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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and thank you for standing by. Welcome to today’s Full Year 2018 Report Conference Call. (Operator Instructions) I must advise you this conference is being recorded today, Wednesday, the February 13, 2019. And I would like to hand the conference over to your speaker today, Emmett Harrison. Please go ahead, sir.

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

Good afternoon. This is the Swedish Match fourth quarter 2018 telephone conference. And with me today are Lars Dahlgren, our President and CEO; and Tom Hayes, our CFO.

In the Investors section of our swedishmatch.com website, you will find the presentation for today’s call, which is intended to be viewed in conjunction with our prepared commentary, so we encourage you to follow along with that presentation. In that same Investors section, you will find the interim report. After our prepared commentary, we will be taking questions.

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 – Slides 3 and 4 of this presentation reiterate the headline bullets from our interim report released this morning, and we refer you to the report rather than repeating them on this call.

And with that, I would like to turn the conference call over to Lars Dahlgren, who will begin on Slide 5.
Thank you, Emmet, and good afternoon. 2018 ended the year on a positive note driven by strong financial performance by our snus and moist stuff product segments. In Scandinavia, after a very strong third quarter where unusually good weather was a contributing factor, the market growth continued at a brisk pace in the fourth quarter. With solid market growth and positive price mix, Swedish Match shipment volumes and sales were higher in both Sweden and Norway despite the disappointing market share performance.

In the U.S., not only did we see continued exceptional volume development for ZYN, but we also experienced volume growth for snus and moist stuff, and after benefiting from the year-on-year calendar phasing on promotions.

Snus and nicotine pouches outside Scandinavia reported positive operating profit compared to operating losses in the prior year. And for the year, operating profit was up by SEK 228 million compared to 2017.

While we continue to add to our store count for ZYN in the U.S. during the fourth quarter, the pace slowed somewhat as anticipated due to manufacturing capacity constraints. Sales rates at retail measured in average counts per store per week continue to increase.

Our initial capacity project for ZYN production in Owensboro, Kentucky follows plan, and some process steps are already operational. Just this week, we decided to further scale up production capacity, essentially doubling expected production capacity relative to previous plans. We strongly believe that nicotine pouches without tobacco will continue to play a meaningful role in reshaping the broader tobacco category, and the added capacity will allow us to pursue growth opportunities in this exciting new segment over the coming years.

Beginning in the second quarter 2019, we will be expanding our U.S. ZYN distribution efforts at a more rapid pace as production capacity comes online.

The nicotine pouch segment provides an interesting growth opportunity not only in the U.S., but also in Scandinavia and other markets. Already, the nicotine pouches segment is more than 11% of the Norwegian market and estimates to be more than 3% of the Swedish market. Also, in early 2019, we launched ZYN on a limited basis in the Czech Republic and in Denmark.

As you’re likely aware, last week, the FDA’s Tobacco Products Scientific Advisory Committee had meetings to assess the resubmission of our modified risk tobacco product applications for General Snus in the U.S. We are hopeful the FDA will approve the MRTP designation and that General Snus can have the same positive effect on U.S. smokers as already been evidenced in Sweden, bringing us one step closer to realizing our vision of a world without cigarettes.

Last quarter, we noted that we faced difficulties in obtaining adequate supplies for the cigar leaf needed for our rolled leaf assortment. This had a negative effect on our cigar shipments during the fourth quarter, with volume for our rolled leaf cigars down by 40% on a sequential basis, and by 30% compared to the fourth quarter of the prior year. Overall, however, our shipment volumes declined by only 4% and operating profit was up slightly in local currency.

For U.S. chewing tobacco, we ended the year on a strong note with only modest volume declines. For the full year, both sales and operating profit were in line with prior year levels in local currency.

Our acquisition of Oliver Twist with its tobacco bits, contributed to sales and operating profits. You should note that this was the first quarter with like-for-like comparisons for V2 Tobacco acquired in August 2017. We’re encouraged by the continued contributions from these acquired businesses. And as of the beginning of this year, we have established our own sales force in Denmark that will carry the combined portfolio of V2 Tobacco, Oliver Twist and now also ZYN.

For Lights, while our lighter business reported increased sales in local currencies for the quarter, on increased volumes and positive price/mix, increased input costs, most notably nylon costs, continued to weigh on our Lights financial performance.

Match volumes held up relatively well, while our sales declined due to adverse price/mix.
Thomas Hayes - Swedish Match AB (publ) - Senior VP & CFO

On Slide 6, we've summarized some of the quarterly highlights of the snus and moist snuff product segment. Swedish Match reported increased shipment volumes for snus in Sweden, Norway and the U.S. for moist snuff in the U.S. and for ZYN and nicotine pouches in all markets. While the fourth quarter financial performance of this product segment was reasonably consistent with its third quarter performance with sales and operating profit of 16% and 18%, respectively, the underlying performance softened somewhat relative to the third quarter.

Looking specifically at Scandinavia, reported shipment volumes grew by 5% and by only 1% on an underlying organic basis. While category volume development in Scandinavian market remains robust, it remains very competitive, and we lost market share in both Sweden and Norway.

Shipment volumes in the quarter for our snus and nicotine pouch business in the U.S. almost doubled compared to the prior year driven by ZYN, which as Lars noted, had a notable impact on our improved operating profit performance, while also providing support to our improved operating margin in the quarter and for the full year.

