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PRESENTATION

Operator

Ladies and gentlemen, welcome to Swedish Match Second Quarter Report for 2021. (Operator Instructions)

Today, I'm pleased to present Emmett Harrison, Senior Vice President for Investor Relations. Please begin your meeting.

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

This is the Swedish Match Q2 2021 Telephone Conference. And with me today are Lars Dahlgren, our President and CEO; and Anders Larsson, our CFO. In the Investors section of our swedishmatch.com website, you will find our Q2 investor presentation. We encourage you to have that presentation at hand as you listen to our prepared commentary for this call.

Several of the slides in the investor presentation repeat key messages from the interim report that we published this morning. We will focus our commentary on select slides only. And while doing so, we will refer to the applicable page number of the presentation.

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 today's interim report as well as the 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. I will now hand over the word to Lars.

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

Thank you, Emmett, and good afternoon, everybody. With today's interim report, Swedish Match reported its eighth consecutive quarter of double-digit year-on-year operating profit growth in local currencies. For the quarter, both sales and operating profit in local currencies grew for

all of our product segments. In absolute terms, the Smokefree product segment was the largest growth contributor, driven by an excellent performance from same nicotine pouches in the U.S. and a solid performance in Scandinavia.

Adjusted for acquisition effects and income on temporary character in the Light segment, the steepest local currency sales and operating profit growth in percentage terms was delivered by Cigars, where Q2 of prior year represented a relatively soft quarter. For Smokefree, both sales and operating profit grew by 18% in local currencies, resulting in an overall operating margin that was virtually unchanged. With significantly higher market investments relating to nicotine pouches in the U.S. and Scandinavia as well as in other markets, this demonstrates the operating leverage and growth potential in our largest product segment.

Strong volume growth for ZYN nicotine pouches across the U.S. market continued to be the key growth driver for the Smokefree segment, but also the more traditional smokefree products in the U.S. portfolio contributed with good year-on-year earnings development.

In Scandinavia, the local currency sales growth was driven by nicotine pouches and for earnings, relatively strong profit development for snus more than compensated for the increased market investments relating to nicotine pouches. In Q2 of the prior year, the COVID-19 situation resulted in an unusually low shipments of natural leaf cigars and some additional costs. In this year's Q2 very strong demand for natural leaf varieties, improved pricing and continuing progress in raising productivity at our Dominican facility, all contributed to the strong increase in sales and profitability for Cigars.

For Lights, underlying performance was solid and the reported numbers further benefited from the inclusion of a recent smaller acquisition as well as income from continued land sales and the recovery of indirect taxes in Brazil. Strategically, Swedish Match aims to actively invest and have a leadership presence in those categories and segments where we see the best growth potential. With a keen focus on consumer needs and societal trends, our targeted efforts have resulted in the portfolio of businesses with highly attractive prospects.

The second quarter is not only a good illustration of our ability to compete effectively but also the attractive prospects for several of the categories in which we operate. The U.S. nicotine pouch market close to doubled in size compared to 1 year ago, and relative to the first quarter, the sequential growth remained strong.

In Scandinavia, over the past few years, the Smokefree category has become more and more Unifix with accelerated category growth as a result. In the U.S. market, despite the easing of COVID-19-related restrictions, the category growth for cigars in Q2 held up well with more and more consumers transitioning to the natural leaf segment, which represents the majority of Swedish Match's portfolio mix.

While the generally improved COVID-19 situation during the second quarter -- with the generally improved COVID-19 situation during the quarter, we were able to accelerate our marketing and consumer engagement activities in several markets and thereby better match investments to the growth prospects of our businesses. For ZYN in the U.S., we attended more events and expanded our loyalty building programs to both consumers and retailers. Encouraged by the consumer traction in initial geographies, during the quarter, we rolled out ZYN Menthol and Chill products nationally. In Sweden, we introduced a new modern range of nicotine pouches under the VOLT brand family, along with an ambitious activity plan.

Swedish Match will continue to invest in brand building awareness and loyalty with consumers and retailers and not the least for ZYN in the U.S., our marketing calendar for the upcoming quarters ambition.

