comments that constitute forward-looking statements and are subject to risks and uncertainties. Management believes that these expectations -- these statements are based on reasonable assumptions, but can give no assurance that expectations will be achieved. Risk factors are outlined in the latest interim report and annual report, which are available on our website. Swedish Match assumes no obligation to update information concerning its expectations.

A recording of this call will be made available on the Swedish Match website. And with that, I will turn the conference call over to Lars.

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

Thank you, Emmett, and good afternoon, everybody. In many respects, the second quarter was similar to the first in terms of growth drivers and strong financial performance. The second quarter was active with launches and continuing expansions on the main innovative products across our portfolio. And I'm very pleased with what Swedish Match has been able to achieve in the first half of 2016.

Our underlying snus volumes in Scandinavia were once again strong. Growth in actual shipments was even higher than that of underlying volumes, being impacted by favorable calendar effects.



Despite negative mix and currency effects, revenues in Scandinavia grow in line with volumes, driven by increased deliveries to Norway, modest price increases early in the year and a more stable premium segment in Sweden.

The Scandinavian market continued to experience solid volume growth in the first half of the year, with a modest slowdown in growth during the second quarter, attributable in part to a stronger comparable period as the successful introduction of XRANGE in April last year helped accelerate category growth in Sweden.

In the US, General Snus continued its growth trend. Distribution in terms of number of stores has remained stable, so the volume growth is fully attributable to increased velocity.

On the topic of snus outside Scandinavia, on July 1, Swedish Match filed a legal challenge in the UK concerning the EU ban on sale and distribution of snus. With the new tobacco products directive, we are of the opinion that there are significantly stronger arguments to question the legality of the ban. While we expect the legal process to take time and the outcome cannot be certain, we consider several countries in Europe as attractive potential long-term opportunities for snus.

On the innovation and new productivity front, there are several exciting ongoing initiatives. In Norway, our General G3 range of products has continued to experience share growth. Still not enough to offset declines in other parts of our portfolio, but clearly helping to address our overall share decline in that market.

Our new G3 Super Slim product appears to be off to a good start, with a very positive reception of this new format of a longer, even slimmer pouch.

Last quarter, we mentioned that we had acquired the patent for a new type of product. ZYN, one of our brands which uses this exciting new technology, is an all-white nicotine pouch that contains no tobacco. During the quarter, we expanded the distribution of ZYN in the US and it's now available in more than 2,000 stores.

In Sweden, we now offer a new brand, Omni, in a limited store base. Omni, which is the new form of snus worldwide, completely dry but with excellent flavorings.

New product activity within our other tobacco products segment included chew bags in Switzerland and Night Owl cigars in the US. Chew bags are discrete pouches of chewing tobacco that we market under General brand. We have expanded distribution of the product during the quarter and are now in some 500 stores. While the product has been in the market for a limited time, consumer takeaway has been encouraging.

As for Night Owl, a tipped pipe tobacco cigar, we believe that we offer an excellent value alternative versus the competitor's largest brand in that segment.

In cigars, we had another very strong quarter and our shipments reached a new all-time high in Q2. Our natural Garcia y Vega and Game cigars continued to demonstrate strong growth momentum, and our value-priced Jackpot brand has also shown good growth in this highly price-sensitive segment of the category.

Our lights business also showed improvement versus the second quarter prior year and the first quarter of 2016.

Sales and operating profit grew when compared to the first quarter 2016. And compared to the second quarter of the prior year, operating profit grew, while sales were flat.

With that, I'll hand over to Marlene.

Marlene Forsell - Swedish Match AB - CFO

Thank you, Lars. Sales grew by 8% on a reported basis and by 10% in local currencies. The strong sales performance was driven by growth across all product areas.

Operating profit also grew for all profit areas, except for other operations. As reported, operating profit from product areas was up by 8% to SEK1.008 billion, which is a record quarter for Swedish Match. Operating profit from product areas in local currencies grew by 11%.

In Scandinavia, the favorable calendar effect from the timing of Easter and differences in the number of delivery days positively impacted both sales and operating profit growth for the snus and moist product area, as well as for other operations. We estimate the positive effect on Group sales growth to be almost 2 percentage points.

Our reported share of net profit in STG was down due to both our ownership interest being lower and the seasonal mismatch of quarters resulting from the introduction of one quarter lag reporting. These factors negatively affected the growth of Swedish Match operating profit, which was up by 4%, and also the growth of net profit for the period.

Our earnings per share amounts to SEK4.01, up by 11%.