For moist stuff in the U.S. promotional phasing contributed to our volume growth during the quarter. And pricing improved versus the prior year despite some negative mixed effect.

On Slide 7, we provided estimates of trended total market in Swedish Match volume growth in Scandinavia adjusted for hoarding and calendar effects as well as Swedish Match organic currency-adjusted price mix effects by quarter. Our volume development relative to the overall market reflects the market share challenges we faced during the fourth quarter. The price/mix effects remains positive as similar levels to previous quarters supported by both higher pricing and geographic mix.

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

Slide 8 presents Swedish market growth trends in volume and value terms, according to Nielsen, on an unadjusted basis. 2018 category growth in both volume and value terms was at its highest level since 2015. What is also encouraging is that 2018 represents the second straight year where growth in value terms outpaced growth in volume terms. This is due in part to both the rapid growth for newer formats such as nicotine pouches as well as the return of positive pricing for many varieties.

On Slide 9, you can see our share performance in Sweden within the premium and value segments as well as our total volume share, according to Nielsen. Swedish Match continues to lose market share both in the premium and the value segment. And in Sweden, the competitive landscape is increasingly focused within the popular price premium segments, what we refer to as the premium 2 segment, and in the emerging nicotine pouch segment, which has provided a degree of stability between the premium and value price segments. While these trends from a category perspective are encouraging, the premium 2 and nicotine pouch segments are dynamic and less reliant on traditional formats and brands where we have historically enjoyed market share advantages.

Moving to Norway, Slide 10. Depicts our market share development within different segments in this market. Our market share declines in Norway are partly a result of the continued rapid decline of the loose segment, down more than 15% in the fourth quarter where Swedish Match has a very strong position. For pouches, which make up more than 90% of the market, our share declines can attributed to the rapid growth of the nicotine pouch segment where Swedish Match holds #2 position, with roughly 17% of this segment.

The trends for our modern G.3 range remains encouraging and its market share reached almost 15% of the pouch category in the latest Nielsen measure.

On Slide 11, you can see some of our more recent new product launches for snus in both Scandinavia and the U.S. Our activity levels for new products in Sweden during the fourth quarter was light and comprised principally of our Small Batch limited edition. In the U.S, we launched Thunder Xtreme on a small scale, which appeals to consumers seeking a stronger snus product.
In Norway, we had no new product offerings during the second half of 2018. One should note, however, that we had a heavy portfolio of new product introductions in Norway in the quarters preceding the move to plain packaging. This month, we are launching a new nicotine pouch product in Norway under the G.4 range, Blush, with its unique characteristics of a slim all-white pouch with a hint of ginger and blood orange.

Turning to U.S. moist snuff on Slide 12. In 2018, we estimate that the U.S. moist snuff market declined by 1% in volume terms compared to the previous year. Volume declines in traditional 1.2 ounce loose formats were only partially offset by volume gains in the pouch segment. In value terms, the category, according to our estimates, grew by approximately 4% in 2018 as a result of price increases and some increased excise taxes. Moist snuff pouches are growing at much more pronounced rate than the overall market in both volume and value terms.

On Slide 13, you can see the continued strong growth of the pouch segment overall in the U.S. Swedish Match has outperformed this segment over the past several years and in 2018, our own volume growth for pouches was significantly higher than the estimated market growth rate for pouches of close to 6%.

On Slide 14, you can see the rolling fourth quarter volume trajectory for snus and nicotine pouches in markets outside of Scandinavia, with the bulk of this volume being in the U.S. Note that the volumes showed on this slide excludes volumes from V2. Snus volume growth was relatively modest in 2018 while for ZYN, U.S. shipments volumes were 4.2 million cans in the fourth quarter versus 1.5 million cans in the fourth quarter of 2017. This rapid volume growth stems partly from increased distribution, but more so from increased sell-through rates at retail. Stores where ZYN is available in the U.S. increased by approximately 500 stores in the quarter to 13,500 stores at the end of the year.

Thomas Hayes - Swedish Match AB (publ) - Senior VP & CFO

For OTP product segment, I will refer you to Slide 15. In the interim report, we referenced the current shortage of tobacco leaf for our rolled leaf cigars. This had a notable negative impact on our fourth quarter shipment volumes. We anticipate this issue will be resolved in late spring as new crops become available. Despite the volume decline of 4%, operating profit improved due to higher average pricing for both our product mix and the price increase for rolled leaf cigars implemented earlier in the year.

In our U.S. chewing tobacco business, we continue to see a shift toward value-price offerings with value price offerings now representing more than half of the category. Our own volume declines for our premium products, however, were more modest than the overall premium segment. And our sales and operating profit increased in the quarter compared to the prior year.

The chew bag market in Denmark grew by more 30% in volume terms in 2018, and is our second-largest chew bag market behind Germany.

On Slide 16, you will note that the category growth rate per store in the U.S., while still respectable, slowed to roughly 4% in 2018. Somewhat more surprisingly, however, is that based on our measure of distributor shipments to retail, total cigar category volumes declined in the fourth quarter compared to the prior year, the first year-on-year quarterly decline in recent history. The category softness was most notably within HTL segment including HTL value offerings. While Swedish Match volumes based on this measure were up slightly due to our portfolio positioning with a focus on natural leaf cigars.

