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SWMA.ST - Q3 2016 Swedish Match AB Earnings Call

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## CORPORATE PARTICIPANTS

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

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

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

## CONFERENCE CALL PARTICIPANTS

### Operator

**Adam Spielman** *Citigroup - Analyst*

**Stellan Hellstrom** *Nordea - Analyst*

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

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

**Martin Arnell** *DNB Markets - Analyst*

## PRESENTATION

### Operator

Thank you for standing by and welcome to the Swedish Match Interim Report January-September 2016 Conference Call. At this time, all participants are in a listen-only mode. There will be a presentation followed by a question-and-answer session. (Operator instructions). I must advise you that this conference is being recorded today, Friday, October 28, 2016.

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

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

Thank you. Good afternoon, this is the Swedish Match's third quarter 2016 telephone conference, and with me today are Lars Dahlgren, our President and CEO; and Marlene Forsell, our CFO. After providing our prepared commentary, we will be taking questions. For further information on the third quarter's performance, please visit the [swedishmatch.com](http://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 statements are based on reasonable assumptions, but can give no assurance that the 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. With that I would like to turn the conference call over to Lars Dahlgren.

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

Good afternoon and thank you, Emmett. Similar to previous quarters this year, the third quarter delivered a solid financial performance. In fact Swedish Match reported record results from product areas with strong growth in sales and operating profit. Sales increased for all product areas and operating profit increased for all product areas except for other operations.

Snus volumes in Scandinavia are up for the year-to-date period versus prior year, but were down slightly in the quarter. We attribute the decline to some adverse calendar effects and the decline in their market share. Compared to previous quarters of this year, we also noted slower market



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growth driven by Sweden and both within premium and value segments. The slowdown on growth within the premium segments be primarily attributed to the anniversary of the introduction of our XRANGE assortments.

Sales in Scandinavia grew despite lower volumes with modest price increases at the beginning of the year more than offsetting some negative mix effect in our portfolio. During the year, we've had good inroads with several newer products aimed at specific market segments, the XRANGE in Sweden, General G. 3 in Norway and OMNI, our newest assortment designed to what the consumer wants, a white and dry pouch product. We continued to devote a great deal of time and resources on R&D for new products and innovations and look forward to new offerings.

In the US, our strategy of focusing on faster growing segments in the snuff snus category continues to provide benefits. We see good traction for pouch products, (inaudible) General Snus and moist snuff portfolio, but also early positive indications for our ZYN nicotine pouches, where we have recently expanded distribution into the Western states. Our moist snus and snuff, another growing segment, continue to show solid gains.

Once again other tobacco products were the best performing product segment and cigars had another outstanding quarter with record sales and volumes. As has been the case in recent quarters, demand has been strong and growing for our natural leaf cigars. In the third quarter, we also had good year-on-year growth for our HTL cigars both for White Owl and Jackpot.

For our chewing tobacco business, despite further volume declines, we still recorded increased sales and operating profits for US chewing tobacco on the back of good pricing and higher contract manufacturing volumes. As highlighted last quarter, we expect that the fourth quarter operating results for other tobacco products will be lower than what we achieved this quarter. This is due to several factors including FDA user fees for cigars and cigar factory downtime and fewer delivery days. [It sure] has also been pointed out that Pennsylvania just introduced a relatively high excise tax for chewing tobacco. Pennsylvania is one of the larger chewing tobacco markets in the US and we expect a notable impact on volumes in the fourth quarter.

Our lights business had a strong third quarter. Sales and operating profit increased both compared to prior year and the previous quarters during this year. Lighters had good volume development in several important markets, most notably in Asia and the product mix and cost developments were favorable. Also complementary products had a strong quarter in Brazil.

In late 2017, we have a large bond maturity that becomes due, taking advantage of current credit market conditions; we issued a new EUR300 million, eight-year maturity bond. For this long-term bond, the interest rate was at a record low for Swedish Match. We're now well placed for a substantially improved average cost of debt post 2017. We also successfully placed 13 million shares of STG during the quarter with strong demand and a tight discount. With the increased free float on STG shares, we believe that this will benefit the STG as a Company, will benefit liquidity of our remaining shareholding on 18%.

Net proceeds from the sell-down amounted to SEK1.75 billion, the amount that we will be distributing to our shareholders via a special dividend if approved at the upcoming extraordinary shareholders' meeting.