By that, we will now turn to some more detailed commentary and continuing with ZYN. And starting on Page 8 -- Slide 8 of the presentation. This chart illustrates the impressive trajectory of ZYN shipment volumes on a 12-month rolling basis. During the second quarter, we delivered an all-time high volume of 42.5 million cans, which brought the 12-month rolling shipment volume to close to 143 million cans, of which close to 80 million cans were sourced from the first 6 months of this year.

Our staff in the Owensboro, Kentucky facility has done an outstanding job in coping with the elevated demand, while at the same time delivering on the capacity expansion projects in line with or better than original plans. And at this point, we do not anticipate that our manufacturing capacity will be a constraint in our ability to meet further growth in demand.

Moving to Slide 9. This graph illustrates the volume development for all the brands included in the nicotine pouch category in the U.S., as measured by MSA data, which captures deliveries from distributors to retail. The MSA data is helpful in understanding market trends, especially when viewed over longer periods. The 13-week period largely representative of calendar quarters are somewhat volatile as they are susceptible to waves of distribution expansion and promotional offerings that cause retailers to stock up. Viewed over several quarters, however, the chart clearly depicts the impressive growth trend of the nicotine pouch category.

And in annualized terms, with the 13-week MSA data as a basis, we estimate the Q2 category size to exceed 250 million cans. While the data indicates a close to 20% category growth in Q2, it is important to view this against the background of heavy distribution builds and aggressive price promotional activity by competition. In that respect, it's very encouraging to note that the steady volume trajectory for ZYN has continued despite relatively modest store distribution expansion for ZYN. On a sequential basis, the MSA data shows a slight market share decline for ZYN in Q2. However, this decline is not necessarily fully representative of market share based on consumer purchases and particularly in terms of market share measures based on dollar share.

Moving to Slide 10, which provides some further details on the trajectory for ZYN based on the same MSA data. The graph to the left illustrates the store distribution for ZYN based on isolated 13- and 26-week period. The graph to the right shows the velocity for ZYN measured as cans per store per week on a 13-week trended basis. The strong volume performance for ZYN during the quarter was partly enhanced by the national rollout of Chill and Menthol varieties, but also when adjusting for this, ZYN continued to grow its velocities on a sequential basis. With the store count for ZYN being up only marginally from Q1, we are pleased to note that the sequential velocity growth for ZYN was the strongest across all brands captured in the MSA database.

Turning to Slide 11. The nicotine pouch category continues to demonstrate its premier position among next-generation products, and not the least with its appeal among cigarette smokers that seek better alternatives. Based on MSA data, our estimate is that annualized year-to-date volumes for nicotine pouches measured by cans correspond to close to 7% of 2020 cigarette volume measured by packs in the Western region.

Despite being present in the rest of the U.S. for only 2 years, the corresponding number on a national basis now exceeds 2%. Consumer research confirms that nicotine pouch consumers gradually increase their weekly consumption as they transition from other tobacco products, and that current weekly consumption levels remain well below those of cigarettes. Our estimate is that the number of nicotine pouch consumers correspond to about 10% of the number of cigarette consumers in the Western region. And that on a national level, that number has already reached 5%. With the superior function and emotive benefits, there is significant potential for further increased penetration as well as average consumption for nicotine pouches. With that, I'll hand over to Anders.

Anders Larsson - Swedish Match AB (publ) - CFO & Senior VP of Group Finance

Thank you, Lars. Turning to Smokefree in Scandinavia and Slide 12 with continued COVID-19-related restrictions and timing effects on shipments, it remains a challenge to determine the underlying growth of the Scandinavian smokefree market. However, as Lars pointed out, we are encouraged by the strong market dynamics and our estimate is that the Scandinavian smokefree market reached double-digit consumption growth in volume terms for the 6-month period ending June 30.

While the growth has been driven by nicotine pouches, it is positive to note the resilient trajectory for more traditional products. One contributing factor to the growth development, we believe, is the lowered Norwegian excise taxes at the beginning of the year, which have resulted in a notable decrease in retail prices.

Slide 13 provides more details of the Scandinavian category trend development on a 12-month rolling basis. As the picture depicts, nicotine pouches have provided incremental growth to the category with the broadening of the consumer base as the range and types of products cater to more diverse preferences and needs. Of particular note, more females have now found a viable alternative to the combustible cigarettes. And as cigarette consumption historically has been higher for females, we view this as a very positive development from both a harm reduction and a commercial perspective.