On Slide 17, we look at our own shipment volumes in more detail. Here, you can see the rapid development of our rolled leaf assortment, but also strong growth of our other natural leaf offerings. While growth in the coming quarters may be negatively influenced by the current rolled leaf cigar shortage, we believe that the natural leaf segments, including rolled leaf, will continue to provide further growth opportunities for our U.S. cigar business over time.

On Slide 18, we provide a breakdown and a split between natural leaf small, natural rolled leaf and HTL variety compared with the overall category in each case, excluding pipe tobacco cigars where our current participation is relatively insignificant. This slide illustrates Swedish Match's positioning toward the more attractive segments of the cigar market with well above half our portfolio in the faster-growing segments.

Turning to U.S. chew tobacco on Slide 19. Swedish Match is well positioned in both the premium and value segments. And based on our measure of distributor shipments to retail, we once again outperformed the overall category in both segments. While the shift in the portfolio toward more
value-priced products places added pressure on average selling prices and margin, the moderating rate of volume declines mitigates this development somewhat. To that end, the 2018 volume decline rate of our shipments slightly less than 4% is considerably better than the average historical decline rate of 6%.

Moving on to Lights on Slide 20. Despite a very weak start to the year, the full year sales performance was only down 4%. During the fourth quarter, our sales growth was attributable to both higher volumes, and a positive price/mix effect for lighters as well as a very strong finish to the year for our complementary products business. The match business held up relatively well against what was a fairly solid prior year fourth quarter. As we’ve mentioned earlier, we’ve been facing significant cost pressures on nylon, one of the key input materials for our lighters.

Moving on to regulatory and other developments, I would like to point out a few of the key recent highlights at this point on Slide 21. The TPSAC hearing of our MRTP application related to General Snus took place on February 6, and we’re particularly pleased with the balanced comments by the FDA, and look forward to the agency’s final decision, which we expect in the not-too-distant future. Regarding the FDA commissioner’s communication in relation to a ban on flavors in cigars, there have not been any further clarifications and no rules or specific time line has been proposed, particularly within natural leaf cigars. For varieties that we believe stand a better chance of remaining on the market after a probable flavor ban, our market share is relatively high.

On Slide 22. In Sweden, the parliament adopted new legislation on tobacco products in December. For snus, there will be very few notable changes to current legislation, while for cigarettes there will be more restrictions on smoking, including extending smoking bans to certain outdoor public places and restaurants.

On Slide 23, I would like to point out that we have yet to receive any new information from the Bavarian Administrative Court in Germany on our Thunder chew bags and loose chew products. We anticipate further clarification on this issue during the course of the year.

And on Slide 24, we summarized relevant metrics from our interim report relating to finance costs, our financial position and earnings per share. Net finance costs during the quarter were lower than the levels that we experienced during the first 3 quarters of 2018. The fourth quarter of 2017, much like the second quarter of 2017, included dividend income from STG with a net finance cost, which impacts the year-on-year comparability of finance cost. The weighted average interest rate of our loan portfolio at December 31, 2018 was 2.18% compared to 2.64% at the end of 2017. The capital duration was 4.1 years with 96% of the portfolio subject to fixed interest rates. The debt default due in 2019 of SEK 1.1 billion at an average interest rate of 3.9%. In January 2019, we secured SEK 1 billion of borrowing via private placement, a 7-year tenure at 2.71% in anticipation of this 2019 repayment. Our net debt-to-EBITDA for the full year 2018 was 2.2.

The EPS bridge illustrates the components of our 26% growth in adjusted EPS for the full year. Apart from the after-tax effect of our increased operating profit, both the lower tax rate and reduced number of shares had a meaningfully positive impact. The lowering of the tax rate principally resulted from the U.S. income tax reform enacted in late 2017.

During 2018, we distributed strong cash returns to our shareholders through dividends and share repurchases. We’ve paid SEK 2,911,000,000 in dividends consisting of both an ordinary dividend and a special dividend following the final sale -- shares in STG. We also repurchased shares for SEK 2,512,000,000. At the upcoming Annual General Meeting, the Board of Directors will be proposing an ordinary dividend of SEK 10.5 per share, which was proposed to be paid on April 16.

On Slide 25, we have represented our 2019 outlook statement that was released with our interim report earlier today. I would like to highlight the guidance on capital expenditures. With the expectation of an increased CapEx in 2019 versus 2018 due to the recent decision to further expand manufacturing capacity for ZYN in the U.S. Also, given that our non-Scandinavian snus and nicotine pouch businesses are no longer reporting operating losses, we will no longer be providing those profitability measures in future interim reports. Finally, as always, fluctuations in currency rates will impact our future reported results. And you may want to take note of some of the more important average exchange rates versus the SEK. The average exchange rate in the first quarter of 2018 for the U.S. dollar was 8.11; for the NOK, it was 1.03; and for the Brazilian real, it was 2.5.

With that, operator, please open up the line for questions.
QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line from Niklas Ekman from Carnegie.

Niklas Ekman - Carnegie Investment Bank AB, Research Division - Head of Consumer Discretionary & Staples and Financial Analyst

Yes, I have a couple of questions. I'd like to start with cigars business and this decline of over 30%, you talk about these problems prevailing until the late spring and I'm curious if you're talking about the same magnitude of decline, or if this was exceptional here in Q4?