The currency translation effects were negative, stemming from the Norwegian Krona, the US dollar and the Brazilian real. Given the currency fluctuations in the second half of last year, as well as the recent strengthening of the US dollar and the Brazilian real, we expect, at the current exchange rate, that the currency translation effect will be slightly positive in the second half of 2016.

For commentary comments, I will generally refer to sales and operating profit development in the local currency. Comments on market shares or segment shares will generally refer to shares measured based on product volumes if not specifically commented.

For the commentary on snus and moist snuff, reported sales were up by 5%, and by 7% in local currencies. The negative currency effects were primarily due to the continued weakness of the Norwegian krona and the improvements in sales and operating profit can be attributable to strong volume performance in all markets, lower operating loss from our investments in snus outside Scandinavia and, across the board, improved net pricing in local currencies.

In Scandinavia, sales and operating profit grew also on an underlying basis when adjusting for the positive calendar effects on shipment volumes. Operating profit grew slightly less than sales owing to higher market-related costs and the weak Norwegian krona. With a less negative mix effect and some price increases in the beginning of the year, the net price mix effects were positive in the quarter.

We are encouraged to see that the premium segment in Sweden continues to be relatively stable. According to Nielson, the premium segment represented 53.8% of the Swedish market, down only 0.6 percentage points from the prior-year period and slightly up from the first quarter 2016.

Swedish Match's market share in the premium segment also remained relatively stable as we lost slightly more than a share point versus the prior-year period in the value statement. Our overall market share declined by 1 share point in volume terms. The decline was similar for the market share as measured in value terms. And sales of Swedish Match products represented 75% of the Swedish market based on value during the second quarter, according to Nielsen.

In Norway, our market share during the quarter was 53.6%, down 3.3 percentage points from the prior-year period. Within pouches, our share declined by 2.5 percentage points and amounted to 48.9% for the quarter. General G3 has continued to take market share and ended the quarter at close to 10% of the pouch segment.

It is now clear that the Norwegian government intends to implement standardized packaging also for snus despite opposition from several stakeholders. A legislative proposal was published in June and the ministry has communicated that they have political support in the parliament. We expect the final bill to be enacted during the quarter.

Regarding the implementation of the new packaging, we find it likely that a transitional period will apply, and there are comments in the proposal mentioning 12 months.

In the US, volumes has grown, both for Snus and moist snuff. For moist snuff, the timing of promotions contributed to the volume increase, while snus continued its growth trend.

During the quarter, we have taken list price increases for both US snus and moist snuff. Our net realized selling price was higher than prior period for both these categories despite the higher level of promotion and some negative mix effects from continued growth of pouches (inaudible) moist snuff.

Our total operating loss for snus outside Scandinavia amounted to SEK55 million, compared to SEK70 million in the prior-year period.

As we noted in the first quarter release, the investment load looks relatively low at the beginning of the year, due partly to timing of marketing activity. The level was higher in the second quarter as investments also included the support of the expansion of ZYN in the US. For the second half, we expect operating loss for snus and ZYN to remain well below prior-year levels despite an expected high level of activity.

Turning to other tobacco products, the strong sales growth of 8% in local currency was driven by the 15% volume increase of cigars in the quarter. Sales for cigars grew slightly less than volume due to slightly lower average selling price per unit, in part due to Jackpot, which carries a lower selling price than other products in the portfolio, and also due to a higher percentage of products sold at a two for [0.99] price point.

For chewing tobacco, the second quarter represented a relatively soft volume performance, with Swedish Match brand volume down 8%. Sales declined as price increases could not fully compensate for the volume decline. For the third quarter, we expect a more favorable volume development compared to the first-half performance due to the promotional phasing.

On May 5, the US Food and Drug Administration, FDA, published its deeming regulations for cigars, which will be enforced from August 8, 2016. Volume-based user fees become effective October 1, 2016, and we expect these to amount to approximately \$2 million in the fourth quarter. In addition to the user fees, we expect, over time, to incur some additional administrative costs to manage the regulatory requirements.

For other tobacco products, the fourth quarter is normally a bit softer than the third quarter. This year, we're expecting the effect to be more pronounced than prior year due to promotional phasing, the commencement of user fees on cigars and some production downtime.

The longer-term category dynamics as from FDA regulations on cigars are hard to predict. With a requirement on new product applications, introducing future product innovation to market will become more challenging, which could adversely affect the category growth. The requirements for substantial equivalence and new product applications apply though to the entire industry. And Swedish Match, as a significant player, has extensive experience from dealing with similar FDA requirements in the chewing, moist snuff and snus categories.