On Page 14, we look at snus isolated. According to Nielsen, our share within the snus category in Scandinavia has been relatively stable, and we remain the clear #1 player, more than twice the size of the next largest competitor. While the declining percentage of snus relative to the entire smokefree category is apparent, as illustrated to the right on the slide, this needs to be considered in the light of the very strong overall category growth.

Moving on to Page 15 and nicotine pouches in Scandinavia. The category for nicotine pouches remains highly competitive. And over the past year, the level of activity from competition has been extremely high in terms of both new brands and variants and promotional offerings. This high level of activity has helped to support category growth. And according to Nielsen, nicotine pouches now represent close to 21% of the Scandinavian smokefree market. While our volumes of nicotine pouches have been very strong, they have yet to match the growth of the overall category. The introduction of the VOLT series is one initiative that we believe has prospects to make the Swedish Match assortment even more relevant for consumers, and apart from consumer activations at physical venues, the digital engagement has been extensive.

Turning to moist snuff in the U.S. on Page 16. Our moist snuff positioning in the value segment is serving us well as we note the growing share within the total moist snuff market. As for a number of products within the U.S., volume development was unusually strong in the third quarter of 2020, implying tough comparisons for the coming quarter, which was also the case for our chewing tobacco business. With sustained momentum for our Longhorn brand, our moist snuff volumes have grown year-on-year despite the discontinuance of certain products within our range. We also note that recently a large competitor repositioned a brand to seemingly match Longhorn EDLP price positioning.

Turning to cigars on Page 18, which illustrates several interesting aspects of the cigar category based on data from the MSA set, measuring shipments from distributors to retail. As the bars in the middle show, the total category continued to exhibit good growth in the second quarter when considering that across several parts of the U.S. COVID-19-related restrictions have been eased. The natural leaf segment stands out as the key driver of the category growth, which is in line with long-term trends. With close to 60% of our portfolio in the natural leaf segment, Swedish Match is very well positioned to capture growth opportunities as consumer and segment dynamics play out.

We manufacture our natural leaf varieties in our facility in the Dominican Republic. And over the past 15 months, keeping up with market demand has been a challenge. Production of natural leaf cigars at our Dominican factory reached an all-time record in the second quarter. But with the strong growth trends within the cigar category, we need to balance our resources and fully meeting demand remains a challenge. Year-on-year, our cigar market share increased as we have been able to compensate for production constraints on the natural leaf side with increased HTL production.

In the second quarter, with the improved production situation, shipment volumes grow for natural leaf cigars, and we also noted a sequential improvement in our market share within the natural leaf segment. Within HTL, we noted a sequential share decline in the quarter, but it should be noted that this was partly attributable to very limited shipments of our low-price offering Jackpot, which was one of the contributing factors to the improved price mix in our cigar segment.

On Slide 20, we have 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 substantially flat versus prior year on somewhat higher interest rates and lower returns on surplus cash, which was partly offset by lower average debt. The weighted average interest rate of our loan portfolio at June 30 was 2.07%, virtually unchanged compared to the end of 2020. Our net debt to EBITDA for the 12-month period ending June 30 was 1.9%. During the first 6 months, new bond loans of SEK 1.6 billion were issued, repayments of maturing bond loans amounted to SEK 750 million and early repayment of short-term bond loans amounted to SEK 716 million.

During the remainder of 2021, SEK 803 million of bond debt falls due for payment. As of June 30, 2021, Swedish Match had SEK 15.347 billion of interest-bearing debt, excluding retirement benefit obligations, but including the recognition of lease liabilities of SEK 283 million. The capital duration was 3.9 years, with 98% of the portfolio subject to fixed interest rates. The EPS bridge illustrates the components of our 26% year-to-date growth in adjusted EPS. And apart from the after-tax effect of our increased operating profit, the reduced number of shares had a meaningfully positive impact. The adjustments highlighted in the EPS bridge refers to the after-tax effect of settlement income related to a previously ongoing arbitration.