Thomas Hayes - Swedish Match AB (publ) - Senior VP & CFO

Yes, Niklas, part of the challenges that we had in terms of availability of wrapper leaf for our rolled leaf assortment had to do with appropriate curing time to ensure the appropriate levels of quality for our product. So we do have tobacco leaf that will support rolled leaf volumes during Q1. It's not as if we are completely out of leaf, but we needed to allow for a sufficient level of time. So I do think it's fair to expect that there could be declines, but it would not be to the level that we experienced in Q4.

Niklas Ekman - Carnegie Investment Bank AB, Research Division - Head of Consumer Discretionary & Staples and Financial Analyst

Okay, excellent. And I'm curious also, you mentioned here that the HTL segment here reported a decline -- a market decline for the first time ever. Is this also due to temporary issues, or is this something structural here that has changed in the market?

Thomas Hayes - Swedish Match AB (publ) - Senior VP & CFO

Yes, I think there has. Over the longer term, we have seen declines -- not declines, but we've seen a softening growth rate within HTL, and particularly, HTL value as more and more consumers are converting to natural leaf cigars. I think there is an effect that you could see in market as it relate to promotional levels within the HTL segment, but it is not a function of input shortages within HTL.

Niklas Ekman - Carnegie Investment Bank AB, Research Division - Head of Consumer Discretionary & Staples and Financial Analyst

Okay. And then turning to ZYN. I was curious, when you talk about rolling this out in Denmark and the Czech Republic, can you tell us a little bit here about how many stores are we talking about? What's the pace of rollout here? When can we expect this to be accelerated with more stores being added? And if you could say anything about the discussions you've had with local regulators as well, just to give some flavor on what's going on? And when we can expect more of a ramp-up in European rollout?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

Niklas, this is Lars. I think we're in around 100 plus stores in the Czech Republic and I don't recall from the top of my head, how many we are in with chew bags, but it is a niche category in that market. It's a growing category and so the store universe isn't immense. And we'll have to see how the continued demand is from consumers and the trade. When it comes to Denmark, we just entered into that market very recently and we started with 100-plus stores, but going out in new one petrol chain this week if everything follows plan, and then we'll have to see from there. And when it comes to our dialogue with authorities, I think, referring to what I said before, which is indeed true that we want to behave responsibly and professionally and discuss with authorities about our intentions, but we prefer to keep those dialogues to ourselves, and between us and the authorities.
Niklas Ekman - Carnegie Investment Bank AB, Research Division - Head of Consumer Discretionary & Staples and Financial Analyst

Okay, fair enough. And finally, on ZYN also, if my calculations are correct, you're now selling about 25 cans per store per week in the U.S. And I was wondering if you could give any kind of data how this compares to volumes of snus in Scandinavia, just as a comparison.

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

It's significantly less than what we see in Scandinavia per store, but it's very different dynamics. And the potential store universe in the U.S. market is big multiple of what we have in Scandinavia.

Niklas Ekman - Carnegie Investment Bank AB, Research Division - Head of Consumer Discretionary & Staples and Financial Analyst

Yes, but you don't have a number. It will just be interesting to see the ratio.

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

Not on top of my head, but we're talking, I think, over 100.

Operator

Your next question comes from the line of Adam Spielman from Citi.

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

Two questions, if I may. Can I return to the question of declining cigars volumes in the U.S. Do you think that's impacted at all by the success of dual or do you think that's entirely irrelevant?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

I think it's very hard to say on 1 quarter. I mean, we have seen -- if you compare 2018 to some previous years, we have seen a little bit of softening, but still very healthy category growth rates. And then an isolated quarter like this, it's based on distributor shipments from distributor to retail, it's hard to read too much into. We have to see if it continues, and it's hard to read into much explanations into this point in time.

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

And would you give us a similar comment about the decline of moist snuff, and I'm talking about the market level here, not yours.

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

Again, in moist snuff, I think, we see a couple of factors. First of all if we compare the recent years to a little bit further back in history, there is a clear shift in the category dynamics where we see quite a bit stronger pricing in the category. And we believe that, that is one factor for slowing down. And when it comes to moist snuff and other type of products, there, I think, it's fair to say that we do see bit of impact from alternatives. I mean, if we zoom in on the Western region, based on distributor shipments, again, that is the worst performing region year-to-date in the U.S. for moist snuff. And when we look at our ZYN data, our volumes of ZYN, our shipments in the fourth quarter actually corresponds to more than 7% of the
entire moist snuff category in the Western region. So it’s not surprising if there is an effect, but on the decline in the Western region coming from product mixing, but it is of course, hard to say exactly what is what in that equation.

Adam Justin Spielman - Citigroup Inc, Research Division - MD and European Tobacco and Beverage Analyst
So just to make sure, I recall that, you said in the Western region, your market share is measured by shipment is 7%?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO
I mean, market share, you get slightly less than the number I said because what I said is that our volumes of ZYN represent slightly more than 7% of the moist snuff category. If you are going have the market share, you need to combine the 2.

