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SWMA.ST - Q1 2013 Swedish Match Earnings Conference Call

EVENT DATE/TIME: APRIL 29, 2013 / 12:00PM GMT



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## PRESENTATION

### Operator

Welcome to the interim report January-March 2013. At this time all participants are in a listen-only mode. There will be a presentation followed by a question-and-answer session. (Operator Instructions). I must advise you that this conference is being recorded today, Monday, April 29, 2013.

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

Mr. Harrison, your line is open.

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### Emmett Harrison - Swedish Match - VP of IR

Good afternoon, this is Emmett Harrison, Senior Vice President of Corporate Communications and Sustainability. Welcome to the first quarter 2013 results telephone conference for Swedish Match.

Lars Dahlgren, President and Chief Executive Officer is joined today by Joakim Tilly, Chief Financial Officer, and myself. The conference call should last about an hour and will include an overview by Lars Dahlgren and a review of the financials from Joakim Tilly. A question-and-answer period will follow.

A shortened version of our investor kit accompanies this presentation via webcast and a complete investor kit is available in the investor relations section of our website, SwedishMatch.com.



During today's conference call we will discuss certain items which may constitute forward-looking statements. Because such statements deal with future events, they are subject to various risks and uncertainties. Although management believes that its expectations are based on reasonable assumptions, it can give no assurance that its expectations will be achieved. Risk factors are outlined in the latest annual report which is available on our website, SwedishMatch.com. Swedish Match assumes no obligation to update information concerning its expectations.

This conference call is being recorded and the recording will be published on the Swedish Match website. I would now like to turn the conference call over to Lars Dahlgren.

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

Thank you, Emmett, and good afternoon, everyone. Before going into the first-quarter results, I would like to mention that at the annual general meeting held on April 25, shareholders approved an increased dividend to SEK7.30, an increase of 12% versus prior year. Shareholders also approved a cancellation of 4 million shares and they renewed the share buyback mandate. More information about the annual general meeting can be found on our website.

For the first quarter of 2013, Swedish Match delivered sales growth in local currencies of 5% with gains in our other tobacco products and lights businesses as well as in our distribution business. Sales declined marginally in our snus and snuff product area.

Operating profit from product areas in the first quarter amounted to SEK832 million, down from SEK903 million in the previous year. Currency translation, significantly higher spending behind international snus and the relatively low risk (inaudible) from other tobacco products were the key factors behind the decreased operating profit from product area.

For other tobacco products, we expect a significant improvement already in the second quarter. And as regards spending behind snus internationally, we expect the level of -- for the remainder of the year to be more in line with the levels we saw in 2012. In local currencies, operating profit from product areas declined by 6%.

Operating profit including our share of net profit from Scandinavian Tobacco Group and the one-time game from a land sale amounted to SEK1.031 billion, up from SEK972 million in the first quarter of 2012.

Scandinavian snus sales declined by 2% compared to the first quarter of the prior year on 2% lower shipment volumes. If we back out hoarding effects and Easter timing effects, we estimate that underlying volumes declined between 2% and 3%. Operating profit for snus in Scandinavia improved versus the same quarter of the prior year as a result of lower operating costs.

In Sweden for the 12 week period ending March 24, Nielsen excluding tobacco tobacconists reported a total market share for Swedish Match in volume terms of 73.3% compared to 79.7% in the corresponding period of the previous year and in value terms a total market share of 79.5% compared to 84.1% for the same period. For the most recent four-week period, our market share according to Nielsen in volume terms was 72.9%.

Swedish Match divides the Swedish snus market into three price segments. For the four-week period ending March 24, we estimate that we had a volume share of approximately 96% of the full-priced segment, 54% of the mid-priced segment and 26% of the low-priced segments. The full-priced segment accounts for approximately 62% of the Swedish market in number of cans down from approximately 67% in the corresponding period last year.

According to Nielsen excluding tobacconists for the 12-week period ending March 24, the total Swedish market showed growth well above 5% in the first quarter in volume terms and full-priced volumes were down by 2.5% which is a more stable full-priced development than in previous quarters.

In January 2013, we [weight-based] taxes increased in both Sweden and Norway. As the tax increases were modest, only minor adjustments were made and in Sweden we decided to absorb the tax increase for nearly all of our products. For our Kaliber brand after having taken a price increase



at the beginning of the year, we have adjusted the price downward in light of the competitive situation which has helped to strengthen the brand's market position over the past couple of months.

To strengthen Kaliber further, we are now launching two new varieties in the Swedish market. But importantly, we are also now launching a number of new products in the mid- and full-priced segments in Sweden and in the full-priced segment in Norway.

Some of our premium pouch products are being rolled out with updated packaging including larger disposable lids. We are also launching General Tailored in Sweden with a softer smoother mouth feel and an outstanding flavor delivery. General Tailored is made with a unique process and we are confident that these products with this technology will further raise the quality bar versus the competition.

In Norway, our market share according to Nielsen in value terms in the latest four-week period ending March 24 was 65.7% compared with 66.3% in the previous period and 71.1% in the corresponding period last year. Much of the share decline is due to the rapid shift away from loose snus towards pouch products. Swedish Match has the highest share in the loose segment.

The Norwegian market continues its solid volume growth. For the six months ending March 24, snus indicates that the market was up by nearly 12% and the Swedish Match volumes were up by close to 5%.

In the US market while our total US moist snuff business declined also on a constant trading day basis, we noted significant progress in the quarter with our growth initiatives for pouches and value packs. As a follow-up to our successful 14.4 ounce tub, we are now launching 7.2 ounce tubs containing the equivalent of six cans.

Operating profit in the US for the total product area of snus and snuff during the first quarter was well below prior year due in part to the softer quarter for US moist snuff but mainly because of the significantly higher investments behind snus in the US.