During the first half of the year, we made share repurchases in the amount of SEK 1.36 billion, buying 18.8 million shares at an average price of SEK 72.16 per share. Finally, regarding currencies, if current exchange rates prevail, we will continue to face some currency headwinds over the next quarter. For reference, the Q3 2020 average exchange rate for the U.S. dollar was SEK 8.83; for the NOK, it was SEK 0.97; and for the Brazilian real, it was SEK 1.64. And with that, operator, we can open the floor for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

We have a question from the line of 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, if I may. Firstly, on the U.S. nicotine pouch market. Can you tell us a little bit more about the pricing environment? You mentioned heavy campaigns by your competitors? And I know you mentioned earlier here with Velo selling at 0.99 per ton on having quite heavy promotions. How aggressive is Dryft in this market? And I'm also curious if you could just elaborate here -- is this purely when they are aggressive on campaigns. So when campaigns ease, do they go back to similar prices as ZYN or are they permanently selling at a lower price compared to ZYN? So if you could just going to elaborate here on the pricing environment, that would be very helpful.

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

Sure, Niklas, this is Emmett. If we start off with our own products, we have had some promotional activity for visibility and trial generation for Menthol and Chill varieties consistent with the national expansion. And we've also had some targeted accounts that we have had some other price promotions on. But effectively, our consumer price has been largely stable on a nationwide basis. If you then move on to the large cigarette companies that are trying to build a presence in the U.S. For the most part, you are still seeing a lot of those promotions with a free can offer. If you buy a competitor's product or a cigarette product, \$0.99 offerings as well. And at different price points, let's say, \$1.99 or \$2.99. Oftentimes, when they go off of the promotion, which usually lasts maybe 3 or 4 weeks in a large chain, the price does revert to a somewhat higher level, but there are differences in pack size as well between ZYN and the competitors' products that happens. But I would say, for the most part, it's been pretty stable in terms of the high level of promotional activity.

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

And one clarification. You asked about the Dryft. I mean, Dryft has been acquired by BAT and it hardly exist anymore as Dryft brand migrated that to Velo.

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

Yes. Sorry. Thanks for clarifying that. I actually meant Rogue, I meant to ask about Rogue. It's -- because I see that they are also gaining some market share here. So I'm just curious if they are doing this with promotions or on kind of on quality and distribution?

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

If we look at the data that we're getting from outside sources on Rogue, we do see a little bit more stable pricing more in line with what Swedish Match is doing. So those price levels do tend to stay a little bit higher.

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

Okay. Secondly, I'm curious about the EU commissions TPD2 application report that was out here in late May. I know this reported didn't contain very much details here, but they mentioned nicotine pouches as using a legal loophole to circumvent the EU ban on snus. Are you seeing any serious action from the EU Commission to move against nicotine pouches? And on the other side, I know that several markets in the Nordics and Eastern Europe have allowed nicotine pouches. So if you could just elaborate on the regulatory environment in Europe, that would be very helpful.

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

And generally, I'd say the commission report didn't contain any surprises you are aware of and we pointed to the fact that they show interesting in nicotine pouches as a category, which is not surprising in that -- given that we see increasing consumer demand across several markets. And I mean, it's going to be a political process, but we consider it to be the more likely course of action here is that nicotine pouches will be regulated in at some point in TPD and say properly regulated. You may recall that the commission reports on E-cigarettes shortly prior to the revision of the tobacco directive, the last time they were very negative as well. And actually, the commission didn't want to see them in the market at all unless they were classified as pharmaceutical products.

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

That's very clear. Finally, I'm just curious about the Scandinavian nicotine pouch market. You mentioned here launching VOLT in May with increased marketing efforts, and we see your margins trending a little bit lower here as well for the segment. Still, your market share in nicotine pouches is down nearly 1 percentage point. And any particular reason for a declining market share?

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

I mean it's a mix of thing, and this is Nielsen data that doesn't capture, for example, the e-com channel where actually we have a relatively higher position compared to the Nielsen data. And then another factor is that we have lost share in the Danish market, which actually is becoming big enough to make a difference on the total share. With a relatively small position from the start, the ZYN franchise hasn't been able to defend its position properly against consumers in a more regulated environment that we see in the Danish market at the moment now where, for example, there's a prohibition on price displays.

Operator

Our next question comes from the line of Fredrik from ABG.