Adam Justin Spielman - Citigroup Inc, Research Division - MD and European Tobacco and Beverage Analyst
Yes, okay. that's right then. And then turning to Scandinavia, particularly, I guess, Sweden. In the conference call, you said, or in the prepared remarks, you said the premium 2 segment and the new all white nicotine pouch segment, they're sort of more brand churn, if you like, and before on that, the segments are growing, but it's hurting your market share. I -- so the question is what can you do about it? Should we, on the one hand, either expect this new accelerated rate of market share decline in an acceleratingly growing market or is there something you can do to make sure your market share stabilizes in the coming quarters?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO
I mean, it's, of course, a clear focus of ours to take a larger share of the growth of these very appealing segments of the market, and we did in the fourth quarter. I think you need to remember that if you look at the Swedish market and the premium 2 segment, essentially, we created that segment with the launch of XR and then competition has followed. So you can say we started on 100%. But it is a segment that has a younger consumer profile and young adults are more -- they're more prone to try around different types of products and so forth. So it's about making sure we have the best quality and the most relevant offerings in that segment. When it comes to the nicotine pouch segment, and in Norway, the nicotine pouch is sort of a slight ingredient of it go as well. It is obviously very competitive segment because we are not the only ones seeing the growth there, and -- but we need to take larger share of the growth in that segment. And then it boils down to again, I'd say relevant products and with the best quality products in the market. But we do see that competitors of ours have a somewhat of a first mover advantage in that segment and that is a challenge to catch up. But we're working hard on it.

Adam Justin Spielman - Citigroup Inc, Research Division - MD and European Tobacco and Beverage Analyst
And should we expect to see accelerated new product developments or new product launches in those premium 2 and all-white nicotine pouches?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO
Generally speaking, I think you should expect high competitive activity in growing segments, that goes for Scandinavia and also goes in countries outside of the Scandinavia. And as I pointed out, we have launched a, in my opinion, a very good product, white pouch in the Norwegian market now with a nice ginger flavor, and that similar -- very similar product is coming, as we speak, in the Swedish market under the ZYN brand together with an apple mint product. So those are examples of how we complement our product range there with good and relevant offerings.

Operator
The next question comes from the line of Fulvio Cazzol from Goldman Sachs.
Fulvio Cazzol - Goldman Sachs Group Inc., Research Division - Equity Analyst

Both of mine are on ZYN. The first one on ZYN in Denmark and the Czech Republic. Can you maybe give us some details on what taxes apply to the ZYN product? And maybe some color on the retail price points of ZYN versus chew bags in these 2 markets? And also, what are you allowed to do in terms of marketing to drive consumer awareness and trial, please?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

I don’t have those details in front of me on the tax side, but from my recollection, price level is similar to chew bags in retail. And these categories are essentially new categories. So we treat them from a marketing point of view in a very similar way that we treat the chew bag assortments. But it is yet to be worked out exactly what type of regulations that apply to these type of products in the European states.

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

Okay. Great. And then my second question is on ZYN in the U.S. Can you comment a little bit on whether you’ve seen any changes for the competitive landscape? Have you seen sort of some of your existing competitors broaden out their distribution? Any signs that more companies are stepping into the category?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

Yes, we’ve seen-- there are a couple of product offerings out there that they have expanded distribution, but they’re relatively far from our footprint. And then we do see announcement of other products from other players, but it’s my understanding, we haven’t seen them out there in the real market yet.

Operator

Your next question comes from the line of from Karri Rinta from SHB.

Karri Rinta - Handelsbanken Capital Markets AB, Research Division - Research Analyst

Karri Rinta from Handelsbanken. And maybe a follow-up on the previous question. Those announcements that you have seen, but you haven’t seen the actual product, can you give us a little bit more color on that, if possible?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

I think most of you are aware that one major tobacco player has spoken about the tobacco-free variety that could potentially be launched in the market. And then, I would basically urge you to -- if you search the Google around on looking for nicotine pouches, you’ll find some small examples from smaller players.

Karri Rinta - Handelsbanken Capital Markets AB, Research Division - Research Analyst

All right, but just to be more specific, are you talking about BAT and (inaudible) when you mentioned the larger player?
Lars Dahlgren - Swedish Match AB (publ) - President & CEO

Yes.

Karri Rinta - Handelsbanken Capital Markets AB, Research Division - Research Analyst

Okay, right. Then, you mentioned that you will no longer be giving or disclosing the profitability for the snus and nicotine pouches expansion outside the Scandinavia. Can you give us any guidance on, how should we think about 2019 in terms of that volume ramp-up, maybe some sort of indicative run rate by the end of 2019? And if there's something that we should take into account when it comes to phasing of -- of marketing spend, i.e., is there an extremely front-end loaded campaign of building distribution in the first half of -- or how should we think about phasing of marketing expenses?

Thomas Hayes - Swedish Match AB (publ) - Senior VP & CFO

Yes, I think it's fair to think about the national expansion of ZYN in the U.S. as a build, as capacity allows. So there's not an expectation on day 1 when we've completed all of the facets of our capacity expansion that we're going to be at full capacity. So there will be a -- it's not a kind of a ratable phased expansion plan over the course of 2019, but it will touch each of the quarters, beginning with the second quarter in 2019. And there is, and the nature of the marketing efforts that we anticipate, there is a cost involved with the -- whether it's merchandisers or point-of-sale, with the placement of the ZYN products in each of the stores as we roll this out nationally. So if we ended the year at a little over 13,500 stores, you can think about that as being 1/4 of the U.S., I mean, that should give you some feel and flavor of plans and expectations at least in this initial wave of 2019 activity, predominantly focused on what I would say Q2, Q3.

Karri Rinta - Handelsbanken Capital Markets AB, Research Division - Research Analyst

All right, then. How should we think about the run rate -- volume run rate at the...