Now I will hand over to Marlene Forsell for some further comments on the financials.

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### **Marlene Forsell** - Swedish Match AB - CFO

Thank you, Lars. For the quarter sales grew strongly and were up by 10% on a reported basis and by 9% in local currency. Sales grew across all product areas, [positive effect] of the group's sales growth was driven by a very strong performance of cigars. In Scandinavia, there were some negative calendars, which had an impact on both sales and operating profit growth for the snus and moist snuff product area as well as for other operations.

During the quarter, we have recognized two larger one-time items. The sell down of another 13 million shares in STG in September generated a gain of SEK648 million. As our ownership, we have [reduced] to 18%, the ownership from the build is 20% (inaudible) for equity accounting. A bond reclassifying our remaining holding in STG from an (inaudible) to financial assets. We also recognized an unrealized gain on SEK902 million after remaining holding was revalued to market value.



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Group operating profits and including these gains amounted to SEK2,694 billion. Our earnings per share amounted to SEK12.32 in the quarter, up from SEK3.84 on a reported basis, reflecting gain from STG. Excluding STG and adjusting for the larger one-time item, earnings per share was up by approximately 11%.

Currency translation effects were minimal in the quarter. The currency translation effect turned slightly positive in the third quarter, but remained slightly negative for the first nine months. As the current quarter rates are relevant currencies versus the SEK, we expect that the currency translation effect will be functioning in the fourth quarter. For the product area producing moist snuff, sales were up by 2% and operating profit by 4%. The improvement in sales can be attributable to good volume performance from moist snuff and snus in the U.S. and improved net pricing for snus in both Scandinavia and U.S.

In Scandinavia, we estimated our volumes were up slightly on an underlying basis in the quarter, whereas our shipments were down by 1% due to the calendar effect. An effect that we indicated in second quarter release could negatively impact the second half of the year. Still as pointed out, sales grew on improved pricing. The operating profit development for Scandinavian snus was negatively impacted by the calendar effects and by higher cost for market initiative.

The total Scandinavian market continues to grow and its estimates have been up by 3%. Its growth rate is slower than in the beginning of the year and the growth for the first nine months is estimated at sum of less than at 5%. Despite having passed the anniversary of introduction of XRANGE, the premium segment in Sweden continues to grow year-over-year and the quarter according to the inputs. Accordingly to me, some of the premium segment represented 54.3% of the Swedish market, down 0.9% this point from the prior year period and slightly up from those of the first and second quarters of 2016.

Swedish Match market share in the premium segment was down less than 1 percentage point, but we lost two share points versus the prior year period in the value segment. Our overall market share declined nearly 2 share points in volumes terms in third quarter versus prior year. The decline for the market share as measured in value terms was slower and Swedish Match product represented just over 74% on the Swedish market based on the value during third quarter, according to Nielsen.

In Norway, our market share during the quarter was 53.2% down 2.9 percentage points from the prior year period. This year-on-year decline has somewhat improved versus prior quarters. With pouches, our share declined by 2.1 percentage points and amounted to 48.7%. This shared decline in pouches is also somewhat lower than what we previous had experienced over the past several quarters. And General G.3 has continued to take market share and they reported with more than 10% of the pouch segments. With regard to excise taxes in Sweden and Norway, and the Norwegian government has decided to raise taxes on snus from NOK1,010 per kilogram to NOK1,030 per kilogram or approximated to [a percent]. The Swedish government has in a (inaudible) suggested an increase of the excise tax percentage on par with the inflation, an adjustment we expected to be finally determined to 1% and a tax of SEK435 per kilogram. Both increases will be effective from January 1, 2017.

In the US, volumes have grown both for snus and moist snuff. For moist snuff, the timing and promotions contributed to the volume increase with positive development of pouches and tubs. In May this year, we took list price increases for both US snus and moist snuff. Our net realized selling prizes were higher than prior year for snus, but slightly below prior year for moist snuff. The average selling price for moist snuff continued though to be positive for the first nine months, but will be impacted by a higher level of promotions on some negative mix effect during this quarter.

In the US, we have also continued our [fashion] of the ZYN and nicotine pouch, as you have noted in the interim report, we included the net sale from cost for this initiative together with the initiative for snus outside Scandinavia. The operating loss for snus and nicotine pouches out of Scandinavia have continued to decline on a year-on-year comparison, but was more negative than in the first two quarters of the year. The operating loss amounted to SEK66 million compared to SEK95 million in the prior year. The operating loss for the first nine months is significantly lower than in prior year driven by lower cost and higher gross profits. The higher gross profit is attributed to higher volumes, improved pricing and also stepwise improvement in product costs.

