

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

SWMA.ST - Q1 2017 Swedish Match AB Earnings Call

EVENT DATE/TIME: MAY 08, 2017 / 12:00PM GMT



MAY 08, 2017 / 12:00PM, SWMA.ST - Q1 2017 Swedish Match AB Earnings Call

CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

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

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

Fulvio Cazzol *Goldman Sachs Group Inc., Research Division - Equity Analyst*

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

PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and thank you for standing by. Welcome to today's Swedish Match Interim Report January-March 2017. (Operator Instructions) I must advise you that this conference is being recorded today, on Monday, the 8th of May 2017.

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

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

Thank you. Good afternoon. This is the first quarter 2017 telephone conference for Swedish Match. And with me today are Lars Dahlgren, our President and CEO; and Marlene Forsell, our CFO. After our prepared commentary, we will be taking questions. For further information on the first quarter's performance, please 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 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.

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

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

Thank you, Emmett, and good afternoon, everybody. This quarter, our financial performance in terms of operating profit from product areas was relatively flat in local currencies compared to the prior year on higher sales. In local currency, our growth in sales was mainly derived from other tobacco products, but both snus and moist snuff and Lights also demonstrated sales growth.

For operating profit, Lights delivered a notably stronger result, while both snus and moist snuff and Other tobacco products were at similar levels as the last year in local currencies. Operating profit from product areas was adversely affected by a number of headwinds, most notably the introduction of the FDA user fees for cigars, which, like in the fourth quarter, amounted to about \$2.5 million. Given these fees and some tax-related impacts, the like-for-like financial performance during the first quarter was encouraging.



MAY 08, 2017 / 12:00PM, SWMA.ST - Q1 2017 Swedish Match AB Earnings Call

During the quarter, we further reduced our holding in STG by divesting 9 million additional shares at a price of DKK 118 per share. The net proceeds are being distributed as special dividend of SEK 7.50, which will be paid out in conjunction with the ordinary dividend of SEK 8.50 per share. As noted in our interim report, we also had another positive large one-time item during the quarter, resulting from the divestment of a parcel of land in 2007.

Within Other tobacco products, we had yet another solid quarter for cigars in the U.S., with double-digit increases in both sales and volumes. The overall market growth for cigars in volume terms is maintaining its strong momentum. And Swedish Match again outpaced its growth rate in the first quarter, driven by White Owl this period. The somewhat slower rate for our natural cigars, also attributable to trade inventory movements early in the quarter, and we have since experienced resumed strong growth momentum for that range.

One of the key drivers for growth has been the continuing excitement we have generated through innovation pipeline. We have a real asset in being able to generate and maintain strong consumer interest for our products through novelty and change. Our portfolio contains a number of products that are available on a limited scale. And we continue, through geographical assortment shifts, to maintain consumer excitement and relevance within our portfolio.

Chewing tobacco, the other business in Other tobacco products area, had a strong -- had stronger volumes and sales performance than has recently been the case versus prior year quarters. And it should be acknowledged that the first quarter of 2016 was especially weak. On the other hand, the tax increase in Pennsylvania toward the end of last year made the year-on-year comparison tougher, and Q2 and Q3 comparisons will be similarly challenging. During the quarter, we have been more active in the growing price value segment of chewing tobacco with the reactivation of our Big Duke value-priced brand, which contributed to a relatively strong volume development, but also resulted in adverse mix effect that almost upset pricing benefits in our portfolio.

Having an adaptive portfolio is important for our cigars, but also for our smokeless products. More and more, consumers of tobacco products are seeking out new options beyond traditional cigarettes. This shift in consumer sentiment is a very good thing, which could over time improve public health. It is also possible -- positive for Swedish Match. We have a vision of a world without cigarettes and continues to work to provide choices that meet the changing consumer demand among adult tobacco users. Recent innovations for our smokeless products, which include variations in pouch sizes, moisture levels and strength, have expanded consumer choice and market interest. Products like our non-tobacco nicotine pouches under the ZYN brand can further expand our reach.

In Norway, we are right now in the process of introducing a completely new all-white snus under the brand G.4, a moist product with [an excess of] mild seal developed utilizing innovative technology. For snus and moist snuff, we experienced only slight changes in our sales and operating profit versus the prior year on a local currency basis, with the weaker performance in Scandinavia, offset by stronger performance in the U.S. And there were challenges, but also positive developments. In Scandinavia, for example, while we have seen a slowdown in overall market growth on a year-to-year comparison, the rate of our market share decline in Norway has been steadily improving over the past several quarters.