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

It depends on the consumer demand and when we've done it on a -- in a broader case. We're obviously very encouraged by the demand we've seen in the Western region, but we also have to see how consumers receive it in the rest of the country.

Karri Rinta - Handelsbanken Capital Markets AB, Research Division - Research Analyst

All right, fair enough. And then just a small detail. I saw that depreciations went up into snus and moist stuff. Is that temporary or is that more permanent?

Thomas Hayes - Swedish Match AB (publ) - Senior VP & CFO

No. I think part of what you may be seeing there -- because there is -- I wouldn't characterize it as temporary. I mean, much of our capital that we've been putting in play have been directed towards our snus and moist stuff product segment, and that pace of capital spend should -- you should -- you shouldn't expect that to continue. But also, there's general currency effects that you would expect year-on-year with the strengthening dollar -- full year effect of the strengthening dollar. But I would -- if you're thinking forward, I would look for that number to go up versus coming down.

Operator

(Operator Instructions) Your next question comes from the line of Sanath Sudarsan from Morgan Stanley.
Sanath Sudarsan - Morgan Stanley, Research Division - Research Associate

So two very quick questions from my side. One, on the announced additional CapEx for ZYN, could you give us some more color on how fast you can now expand capacity or rather add incremental capacity? And also, what is driving this higher CapEx, is it the opportunity now you see in the U.S. or it’s just more options you want to explore in Europe? That’s on ZYN. And the other one is on U.S. cigars. Could you give us some sense on how much of your sales are in markets, which now have a flavor ban and how the trends in these markets are possibly different from the ones where flavors are allowed?

Thomas Hayes - Swedish Match AB (publ) - Senior VP & CFO

Yes. So the capital expansion project for ZYN, you should keep in mind that, I mean, this is -- it’s kind of a phased capital expansion project that was initially started in July 2017. So what we’re seeing now come online that should support our plans for a national rollout will be the earlier -- basically, the initial stage. That plan was added to in the early part of 2018 and the decision that we made this week to further expand capacity, that would likely be online toward the end of 2020. Once again, in each case, not full capacity on day 1 of closing one of those phases of the projects. And your other question as to flavor bans within the U.S., I would characterize -- there are pockets within the U.S. that have implemented flavor bans. There are other local legislations into minimum pack sizes and so forth that also have effect on cigar volumes. What you do end up having with whether it’s an isolated county or city that put in place a flavor ban is you tend to see the balloon may get smaller in one area, but the air goes elsewhere and consumers are purchasing flavored cigars in geographies that are outside of that specific county or city. So it’s difficult to determine with full transparency as to what the effects of a flavor ban would be. But our -- from a total, our business, total U.S. portfolio of cigars, it’s a relatively nominal level of cigar volumes sold in those areas that have flavor bans, and that was the case pre-ban as well.

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

And this is Lars filling on that one. On your question on export in European markets. The citing of the capacity expansion in the U.S. is aimed at the U.S. market but, of course, that doesn’t prevent us from exporting from the U.S. to other geographies. But we are also, we already been exporting from Sweden to the U.S. during the buildup phase, which means that we have capacity of U.S. variety in Sweden, which has been rather manual and complex. And we actually also have invested -- started to invest in little bit more automation, higher capacity there to be able to serve Scandinavia and other more nearby, in markets. But when it comes to Europe, we are selling 2 different types of nicotine pouches. The dry one and the variety that we call Slim, which is a bit moist, more similar to more traditional snus. While currently, in the U.S. market space, it’s only the dry one.

Sanath Sudarsan - Morgan Stanley, Research Division - Research Associate

And just to clarify on that, is there any complexity in kind of manufacturing those that’s very easy to switch between the capacities you have in Sweden and U.S?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

They are different processes. So in -- if you refer to the distinction between the dry one and the moist one. So in Sweden, we can manufacture both, but in U.S., the capacity we’re installing is for the dry one.

Operator

Your next question comes from the line of Andreas Lundberg from ABG.
Andreas Lundberg - ABG Sundal Collier Holding ASA, Research Division - Research Analyst

Back on the cigars. Can you talk about your strategy if all flavored cigars will be banned? And how do you work, while waiting for the FDA decision in this category? And also, lastly, what are the risks sitting on any excess inventories, if there will be any bans?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

When it comes our strategy, I think it's important to stress the fact that potential flavor ban in the U.S. is something that did not come as a surprise. There's communication from the FDA to us. On the contrary, we have worked consciously to make sure that we have a very broad portfolio of offerings that we think, under all reasonable definitions, would qualify as non-flavored cigars. So it's pretty much but making sure that we have full assortment of relevant product. And in terms of a potential -- disturbances in conjunction with implementation of a ban, I think definitely, one cannot rule out that one would see such effects, but it depends a lot on how the ban is implemented, if there are transition periods and so forth. And we have no details on -- such details at all at this point in time. So I think it's something we need to get back to.

Andreas Lundberg - ABG Sundal Collier Holding ASA, Research Division - Research Analyst

And what's the kind of a chance, do you think to get conversion of lost volumes into other cigars?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

I mean, already, today, we see that the typical cigar smoker is not necessarily using only one variety. On the contrary, likes to try different ones and switches around a little bit depending on what’s promotional offers and so forth. So we think that a reasonable assumption is that the vast majority of the consumers that today are consuming flavored cigars would just switch to a non-flavored varieties, but that is of course, to some degree of speculation on our side.

