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SWMA.ST - Q1 2014 Swedish Match AB Earnings Conference Call

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## CORPORATE PARTICIPANTS

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## PRESENTATION

### Operator

Thank you for standing by, and welcome to the Swedish Match Interim Report January to March 2014. (Operator instructions.) I must advise you that this conference is being recorded today on Friday, the 9 of May, 2014. I would now like to hand the conference over to your speaker today, Emmett Harrison. Please go ahead, sir.

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

Thank you. Good afternoon. This is Emmett Harrison, SVP of IR and Corporate Sustainability. Welcome to the first quarter 2014 results telephone conference for Swedish Match. Lars Dahlgren, President and CEO is joined today by Tom Hayes, Acting CFO, 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 Tom Hayes. 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 IR section of our website, [swedishmatch.com](http://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're subject to various risks and uncertainties. Although management believes that its expectations are based on reasonable assumptions, we can give no assurances that its expectations will be achieved. Risk factors are outlined in the latest Annual Report, which is available on our website, [swedishmatch.com](http://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 AB - President & CEO

Thank you, Emmett, and good afternoon, everyone. Before going into the first quarter results, I'd like to mention that, at the Annual General Meeting held on May 7, shareholders approved a dividend of SEK7.30 per share. Shareholders also approved the cancellation of 1.5 million shares and renewed the share buyback mandate. More information about the Annual General Meeting can be found on our website.

For the first quarter 2014, Swedish Match delivered sales growth in local currencies of 2%, with gains in our other tobacco products and the lights product areas, as well as in our distribution business. Sales were essentially flat in our Snus and moist snuff product area in local currencies. Operating profit from product areas in the first quarter amounted to SEK809 million, down from SEK872 million in the previous year. Higher spending behind international Snus, currency effects, and currency effects contributed to the decline. And excluding these effects, Swedish Match reported stable operating profit from product areas.

Operating profit, including our share of net profit from Scandinavia Tobacco Group but excluding large one-time items, amounted to SEK858 million, down 2% from SEK872 million in the first quarter of 2013.

Sales revenues for Swedish Match Snus in Scandinavia were essentially flat in local currencies but declined 2% in SEK in the first quarter versus the comparable quarter of the prior year. Operating profit declined somewhat more in percentage terms mainly as the result of the weaker Norwegian krona. Overall, Snus shipment volumes in Scandinavia were up by close to 1% versus Q1 last year, and were also 1% higher when we adjust for Easter timing and hoarding effects between the periods.

Volumes increased in Sweden in Norway but declined in travel retail. In Sweden, price mix effects were impacted by a higher share of low-priced products in the portfolio, as well as lower prices for the Kaliber brand than in the first quarter of the prior year, partially offset by small price adjustments in September 2013.

With changes to the consumer pricing landscape in the Swedish market over the past year, we have decided to segment the Swedish market into two segments, a premium segment and a value segment. In Sweden, our market share is highest in the premium segment, and we have a growing and leading position within the smaller value segment. The sequential share gain within the value segment contributed to a moderation of the share loss versus the trends in previous quarters.

In Sweden, using Nielsen data, excluding tobacco (inaudible), our market share for Snus in the value term was 76.8% in the four-week period ending April 20, unchanged from 76.8% for the preceding four-week period and down from 79.2% in the corresponding four-week period last year. Our market share in volume terms was 70.1%, up from 69.9% in the preceding four-week period, and down from 72.8% in the corresponding period last year.

Based on our own segmentation on Nielsen data for the four-week period ending April 20, Swedish Match had a volume share of 93.8% of the premium segment and 38.0% of the value segment. Our share of the premium price segment was down somewhat from the prior year corresponding period, while our share of the value segment was higher. The value segment accounts for 42.5% of the Swedish market in number accounts, up from 38.5% in the corresponding period last year.

In terms of pricing, Swedish Match took modest price increases across the portfolio apart from the Kronan brand last September, as this brand was in a declining trend. Recently, we decided to improve the competitive positioning of Kronan by improving the visibility at retail, secure listing for the smallest SKU, and affecting a price decrease of the pouch product range. While this will affect our year-on-year average price comparison within the value segment negatively in Q2, it should be noted that, towards the end of Q1 in the prior year, we affected a relatively significant price decrease of the Kaliber brand.

While the current government has proposed a higher tax increase on Snus than cigarettes in the preliminary budget for 2015, we note that this has created a relatively large debate in media, and the opposition parties have indicated that they would propose a more balanced proposal. The elections in Sweden are in September of this year.