In Sweden, we experienced an acceleration of our volume for our value-priced products, following the launch of Kaliber+. Also, even with the absorption of the Swedish tobacco tax during the first quarter and despite faster growth of our value-priced product, our average manufacturers take per unit in Scandinavia was maintained with good contributions from Norway.

In the U.S., we continue to see a good volume development for our portfolio of snus and nicotine pouches without tobacco, and our gross profit for these products continued to improve. In the U.S. moist snuff market, continued traction within the faster growing and strategically important segments of tubs and pouches more than offset volume declines for our more traditional cans of loose product.

For Lights, the strong financial performance was experienced across our portfolio, with improvements in sales and earnings for lighters, matches as well as complementary products. While the comparison did benefit from more favorable exchange rates and certain prior year cost of temporary nature, there was also a solid improvement for the segment on an underlying basis. On the organizational side, we are currently in the process of changing our working structure in Scandinavia, which will result in a more fully aligned and efficient organization and over time should result in reduced cost. The cost for the organizational change will be largely recognized in the second quarter.



MAY 08, 2017 / 12:00PM, SWMA.ST - Q1 2017 Swedish Match AB Earnings Call

With regard to regulatory development, as you may recall, the FDA encouraged that we amend our modified risk application for our General snus product and continue to seek MRTP status. They invited us to meet for further discussions. We have now met with the FDA and have gained valuable information on how to best move forward with our MRTP application. Also during the quarter, the U.K. High Court decided, in line with our request, to refer the legal review of the validity of the European snus ban to the European Court of Justice. While we expect the process in the ECJ to take some time and the outcome is difficult to predict, we are of the opinion that we have a very strong case. In Norway, we are still waiting for detailed guidelines relating to the implementation of plain packaging. But our best assessment is that it will affect products sold in the marketplace from mid-2018.

Concerning cigars, last week, the FDA stated that it is delaying by 3 months substantial equivalence exemption requests, substantial equivalence applications premarket tobacco product applications, among other items, in order to give the new leadership at the FDA and the Department of Health and Human Services additional time to more fully consider issues raised by the final deeming rule that are now the subject of multiple lawsuits.

With that, I hand over to Marlene.

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

Thank you, Lars. For the quarter, sales grew by 6% on a reported basis, by 3% in local currencies. Based on local currencies, decreased slightly for product sales in moist snuff, lights and other operations. So we had more robust sales growth for Other tobacco products driven by cigars.

Operating profit from product areas increased by 6% to SEK 994 million for the first quarter versus SEK 939 million in the prior year. In local currencies, operating profit from product areas increased by 1%. But for the addition of USD 2.5 million in FDA user fees in Q1, operating profit from product areas in local -- would have increased by 4%. Group operating profit amounted to SEK 1,232,000,000 for the first quarter, including larger one-time items of SEK 238 million relating to the capital gains from divestment of shares of STG and the sale of land. This compares to SEK 1,711,000,000 in the prior year, which included larger one-time items of SEK 704 million relating to the capital gains from divestment of shares in STG and divestment of a distribution center property. Earnings per share, excluding larger one-time items and share of net profit in STG, increased by 12% to SEK 3.76 versus SEK 3.35 in the prior year.

Currency translation effect [grew positively] in the quarter at the current spot rates (inaudible) is positive for the balance of 2017. For the product area of snus and moist snuff, sales were down by 4%, and operating profit was up by 2%. In local currencies, the sales increased, while operating profit declined. The total Scandinavian market is estimated to have grown by 2%, with growth in both Sweden and Norway. Our Scandinavian shipment volumes, measured in number of cans, were flat. Adjusted for calendar effects and prior year trades in booking, these measured underlying volumes are estimated to be down by 1%. Sales in Scandinavia increased slightly in Swedish krona, aided by a strong Norwegian krone. In local currencies, sales in Scandinavia were down slightly, negatively impacted by mix in Sweden as well as the absorption of the 2017 excise tax. The adverse excise tax absorption effect was mitigated by (inaudible) in May. Operating profit for Scandinavia for this quarter declined. In Sweden, Swedish Match's overall market share in volume terms declined by 2.4 share points in the first quarter versus the prior year. The value segment and the share of the total market, measured by the number of cans, continued to grow and was up by 0.9 percentage points from the prior year period. Swedish Match's market share in the premium segment was down by slightly more than 1 percentage point, and we lost [73 percentage points] versus the prior year period in the value segment. Since the launch of Kaliber+, Swedish Match has dropped off (inaudible).