Operator

The next question comes from the line of Stellan Hellström from Nordea.

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

Yes, on the decision now to expand production capacity of ZYN, and you say you are in about 1/4 of the U.S. currently, geographically, does that mean that you'll be targeting 50,000 stores roughly by the end of '19?

Thomas Hayes - Swedish Match AB (publ) - Senior VP & CFO

Yes, I would -- we are in 1/4 of our regional footprint within the U.S. But what I would say is, I mean, if you take -- there are more than 13,500 stores in the West region and obviously there are more than 60,000 retail stores across the U.S. So the upper band of what we would look to target, I think, is going to be somewhat dependent upon what we’re seeing through our national rollout. But in terms of our plans for 2019, it would be to I would think, initially target and look toward that level of 60,000 stores that you mentioned. But I would not say that would be necessarily the endpoint or otherwise.

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

Is there any reason why we would think that the reception of ZYN will be different in other parts of the country?
Lars Dahlgren - Swedish Match AB (publ) - President & CEO

I mean, it’s -- there are several reasons why the development can be different, but it’s not necessarily saying that it will be different. I mean, for one thing, first of all, the Western region is one of the stronger snus regions in the country, which shows some kind of consumer interest for alternatives to start with. And we also see relatively speaking, that within the moist snuff category where there are strong indications that the resourcing volume from the Western region is overrepresented when it comes to pouches. And so it could be, for example, that some of the states where moist snuff consumption is heavier and more skewed towards loose, the consumer interest is not as strong as we’ve seen in the Western region. But again, that’s a speculation. And then, we’ll have to see also how the retail landscape and also the competitive landscape plays out in the rest of the country. I think it’s fair to say that in the U.S. market, generally the focus on alternatives to cigarette has increased relatively strongly in the last couple of years. So in the Western region, for example, we have had the benefit of getting very good visibility on our displays. It could well be that in the rest of the country, that, so to say, the category of alternatives is a little bit more crowded and that ZYN would be one among several products. So there’s all these kind of factors that means that we can’t take for certain that we have the same type of rapid development that we’ve seen in the Western region. But the consumer demand for ZYN is, in our opinion, a clear testimony to the potential of the product. So it’s more a matter of timing in terms of -- we’re convinced that the category will become big over time on a national basis.

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

All right. Then a question also on the -- I mean, we’ve seen now that your -- the profits from snus and nicotine pouches has been increasing quite significantly lately. And then, I mean, you say there will be costs associated with placing the product with the new retailers. And, I guess, there would be also may be under absorption in the production initially. But -- so how are we to think about costs in this respect, if it -- with the profits -- I guess, you also have the benefit, of course, of increasing volumes potentially and also at the end, lower production costs?

Thomas Hayes - Swedish Match AB (publ) - Senior VP & CFO

Yes, I would say that our plans for 2019 with this national rollout would be that the incremental gross profit from increased volumes would be sufficient to cover our initial, even if we’re only going to be an market for 9 months of the year, will be sufficient to cover our marketing costs in support of the national rollout. So we are expecting a positive return from our efforts with the national rollout in 2019.

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

All right. Is there any -- on that note, also, maybe that new markets that you go into, are those to an extent, is it possible that they -- that you will need to spend a lot of money there also potentially to build up sales force, et cetera?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

I would say, we have a very strong sales force with our broad portfolio of offerings for the U.S. market. So we think we’re well equipped there.

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

All right. Just finally also on the rolled leaf or the supply shortages, how well have you -- do you think you will be able to secure volumes then for late spring and -- to support further growth? Is this potentially a permanent problem that you will not be able to get full volumes?

Thomas Hayes - Swedish Match AB (publ) - Senior VP & CFO

I think we’ve implemented a number of measures. Some of it was actually, the commitment of crops in the specific markets that have historically grown the specific rolled leaf wrapper, but also the evaluation of other geographies and locations for those crops. So we don’t deal with it, once
we've kind of come over this -- this hurdle of leaf shortage that it is going to be a recurring issue. I would also say that -- you need to kind of keep in mind that this was a segment within the cigar category that on balance was 200 million cigars in that range as recent as probably 3 years ago, so 3, 4 years ago, and now it's approaching 800 million cigars as a segment. So when you look at it in that way that the success of the segment itself has created a supply issue with respect to leaves -- rolled leaves wrapper.

Stellan Hellström - Nordea Markets, Research Division - Senior Analyst of Retail and Consumer Goods
Surely. There -- you've been obviously surprised then by the strong growth, but -- all that...

Lars Dahlgren - Swedish Match AB (publ) - President & CEO
I would just say, to add to that, the providers of rolled leaf are responding to that increased demand.

Stellan Hellström - Nordea Markets, Research Division - Senior Analyst of Retail and Consumer Goods
So you're not -- also, not expecting significantly higher prices for your supply?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO
We did note that the, I mean, it is -- the rolled leaf cigar is a more complex cigar than either the HTL variety or the natural leaf small cigar that we have in place. And that was one of the reasons that we put in place a price increase in the beginning of the second quarter of 2018. So there could be price increases, there's increases in tobacco from time to time, but we're not expecting there to be sharp increases that would kind of materially impact the profitability of our rolled leaf segment, post price increase.

Operator
Your next question comes from the line of Chas Manso from SG.