Fredrik Ivarsson - *ABG Sundal Collier Holding ASA, Research Division - Research Analyst*

A couple of questions on my side as well. First on ZYN in the U.S. If you could give some feeling for the magnitude of the gross margin expansion that you mentioned, that would be helpful. And second one, on the marketing investment as well. What do you expect in terms of acceleration of those in Q3?

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

If you look at the Smokefree segment, in the U.S., in local currency, while moist snuff and chewing tobacco also reported improved profits and growth for moist snuff, the downside is driven by nicotine pouches. And the -- while the average price is slightly down year-on-year, given what Emmett spoke about some promotional activity related to the national expansion and some other targeted efforts, we've also seen a positive development in the cost of goods, given that we have ramped up our output on a year-on-year basis.

So there is a relatively tight correlation between volume development and gross profit when it comes to nicotine pouch development. And then part of that has then been offset by increased marketing investments. And this is completely in line with our plan. We pointed to that after Q1, and we're very pleased to see that we've been able to step up our activity is largely in line with what we had planned. And in that calendar or planning for marketing activities, there is a further ramp-up in activity level planned for the third quarter. So you should expect higher marketing investments relating to ZYN in the U.S., both relative to the second quarter and the prior year.

Operator

Our next question comes from the line of Gaurav Jain from Barclays.

Gaurav Jain - Barclays Bank PLC, Research Division - Research Analyst

I have three questions. One is that on that Slide #11, I think you mentioned that the smoker share in Western region is 10%, while the consumption share is 6.8% and nationally, it is 5%. How soon do you think that gap closes based on the experience you have had with them so far?

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

I mean if you look at -- as you know, we've been in the Western region since mid of 2016. We started off with relatively limited number of outlets. And then if you look at the expansion markets apart from very isolated presence in some geography, we went nationally in April of 2019. That's the time difference. And when we look at the penetration -- when we look at the velocity of cans per store per week, if you look at the entire category and we compare the Western region to the expansion market and look at the number of months after launch, we can see that in aggregate the expansion markets are trending up at a notably higher average velocity. Then since performance in isolation is actually very close to the Western region trajectory.

This is, of course, a consequence of facing competition in the expansion market that we didn't face at the beginning in the Western region. So this data indicates that if this continues, and we believe there are good reasons why it could continue, that the penetration in terms of number of cigarette smokers that we're estimating to be 10% in the West, but we could see that sooner in the rest of the country compared to what we experienced in the West. And then, of course, cigarette smokers have other alternatives as well to choose from, so there are no guarantees that this trend will continue.

Gaurav Jain - Barclays Bank PLC, Research Division - Research Analyst

Sure. Thank you. My second is, last year in Q4, if I remember correctly, you had 3 lesser shipping days versus Q3, which was impacting your Q4 sequential growth for ZYN. Is there a similar pattern to shipping days this year as well so that the phasing of ZYN through the rest of the year could be that Q3 is higher than Q4 is flat or down?

Anders Larsson - Swedish Match AB (publ) - CFO & Senior VP of Group Finance

Yes, Anders here. There's -- it's similar. But then bear in mind that you have kind of the seasonality around Christmas and so forth in the fourth quarter as well. So...

Gaurav Jain - Barclays Bank PLC, Research Division - Research Analyst

Okay, sure. And recently, we have seen one of your larger competitors acquired a couple of companies in the pharma space, one of which is in the oral sort of pouch business, and every company is talking of like a beyond nicotine strategy. So how are you thinking of these developments in the rest of your peer group?

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

I mean we -- Swedish Match has done limited tests with what you can call beyond nicotine as we spoke about before with CBD pouches in the Swiss market. For now, we have discontinued those tests, but of course, as any company, we don't rule out business development opportunities in the future that build on our core and are adjacent to our core. But when and if we would embark on any such initiatives, we will talk about it then.

Operator

(Operator Instructions) We have a question from the line of Faham Baig from Crédit Suisse.

Mirza Faham Ali Baig - *Crédit Suisse AG, Research Division - Research Analyst*

I will also ask three, if that's okay. The first one really is ZYN in other markets, which in this question will also include Denmark, following on from the earlier question. So what is the strategy in Denmark, because it is seen as a relatively small market today, but one that has significant expansion, I believe, on the last conference call, you compared it to Norway and what the category there was 6, 7 years ago.