Nielsen reported the overall US snuff market to have been up by 5.7% for the year-to-date period ending March 16 with Swedish Match volume down by 3.4%. Nielsen reports growth for our low price brand, Longhorn with declines in the rest of the portfolio.

In the most recent isolated four-week period ending March 16, Swedish Match market share was 7.2% according to Nielsen. Based on reported industry shipments, Swedish Match estimates its market share to be in the range of 10% on an account equivalent basis.

General snus in the US is continuing to have very solid momentum. Selling rates continue to show positive trends and the brand is becoming increasingly visible nationwide. We will continue to invest behind the brand and expand distribution and expect to be in 17,000 to 20,000 stores by the end of 2013. Right now we have distribution in more than 13,000 stores.

With regard to SMPM International, the joint venture company for smoke-free product, testing continues in Canada and we are now in more -- in 1800 stores with General snus. We also have a very small test of the General brand in Malaysia with good sell through. We also continue testing the Parliament brand in St. Petersburg, Russia and Marlboro snus in Tel Aviv, Israel.

In our other tobacco product businesses, sales for US cigars in local currency were up slightly versus the first quarter of 2012 and we make an adjustment for the change to account for excise taxes and volumes increased by 1%.

The first quarter last year were financially strong and we expect solid year-on-year volume growth performance for cigars for the remainder of 2013. Our White Owl Gold and Game by Garcia y Vega Gold cigars began shipping in the first quarter are being very well received and we anticipate good volumes from these products.

For chewing tobacco, our market share for the year-to-date period ending March 16 was 47.4% according to Nielsen estimates versus 46.1% for the year-to-date period in 2012. In value terms, our market share is about 50%. Nielsen estimates the markets have declined by close to 6% in volume terms.

For Swedish Match own brand, shipment volumes in the quarter were down by 11% and contract manufacturing volumes were also lower.

The EBIT margins were lower than last year for both cigars and chewing tobacco and there were several reasons why the operating profit for other tobacco products was on the low side. The fewer shipping days in 2013 had a notable effect for both cigars and chewing tobacco and especially chewing tobacco faced some absorption issues with higher than normal cost of goods as the result.

For cigars, we have an increased productivity and reduced material cost but owing to carrying costs and the inventory, some of these improvements will effect cost of goods positively only from about now and onwards. The [right] accounting principle for pensions also had a relatively large effect for other tobacco products.

Our lights businesses had a solid start to the year. In local currencies, sales were up by 2% while operating profit grew by 12%. For both matches and lighters sales and operating profit were higher in local currencies compared to the first quarter of the prior year.

Sales in other operations for the first quarter amounted to SEK816 million, up from SEK687 million prior year. Operating loss for other operations was SEK20 million in Q1 compared to SEK19 million prior year. The relatively steep increase in sales was to a large effect driven by the fact that the sales in the first quarter of 2012 were light as a consequence of hoarding effects toward the end of 2011.

With regard to our 49% holding on Scandinavian Tobacco Group, the sales for STG during the first quarter decreased by 3% to DKK1.296 billion. Reported EBITDA amounted to DKK215 million compared to DKK259 million in the first quarter of the prior year.

The winter season is the weakest season for several of STG's businesses and with fewer shipping days this year and timing issues and inventory of some key wholesalers in 2013, it was a relatively slow start. The STG EBITDA increased for handmade cigars but declined for the other product areas. Despite the relatively weak volumes, it's encouraging to note that STG market shares were stable or grow in key markets.

As regards to supply chain for STG, the restructuring progresses according to plan and some production has now been moved to other facilities and by the end of the year, one cigar plant in Europe is expected to be closed.

The Swedish Match reported share net profit in STG for the first quarter amounted to SEK39 million compared to SEK69 million in the prior year but excluding the adjustments related to differences in reporting schedules, the Swedish Match share profit in STG amounted to SEK41 compared to SEK59 in the prior year.

On March 7, 2013, Swedish Match received a dividend from STG of SEK224 million. Last year's dividend was received on April 27 and amounted to SEK204 million.

Now I will hand over to you, Joakim for some more comments on the financials.

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**Joakim Tilly - Swedish Match - CFO**

Thanks, Lars. For the first quarter the development of exchange rates had a negative effect on our sales and operating profit comparisons due to a strengthening of the Swedish krona versus both the US dollar and Brazil real in 2012. The total translation effect on operating profit was a negative SEK17 million in the first quarter which mainly affected other tobacco products and lights.

For the first quarter, the total translation impact on sales was a negative SEK75 million which consists of a negative SEK33 million for other tobacco products, a negative SEK15 million for snus and stuff, a negative SEK27 for lights, and zero for other operations.

The accounting principles for pensions were changed on January 1, 2013. The surplus expected return on pension plan assets over the discount rate on obligation can no longer be recognized as an offset to the service cost included in the operating profits. Instead this surplus return has to be booked as an actuarial gain in other compared income. For Swedish Match this results in a negative effect on operating profit of about SEK35 million annually and an increase of the actual gain in other comprehensive income by the same amount.

In the first quarter, this change affected operating profit for other tobacco products negatively by SEK8 million. The change has no cash flow effect.

Swedish Match sold a parcel of land adjacent to the old headquarters building in Stockholm in 2007 for which the final purchase price was subject to the approval of a (inaudible) plan. The (inaudible) plan was approved in January and Swedish Match will receive the additional payment of SEK159 million during the second quarter of 2013. The income from this one-time item was recorded in the first quarter.

Net final costs for the first quarter amounted to SEK 136 million compared to SEK134 million previous year. The average interest-bearing debt was about SEK1 billion higher in the first quarter of 2013 than in the first quarter of 2012 but lower interest rates led to an almost unchanged net finance cost.