For other tobacco products, the exceptionally strong sales growth of 21% in local currency was driven by the 29% volume increase of cigars in the quarter. Sales for cigars grew on par with volume. We continue to have a good momentum for cigars and there is potential for continued year-on-year



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growth also in the fourth quarter. But with the strong comparable prior year quarter and planned factory downtime, potential growth would be significantly lower than in the third quarter.

For chewing tobacco, Swedish Match branded volumes were down by 7%. Sales for chewing tobacco in the US increased slightly as price increases together with increased shipments of contract manufacturing volumes compensated for the volume decline of Swedish Match brand. Operating profit for chewing tobacco declined due to the calls for introduction of chew bags outside of the US. For chewing tobacco outside of the US, the Swiss government has issued an order to clarify specification between chewing tobacco products and snus, and it is our strong view that our chew bag should be classified as chewing tobacco according to Swiss law and allow on the market.

For others tobacco product this fourth quarter, operating profit is normal, a bit softer than the third quarter and this year we expect this affect to be more pronounced than prior year due to the commencement of user fees for cigars with FDA of about \$2 million per quarter and also the planned cigar production downtime as well as the impact from the mentioned Pennsylvania tobacco tax for chewing tobacco.

For lights, we had a quarter and stronger than in early quarters this year and for those sales and operating profits. This was driven by lighter, which have higher volumes than prior year and positive product mix and low production and marketing costs. Complementary products also delivered a strong performance. Sales for matches were similar to prior quarters in 2016, but significantly higher than in the third quarter of 2015.

And now I will provide some commentary on taxes, cash flow, and financing. The reported tax rate was very low for the first nine months at 12.9%. This low tax rate is due to the large one-time item in tax exempt. Excluding associated companies and joint venture in these large one-time items, the tax rate amounted to 24.5%. This is half a percentage points higher than reported in the second quarter release. As previously communicated, we have expected the tax rate excluding associated companies and joint ventures and large one-time items to increase competitive full-year tax rate for the prior year. The income from the US with the relative hike of income tax rates has continued to increase and in addition to the Dominican Republic has just recently imposed 10% withholding tax, which will tight our income for cigar manufacturing.

Taking advantage of favorable market conditions and with the large majority falling due in the end of 2017, we placed the 8-year, [EUR300 million] bond during the third quarter. When (inaudible) to Swedish Krona, the effective rate was approximately 2.1%, which is the record low for the Swedish Match for longer-term debt. The low interest rate is a result of both the market rate and favorable credit spreads. In conjunction with this issuance, we repurchased EUR100 million of our 2017 maturity. The repurchase of profits 2017 maturity causes temporary increase in finance costs for the quarter. Adjusted to this cause is the finance that was reduced to actively effect from SEK106 million on a lower average interest rate.

As per September 30, the weighted average interest rate including the effective hedging derivatives in SEK in our bond portfolio was 3.41% compared to 4.32% for the same date one-year ago. During 2017, the finance cost will include interest costs on the new bonds, but also on the remaining part of the 2017 maturity. However, actual payments of the remaining 2017 maturity, the finance costs will improve significantly assuming no other changes to the bond portfolio. As of September 30, Swedish Match had SEK10.1 billion of interest bearing debt, excluding retirement benefit obligations, approximately 95% of debts have fixed interests, and at our webpage at swedishmatch.com, we provide details on the maturity profile of the debt portfolio.

During the remainder of the year, SEK310 million was due for repayment in December and as of September 30, 2016, Swedish Match had SEK1.5 billion in unutilized committed credit lines. The cash flow from operating activities for first nine months amounts to [SEK2,569 million] versus SEK3,199 million in corresponding prior period. It needs to be noted that the cash flow from operating activities includes the dividends received from STG, which in 2016 was significantly lower than in 2015 due to a lower share ownership, but also the fact that STG distributed the special dividend on top of the ordinary dividends in the comparison period of 2015.

In 2016, we recognized the capital inflow of SEK3,923 million from the portions of STG as cash flows from investing. As expected, our investments in property plants and equipment continue to be above prior year levels. Last year we had a larger investments in the distribution center in Sweden and during 2016 we expect higher level investments for our cigar business and also somewhat for Scandinavian snus.