So I'm a bit surprised that your share, which, as you said, was already 1%, 2% went to, let's say, 5% in Q1, and now you're seeding share again. What's the plan in Denmark? Or do the regulations restrict you from being a real competitor in that market going forward? And just quickly on following off on that. I know it's a sort of second quarter, third quarter running where investments in other markets within the Smokefree division continues at a pretty, pretty steadily high pace. What fruits are you seeing from that investment? If you could walk towards -- are you likely to see from that investment, if you could discuss some of those markets there as well would be helpful.

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

When it comes to Denmark, it's fair to say that the positioning that we have had with ZYN that where we -- if you recall, we made an adjustment to the price level to offer more attractive price or value equation to the consumer. That was successful in building up ZYN from a very low base to decent traction. But there was some competitive reactions that slowed down the trajectory. And then with the regulatory developments that are very new, it's been challenging to sustain that advantage to the consumers.

So that particular strategy in this regulatory environment where effectively displaying prices to consumers at retail that were attractive, I mean that simply doesn't work. That doesn't mean that we are giving up the Danish market. On the contrary, as you pointed out, we see it as a very big opportunity in terms of future market. And we will review the situation and try to develop our strategies accordingly under the new circumstances. And when it comes to other markets in general, we are very pleased to see that not the least the COVID -- the easing of COVID restrictions has implied that we've been able to continue to invest. And just as an example, there's something going on in a fair in the U.K. today that I just saw an internal posting on, that looks very good.

And those type of activities, of course, are relatively costly in relation to the current volume performance. But we believe that the modern oral category has demonstrated its proof of concept not the least in the U.S. market and the trends that we see in terms of the category growth, for example, in the U.K. market, that doesn't even have a tradition of oral tobacco are also very encouraging. So in terms of the benefits that we expect is to, with our focus and our core competencies and our superior products to be able to carve out a meaningful position in these other markets. But it is a long-term investment. We do this for the benefit of the long term.

Mirza Faham Ali Baig - *Crédit Suisse AG, Research Division - Research Analyst*

This is a slightly broad question. Hopefully, you can help us. But I just want to understand the nicotine dynamics in the U.S. As the market is opening up, as people are going back to work, getting out and about, et cetera, post lockdowns, how are you seeing the nicotine pouch category develop? Is it a positive? Is it a negative? Are other categories, maybe like e-vapor benefiting? Any insight you could give on current trends would be helpful.

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

I mean, generally, when COVID hit, so to say, for some categories, it was easier to identify and depict the COVID effect. And the clearest example in the U.S. market, I would say, is chewing tobacco that after many, many years of a steady decline showed full resilience in terms of category growth. When it comes to nicotine pouches, the growth wasn't as been even before COVID, of such a magnitude that to the extent there were any effects, they were very hard to isolate.

And actually, if we look at the trends that we had, they more or less continued in terms of category growth. And it's possible that in a year's time or so when this thing is fully behind us to say hopefully, that we will be able to run some numbers and come up with some intelligent analysis and provide an answer to your question. But at this point, I'm afraid we haven't been able to conclude any effects of that nature.

Mirza Faham Ali Baig - *Crédit Suisse AG, Research Division - Research Analyst*

Okay. One more final question on cigars. The market slowed quite strongly Q1 on Q2. I think it's up over 20% in Q1 and only 4% in Q2. I guess there is an element of now lapping difficult comparatives. But is there anything you're likely to call out to why the market might not be slowing a bit? Is it just simply the difficult comps? Is there an element of price elasticity? Anything you could call out there?

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

And then the main thing there is that, if you remember Q2 for cigars, there we did see an uptick, which -- in last year, which we at least partly attributed to COVID. So you're kind of having year-on-year comps, and now you have the opposite with releasing restrictions there. And then generally, a word of caution on kind of quarterly comparisons in MSA data in general and also that is certainly true for cigars.

And also in a situation where different manufacturers, not only Swedish Match have been facing different types of supply issues and production constraints, it's difficult to draw any exact conclusions. We were pleased to see that the very strong demand for cigars is holding up despite the easing of restrictions. And in particular, we're pleased to see that there is very strong growth in natural leaf cigars where Swedish Match [over SKUs] its portfolio.

Operator

Our next question comes from the line of Mirco Badocco from Bank of America.