As of March 31, 2013, Swedish Match had SEK10.8 billion of interest-bearing debt excluding retirement benefit obligations which is practically unchanged compared to year end since no new bond loans were issued and there were no repayments of loan in the first quarter. During the remainder of 2013, SEK1.2 billion of this debt forced due for repayments all at the end of June.

As of March 31, the average maturity duration of the bond portfolio is 3.3 years and the average duration of the interest binding is 3.5 years. On March 31, the weighted average interest rate on bonds issued including derivative effects was 4.82% with about 5% of the portfolio exposed to variations in interest rates. As of March 31, 2013, Swedish Match had SEK1.3 billion in unutilized committed credit lines.

For the first quarter, the reported tax expense amounted to SEK154 million corresponding to a tax rate of 17.2%. The reported tax rate excluding one-time tax items associated companies in joint ventures was 22%. One-time tax items relate additional purchase price from the sale of land which is tax-free and associated companies relate mainly to the share of earnings from Scandinavian Tobacco Group. It is now our expectation that the full-year underlying tax rate will be about 22%, which is the same level as in 2012.

Cash flow from operating activities for the first quarter amounted to SEK643 million compared with SEK307 million for the same period of the previous year. The cash flow from operations increased compared to the same period previous year mainly as a result of dividends received from associated companies and the better cash flow from changes in working capital.

Note that the dividend received from STG was in the first quarter of 2013 while last year the dividend was received in the second quarter.

Investments in property plant and equipment during the first quarter amounted to SEK70 million compared to SEK39 million in the prior year. The net debt as for March 31, 2013 amounted to SEK8.6 billion compared to SEK8.7 billion at March 31, 2012. The net debt in relation to EBITDA excluding share, profit and STG was SEK2.4 for the 12-month period ending March 31, 2013.

Cash and cash equivalents amounted to SEK3.3 billion at the end of the period compared with SEK2.8 billion as of December 31, 2012. The increase in the cash position is in anticipation of the dividend payment and lower maturity in the second quarter.

In the first quarter, share repurchases of 0.6 million shares were made in the amount net of SEK138 million. During the first quarter, the Company sold 0.5 million treasury shares at an average price of SEK171.60 totaling SEK89 million as a result of option holders exercising options.

As for March 31, 2013, Swedish Match held 6.7 million shares corresponding to 3.26% of the total number of shares. The number of shares outstanding net as for March 31, 2013 amounted to SEK199.3 million. In April 2013, the Company sold a further 0.5 million treasury shares at an average price of SEK141.24 as a result of option holders exercising options.

At the annual general meeting, shareholders authorized the cancellation of 4.0 million shares currently held in treasury. When the cancellation is completed the total number of registered shares in the Company will amount to 202 million shares.

At the annual general meeting, shareholders approved a renewed mandate to repurchase shares up to a total holding and treasury not exceeding 10% of the number of registered shares in the Company until the next annual general meeting in 2013. Owing to the dividend payment in the second quarter, share repurchases will be concentrated to the second half of the year and be very light in the second quarter's earning.



I will now turn the conference call over to Lars.

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

Thank you. And, operator, let's go ahead and open to questions and answers.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions). Andreas Lundberg.

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

I'm wondering about the margin in Scandinavian snus operations. You talk about higher margins year on the year due to lower OpEx. What is behind that OpEx or cost development from a more concrete perspective and how do you see that going forward? That is my first question.

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

Hi, Andres, this is Lars here. Whenever we compare the quarters there are some quarterly fluctuations that can stick out as margin differentials. But if you look at the Scandinavian snus business, we are focusing on to get around that as efficiently as possible. And our ambition is to have costs that do not exceed prior year for the full year. But I think it is more reasonable to think that there will be relatively much in line despite a very steep increase in activities in the market place in calling some of these very numerous launches now in the second quarter.

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

Okay so no material cost savings, etc.?

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

No, it is more a -- there are some things that have been more efficient in the first quarter but it's more of a quarterly timing thing. Given what we are doing I would say there are some efficiency measures but we are doing more as well. So you should think about our ambition for the full year to have costs relatively much in line for the Scandinavian snus business.

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

Okay, thank you. And if I move over to US snus, you talk about relatively nice volume growth there. What changed versus previous quarter or is this very much driven by promotions, free samples, etc.? Was it true underlying improvement or uptick? Thank you.

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

It is definitely a combination with a big impact of true underlying uptick because what we do see is continued positive trends in stores where we have been for a longer period and with market shares that continue to tick up. But then of course also adding a lot of distribution including some introductory offering adds to the volume growth.



But we are talking I mean volumes in the first quarter were about 1 million and we sold about 2 million cans for the full year in 2012. So it is a rather dramatic percentage wise. But -- and it's been mixed bag but we definitely could transfer the underlying consumption of the General in the US market as well.

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

Okay, thank you.

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**Operator**

Anders Hansson.

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**Anders Hansson** - *Danske Bank - Analyst*

Anders Hansson at Danske. I have two questions. First on Scandinavian snus, Lars, I saw you were talking about some premium price increases from local media either after summer or during year-end. I was just wondering are you still working from the hypothesis that the gap between premium and low price needs to narrow before we see before any premium increases or do you think you could implement premium increases without seeing the gap narrowing?

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

I mean what we discussed with the media this morning is that over time we definitely see that the price and elasticity and strength of our brands and so forth do merit also some price adjustments in the premium. And while the price gap is very big, we continue to think that over time low price prices will come up in the Swedish market and I don't necessarily see that has to be a simultaneous price change in the low price and at the premium price.

So I think that it's likely that you will see us do something on the premium end either towards the summer or towards after the summer or towards the end of the year. But having said that of course, we need to continue to monitor the market trends and the stability of full price volumes and so forth. So no final decisions have been made.