For products on the market prior to August 8, the deadline to apply for]substantial equivalence or on new product applications are 18 and 24 months respectively, after which the FDA has another 12 months to respond. It should be noted that the FDA still has a large backlog of substantial equivalence applications for other already-regulated categories and it may take time until we have greater clarity of the process for these applications.

Regarding flavors, the published regulations do not contain a ban on characterizing flavors in cigars, although the FDA has communicated intentions to impose such regulation at some point in the future. However, we do not expect more clarity on any potential flavor regulation in the near future. Currently, about half of Swedish Match's cigar portfolio is flavored, but compared to several other competitors we have a wider range of non-flavored products on the markets.

For lights, performance for both matches and lighters showed a marked improvement in the second quarter, with growth for lighters and a much more modest decline for matches. We have had challenging conditions in some important lights markets, like Eastern Europe and Brazil, for some time. And we are very pleased to note that in these markets we are showing clear improvement.



Now I will provide some commentary on cash flow and financing. The net finance cost of SEK90 million for the second quarter was down SEK25 million, from SEK115 million in the second quarter of 2015. This lower net finance cost was primarily driven by the lower average debt and lower average interest rate.

We efficiently managed capital (inaudible) over the last year, aimed at reducing the level of cash and cash equivalents while keeping the same level of leverage. This also means that the average level of interest-bearing debt has been lowered.

During 2015 and the beginning of 2016 we have refinanced maturing debt at lower interest rates. The weighted average interest rate in the second quarter was 4.06%, compared to 4.33% in the prior-year period. Approximately 93% of the debt has fixed interest.

As of June 30, Swedish Match had SEK8.2 billion of interest-bearing debt, excluding retirement benefit obligations. At our webpage, Swedishmatch.com, we provide details on the maturity profile of our debt portfolio.

During the remainder of the year, SEK310 million was due for repayment in December. And it should also be noted that we have a larger maturity falling due in November 2017, which then amounts to approximately SEK3 billion. We are looking at a strategy to finance this maturity and it cannot be precluded that refinancing this maturity will result in some temporarily increased finance cost.

As of June 30, 2016, Swedish Match has SEK1.5 billion in the unutilized committed credit line.

Turning to the cash flow, and the cash flow from operating activities for the first six months amounted to SEK1.872 billion, up from SEK1.741 billion in the corresponding prior period. The cash flow from operating activities include a dividend of SEK191 million from STG, which is lower than the SEK261 million received from STG during the first half of 2015 due to Swedish Match having reduced its ownership in STG.

As expected, our investments in property, plant and equipment continue to be above prior-year levels. Last year, we had a larger investment in the distribution center in Sweden, and during 2016 we expect a higher level of investment for our cigar business and also for our Scandinavian snus business.

For the full year, as commented in the first-quarter release, investment in property, plant and equipment are expected to be in line with prior year of about SEK500 million. This does not include investment in intangible assets.

The partial sale of STG in conjunction with the IPO gave an inflow of cash of SEK2.172 billion, all of which was paid shortly thereafter to Swedish Match shareholders in the form of a special dividend. In conjunction and in addition to this special dividend, Swedish Match also paid an ordinary dividend. In total, the dividend distributed amounted to SEK3.764 billion and was paid during the quarter.

During the first six months, Swedish Match also repurchased 1.6 million shares for SEK449 million.

And lastly, the net debt to EBITDA on June 30 was 2.3, which is roughly in line with our preferred level.

And I will now turn the conference call back to Lars.

Lars Dahlgren - Swedish Match AB - President and CEO

And I will turn it to the operator and ask you to please open the floor to questions and answers.



QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions). And we have a few questions coming in. Your first question comes from the line of Stellan Hellstrom. Please ask your question.

Stellan Hellstrom - Nordea - Analyst

Yes. Hi. I have a question, first on the Swedish recent volume development within some slowdown in volumes in snus. And I was wondering, I know you're annualizing the XRANGE launch here, but there's also been some slowdown in value. And I was wondering if -- what your thoughts are about this.

And also, you have been losing a little of share in value. Is it important for you to maintain that share? I guess so. And would that possibly affect how you're thinking about price increases in value? Thanks.