Mirco Badocco - *BofA Securities, Research Division - Research Analyst*

So I guess two questions on my side. The first one, following up on cigars. You flagged you had a record quarter in terms of capacity for natural leaf and production or in Dominican Republic, but you still weren't able to meet demand. Is this the cut on capacity you have or can we expect you could increase capacity if needed? And the second one is more general on raw materials and input costs. We are hearing other consumer staples companies talking about input cost inflation, who saw flagging pressure from freight and logistic costs. So I wonder if you can add any color on this. Is it a problem for you or not really?

Anders Larsson - *Swedish Match AB (publ) - CFO & Senior VP of Group Finance*

Yes, Anders here. I mean we are doing what we can. And as you've seen in the numbers, we are -- we had a very good quarter production-wise, and we are doing everything we can to increase that level, and we hope to increase it even further. But then with a strong growth for natural leaf it's hard to say when we can meet -- fully meet demand, so to say. And then in terms of raw material costs, we noticed that as well, but it varies a bit across the businesses. I would say it's more pronounced for our Lights business, for example than compared to Cigars and also with the higher freight cost. But we see it -- noticed the increase, but not of a big magnitude.

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

And we're also taking pricing in our Lights business to compensate for some of those cost increases. But then naturally, you can -- it's not always a perfect match on timing in terms of when the costs hit your cost of goods and timing that you can say with pricing.

Mirco Badocco - *BofA Securities, Research Division - Research Analyst*

Yes. Understood. So nothing big to flag there, I guess. Anything else on other input costs on thinking about plastic, for example. So anything you want to flag on raw materials as well?

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

Yes. I mean the plastics use, I think Lars noted, the most notable changes are on nylon pricing for lighters, yes. And if you kind of derive profitability for our snus business in Scandinavia or other oral tobacco products, plastics as a component is relatively small. So even a notable increase in the plastics prices wouldn't have a huge impact. It's also good to remember that most of the products we sell for nicotine pouch -- or nearly all, nicotine pouches and for snus products, moist snuff, chewing tobacco, cigars, they're generally produced in the same geography that they're sold in large part. So when we talk about freight and those type of charges, you're really talking about within a regional area, not across regional areas. Now in the U.S., it's probably a bit more pronounced in terms of the increases because the tax structure is different in the U.S. than it is in Europe and in Scandinavia affecting the pricing.

Operator

Our next question comes from the line of Jared Dinges from JPMorgan.

Jared T. Dinges - *JPMorgan Chase & Co, Research Division - Analyst*

I just want to come back to U.S. ZYN, and you talked about the rollout of the Chill and Menthol flavors this past quarter. Can you quantify how big the benefit was from, let's say, inventory build there? Just trying to get an idea of your sellout versus your sell-in. And sort of related to that, you guys touched on it a bit. But what are your expectations for revenue per can going forward? You talked about it being down a bit year-on-year. Should we expect that to continue, kind of stabilize at this level or maybe even dip a bit further?

Anders Larsson - *Swedish Match AB (publ) - CFO & Senior VP of Group Finance*

Yes. As regards the first question there on the rollout, it's not an exact science to calculate the magnitude. But my sense is about a couple of million cans in pipeline volumes from the rollout. And then in terms of pricing, we -- I think it's fair to assume that we will increase the elements of promotional spending, but not at the magnitude that we see from our competitors with very heavy discounting.

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

We talked about increases in our loyalty programs, including in our merchandising and trade loyalty programs. And in there, there's an off-invoice element, which affects the manufacturers take.

Jared T. Dinges - *JPMorgan Chase & Co, Research Division - Analyst*

Got it. That's very clear.

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

Just on the new varieties as we pointed out in the prepared script, even if you exclude these varieties completely, the velocities for this in family continue to grow also on a sequentially basis and actually more so and the volumes grown more than the store count. And of course, that's not a fair calculation given that they existed to some extent. So stripping them out complete is very conservative because you can assume that there was some growth also. And also some of the products that were sold in this quarter have been consumed, of course.

Jared T. Dinges - *JPMorgan Chase & Co, Research Division - Analyst*

Got it. Actually, and just a quick one about -- you guys talked about the users basically being ahead of kind of your velocities compared to cigarettes. When you've been having this velocity growth, do you think it's more from new users entering the same stores? Or is it more from your current users increasing their usage per week?