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**Anders Hansson** - *Danske Bank - Analyst*

Okay, thanks. Also one question on STG because when I read the report, you talked about temporary high logistic costs, temperate decline in pipe export volumes, a fund cut hurt by tough comparables and some timing effects on European cigars. And I was just wondering the key message is that Tier 1 was hurt by a lot of temporary factors or is the key message that it is going to be pretty difficult to reach earnings levels of 2012 given European cigar markets being pretty weak right now?

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

I mean when you look at that business and quite frankly we recognize this from when we fully owned the European cigar business which is a big part of that business, the first quarter is a light quarter. And that makes it actually very sensitive to when you have a poor quarter in the sense that you lose out quite a bit from gross profit but you are stuck with your fixed costs. So it really affects the numbers when you have a bad first quarter. And that is what we saw to a large extent.



And then of course, the European cigar markets do face some challenges with volume declines but at the same time, STG has taken market share in some important markets and they have some good initiatives on the brand and innovation side. So we continue to think that the rest of the year will look much better for STG.

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**Anders Hansson** - *Danske Bank - Analyst*

And with much better -- does that imply that you think profits could improve versus 2012?

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

I don't give any forecast for STG businesses.

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**Anders Hansson** - *Danske Bank - Analyst*

Okay, thanks.

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**Operator**

Erik Bloomquist, Berenberg Bank.

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**Erik Bloomquist** - *Berenberg Bank - Analyst*

Could you discuss how you see the snus market price segments developing? I mean the new product launches today seem really focused on mid price and premium. Is that because you see the appetite of the consumer lessened for low-priced product or how do you see those price segments evolving through the course of the year? Thanks.

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

Yes, it is hard to give an exact prediction but what we did see in 2012 first of all was a very steep growth in the size of the lowest price segment. And according to our analysis, a big part of that growth is driven by increased distribution and increased number of (inaudible). So making low-priced (technical difficulty)

So with that distribution build we think that there was an element of low hanging fruit that means that we do expect some growth of the low-priced segment this year but we did say before and we continue to expect that it will be more modest growth than we saw in the prior year.

And when it comes to the new product launches and so forth, we are determined to be the leader in all price segments. And what we have done with Kaliber in terms of adjusting the pricing to make it more competitive following the lack of reactions at year end from other key competitors and also now strengthening with two new varieties we think that in that we actually have a very strong offering for those consumers that want the quality product at the lowest possible price. And we did see that Kaliber did starting take some market share in the latest measure and I would expect that trend to continue to look favorably over the months to come.

So I think we done good things at the low price but it is of course very important for us to address the mid- and the full-price segments and now we have some really interesting innovations as well that we put in the market place.



So it is challenging to launch full-price line extensions and brands in the Swedish market but we think we have some very good line extensions, flavor offerings and also for General Tailored that will be priced a little bit lower than the regular General, a very interesting innovation that should have good prospects in the marketplace.

And then we have upgraded the cans for parts of our full-priced segment to cater to some specific consumer needs so larger disposal lids and so forth. So I think we -- internally we are quite proud of the increased activity and the type and the quality and innovations in line extensions that we now bring to the Swedish market.

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**Erik Bloomquist** - *Berenberg Bank - Analyst*

And then with respect to the operating cash flow stripping out the benefit of the STG dividend, it was about SEK112 million benefit from working capital. Is that something that will reverse through the rest of the year or will those gains will be retained? Thanks.

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**Joakim Tilly** - *Swedish Match - CFO*

You mean versus the cash flow from (inaudible) working capital last year I suppose?

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**Erik Bloomquist** - *Berenberg Bank - Analyst*

Yes, that is right.

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**Joakim Tilly** - *Swedish Match - CFO*

And then you should remember that in the first quarter last year, we were affected by the hoarding that was pretty big in Q4 2011. So that is the big reason why cash flow (inaudible) capital is better this year. Now for the remainder of the year we don't really see that there will be any large deviations for our working capital. We always have this potential timing effect from the purchase of grow tobacco, etc., which we tend to buy when it is available to the right quality as we need.

But we expect to be -- to not have any deviations versus last year on the working capital side.

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**Erik Bloomquist** - *Berenberg Bank - Analyst*

Great, thank you.

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**Operator**

Fulvio Cazzol, Goldman Sachs.

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**Fulvio Cazzol** - *Goldman Sachs - Analyst*

Good afternoon, gentlemen. Firstly on Norway, can you comment on the competitive environment? I know that you highlighted that you are seeing this rapid shift from loose to pouch. What have you seen in terms of competitive behavior on pricing and promotions, please?



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

In terms of pricing and promotions, I would say that in Norway that the competitive rate so to say is really around the type of [perk] introductions that is brought into the market. And that is where we have seen some share erosion because while as we have been successful with some of the new perk introductions for example in the Lab Series and the Nick & Johnny brand who is a main competitor of ours and been as well. And it has not been at all through pricing.

On the contrary, there is one competitor that has tried to introduce a lower price product in the weakened market but with a very limited success.

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**Fulvio Cazzol** - *Goldman Sachs - Analyst*

Also can you give a bit more color on Canada? You are up to 1800 stores now. Do you have any data that you can share on the sellthrough for some of your early stores, i.e., 2011 say versus 2012 like you have given for the US back at your Analyst Day in November, please?

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

I don't have those trends here handy. But what we can say it is similar in the US in that sense that stores where we have been for some time continue to trend the right way. Having said that, it is at the lower level than the US but arrows point in the same direction.

But what we do see is that we measure market share as part of the smokeless category and there we also see that we are trending upwards with General. So where we are -- in stores where we are we tend to have between the 3% and 4% of the total smokeless category in Canada with mostly a positive trend.

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**Fulvio Cazzol** - *Goldman Sachs - Analyst*

Okay, thank you.

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**Operator**

Stellan Hellstrom.