Lars Dahlgren - Swedish Match AB - President and CEO

Hi, Stellan. This is Lars here. If you look at the Nielsen data, first of all, we have seen -- basically we saw an uptick during the spring last year of year-on-year growth. So it was a little bit softer in the first quarter and then it accelerated, according to Nielsen, between 4.5% and 6%, depending on which month you looked at. But we noted in the -- from the main measurement, is that it's been in the 2% to 3% level. And the latest Nielsen measure ending July 10, it was 3%.

We definitely think that the introduction of XRANGE helped to accelerate overall category growth, so that is an important factor. You're right to point out that there has been a slowdown in the value segment as well, but again, this is -- things work together here. So because XRANGE has also helped to stabilize the overall premium segment, XRANGE plays a role there as well.

And then of course it's impossible to exactly isolate the factors from month to month on category growth like that and we cannot rule out that slight price increases that there have been in the value segment as well. And if you take ours and also from one of our competitors from later during the year, has contributed to a slight slowdown of the value segment volumes.

But again, as we point out in the report, we still believe that second-half volumes will continue to show growth in the overall market in Scandinavia. And Norway has remained at a very strong level also through Q2.

In terms of our market share within the value segment, the most important thing for Swedish Match is to have overall stable shares. And we have been clear before when we faced -- particularly the trends for faster growing value segment, that we saw that it was necessary for Swedish Match to grow our share within the value segment in order to stabilize the overall share.

Now when we have a more modest development of the value segment, it's not as important, per se, to grow the share within value segment. But naturally, we need to have a close look at that and make sure that we manage the overall share development.

And in terms of our pricing going forward, we don't communicate anything on that matter before we have taken any decisions and communicated to the trade.

Stellan Hellstrom - Nordea - Analyst

Okay. Very good. That's very helpful. Thank you.

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

Thank you.

Operator

Thank you. Thank you. And we have our next question coming from the line of Niklas Ekman. Please ask your question.

Niklas Ekman - *Carnegie - Analyst*

Thank you. Yes. A couple of questions if I may. Firstly, if you could just specify this calendar timing effect here. Is it purely Easter or is there anything that will spill over into Q3?

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

It is -- depends a little bit on how you look at it, to be quite frank. It is a little bit complex with the Easter and -- but the timing of Easter impacted a number of delivery dates. So if you want to make it simple, you have two more delivery days in Scandinavia in the Q2 this year compared to the prior year. But you have some pretty large volatility around the Easter weekend, so it plays into it.

When we look at Q3, we had the same number of delivery days in Scandinavia, but we actually have a slightly worse mix of days because it actually does matter which weekdays you have in the quarter. But we're talking about very marginal impact here.

Niklas Ekman - *Carnegie - Analyst*

Okay. Thank you. And I may not have heard perfectly well here, but when you talk about cigars, here you had very strong volume development. But it seems that the OTP business area had, in light of that strong volume development, quite poor margin development. So is there any particular reason here for the poor earnings leverage? I think you talked about more discounting and if you could elaborate on this.

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

We don't consider the profitability of the other tobacco price segment to be poor in the quarter.

Niklas Ekman - *Carnegie - Analyst*

No, I said poor leverage, poor leverage on strong sales.

Marlene Forsell - *Swedish Match AB - CFO*

But if I can give some comments, I think there are, of course, a number of factors affecting it (inaudible) fluctuate between the quarters but, as we'd mentioned, then we had some negatives and net price/mix effect in this quarter.

We've also had some -- a little bit of a higher expenditure is due to the introduction of the [ni gum] brand in the US. Then we also had some, even though not material then costs for the introduction of the chewing business in Switzerland.



Niklas Ekman - *Carnegie - Analyst*

Okay, excellent. Thank you.

Marlene Forsell - *Swedish Match AB - CFO*

Moving forward, what it is I know that you're well aware of, that now we know the exact timing of the FDA fees that comes in then in the fourth quarter and that, of course, has an impact on the OTP business and the margin.

Niklas Ekman - *Carnegie - Analyst*

Of course, thanks. And also I was curious in Norway, I saw a comment here earlier that you saw a market share reversal in July that you are -- you were gaining market share sequentially and I was wondering how significant this data is. Do you see this as a tangible turning point for your Norwegian business and also how much of this do you think can be related to this G3 super slim product?

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

If you take G3, it continues to have a very good trend and, clearly, super slim is, so to say, adding or contributing to that trend. But with that said one should be careful with isolated monthly measures, and I'd say especially also with the summer months, where you have some flows of vacation, travel and so far and Norwegians buying in Sweden and vice versa. So we don't consider one month to be a definite proof of a turning trend, but we are pleased with G3 on the Norwegian market.