For the full year investments in property plants and equipment are expected to be in line with the prior year. So far during 2016, we have distributed dividends thorough a token amount of SEK3,764 million consisting of both over 90% of special dividends, relating to the proceeds received of the



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portion divesting STG in conjunction with IPO. Following the breakdown, sell down of shares in STG in September, if we propose at the extraordinary general shareholders' meeting to be held on December 16, that the dividend of SEK9.5 per share are distributed to our shareholders. The total amount of such special dividend is estimated to amount approximately SEK1,760 million, based on the 185.5 million shares outstanding at the end of December. During the first nine months Swedish Match also repurchased 3.4 million shares for SEK999 million.

Lastly, the net debt-EBITDA on September 30 was 1.7, which is below our preferred level and the relatively low net debt EBITDA is actually (inaudible) to the cash infusion from the sale of STG shares in September and is expected to increase the distribution of the proposed special dividends.

Thank you. I'll now turn the conference back to Lars.

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

Thank you, Marlene, I will turn it to the operator and please go ahead and open up the floor to questions and answers.

### QUESTIONS AND ANSWERS

#### Operator

(Operator Instructions) Adam Spielman. Please ask your question.

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**Adam Spielman** - *Citigroup - Analyst*

Hello, good afternoon. Actually I have two questions. First of all, do you have any more insights you can offer about the cost of applying for substantial equivalence orders with the FDA for your cigar portfolio, either by (inaudible) or some sense of where we are with that? That'll be the first question. Thank you.

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

Good afternoon and I'm Lars here. We have added about 12 employees to our R&D for (inaudible) cigars predominantly down in the Dominican Republic that focus on preparing for substantial equivalence applications.

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**Adam Spielman** - *Citigroup - Analyst*

And essentially that's all the incremental cost what you expect from those 12 employees?

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

There might be some smaller machine and analytical testing for that, we don't know exactly now, but we don't think that there will be material costs, increased costs associated with that filings. We will go (inaudible) into preparing the necessary paperwork and analytics.

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**Adam Spielman** - *Citigroup - Analyst*

Excellent, that's very helpful. And, secondly turning to the snus business in Sweden, obviously the market share fell at a slightly worse rate sequentially in this quarter relative to previous quarters and you pointed out a lot of that is to do with or some of that is to do with slightly disappointing results

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in the value segments. And I was just wondering if you could sort of try and explain why you think this is and what you can do about this and how we should think about this going forward?

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

Yes, you're right that the main driver behind the share erosion is our decline within the value segment. And if I look year-over-year rather than sequentially, there is a slight decline in premium segment as well; and that part is actually driven by the decline on the [loose] segment to some extent, which is sort of inevitable trend as long as we have these products nest on the Swedish and the region market. And then you have a slight, you can say, a market segment mix effect, although we have seen that if it stays at premium segment, it means that it's a slight growth in the premium segment year-on-year. The value segment share of the total market is up by close to one share point on a year-over-year basis, since you have a little bit of that mix effect as well. And the reason for this is that we haven't been as successful as we had hoped, and within the value segment, our Mustang brand that was launched last year did very well at the beginning, but since -- that it also even showed slight decline and that is something that we intend to going forward.

**Adam Spielman** - *Citigroup - Analyst*

Is there any change to the pricing environment in the value segments at all?

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

Over the past few years as you know, we've been talking about that, you see more selective fluctuations sort of chain by chain as there are more movements like that, but with the overall picture there are hardly any changes compared to the second quarter. Specifically in our portfolio, we did have a price test in some channels on the Mustang brand to measure the impact of that and we had actually taken up the pricing slightly again on Mustang, but on the other hand we had some price test for our Kaliber brand in certain chains, but reporting very small impacts on the overall pricing here.

**Operator**

Stellan Hellstrom. Please ask your question.

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

Hi, first just a question on the tax increase in Sweden, maybe in particular, how do you see that playing out? Do you expect to compensate for that or do you see any need for absorbing that potentially?

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

The tax increase is 1%, as most likely on the Swedish market and we don't communicate pricing decisions before they have been published to the trade. So that it is something we have to get back to.

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

Okay. I guess, previously you said that -- you believe that the room for price increases is better in the low-end segment, I guess that still holds?