In Norway, our market share during the quarter was 52.2%, down 2.3 percentage points from the prior year period. However, the rate of our market share loss has improved in each of the past 4 quarters. Within pouches, by far the largest segment of the Norwegian snus market, our share declined by 1.7 percentage points versus last year's first quarter and amounted to 8%, having the lowest decline rate in more than 3 years. General G.3 has continued to take market share in this quarter, with more than 11% of the pouch segment. With regard to excise tax in Norway, the Norwegian government raised tax for snus from NOK 1,010 per kilogram to NOK 1,030 per kilogram, or approximately 2%. The Swedish government increased excise tax for snus to SEK 435 per kilogram, an increase of approximately 1%. Both increases were effective in 2017. Swedish Match did not raise prices in Sweden (inaudible). Swedish Match is currently making upward price adjustments, which will have some positive impacts on average manufacturers' take per unit beginning second week of May.



MAY 08, 2017 / 12:00PM, SWMA.ST - Q1 2017 Swedish Match AB Earnings Call

In the U.S., volumes grew for our snus and nicotine pouch products during the quarter and were essentially flat year-on-year for moist snuff. In the U.S., we have also continued our expansion of the new nicotine pouch product. In our U.S. moist snuff business, higher net realized selling prices compensated for mix shift with regards to sales, while the operating profit was higher due to production efficiencies and good cost control. In late April of this year, there were similar price increases as the prior year on similar timing. These prices were put in place for moist snuff, snus and [sniff]

The operating loss for snus and nicotine pouches out of Scandinavia improved on a year-on-year comparison as gross profit has increased and costs have been lower. However, it should be noted that cost basing occurs in the first quarter and is relatively low on snuff. As previously stated, we expect full year operating losses to be broadly in line with 2017 -- '16, sorry, (inaudible) releasing them to operating loss.

For 2017, we expect volume to stay and to grow for both U.S. snus and nicotine pouch. For Other tobacco products, reported sales and operating profit grew by 13% and 7%, respectively, positively affected by the strong dollar during the quarter. In local currencies, sales grew by 7%, while operating profit was up by 1%. But in addition of the USD 2.5 million in FDA user fees in the first quarter, operating profit for Other tobacco products in local currencies were increased by 6%. Sales for our product area in the first quarter continued to be driven by cigars, with volumes up by 16%. The relatively strong performance of our HTL cigars versus our natural leaf cigars had a negative mix impact. Chewing tobacco had a good year-on-year performance both on sales and operating profit, but it should be noted that this compares to a relatively weak first quarter last year.

This year, the competitive activity within the chewing tobacco value segment has been at the higher level than in previous years. Swedish Match has reason to be more active within the value segment and as a result, helped offset the volume declines for its more traditional loose products, with higher volumes for its value priced products versus (inaudible). As we noted in February, the operating profit development in 2017 for our tobacco products is expected to be impacted by the FDA user fees, but also by higher raw material cost, especially towards the second half of the year.

For Lights, both sales and operating profit grew in the quarter. Much of the improvement in operating profit came from matches, with strong volumes on project pricing and favorable country mix. The stronger profit area also aided (inaudible) the operating profit. Operating profit was also supported by lower production costs for lighters and improved costing for complementary products. We should also note that the prior year period was negatively affected by some costs of a temporary nature for matches.

Now I will provide some commentary on taxes, cash flow and financing. Net profit, excluding the share of net profit in STG and larger one-time items, increased by 9%. This increase was a result of improved operating profit and lower finance cost. Lower interest rates on the bond portfolio and on tangible liabilities as well as increased interest income, positively impacted the finance net. The increased interest income was due to high cash positions during the quarter, stemming from the proceeds from the partial divestment of STG and additional purchase price payments relating to a parcel of land sold in 2007. The net finance cost in the quarter was reduced to SEK 80 million from SEK 107 million.

As per March 31, the weighted average interest rate in our portfolio was 3.38% compared to 4.06% for the same date 1 year ago. The tax balance increased on a higher profit before income tax, excluding a profit in STG and larger one-time items. The tax rate, excluding net profit in STG and larger one-time items, amounted to 24.5%.

During the first quarter, we have returned excess cash to our shareholders with a staggering amount of SEK 739 million. These returns have been possible as Swedish Match has continued to deliver strong cash flows and also successfully divested part of the holding in STG. A further SEK 2.9 million is estimated to be returned in the form of dividend from the recently improved ordinary and special dividends.