Niklas Ekman - *Carnegie - Analyst*

Good, thank you. And finally from my end here at least, just wondering about US snus. You're talking about a sustained positive trend here. I'm curious, are you ready to quantify or at least roughly indicate the level of sales that you are generating in US snus at the moment?

And also if you comment a little bit on the magnitude of losses you're expecting in the second half, obviously, a sharp reduction of losses here in the first half. Can we expect the similar magnitude of reduced losses in the second half?

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

We don't go into specifics of stripping out how much of the volumes at our US snus and the sales, but it is showing nice growth both in the first and second quarter and both from volume and, on sales, then from pricing.

When you look at the operating loss for snus - and now also including ZYN - outside Scandinavia, the first quarter it was a very big difference compared to prior year, a little bit less pronounced in the second quarter. And for the second half we continue to forecast that the net loss will be lower than in the prior year, but the absolute level will be a little bit higher than the first half. This then reflects the timing in Q1 where it was, as you pointed out, unusually low.

Niklas Ekman - *Carnegie - Analyst*

Okay, excellent. Thank you very much.

Operator

Thank you. We have our next question coming from the line of Andreas Lundberg. Please ask your question.



Andreas Lundberg - *ABG Sundal Collier - Analyst*

Yes, thank you, Andreas Lundberg with ABG. Good afternoon. If I start with US cigars, you launched this pipe tobacco -- packed cigar, Night Owl, here in Q1, right? Can you update us on the status here; distribution build, any potential consumer feedback so far?

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

It's very early and distribution is limited at this point, so we don't have any clear reads.

Andreas Lundberg - *ABG Sundal Collier - Analyst*

But you're still in a few chains on the East Coast, or (multiple speakers)?

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

We are in one chain on the East Coast and then we're a little bit wider in two states.

Andreas Lundberg - *ABG Sundal Collier - Analyst*

Okay. And also on OTP as such, I think you talked about profit growth there year on year in the second half. How confident are you on that, given that -- I assume if comparisons are getting tougher that you will pay this FDA fee in the fourth quarter?

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

But as we write, we forecast that we will continue to grow profits in local currency during the second half and then we wanted to point out, as we did in the report there, that it's likely to skew quite heavily towards the third quarter.

Andreas Lundberg - *ABG Sundal Collier - Analyst*

But do you expect a higher growth in the second half versus the first on the earnings?

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

That remains to be seen, but we expect continued growth.

Andreas Lundberg - *ABG Sundal Collier - Analyst*

Okay. And also I think on -- if I go back to Scan snus here, at the AGM I think you, Lars, said that you're taking some costs of up to SEK10 million to prepare the production in Sweden for the new warning labels coming on. Was that something that affected your Q2 numbers?

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

Very little in Q2. We have a slight effect, but given the transition period until end of August we believe that we can minimize those costs to, basically, material. It should be SEK5 million or shy of SEK5 million, but there are some extra costs in conjunction with the switchover.



Andreas Lundberg - *ABG Sundal Collier - Analyst*

Okay, thanks. And lastly maybe one for Marlene here. I think you touched upon the debt maturing next year; you talked about some prepayments perhaps. Is it correct that you pay 4.3% on this debt and at what rate do you think you can refinance it? Thank you.

Marlene Forsell - *Swedish Match AB - CFO*

The one that matures in November 2017 actually has a higher interest rate. That one we're paying about 5% on. When it comes refinancing, it depends, of course, on the maturity or the duration of such financing and I would say that with this current market rate it's somewhere between -- depending then, between 1.8% to 2.2%.

Andreas Lundberg - *ABG Sundal Collier - Analyst*

Thank you so much.

Marlene Forsell - *Swedish Match AB - CFO*

Could go down to 1.7% maybe.

Andreas Lundberg - *ABG Sundal Collier - Analyst*

Thank you. That concludes my questions.

Operator

Thank you. We have our next question coming from the line of Adam Spielman. Please ask your question.

Adam Spielman - *Citigroup - Analyst*

Thank you very much. I have a question I hope you can answer about future buybacks. Obviously, you have a very clear strategy on target leverage. If I look at my model it suggests that to basically get to this sort of target you'll need to do significantly more buybacks in -- as far as I can see, in the second half of this year than you have done in the first half. And I was just wondering if you could comment on that if you're still aiming to end the year with about 2.3 times, 2.4 times net debt to EBITA. That would be one question and then I've got another question about cigars, but can we talk about that first?