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

I don't know which conversation you're referring to, but generally speaking our view is that of course, the price levels within the value segment on the Swedish market, the factor implies that we have from an international comparison perspective, an extremely affordable tobacco category in the form of value snus on the Swedish markets. In that sense, I think you are right.

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

All right, I don't know if you want to comment on this -- but also, given that there have been some price increases in the low-end snus and also that maybe some of the lower-end brands have not been successful in taking market share. Do you feel that the price gap low end versus premium is to steep to justify price increases in the premium side even if there is a tax increase?

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

As I said, first of all, we don't comment on future pricing actions, as it becomes little bit theoretical in this discussion, but generally speaking, what we've noticed that, even within the value price, you have almost slight [Q-on-Q] price tiers, where the products that are actually a little bit higher priced, they are later done, relatively speaking, better than some of the lowest priced products, then of course within premium, you have a bit of a mix effect and you see that in our portfolio. So in the third quarter, given that -- for the classic premium products as they continue to decline, but we have good growth on the (inaudible) side.

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

Another question on price, but maybe for cigars. I mean, how this FDAC I guess is affecting competition alike? Do you see or expect any type of compensation for this in the market. I gather you have of course some price points here that are difficult to move, but otherwise do you see anything there?

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

If you take the [\$2 million] per quarter and divide it by that quarterly volume, you'll see that its relatively small cost per cigar. It's still a notable cost overall, but I think it's fair to say that in pricing, in the cigar category it remains a very competitive category and it's not necessarily all the magnitude that this could be a trigger for removing the stickiness and some of their pre-priced models out there in the market, but you know we will have to see going forward, sooner or later there need to be some movements of course.

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

Very well and then on the ZYN product in the US, now in 3,000 stores, maybe you can just tell us a little bit on the way you could see this and maybe in relation to how you expand the business distribution and the cost for this?

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

It is still early days, let's remember that, but in our expansion into that -- to the Western Region, it is clear that the early indications are positive and technically when you launch a new product like this, there is an advantage with the ZYN that it is not a refrigerated product, so it's a less complex product to rollout in that sense and there is definitely initial consumer interest in the offering, but it's premature to draw any conclusions on the long-term trends or potential demand there, but we believe it's a very interesting concept.



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

But that will -- no need for refrigeration, that means that the expansion potentially is somewhat cheaper than what it was for snus, is that's what you are saying?

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

Yes.

**Operator**

(Operator Instructions).

**Operator**

Chas Manso. Please ask your question.

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

Yes, good afternoon. My question is, could you talk a little bit about your snus and snuff profit? I mean excluding that which you're seeing losses in US snus, your visiting businesses saw profit declines in the quarter. Perhaps you could point to us, which was down more, Scandinavia or US snuff and snus profit? I mean, you mentioned about competitive intensity in US MST and perhaps you can give us some color on that, what your initiatives are in US MST to manage that competitive intensity and if that competitive intensity persist, what does that imply for your profit development? So that will be the first question.

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

Yes, when it comes to the -- if you strip out the lower cost from snus in outside the -- outside Scandinavia, we have a relatively similar development on a constant currency basis in the US and in Scandinavia. So, it's a slight decline in the isolated quarter in both markets.

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

But then you should remember also that the Scandinavian market here, as we said, due to calendar effect and so on, the shipments volumes are [bunked up].

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

Does that mean that -- you're saying that's phasing and once the phasing reverts then you should return to profit growth in Scandinavia. So, is the profit pressure greater than in the US than in Scandinavia?

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

We're talking very, very small declines in those markets and (inaudible) by the US -- we have a high level of promotions in the isolated quarter and we have strong volumes and our net sales in dollar terms are up as well. So, the reason for the very slight profit decline there is some higher operating expenses and there you would see quarters with sometimes some improved cost levels and sometimes with a little bit higher in cost levels. And when you count them in Scandinavia's money, (inaudible) it's -- I would say, if you adjust further those timing differences in the quarter,



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it's virtually, you can say, a flat quarter where you see some nice benefit of the improved pricing, there is slight underlying volume improvement, but higher costs related to -- they ramp up effectively in market initiatives that we have on the Scandinavian snus market.