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**Stellan Hellstrom** - *HSBC - Analyst*

I had a question on pricing in Swedish snus again. If you can elaborate a little bit I'm sure I understood correctly. Did you say that you think you can raise prices for premium before prices and the low end are increased? I mean wouldn't that just encourage your competition to continue with the price war?

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

What I said is that I do see that some price adjustments in the premium segment are likely and either enter after the summer or at the beginning of next year.

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**Stellan Hellstrom** - *HSBC - Analyst*

Okay, is this some kind of change in strategy where you are less concerned of losing market share than you were previously for the premium portfolio?

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

I would say that what we -- with the Kaliber line extensions and with the relative pricing of Kaliber that we have against competition we think that we have a very compelling offering at the lowest price segment of the market as well.

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**Stellan Hellstrom** - *HSBC - Analyst*

Yes, I understand but -- so this means that you are feeling more confident that you will see competition raising prices. Is that how to interpret that then?

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

I think that we haven't changed our mind there that in the longer term here we do think that prices will come up at the lower end in the Swedish market. And then exact timing of that is hard to have a firm view on before we've seen anything real in the trade.

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**Stellan Hellstrom** - *HSBC - Analyst*

Okay. Finally also just a question on STG, if you could just tell us where is STG's net debt to EBITDA after the dividend was paid?

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**Joakim Tilly** - *Swedish Match - CFO*

We have said before that they should have a net debt to EBITDA between 2 and 3 and it's about in the middle of that range.

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**Stellan Hellstrom** - *HSBC - Analyst*

Okay, thank you.

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**Operator**

Stefan Nelson.

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**Stefan Nelson** - *SEB Enskilda - Analyst*

Thank you, Stefan here from SEB. Two questions. First again on Swedish snus, it seems that obviously you are a bit more encouraged about the market right now and your position than a few months ago. Is there anything that you have seen apart from the data points and the big launches that you have that has made you more optimistic the things that we maybe haven't seen in the official data?

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

I mean what we have been doing and speaking about the last couple of months at the last conference call, we did discuss the competitive pricing and the fact that we made Kaliber more competitive and we were also mentioning that we are stepping up the activity level. I guess what you see now is more concrete actions because obviously there are some lead times in developing and introducing new product and so forth.

So now is the time it becomes more concrete and you see it out there in the market place within a couple of weeks. The main thing but the underlying we have even before had a strong belief in our own plans and our actions.



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**Stefan Nelson** - *SEB Enskilda - Analyst*

I just think -- if a big reason is that the competitors don't seem to have changed their prices so far this year, I mean if that would happen later on and if your plans would change in a way or if -- I mean is that is the key to the more optimistic approach?

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

If there is price changes out there in the marketplace we need to monitor the situation and dynamics and the trends. But we think right now that we have Kaliber at a very competitive price versus competition. So if that was to change initiated by some of our competition, clearly we would take a look at if we could sustain in making sure that we keep the relative pricing that we have now. Because right now we do believe that with our offer we continue to take some share within the low price segment and that is in line with our strategy.

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**Stefan Nelson** - *SEB Enskilda - Analyst*

Okay, great. Then my second question is just regarding your comments of expecting around 15% profit growth for mass-market cigars. Should we -- is that including the negative impact from the changed accounting principles or should we take that on top of the guidance?

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

No, that is including the change in accounting principles.

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**Joakim Tilly** - *Swedish Match - CFO*

The change in accounting principles doesn't have an effect on the EBIT. It has an effect having excess taxes including cost of goods sold and thereby inflating sales by the same amount.

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**Stefan Nelson** - *SEB Enskilda - Analyst*

(multiple speakers) the pensions exactly that was what --

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**Joakim Tilly** - *Swedish Match - CFO*

The pensions, yes, sure, sure.

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**Stefan Nelson** - *SEB Enskilda - Analyst*

Okay. And it will be at the same level basically per quarter affecting other tobacco products area?

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**Joakim Tilly** - *Swedish Match - CFO*

The negative effect of the pension accounting is SEK35 million on an annual basis and it was SEK8 million for the other tobacco products in the first quarter and it will be a similar amount in the quarters to come.

**Stefan Nelson** - *SEB Enskilda - Analyst*

Okay, great. Okay, thank you.

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**Operator**

Henry Davies.

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**Henry Davies** - *BofA Merrill Lynch - Analyst*

I've got a few questions. First on the margin development in Scandinavia, now if sales were down 2%, profit was up, that is a pretty decent margin expansion. I was just wondering if you could maybe help us strip out the impacts of the trade load both in the 4Q 2012 and 4Q 2011 to kind of give us an idea of what price mix would be or what sales would have declined in the absence of those trade loads?

And also if we were to assume operating expenses flat, the rough margin drag that would have been versus the decline in the first quarter?

Second on STG, if you could just give us an idea of the underlying decline in EBITDA versus the trading day and backlog impacts?

And thirdly, just on Canada and Russia just a word on consumer acceptance in particular in Russia and the pace of the expansion in those two markets would be great. Thanks.

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

Yes, we will try to help each other here, me and Joachim I think. In terms of the margin development and isolating really trade load effects and so forth, I think really the best way to look at it is our shipment volumes were down by 2% and when we -- when we adjust for those trade load effects and including the Easter effects and so forth we estimate that the volumes were down between 2% and 3%. So 2.5% is actually a very good approximation of where we think the underlying was and that is really the difference you can sort of work out from those numbers.

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**Henry Davies** - *BofA Merrill Lynch - Analyst*

Do you have an estimate for the underlying sales progression? Because I know the trade load benefited your mix in this quarter and did the opposite last year. I am just --

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

When you look at the trade load last year, yes, the trade loaded some full price products but if you look at the difference between quarters you don't see a big impact. And this quarter we had a negative impact in Norway which has a little bit better on the shipment basis which has a little bit better net price than the Swedish volume. So that sort of compensates for that as I said.