Marlene Forsell - *Swedish Match AB - CFO*

Yes. Adam, it's Marlene here. When it comes to our finance strategy and the leverage targets and so on I think we are that clear, so I won't comment on the magnitude of share buybacks, because you have your models done. But when it comes then to where we aim for the end of year and so on, on average we aim at being at the 2.3 -- 2.2, 2.4, somewhere in that range. And whether or not that is going to be the exact leverage at year-end I don't comment upon, but over time definitely that's the intention.

Adam Spielman - Citigroup - Analyst

Okay, that's clear enough. And then in terms of the filings for cigars, I would imagine that you will intend to take your full 18 months to apply for substantial equivalents under the new FDA rule. So I suppose that's one question, is that correct?

Secondly, how manage cigar SKUs or brands, or what proportion of your portfolio do you believe you will need to apply for on the -- basically, for substantial equivalents, or for new products?

Lars Dahlgren - Swedish Match AB - President and CEO

When it comes to when we file we don't give exact details, but it's definitely the case that it will take some time to prepare these applications. And I would imagine that if you look across the industry as a whole one would expect that it will be quite a high inflow of applications towards the end of the filing period.

When it comes to the proportion of cigars in our portfolio that needs SE application, quite frankly, it remains a little bit to be seen and we hope to have a good dialogue here with FDA in terms of where they'll put the requirements for cigars. But, as you know, the entire cigar industry evolved substantially, and not only for Swedish Match, since 2007, so we plan for having to file for just about the entire cigar assortment.

Of course, although we have many varieties, many of those varieties are, between them, very similar, so we count on being able to do the groundwork on much fewer varieties than the actual number of applications that we turn in, with only slight modifications between various SKUs.

Adam Spielman - Citigroup - Analyst

So, I'm sorry, but I just have to come back on that. If I heard you correctly, you said you need to -- or potentially file, eventually, SE applications for substantially your entire portfolio. And I guess the risk is if the FDA doesn't grant those - and it really hasn't in cigarettes - then potentially the whole portfolio pretty much could basically be banned. Is that really what you're saying?

Lars Dahlgren - Swedish Match AB - President and CEO

What I'm saying is that if you look at the entire cigar category, and not only Swedish Match, there have been big changes in terms of, for example, packaging formats or just about the whole category down to foil, fresh and so forth, so it depends on how this will work out in practice, quite frankly.

Adam Spielman - Citigroup - Analyst

Okay, thank you. That's very clear.

Marlene Forsell - Swedish Match AB - CFO

Adam, can I add --

Adam Spielman - Citigroup - Analyst

Of course.

Marlene Forsell - *Swedish Match AB - CFO*

-- a thing on your comment on the share buybacks and so on?

Adam Spielman - *Citigroup - Analyst*

Yes.

Marlene Forsell - *Swedish Match AB - CFO*

When it comes to just cash flows it's good to know that we actually skew light on some of the cash flow in the first six months when it comes to cash -- or tax payments, also interest expense payments and pension payments.

Adam Spielman - *Citigroup - Analyst*

Okay, thank you. That's helpful.

Operator

Thank you. We still have a couple of questions coming up. The next question comes from the line of James Bushnell. Please ask your question.

James Bushnell - *Exane BNP Paribas - Analyst*

Hi, thank you. Good afternoon. I've two questions please. The first one is on down trading. You mention that there's been a slowdown in down trading as XRANGE has helped to stabilize the premium segment. Of course, within the premium segments there is some down trading from your proper full-price brands, if you like, to XRANGE. So I just wondered if you could give us your latest thoughts on how much of XRANGE's market share has been taken from consumers that would have stayed in those full-price General, Goteborgs Rape brands and, therefore, just to give us a feeling of the underlying drag. That's my first question please.

Emmett Harrison - *Swedish Match AB - SVP, IR and Corporate Sustainability*

James, hi, it's Emmett. Prior to launch of XRANGE the traditional premium pouch product decline was in the range, you can say, of 6%. After the launch of XRANGE, shortly after that, the decline rate increased slightly, but since then the decline rate has gone back to about those levels and, in some cases, a little bit better than that.

While a growth of the premium segment has occurred and our own growth has -- in the premium segment has been in the low single digits, let's say, 3% or 4%. So clearly XRANGE has gotten volume from the value segment. And looking at the value segment you see that the low end of the value segment is -- has declined a little bit versus prior year based on our own estimates, so these aren't Nielsen estimates.