Charles Manso de Zuniga - Societe Generale Cross Asset Research - Director of Consumer Equity Research
I think quite a lot of this has been covered. But just to drill even more down into this. So on ZYN doubling its capacity, I think earlier you said that the total U.S. store universe was over 100,000, something like that. And in your current, there's a 13.5, you sold 4.2 million in the quarter, which analyzes at 17 million for the year. You grossed that up for 100,000 stores, you kept broadly to the 120 million cans of -- that you've announced as your new capacity. And that assumes similar traction across all regions, the Western region, and no competition. And you've gone through why you may not get the same amount of traction in all regions as the Western region, and you also mentioned competition looks as if it's going to come in. So the missing piece of the equation, I guess, is the penetration potential that you see. Clearly, you see it will be much more in the calendar years. So could you talk a bit more about the penetration potential you see that formed the basis of your decision to double capacity to 120 million cans?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO
Yes, I mean, when you draw out the trends, so to say, and try to scale them up on a national basis, you can obviously end up with intervals, and there can be low cases and high cases and so forth in the pace of consumer demand. I think one, a couple of comments to your kind of algebra there. Yes, we are in 13,500 stores. There are more stores in the Western region, and 4x 13,500 is not 100,000. And as you would expect -- we have gone to sort of stores that sell relatively much product to start with. So I think you should -- to start with it, expect that as you -- beyond those roughly 50 million, 60 million -- or 50,000, 60,000 thousand stores then you start to add on stores that are smaller stores. But, another comment
on kind of current universe is that your maths are obviously right in terms of where we are now, but I think it’s important to point out that the trend is, within the Western region, is still very strong. It’s basically growth across stores, and when I say across stores, we typically analyze the stores based on when we enter into the stores. So if you take the stores that we entered into as early in 2016, those stores are still growing. And if you take the stores that we entered into 2017, they’re growing and the same for the 2018 stores. So there is a good chance if the current trends persist that we will see incremental growth from the Western region. And then it boils down to, of course, those uncertainty factors in terms of the national potential, but we feel confident that there is significant long-term potential. But exactly when we will get to 50%, 60%, or 80% capacity utilization on that installed capacity is obviously very hard to say at this point in time. But also with these types of projects, there are indeed long lead times. And given the size of the opportunity, we think that the risk of opportunity cost of not being able to supply, but also the significance of its -- it’s rational to take these incremental steps in terms of adding capacity.

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

Okay. And one more for me. On General Snus in the MRTP, February 6, can you sort of talk us through, assuming that the FDA does approve how that would impact your strategy for General Snus in the U.S.?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

I mean, the most clear change to our strategy would be that we would start to use the communication towards consumers that FDA in such case would allow us to do and pointing out the benefit, the number of diseases relative to using cigarettes at point of sales, and another type of communication. And we are hopeful based on the commentary by the FDA, both before and after the TPSAC hearing, so we think there’s a good chance, but no guarantee that we will obtain the MRTP status. And we definitely think that, that is positive for General Snus and the snus category, generally speaking.

Operator

Your final question from the line of Adam Spielman from Citi.

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

Can I just follow up on Chas’ question a little bit. What was it that persuaded you, I mean, what have you learned in the last couple of months that persuaded you to authorize this new round of capital expenditure that you didn’t know back in, let’s say, the summer of 2018?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

Say, what we have seen is quite frankly, the initial stores that -- where we made ZYN available, I think if we -- back to take where we were then, we would have expected little bit more of a leveling off of maybe stabilization of the velocity in those stores and especially since we’ve been adding distribution, one could think of somewhat of a cannibalization as consumers buy their product in a store closer to them as opposed to the store where they used to buy it. But we have seen, as I’ve said, very strong continued growth trend basically across the store universe. And therefore, on an aggregated level, it has kind of exceeded our initial plans and expectations. And with more time and with more volume and bigger store universe, also our understanding of the consumer potential has obviously increased as well.

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

Do you have sort of done any studies in the local area perhaps 1 or 2 counties where in that local area, you basically give unlimited supply of ZYN, in essence, to try and determine what the sort of potential market share could be if supply wasn't constrained?
Lars Dahlgren - Swedish Match AB (publ) - President & CEO

Those are kind of the details that I don't have an exact answer to. But I think it's fair to think of the development in the Western region, as, yes, we have had to manage the capacity, but effectively we made that product available to consumers, and maybe not in the exact stores closest to them and so forth, but I would say on a kind of a temporary basis from month-to-month and so forth, the capacity constraints may have impacted the shipment volumes. But trend-wise, I would not think that our capacity limitations means that we are masking much bigger potential than what we are seeing. It's already very impressive buildup of consumer demand as it is.

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

And one final question from me, and thank you very much. Do you have any -- or can you provide any color on where this volume is coming from? I'm assuming the vast bulk of it is coming from pouch -- the moist snuff in pouches, but can you be more specific at all?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

We have some consumer data on where consumers are coming from. And moist snuff users, I would say, are overrepresented, but we also see, including loose consumers, but we also see that it pulls cigarette smokers into the category, and we see that relatively many of the ZYN consumers stated they have prior experience of dual use between smokeless tobacco and cigarettes.

Operator

There are no further questions. Please continue.

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

Okay. Then, I would like to thank you all for listening and asking questions today. And I have to finally, inform you that the release of our Q1 report will be on May 9. Thank you.

Operator

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