The difference between 2% and 2.5% decline is actually a very good estimate where we are on to approximate the effect of the underlying volumes versus the shipped volumes.

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**Henry Davies** - *BofA Merrill Lynch - Analyst*

And why is it that your price mix is not negative given the down trading that we are seeing in the Swedish market?

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

One effect -- first of all, we are talking decimals here. So it happens to be 2, too, but one effect is that also that actually for a part of the quarter the lowest-priced product had quite a bit higher prices on the Swedish market.

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**Henry Davies** - *BofA Merrill Lynch - Analyst*

Okay and maybe if we just -- sales in line with volumes --

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

Then you have -- and then under that you have positive pricing coming out of on Norway although we had a negative -- it becomes very detailed but a negative volume effect between shipment volumes and underlying volumes in Norway. There were still some positive pricing in Norway from a small price increase but also from the gradual mix shift away from loose pouch products.

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**Henry Davies** - *BofA Merrill Lynch - Analyst*

Okay, perfect. And then the other question was on STG. If you could give us an idea of the underlying decline in EBITDA versus the couple of technical impacts?

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

We don't have any good estimates there but -- and you do need probably a little bit longer trend there so I hope to be able to give you some more clarity after six months.

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**Henry Davies** - *BofA Merrill Lynch - Analyst*

Okay. And actually one question I forgot to ask. On your comments on pricing in Sweden, if I read between the lines -- if I was to take that as your plan is to now take pricing on across the whole portfolio rather than just trying to increase it on discount before, would that be a fair assumption?

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

I mean we communicate specifics of our pricing decisions when we have decided and communicated them to the trade but you should think of it that we do think that Kaliber has a competitive relative pricing where it sits today and that we do think that over time here that full price segment can also absorb some price increases over time.

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**Henry Davies** - *BofA Merrill Lynch - Analyst*

Okay, great. Thanks for that.

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**Operator**

Owen Bennett.

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**Owen Bennett** - *Nomura - Analyst*

Just a quick one. First of all, just to clarify if you could, the price point of Kaliber at the bottom end now versus competition. Second question is do you still expect to spend between SEK10 million to [SEK15] million on the international snus? I mean is that still valid now or do you think it will be a bit more or a bit less? Thanks a lot.

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

Yes, I'll take the second question here a while Emmett looks up some of the latest pricing -- provide some statistics. The increased spending in the first quarter was SEK28 million compared to prior year in terms of international snus investments. And what we foresee for the remainder of the year is that the nine-month period so to say, that level is a good indication of what we see this year as well for 2012 levels, which means that if we are a spot on there, we are in the middle of that interval.

But it can be -- it can obviously deviate a bit from that and it will deviate on a quarterly basis. But I would say the interval is still valid. But if anything I would estimate that it is rather towards a little bit lower end of that interval than the top end.

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**Owen Bennett** - *Nomura - Analyst*

Okay, thanks.

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**Emmett Harrison** - *Swedish Match - VP of IR*

Hi, Owen. This is Emmett. One always needs to take these numbers with a little bit of grain of salt if you are looking at four-week data and so forth. But if you take white pouches for Kaliber versus some of the other competitor products, Kaliber white pouches are 16 grams. And in March, the average price was around SEK24.5 per can.

For Knox, which is a heavier weight product -- for the white pouches, it is a bit more than 19 grams, the retail price was just under SEK27, between SEK26.7 and SEK27.

And then if you look at another -- the [LD] product which is also 18 grams so a little bit heavier than Kaliber, it was a bit more than SEK25 per can. So very similar pricing.

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**Owen Bennett** - *Nomura - Analyst*

Okay, cool. Thanks.

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**Operator**

Adam Spielman.

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

I have two questions. One is on the rate of decline of a full priced snus in Sweden. So if I remember rightly you said it was about trending is about minus 8% in Q3 of last year. And then out of that, it went to minus 6% I think you said in Q4. And now you said it is about trending at minus 2.5%. And I was wondering is there something strange about the 2.5%? I have to say I thought the whole market being up 5% surprised me, but 2.5% seems surprisingly good to me. Or is this the new trend we should sort of pencil into our models going forward? So that's one question. And I've got another question too, please.

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

Adam, it's a short period but I think it definitely points in the right direction. But it is short period and although this is Nielsen data, the 2.5%, you have the holding effects and you have different timing of Easter and so forth. So I wouldn't read into the decimals. And quite frankly when we look at our own shipments, it is a little but difficult to give you an exact number for underlying full price with the effects of holding and so forth.

But it is definitely an improvement from the situation we saw in the second half of the prior year. But I wouldn't go into the specifics and say 2.5% is now written in stone.

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

I presume you had made the same sort of comments about the overall growth of 5% that you referred in the Nielsen data. But it's (multiple speakers) I mean is 8% a good number but let's not get too carried away here?

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

Yes but it is -- it is a good number and you are right it is also -- it is only one quarter. But it is definitely very good growth in the Swedish market in the beginning of the year.

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

Thank you very much for that. And turning to your innovations, I'm sorry maybe I missed something, maybe it is because my Swedish is not as fluent as my English. I understand you're launching new -- two new SKUs of Kaliber, which are -- that's very clear. And we are also quite excited about the launch of General Tailored. But can you say, are there any other brand extensions that you think is significant that you sort of announced? And can say where they will be priced relative to their -- to the mother brand, if you like?

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

The other introductions in the Swedish market that we are doing and then the consumers will determine what is significant or not but we have one new variety of General -- regular General so to say in the line extension with a licorice flavor. Then we have an new variety of Grov as well and those are all in the regular premium price points. And then we have a strengthening of the (inaudible) offering in the mid price as well with a wide strong product.