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

So are you saying that the step-up in US MST promotion is sort of facing quarter-by-quarter issues --

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

Yes. I mean that is perfectly normal for all players and then I'll say that you will see different intensity when it comes to the promotional offerings and to the trade and sometimes you get this year-on-year effects where you have relatively high -- so that's why also we have a very slight decline in average net selling price per count in our moist snuff business this quarter, but year-to-date, it's still up.

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

Second and last question is on the FDA regulation again, but this time could you give us your thoughts on what the FDA regulation means for the mass market cigar innovation going forward. And then one thing is getting the existing products approved, but in terms of getting new products in there with the new regulation, does that become a lot tougher and therefore the rate of innovation becomes a lot slower going forward.

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

Yes, but it's the likely scenario given that it's going to be significantly more complex to develop and launch new products. With that said, Swedish Match and quite frankly other players as well have made sure to have product varieties out there in the market prior to August 8. But let me take this opportunity to just to point out because I saw some comments today that suggested that our strong cigar volumes in the third quarter were attributable to (inaudible) market and our volumes in the marketplace prior to August 8, and that is by no means the case. They are talking very marginal impact from the fact that they have unusually many SKUs out there tied in the marketplace prior to August 8 that strong performances, they are big sellers.

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

Great and you have committed on Norway, but maybe just a little bit more there on the progress on the Super Slims -- and the share progression there of late?

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

Yes. We continue to not be (inaudible) of course with the share erosion in the Norwegian market, it's a very important market. But with that said, G.3 is doing well and the Super Slim is doing well, and importantly according to all the metrics that we have, both G.3 in general and Super Slim in particular hit very well on our strategic objectives of having products that are relevant for consumer groups where Swedish Match has underperformed relative to the market and also where the growth has been in the market, i.e., younger consumers and also female consumers. And that is really our challenge in the Norwegian market that we have very strong franchise of high quality traditional products, and in addition, we have what you can call more modern products that we haven't been as successful as our main competitor to position ourselves for growth historically. It takes time to address the situation. We are pleased to see those indications that strategically these new products hit on those parameters and naturally also -- pleased to see the slightly lower share erosion, but it's still a share erosion and we are working on it.



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**Operator**

Andreas Lundberg.

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

Yes, Andreas Lundberg with ABG here. Good afternoon. I think you maybe touched upon it, but were there any timing effects on the cigar side in the third quarter that affects the volumes?

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

Not really, there are timing effects, you can say between third and fourth quarter.

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

But nothing particular in the third quarter?

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

No, there were very marginal effects from some promotional programs, which are standard operating model in the cigar market. So, it's a strong -- there has been a strong demand in our cigar business. And as you heard Marlene commenting also on -- when it comes to the capital expenditure, we have invested in additional capacity during the year. So, it's been helpful also to have had that -- some of that additional capacity on board

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

What caused you this stronger grow for HTL products versus --?

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

Stronger growth for natural leaf products. Quite frankly, I think it's a better product. It's a natural rapper compared to HTL rapper, so many consumers consider that higher-quality product and given that you can find that at a very attractive price point out there. You have stronger growth in that segment over several years now and what you are seeing is that, we are focusing a lot on the natural cigars and we are growing market share, but importantly, we are contributing to growing that category.

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

But you also saw some gains year-on-year on the HTL cigars, right?

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

Yes.

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

That has been weaker in previous quarters, if I'm correct. what caused --



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

Yes, you have quarterly fluctuations there and if you look at our track record in the last couple of years, in HTL it is not as strong, but you will see some -- or you have seen some quarters with growth and some declines.

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

What is the status for Night Owl products?

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

The Night Owl is out there. It's in relatively limited distribution and I think it's fair to say that the response is there, but it also shows that we are trying to enter into a completely new segment where there is very strong competition and we believe we have a very good product that is compelling value to the consumer, but it's one of those challenges that we knew that it will take time to address.

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

And [Night Owl] cigars, it's seems more and more strong in the quarter, was that only driven by scale or by the volume gains?

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

Generally speaking in all our businesses, volumes are important for margins, that's things to keep in mind also, and we approach to fourth quarter and you hear us talking about the comparison for within the OTP, but also in the Scandinavian snus business where we had some hoarding last year that we don't think would repeat itself, given the magnitude of the tax increases suggested this year. Maybe, let me guess that there are no question marks on these cigar volumes. The main reason why we talk about it a lot now that you didn't hear us talk about last year and if you look at that quarterly cigar volumes last year, we actually had very strong cigar volumes also in the fourth quarter last year. We did also have fewer production days than in the fourth quarter than in the third quarter, but we have a slightly more extensive factory maintenance program this year, but the biggest factor is actually that we went in through the fourth quarter last year with a decent inventory and then given the strong demand that we've seen in the third quarter, we entered the fourth quarter with the very low inventory. So the result of that is that there is a direct correlation with our production -- number of production days in the isolated quarter in terms of what we can say and provided that demand is still there.