The reported cash flow from operation was higher than last year, mainly as a result of higher cash flow from changes in working capital. During the first quarter, Swedish Match had a positive net cash flow from investing activities. Swedish Match received SEK 1,355,000,000 from the partial divestment of STG in January and another SEK 107 million of additional purchase price payments relating to a parcel of land sold in 2007.

Investments in property, plant and equipment as well as intangible assets decreased to SEK 86 million, with prior year investments reflecting the acquisition of patent rights for a nicotine pouch product without tobacco. And prior year investment of -- in property, plant and equipment amounted to SEK 202 million for the period. Investments in property, plant and equipment are expected to continue at similar levels in 2017. During



MAY 08, 2017 / 12:00PM, SWMA.ST - Q1 2017 Swedish Match AB Earnings Call

the first quarter, no new bond loans were issued, and no repayments of bond loans were made. As of March 31, 2017, Swedish Match had SEK 9.8 billion of interest-bearing debt, excluding retirement benefit obligations. During the remainder of 2017, SEK 2 billion of this debt falls due for payment. Approximately 95 -- 94% of the debt has been [repaid].

Lastly, the net debt to EBITDA on March 31 was SEK 1.6, impacted by the proceeds received from the sale of 9 million shares of STG in January 2017. I also want to inform you that we provided details on the maturity profile of our debt portfolio at our web page for international costs. Also, as of March 31, 2017, Swedish Match had SEK 1.5 billion in unutilized committed credit lines.

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

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

Thank you, Marlene, and I hope you could all follow. Marlene is traveling, so she's on a video link. But if you have any problems getting the details of what she said, you can refer to the script.

With that, we'll open up the floor for questions and answers.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Stellan Hellström from Nordea Stockholm.

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

Yes first, I have a question on this price increase in Sweden. If you can maybe say to what extent you expect this price increase to stick or if it's dependent on competitor response, and maybe also comment to what extent you're worried that the price increase could exaggerate market share losses.

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

Stellan, I mean we should remember that there was a tax increase 1st of January, and we didn't make any of these price changes at that time. So what we've done now is that we have adjusted to reflect that one, plus what I would call normal inflation. So it's a fairly modest price increase, and it's fairly similar in absolute terms across products. So the percentages vary a little bit, depending whether it's a premium or a low-price product. In terms of future pricing, first of all, the retailers are the ones deciding the final price to the consumer. And we'll have to see what -- how the market develops and how the competitors react. But we will talk about that when we learn more about the future.

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

All right. I don't know, maybe this was covered, couldn't hear all of it, but did you talk -- or can you comment on where you are in terms of market shares with the Kaliber+ and maybe how that is going on also with the phasing out of Mustang?

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

I know that it's doing better than Mustang did after the same number of weeks at the market. Mustang has a loose product, but if you compare the pouch range of Mustang to Kaliber+, Kaliber+ is doing better, and that probably has the effect number.



MAY 08, 2017 / 12:00PM, SWMA.ST - Q1 2017 Swedish Match AB Earnings Call

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

Okay. Should I go on then? And...

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

You know what, I'll find it.

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

Yes. Just finally, also that you mentioned the organizational changes that you're planning for Scandinavia. If you can just maybe talk a little bit more about those and what savings you expect to achieve.

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

Yes, we're making certain organizational changes in our Scandinavian organization. It's not limited to the snus and moist snuff organization. I wouldn't call it material, but we wanted to flag it because there will be some costs associated with this in the second quarter. And I would say that we expect normal payback that you get on these type of reductions in employees.

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

Just real quick on Kaliber. If we look at the shares within the value price segment, the total Kaliber share of market of that segment is about 20.5%, which is about the same as it was last year. But if you compare it with the pre-Kaliber+ launch within the value segment, it's gained almost 1 percentage point.

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

And you should bear in mind that there is a little bit of cannibalization between Kaliber+ and the former Kaliber. But as Emmett pointed out, the net effect has been positive.

Operator

(Operator Instructions) Your next question comes from the line of Adam Spielman from Citi London.

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

First quick question, can you talk about your hopes of the new products in Norway? Sort of how material are these launches? That will be my first question.