And then we have -- now and May is when -- when you have the full impact of the increased weight on the original pouches back to one gram as well. And then you have the packaging upgrades which we think are important and for two reasons. First of all, it is a feature that consumers have asked for in terms of a larger disposal lid and it also gives the product a very good visual impression. And then we have some introductions also for the Catch family. So it's a rather full schedule I think.

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

But if I mean one of my questions had been would you introduce new products and new extensions at lower prices relative to existing extensions, and it sounds like the only one you are really doing that for is for the tailored white product?

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

That is correct.



**Adam Spielman** - Citigroup - Analyst

And are you able to say how much -- what is the price point you expect or what sort of discount at retail you would expect to be at?

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**Emmett Harrison** - Swedish Match - VP of IR

We don't have a suggested retail price out there for the different products on the market. But the General product is a somewhat lighter lower weight than the other pouch products that are out there. And it's going to be more in the mid-priced segment range.

So mid-priced product, pouch products tend to be kind of in that SEK35, SEK36 range, something like that. And the full price premium product pouch products tend to be more like SEK45 to SEK47 range. So we don't have a specific price on those.

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**Adam Spielman** - Citigroup - Analyst

Thank you. And one final question, I am sorry to go on so long. What weight is it?

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

16, right?

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**Joakim Tilly** - Swedish Match - CFO

Yes.

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**Emmett Harrison** - Swedish Match - VP of IR

It is grams when the other pouch products in the premium assortment full-priced assortment tend to be between 22 grams and 24 grams in General.

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**Adam Spielman** - Citigroup - Analyst

That is perfect. Thank you very much indeed.

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**Operator**

Jon Fell.

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**Jon Fell** - Deutsche Bank - Analyst

I was just wondering if you could help us with the US accounting changes on excise tax for cigars. What is it that you have done in terms of that logistic setup which has caused this? And is the impact on your sales which I have sort of guesstimated is about 7% for this quarter going to be pretty similar in the quarter and the rest of the year?

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**Joakim Tilly** - *Swedish Match - CFO*

Okay, Jon, this is Joakim. We have increased volumes quite a bit in the cigar business in the US and due to that, we have made some changes to increased efficiency and to some extent also to reduce the risk in the supply chain.

We are using third-party solutions for parts of the imported volumes from the Dominican which means that we buy some of the products already taxed and the tax gets included in cost of goods sold and inflate sales by the same amount.

US mass-market cigar sales increased by 8% in local currency and excluding this change, the count increase was a bit less than 1%. And if you look at the margin for other tobacco products, the effect from the change was a bit less than 3 percentage points negative from this inflation in sales.

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**Jon Fell** - *Deutsche Bank - Analyst*

So that gap of 7, 8 percentage points between underlying and what you report in dollar sales growth, is that likely to be broadly similar for the rest of the year or was it especially high or low in the first quarter?

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**Joakim Tilly** - *Swedish Match - CFO*

Well, if we look -- if we talk about the margin in our tobacco products, of course we will -- we will continue to have margin pressure from this changed accounting treatment. But it will be partly offset by the expected volume growth and also from the improvement that we expect in cost of goods sold since they run usually high in the first quarter.

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**Jon Fell** - *Deutsche Bank - Analyst*

Thank you.

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**Operator**

James Bushnell.

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**James Bushnell** - *Exane BNP Paribas - Analyst*

All of these product launches and so on, the endgame of this at least seemingly to me is to slow down your share loss which you have been suffering over the past year or 18 months. I wonder if you could tell us what you think is a stable share development, i.e., what is a normalized rate of share decline that you would expect just from being the market incumbent and one that is overweight the premium segment in what is a naturally down trading market like most mature tobacco markets would be? Thanks.

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

We don't give a market share prediction. But you are right in that sense that what you see here is a reflection of our ambition and our strategy to be the clear leader in every price segment. And clearly we wouldn't do this if we didn't think that it would affect the market dynamics and our shares. So we certainly hope to improve from the kind of trends that we saw during 2012.



**James Bushnell** - *Exane BNP Paribas - Analyst*

Okay. I mean I guess another way I could put it was if as we all hope the snus market particularly in Sweden keeps on growing at quite a healthy pace, you would presumably hope to see volume growth in your own business as well even if it was a little bit below the run rate of the market. Is that a fair assumption?

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

Yes, and that is our ambition to grow volumes in the longer term in the Swedish market as well.

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**James Bushnell** - *Exane BNP Paribas - Analyst*

Okay, thank you very much.

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**Operator**

Fulvio Cazzol.

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**Fulvio Cazzol** - *Goldman Sachs - Analyst*

Hi, gentlemen. Sorry, I've got a follow-up question. You mentioned that -- and this has been one of your objectives for some time to achieve leadership in Sweden across all the price segments. But assuming that you succeed, what conditions would you need to see before you will consider increasing prices again in the low end brands basically?

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

I mean we -- as you know, we did raise the prices at January 1 and based on the competitive dynamics and the market share trends, decided to reverse that because thought that Kaliber couldn't tolerate that relative pricing. Right now we have a positive trend for Kaliber. It has only been at this relative pricing for a short period of time but it has been taking market share and we are now strengthening the family further.

So we do think that this positive trend for Kaliber will continue. And on that while we are not the largest manufacturer in the low-priced segment on brand wise, Kaliber starts to approach being the biggest brand in the low-priced market because one of our competitors has more than one brand down there.

So the important thing for us I would say is that we see these trends continuing that we are developing towards leadership and then obviously we especially look in the segments where we compete because you need to bear in mind that we don't have any loose product offerings in the low-priced segment. And that is something where we have consciously made a decision not to compete because we think that most loose consumers value high quality premium products more than anything else.

And then we also have (inaudible), that is a mid-priced pretty good offering. So I mean if we have good trends with trending towards leadership and especially in segments where we compete, you shouldn't rule out that Swedish Match makes further initiatives to increase the price on Kaliber. But it won't happen anything before the summer in that respect. And more probably toward the end of the year.