And the higher end of the value segment has grown as a share and the overall value segment is basically flat. So you could say that there is some down trading, but there was down trading before down to even lower-price products.

James Bushnell - *Exane BNP Paribas - Analyst*

Okay, so what you're saying is the people that have down traded to XRANGE are the ones that would have, going on the previous trend, down traded to what is now the value segment instead?



Emmett Harrison - *Swedish Match AB - SVP, IR and Corporate Sustainability*

That seems to be the indication from the trend lines that we've seen, yes.

James Bushnell - *Exane BNP Paribas - Analyst*

Okay.

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

And then you're correct in pointing out that within premium, then, there is in that sense a negative mix effect, but on the other hand, you should remember that we did take some pricing on our loose premium products at the beginning and of the year and we also took some pricing on XRANGE.

Actually, particularly in the second quarter, when you compare if you -- one year ago when we introduced XRANGE we had some introductory pricing as well, so that has helped the price mix in the second quarter.

James Bushnell - *Exane BNP Paribas - Analyst*

Okay, thank you very much. Then my question was probably for Marlene, which is just on CapEx. So it looks like this year you're having another fairly high CapEx. I just wondered how we should think about that over -- into 2017 and beyond, if I can tempt you to look that far out.

Marlene Forsell - *Swedish Match AB - CFO*

Yes, when it comes to -- we have given then some guidance for this year and I would say that we believe that it remains a little bit higher than we have been used to for a little bit longer than this year.

James Bushnell - *Exane BNP Paribas - Analyst*

Sorry, I didn't quite catch that. Do you think that 2017 will see a similar level to 2016?

Marlene Forsell - *Swedish Match AB - CFO*

I'm not guiding on the 2017 level, but I think that if you compare it to where we've been prior to previous year we will remain on a higher level also in 2017.

James Bushnell - *Exane BNP Paribas - Analyst*

Okay, got it. Thank you very much.

Operator

Thank you. We have our next question coming from the line of Fulvio Cazzol. Please ask your question.



Fulvio Cazzol - *Goldman Sachs - Analyst*

Yes, good afternoon everyone. I was just wondering, it's been six months since you tweaked prices higher in Sweden and, looking back, I was wondering if trends have played out better or worse than you expected in terms of market share losses. Thanks.

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

Largely we're content with the development in Sweden and in Scandinavia. We have lost a little bit of share, especially at the beginning of the year. And if you look among our major competitors, one has adjusted prices upwards, but two have not. And we do attribute our share decline within the value segment partly to that, but overall we're very content with the development inclusive of the Swedish market.

Fulvio Cazzol - *Goldman Sachs - Analyst*

Great, thank you.

Operator

Thank you. We have our next question coming from the line of Chas Manso. Please ask your question.

Chas Manso - *Societe Generale - Analyst*

Yes, good afternoon, everyone. I apologize, because I got to the call late, if these have been asked already. But in the last call -- Q1 call you did say the constant currency price mix had been, in Scandinavian snus, at minus 1.3. Could you update us on that price mix for Q2 and perhaps also the price mix dynamic in US MST as well?

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

In Q2 -- if you take reported it's flat in Q2 and if you take in constant currency it's -- with the weakening on Norwegian krone it's a couple of percent up, but then it's a little bit inflated by the XRANGE introductory pricing last year and relatively strong volume shipments to Norway.

Chas Manso - *Societe Generale - Analyst*

Okay, and in the US?

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

In the US I -- it's positive, but I don't have the number in front of me.

Chas Manso - *Societe Generale - Analyst*

Okay. Also in the last quarter you were talking about perhaps needing to tweak the Mustang offering. Could you update us on what's happening with that brand?

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

It's stable from when we spoke last time. It started off very well, then it declined a little bit, and it has remained at around 3% of the value segment. We did work with certain channels where we saw some relative pricing that we thought needed to be changed. So it's been a slight average decline on that brand in the quarter, but the trend is not really better, but not really worse, so no big news there.

Chas Manso - *Societe Generale - Analyst*

Okay. Again, I apologize if you explained in your script, but clearly the cigar volume acceleration to 15% looks good. What were the drivers behind that?

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

Primarily natural cigars, and then also good growth on Jackpot, but that's a relatively small share of our portfolio.

Chas Manso - *Societe Generale - Analyst*

Excellent, thank you very much.

Operator

Thank you. (Operator Instructions). We still have a couple of questions coming in. We have our next question coming from the line of Adam Spielman.