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

Yes. Adam, I mean, if you look at the Norwegian market, it's a very dynamic market where, for a long time, you've seen exceptionally strong growth in the pouch segment there and where we have seen an evolution of products that I will call less traditional, both in terms of format and the flavors and so forth. So with this latest launch with G.4, with the normal light snus, we have seen that there is a competitor's product that is a white



MAY 08, 2017 / 12:00PM, SWMA.ST - Q1 2017 Swedish Match AB Earnings Call

product that is doing fairly well in certain channels in the Norwegian market. So I think it's clear that this type of product is in demand by certain segments of the Norwegian population.

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

And just to be -- I was a little bit confused because in your presentation, you talked about G.3 VOLT. But obviously, you mentioned in your script, G.4. Can you sort of explain the difference between the 2 and how we should think about this relative importance?

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

Yes. G.4 is a all-white product, so no tobacco color of the pouch itself. And the VOLT product is more of a normal line extension, but with some extra nicotine strength.

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

Okay, that's very clear. And then turning to the United States and the FDA, you obviously reiterated the point that the FDA has delayed by 3 months the applications. But my question is, have you heard anything else from the FDA about how they're interpreting or thinking of the deeming rules? Or are you just as much in the dark as we are?

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

Yes, we -- people in our organization are in contact with the FDA on those applications and so forth. But I -- we keep those discussions internally. But in terms of official communication, there are no -- there is no communication on any changes or anything to the rules apart from this delay. But we do note the language in there that they will -- this gives them time to assess the implications of the -- on the system.

Operator

(Operator Instructions) Your next question comes from the line of [Tan Giran] from [Springs Capital Management] .

Unidentified Analyst

Yes. I have kind of a big-picture question. It was very gratifying to see the U.S. growth offsetting a weaker Scandinavia for snuff and snus. Can you kind of provide some thoughts on, without divulging competitive information, of course, on the balance between feeding new markets and -- for snus versus not in terms, of course, there's a lot of upfront cost and it took a long time and a lot of work in the U.S. to get to where you are now. So I'd like some thoughts on -- the company's thoughts on balancing the upfront cost of seeding new markets versus not and whether you're being too cautious or too aggressive or just some general thoughts in that area?

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

The U.S. market remains, as you know, by far, our biggest sustained international investment when it comes to snus and nicotine pouches. When we look further into the future, and certainly, we hope to see additional markets where we can have snus, and we have hopes that the ECJ then will reach the conclusion that the snus ban is illegal, which would open up for opportunities, for example, in the European Union. Our experience, so far, is that in most countries, it's not necessarily big, bold and very expensive initiatives that is the best strategy to grow this type of novel smokeless product for the market. You should remember that the U.S. is a very, very big country. So if you want to do something in the U.S., it takes certain resources and investments. But if you take, for example, the [2-pack] category that exists in certain countries in Europe, there, there has



MAY 08, 2017 / 12:00PM, SWMA.ST - Q1 2017 Swedish Match AB Earnings Call

been some progress, but I would call at the niche level. And there, the investment equation looks quite differently. So we think also that in the future, there can be -- a handful of markets may adopt something meaningful, but more in the niche type of investment level.

Unidentified Analyst

Do you have any thoughts more specifically on places like Japan, Korea, China? I guess those markets, I assume, are not subject to any sort of snus ban?

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

I think on that question, that's when we kind of get into things that we would like to keep to ourselves before we inform competition. But we do evaluate on a global basis for our long-term thinking and where we think that alternatives to cigarette, where we have our core competencies can make sense.

Operator

(Operator Instructions) And your next question comes from the line of Fulvio Cazzol from Goldman Sachs.

Fulvio Cazzol - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

I've got 2 questions. My first one is on the ZYN brand. I know it's still early days, but I was wondering if you can give us some details on how the brand is performing in the first stores that it has been launched in, please?

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

Yes. I would say that the start for ZYN is very promising. It's clear that ZYN is also then an all-white, very dry product and without tobacco. I'd say it's clear that the barriers to try ZYN is, relatively speaking, lower than for smokeless products that contain tobacco. So it's off to a good start. And then you know what is the long-term potential remains to be proven, but we are encouraged by the trajectory and the repeat orders that we see on ZYN in the Western region of the U.S.

Fulvio Cazzol - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

Okay. And my second question is on plain packaging in Norway. I was wondering what concerns you the most, if anything, and how relevant do you think the learnings are from Australia and the U.K. on cigarettes?