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**Fulvio Cazzol** - *Goldman Sachs - Analyst*

I see. So is it fair to assume that going forward some of your pricing strategies might be more consistent against price segments whereas before, i.e., earlier this year I guess the objective was to narrow price gaps. Is that no longer objective number one for you now? Are you treating each price segment I guess differently -- in isolation of the others? Is that how we should think about it?

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**Emmett Harrison** - *Swedish Match - VP of IR*

I think from a competitive standpoint I don't think we really want to address what our pricing strategies are for different segmentations.

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**Fulvio Cazzol** - *Goldman Sachs - Analyst*

Okay, great. Thank you.

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**Operator**

[Chas Mentzer].

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**Chas Mentzer** - *Analyst*

Could you comment on whether you have seen any easing generally in the competitive promotional activity in Sweden recently or not?

And secondly with all the new variance you are launching, would you expect to gain a significant share of shelf or are you sort of taking out older variance to make way for the new ones?

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

In terms of the competitive activity and I guess you refer to the low-priced segment there, I would say it is fairly similar to what we saw when we discussed this after the fourth-quarter results. So it is still a very high activity in terms of number of products on display in the stores and so forth.

And the other question there in terms of whether increasing share of shelf, that can vary a little bit from outlet to outlet but clearly there are outlets where there are clear constraints on the number of SKUs that can be in the (inaudible).

So that is normal -- it is a normal job for us to come with new products and constantly review and see if we need to remove some of the products that are performing less well, so to say. And it just happened now it is quite a few products out there at the same time. And we need to look at that on an account by account basis and see.

In many accounts we are hopeful that we don't need to remove much products but there could be accounts where we need to take out some of the tail, so to say, make room for these new offerings.

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**Chas Mentzer** - *Analyst*

Great, thank you. And just on the US side, the US snus side, could you update us on what that US snus market growth is at the moment? And you are highlighting that the rest of the year increments of investments aren't going to be material. I mean is -- could you just explain why it's now stabilizing, why you are not continuing to increase investments? Does that signal anything about your ambitions in that market?

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

It is really more a timing thing where if you look at prior year, the first quarter was relatively light while as this year the marketing investments there are much more evenly spread throughout the year. And then we have also expanded distribution quite a bit here in the first quarter and clearly that comes with some costs.

So it is -- and it is going to continue to stay at the high level. And then in 2014, given that trends continue the way they do now, you should count on that our plans is to further build up distribution and our marketing activities in the US market in 2014 as well.

So the comparison but it may even be lower than the prior year for the rest of the year is not a reflection of that (inaudible) more than we did before.

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**Emmett Harrison** - *Swedish Match - VP of IR*

In terms of the overall snus market in the US, not a lot of movement in terms of the overall market but a lot of dynamics going on. The largest competitor in that segment has said that they have had some growth there. Our growth has been tremendous where we doubled our shipment volume out from 2011 to 2012 and Lars said in the first quarter, our shipment volume was up -- was what our entire shipment volume was in 2011 in the first quarter.

Now you have to remember though we are still only in about 13,000 stores so we are in maybe 1/5 of the number of stores of the competition. If you look at the stores that we have been in for awhile where we are competing against the likes of Reynolds, our share of market is 25% plus getting up toward 30% of the market in that segment.

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**Chas Mentzer** - *Analyst*

Thanks.

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**Operator**

(Operator Instructions). Henry Davies.

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**Henry Davies** - *BofA Merrill Lynch - Analyst*

Just a couple of quick follow-ups. On the innovation pipeline, can you just give us an indication of when all of these products will actually be in the market so on the shelves?

And then on General Tailored, I am just wondering this new pouch technology, is it just General Tailored that that is going into at this point in time? And maybe just your sense on how material this change in the pouch actually is, maybe some insight from the consumer testing would be great.

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**Emmett Harrison** - *Swedish Match - VP of IR*

In terms of the innovation pipeline, most of the ones that we have talked about and you can find information about, those will be in the stores in pretty much in May and June.

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

Yes, next week. And then in terms of the innovation, this is a new production technique. And the way to think about this is really I'd say a further development of the white technology. What is really good about it is that it opens up for bringing out different type of features in the pouch. In



this case for example, we focused on the softness and on the flavor release and it's typical for this technology. So a nice, good strong flavor where we really sort of used the entire patch.

It is definitely something which we think or what we planned for -- that we plan for introducing on additional brands in the future. And if you look in the office here who is using the product, I can tell you that the employee reception is overwhelming. But now it is of course up to the -- the consumers will determine how significant it can be and how fast we roll out this type of innovation.

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**Emmett Harrison** - *Swedish Match - VP of IR*

It has legs.

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**Henry Davies** - *BofA Merrill Lynch - Analyst*

And how long have you been working on it and how easy would it be to copy?

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

Well, we have a pending patent on this one so it is extremely challenging to copy. And it has been for quite some time that we worked on this technology.

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**Henry Davies** - *BofA Merrill Lynch - Analyst*

Okay, great. Thanks very much.

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**Operator**

Adam Spielman.

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

Very, very quickly. As you went through -- (inaudible) asked the question about this decline in the premium or full-priced segment in Sweden. As you went through the core (inaudible), was there any change in trend? Can you comment on how your shipment has been -- it is a very early in Q2 in the premium segment in Sweden?

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

If you look at the first quarter, as we said, it's three months with some Easter effects and hoarding effects is a relatively short period of time. And if you look inside the quarter, it becomes even shorter. So we will discuss it again after six months.

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

All right, thank you.



**Operator**

There are no further questions at this point. Mr. Harrison, please continue.

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

Yes. We thank you for listening today and just to remind everybody that the release of our first-half results 2013 will be on July 19. Thank you very much.

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