Adam Spielman - *Citigroup - Analyst*

Hi, thank you very much for the follow-up. Just talking about Q2, so you've talked about the acceleration just in the answer to Chas's question of the 1882 brand in cigars. I was just wondering if you could try and explain why it's accelerated, whether you were putting it in more stores, or promoting it more heavily, or why was that really, I suppose is what I'm asking?

Emmett Harrison - *Swedish Match AB - SVP, IR and Corporate Sustainability*

First of all, the growth is from the rolled natural tobacco, which is GAME and Garcia y Vega 1882. So we've had growth in natural leaf and in Jackpot. We have continued to gain some market share in the natural leaf segment and the natural leaf segment is continuing to grow.

The overall market growth rate seems to be slowing down a little bit, but it's just generally a good performance for those natural cigars. And, as Lars said, Jackpot as well had some overall volume growth.

Adam Spielman - *Citigroup - Analyst*

Fine, thank you. So it's --

Emmett Harrison - *Swedish Match AB - SVP, IR and Corporate Sustainability*

Our share today in natural leaf is up to about 63% and if you compare that with the second quarter of 2015 it was 52%. In addition, for some of the natural leaf cigars our velocity has increased.



Adam Spielman - Citigroup - Analyst

Okay, thank you. It's nothing specific behind that, it's just days of a trend and you're enjoying them and doing well?

Emmett Harrison - Swedish Match AB - SVP, IR and Corporate Sustainability

Great products.

Adam Spielman - Citigroup - Analyst

Thank you.

Operator

Thank you. Our next question comes from the line of Niklas Ekman. Please ask your question.

Niklas Ekman - Carnegie - Analyst

Yes, thank you. I just want to come back to the issue with the FDA regulation, because you seem to be very relaxed here about the FDA regulation. You're not overly concerned that this will lead to any bans on your products and you're referring here to your extensive previous experience with FDA. And I'm just curious what are you basing this on. What kind of evidence is there in the past? How many products have we seen being banned by the FDA in previous processes, both within your product categories as well as in cigarettes? If you can give any examples here just to highlight what kind of challenges you are facing here with the FDA.

Lars Dahlgren - Swedish Match AB - President and CEO

I think what we are saying is these regulations on the cigars they're just published. As you may be aware, there's a lot of discussions as well and even some litigation here specifically regarding the predicate date. So we are entering in a period of uncertainty and we are clear about that. So it's a little bit early to say exactly how this will play out in practice and that's why I can't be specific on exactly how many applications we need to be sending in and so forth.

So don't get me wrong, we definitely take the matter very seriously, but -- and when we talk about our extensive experience, we have done a substantial amount of applications with the FDA. The vast majority of those are actually pending. And what typically happens is that there is ongoing correspondence back and forth with, quite frankly, very detailed questions and sometimes even more detailed answers. So it is burdensome and it takes resources and we cannot rule out that there will be negative FDA decisions, but when we look forward I think it's unlikely that, effectively, FDA would ban an entire industry from being present in the market. That would be very strange.

Niklas Ekman - Carnegie - Analyst

I agree and that's why I'm curious from the past what type of products and what kind of ratio of products have you seen that have been banned in the past either in your product categories or in, for instance, cigarettes. If there's any past evidence here that we can base this on -- what kind of risks you are facing.



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

I don't have those exact statistics in front of me. The vast majority of our provisional and SE applications are pending. We have had some denials on some constituents that the FDA didn't find were substantial equivalents on specific constituents. And then we have withdrawn a handful of applications as well because there has been this ongoing dialogue back and forth and we actually changed our mind from a commercial point of view and did not want to pursue those type of products.

Niklas Ekman - *Carnegie - Analyst*

Okay, thank you. That's helpful.

And secondly I'm curious here. You mention here that the lock-up period expires here for your ownership in STG and the first transaction you made here with the IPO you used this to do an extraordinary dividend and I'm curious what is your, or the Board's, thinking going forward. If you were to sell down further would you be looking at an extraordinary dividend again, or would you prefer buybacks, or just how -- if you could elaborate a little bit on your thoughts there.

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

That's something that we and the Board would look at when, and if, we decide to reduce our holding further.

Niklas Ekman - *Carnegie - Analyst*

Okay, thank you.

Operator

Thank you. (Operator Instructions). There are no further questions at this time, sir. Please continue.

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

Then I thank you all for listening and just to inform you that the release of our nine-month report will be on October 28. Thank you.

Operator

Thank you and that does conclude our conference for today. Thank you for participating. You may all disconnect. Speaker, please stand by.

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