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

I think when it comes to plain packaging in Norway, what concerns me the most, quite frankly, is that this is an example of where the authorities bundle snus together with cigarettes, regulatory-wise, which sends the wrong signal to the consumers to make an informed choice and opting for a lower-risk alternative. In terms of market consequences and parallels between different markets, I do think that it's difficult to make assessments. The categories are different and the competitive landscape is different and so forth. And quite frankly, I think it's early days even for those countries to draw the long-term conclusion. But one reflection is that in the case of Australia, as you know, there have been relatively large tax increases as well. One can speculate whether this has also been a way for the authorities to affect consumption, and that gets blended with the overall results, so to say, from the plain packaging legislation. So to the extent that -- let's hypothetically assume that plain packaging does not affect consumption, will there be other type of regulations put in place, then that's a risk that we see.



MAY 08, 2017 / 12:00PM, SWMA.ST - Q1 2017 Swedish Match AB Earnings Call

Operator

(Operator Instructions) Your next question comes from the line of Chas Manso from Societe Generale.

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

Three questions from me, please. Firstly, could you give some color on what's happening in the U.S. moist snuff tobacco area? I think you mentioned that this quarter was a high promotional quarter. If I recall, Q4 was another high promotional quarter. So I was just wondering whether the level of promotional activity has kind of hedged up, whether you have any sort of commentary around that competitive intensity and all that? Second question would be on mass-market cigars and a question on the mix. It seems as if the natural leaf portion has been coming down since Q3, and I was wondering whether that reflected any supply issues. I think you've been talking about higher costs on natural leaf and whether that is a drag to your growth in mass-market cigars, and if so, when that could be resolved? And the third question would be on the modified risk status. You've mentioned that you've been encouraged by the FDA, and you've had a meeting with them. And I may have missed it, but from the encouragement from that meeting, do you now have more concrete pathway, a series of actions you now know what you need to do in order to get modified risk approval. And if so, any feeling for the time line?

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

Okay. I'll start from the back and take the first 2 questions, and then I'll let Emmett take the moist snuff question. In terms of the MRTP, the meeting with FDA, I would say, was very constructive in the sense that they provided good comments to our application, which gives us good leads in terms of necessary amendments. So we do intend to file amendments. Specifically, what we will do is that we will rephrase the claims of relative risk rather than communicating relative risk by suggesting different warning labels. We intend to have separate communication, whether on the can or point of sales or in advertising of relative risk. So we are in the process of identifying which specific claims on relative risk that we will include in the amended application. And once we have done that, the processes that we need to take, those new claim -- or claims to consumers in a rather extensive market research to prove that consumers get the correct understanding of what we're trying to communicate. So we feel we have a clear pathway in terms of what we need to do. We have a good hypothesis of claims that we think are relevant. And what we think that where we can support it with data, that would be acceptable to FDA. But of course, there are no guarantees. In terms of the market research, it's much more extensive than what you would expect from a traditional, normal market research. So the whole process is going to take some time, and it's hard to give an exact estimate at this point. In terms of the cigars, the first quarter was a little bit unusual compared to our trend from last year on the mix between HTL and natural leaf. And we do attribute that to some inventory movements at the trade and related to capacity issues, but previously, where we had the capacity issues last year, and we have invested in -- for natural leaf, and then we have invested in additional capacity there. And once we could supply local demand, there was a bit of pipelining on the natural leaf side, so that those orders were unusually low at the beginning of the year. But instead then, we had a good traction with some of the reintroduction of our varieties within HTL that compensated. And also, natural leaf cigars grew in the first quarter. It's just that HTL cigars grew stronger. And if you look at within the quarter, sequentially, we have seen a gradual pickup to the -- more in line with the trends that we had before. So we expect, in the coming quarter, we expect to have a mix of our portfolio more reflective of what you saw in 2016.

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

And with regard to moist snuff, our different brands have different promotional cycles, and they change a bit from year-to-year. So yes, we had a bit more promotional activity going, but you might have a quarter or 2 with more promotional activity and then a quarter or 2 with less. It's depending on how the cycles go. In this quarter, we also had a bit of a price/mix shift as well because we did quite well with higher volumes for our tub, our bulk price products, and the average selling price per can equivalent is lower for that product and also for pouch products. So it was a bit of a price/mix as well as from promotional activity.



MAY 08, 2017 / 12:00PM, SWMA.ST - Q1 2017 Swedish Match AB Earnings Call

Operator

(Operator Instructions) We've got no further questions in the queue. Please continue.

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

Okay. Then we thank everybody for participating and inform you that the release of our half year report will be on July 21. Thank you.

Operator

And that does conclude your conference for today. Thank you for participating. You may all disconnect.

DISCLAIMER

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

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

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

©2017, Thomson Reuters. All Rights Reserved.