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

It's a combination. I'd say the main factor is new users, but our market research confirms also that consumers consume more on average, but we are well below the number of average cigarette packs per week and well below other benchmarks like moist snuff -- number of cans for moist snuff used or snus consumption in Scandinavia. So that's why we see kind of growth from 2 dimensions there in terms of both affecting more and more users, and also increasing consumption among existing users.

Operator

Our next question comes from the line of Sanath Sudarsan from Morgan Stanley.

Sanath Sudarsan - *Morgan Stanley, Research Division - Research Associate*

Two questions from my side. First one last, could you possibly articulate your strategy in Scandinavia better, please? I mean it seems to be an ongoing share loss due to underperformance in the nicotine pouches business, which where you haven't really been able to gather momentum? And then also from time to time in specific snus subcategories. The market, as you said, has been growing very robust, but what do you think about the run rate we should expect for Swedish Match going forward from these markets?

And then secondly, coming back to the U.S., I take nothing away from ZYN and the product you've built over the medium, but the medium to long term, is there a risk that your current product advantage is taken away, say, in the next 12, 18 months post PMTA especially by on, which is a very similar product to you. I'm interested to hear you on how long you can stay away or to an extent, ignore the strong price promotion by peers? Would you be willing to sacrifice much more of your current high margins in ZYN to retain your strong share in the category?

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

I mean if I start with the second question, Swedish Match. We have a very attractive assortment in the market today for which we have applied for PMTA applications for all the current SKUs, and that score very well in market research, relative competitive offerings and which where very clearly hold up very well on a same-store basis, even though we have not at all the same type of pricing strategy, generally speaking, as competition.

In addition to that, Swedish Match has development projects, and you should expect Swedish Match to secure further PMTA approvals beyond the current versions. And to the extent that competition want to improve their product portfolio, they need to go through the same processes. And we're very confident in their ability to work with the type of data that the FDA requires and also with our track record in terms of relationship with FDA, not the least on being the first with both MRTP and PMTA in the smokefree space.

When it comes to Scandinavia, the quickest summary of the strategy is to protect the profitability and grow the profitability in tobacco and snus, and invest for a stronger position in nicotine pouches. And while I agree that it's -- we haven't reached our objectives when it comes to market share in nicotine pouches, we studied the market in detail, you'll see that it's extremely competitive, and there are lot of offerings. And there's actually only 1 competitor of ours, so to say, have been growing share. So from that perspective, you can choose to see the glass half full, but we are far from satisfied with the current performance.

And -- but it boils down to being able to supply the consumers with the most attractive portfolio of products and that goes for brands and that goes for product type and characteristics and the highest quality. And some of these issues, they do take some time. We do suffer a bit from having not as the first mover advantage in the Scandinavian market, and there's a history to that where we have to focus very much on the U.S. situation, which we believe was the right choice for the shareholders.

But it's -- it is a very important topic to the group to improve our position in Scandinavia. And I understand from your perspective that it sounds repetitive, but there is also a reality out there that some of the things we're doing are things that are not turned overnight. And if you take the VOLT launch as one example of the type of things that we are doing, that's not the type of initiative where you see an immediate effect in the marketplace and the market share. And actually, we believe that the performance is a little bit better there than Nielsen does indicate given that it's done very well, not the least in digital channels.

Sanath Sudarsan - *Morgan Stanley, Research Division - Research Associate*

Lars, can I just extend that logic one more to the U.S.? And do you see the trend repeating with the first mover advantage within, I mean, I'm not sure how much of the product similarities are there with your peers in Scandinavia and how that dynamic has helped or not helped. But any read across in the U.S.?

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

I mean there is a benefit clearly with first mover advantage in general. And that you see, as you know, in many consumer goods categories and markets. With that said, in the long run, it's about the complete offering in terms of product quality and your brands. And that's where in the U.S., we feel very good on both those parameters. Our current product score very, very well. In Scandinavia, we feel very confident about our capabilities on those parameters, but we are not there yet.

Operator

There are no further questions registered at this time. So I hand back to the speakers.

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

Okay. Then we thank everybody for joining today's call and remind you that the release of our Q3 interim report will be on October 27. Thank you.

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