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

(inaudible) quite often [which you still] have done a increased -- touch.

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

Lastly on US snus, I don't know if you mentioned, what's your outlook there for going into 2017? Thank you.

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

We believe that this is a long-term growth opportunity and the trends this year have been fairly consistent overtime and there are always some quarterly fluctuations, but we have a nice solid growth in our snus business and the same amount or even slightly lower amount of stores.



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

And for the cost level for next year --

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

Sorry, the cost level. On the cost level, there you should not count on kind of year-over-year improvement that we have in 2016 versus 2015. Again, (inaudible) time here is, of course, to continue to reduce our operating loss and to turn it into profit, and our detailed planning for next year, we need to get back to the extent that there is a decline in operating loss or an improved operating loss, so to say, the effect with the [delta] will be much less pronounced than 2016 versus 2015.

**Operator**

Martin Arnell. Please ask you question.

**Martin Arnell** - *DNB Markets - Analyst*

Hi guys this is Martin with DNB Markets. Firstly, could you just maybe clarify this negatives in OTP for Q4, if you don't want to quantify your estimates, but could you just like rank the three, the FDA we know and then Pennsylvania and then the downtime? Then secondly, could you just spend some time on the U.S. cigar mix, which has been positive for you this year and how did that look in Q3 and what's in your expectations for next year?

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

This is Emmett. Just is starting with the Cigar mix; during 2015, especially and also part of 2016, the increase in natural rapper cigars versus HTL, the mix was quite a change. So -- not the average selling price per stick for -- our total sales was up slightly. Now you have a situation, where that big change in the dynamic is much smaller. So you don't get that notable positive effect any more on the net selling price. In the third quarter we did have grown in both the natural leaf cigars and HTL, White Owl and Jackpot as already noted. So, I think it's fair to say that those increases that you saw before and small increases in average net selling price all out being equal are much more modest, you don't really see them nearly as much.

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

Let's say, when it comes to your question, then on the fourth quarter and the magnitude of this effect. I would suggest (inaudible) the second quarter operating performance on the OTP (inaudible) the performance in third quarter. I would say that the increase is larger than what the (inaudible). So I would say that the combination of cigars and chewing, probably on the higher side than (inaudible).

**Operator**

[Dan Joran].

**Unidentified Participant**

Good morning Lars and Marlene.



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

Good morning.

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**Unidentified Participant**

I missed -- I struggle to get in here at 7 o'clock, so I missed your prepared comments. So if you already addressed this, I apologize. I just want to hear if you have any update on the international expansion efforts with snus besides the U.S.? Thank you.

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

No, the only update we have and the one we provided in the commentary is that we have expanded within the US, the ZYN offering into western states, basically what we write in our report, that just the 3,000 outlets at the end of the quarter. And we do continue to see that -- we will add some stores towards the year-end and that's probably relatively a good time to assess the performance and see whether the current right strategy is to continue to expand the store base next year and or whether it is to focus more in existing stores. Apart from that, what we currently have for snus internationally is that we have very small sales to Malaysia. We actually -- there is actually a contribution there to the reduced loss because we've changed the assortment to a more standard Swedish type product in cooperation with our distributor. It was used to be a special product adapted for the Malaysian market, that was relatively expensive to produce. So there is some effect there contributing to the reduced loss. And then we are also in the Canadian market, which is very small compared to the US market, which will also -- as you are probably aware, very small, but existing moist snuff market compared to the US market, but it is -- we consider Canada to be an interesting market long-term, where there is some demand and where the gross margin is very healthy.

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**Operator**

Thank you very much and we have no further questions at this time, please continue.

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

We thank you all and please note that the release of our full year report will be on February 17. Of course, we hope to see as many shareholders as possible on our extraordinary shareholders meeting in the bright and sunny Stockholm on December 16. Thank you.

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**Operator**

Thank you all very much and that does conclude our conference for today. Thank you all for participating. You may now disconnect.

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