In Norway, our market share in value terms in the latest four-week period ended April 20 was 61.1% versus 61.4% in the preceding period and compared with 63.9% in the corresponding period last year. The total market increased by more than 9% in the latest six-month period versus the same period one year earlier, according to Nielsen.

Nielsen reports that, over the same six-month period, Swedish Match consumption volumes are up by more than 4% versus that same period a year ago. While the indicated 4% volume growth in itself is a healthy number, we are not pleased with the share erosion and have strong focus on the Norwegian market. A current example of an action is the introduction of enhanced products under the lab Fresh Product range.

In the US, Swedish Match moist snuff sales and shipment volumes were virtually unchanged versus the first quarter of 2013. Operating profit in the US for moist snuff was higher than last year, mainly due to lower cost of goods. Swedish Match estimates its volume share of the US moist snuff market to be in the range of 9% to 10%, with good volume development in the growing [pouch] segment. The pouch segment in the US now makes up close to 14% of the moist snuff market and has been growing faster than the category growth rate over the past several years. Another fast-growing segment is for larger packaging formats, and here we continue to see good growth for our Longhorn tub.

General Snus in the US is now available in more than 23,000 stores. For the remainder of 2014, we would focus on adding distribution in selected high-quality outlets, and the pace of store expansion is likely to remain modest during the year. With the current plans of expanded consumer engagement and brand-building activities, the operating loss for the remainder of 2014 is expected to be of similar magnitude as in 2013.

During the first quarter, net shipment volumes were down year-on-year on a net basis. This was due to product returns that we attribute to unrealistically high buy-in from temporary promotions in 2013 and rapid distribution efforts in the first half of last year affecting comparisons.

In our other tobacco products businesses, sales of mass-market cigars in local currency were in line with the first quarter of 2013, with the volumes increasing by 5%. Higher volumes are primarily coming from our natural wrapper Game products by Garcia Y Vega. In the first quarter, operating profit for cigars was down somewhat. This was anticipated and the result of an increased promotional product mix versus a year ago.

For chewing tobacco, we recorded volume growth [of our own] brand. This is in a category that typically declines in the range of 4% to 7% per year. Want you to remember that shipment volumes in chewing tobacco can be volatile, and it's unusual to have volume growth year-on-year. Contract manufacturing volumes were also higher in the quarter compared to the first quarter of the prior year. For the first quarter, chewing tobacco sales and profits in local currency were above first quarter 2013 levels.

In the lights product area, sales were up in local currencies for both lighters and matches. While lighters continued to deliver solid operating profit growth in local currencies on the back of higher sales and improved productivity, operating profit in local currency declined for matches. Matches suffered from a weaker country mix and a negative currency transaction effect. The total product area operating profit in local currencies was down by SEK4 million.

Sales in other operations for the first quarter amounted to SEK858 million compared to SEK816 million previous year. Operating loss for other operations was SEK18 million in this quarter and SEK20 million in the first quarter of the prior year. Reported sales for Scandinavia tobacco group during the first quarter totaled DKK 1.310 billion compared to DKK1.305 billion prior year.

In local currencies, sales were up by 3% with increased sales for all product areas. Gross profit also increased in local currencies compared to the first quarter of the prior year. reported EBITDA increased by 3% to DKK221 million, and on an underlying basis in local currencies and adjusted for one-timers, EBITDA increased by more than 10% due to increased sales and lower operating expenses.

On the gross profit level, gross profit increased for handmade cigars and both fine cut and pipe tobacco but declined for machine-made cigars. Operating expenses in the quarter were lower than in Q1 last year even with additional cost of temporary nature of about DKK20 million, including rationalization cost relating to the ongoing supply chain optimization program. STG's net finance costs for the quarter increased to DKK25 million, up from DKK18 million in the previous year, mainly due to exchange gains in the first quarter of the prior year and the net profit in the first quarter amounted to DKK75 million.

The Swedish Match share of net profit in STG for the first quarter amounted to SEK49 million, up from SEK39 million in the previous year. On March 26 of this year, Swedish Match received a dividend from STG of SEK223 million.

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

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**Tom Hayes - Swedish Match AB - Acting CFO**

Thank you, Lars. For the first quarter, the development of exchange rates continue to have a negative effect in sales and operating profit comparisons. Currency shifts relative to the Swedish krona were most pronounced with the Brazilian real and the Norwegian krona. Overall, there was a negative translation impact on sales of SEK28 million for the first quarter. This consists of a negative SEK14 million for Snus and snuff, a positive SEK3 million for other tobacco products, and a negative SEK17 million for lights.

The total translation effect on operating profit was a negative SEK1 million in the first quarter. Note that, while technically not a translation impact, the weakening Norwegian krona adversely impacted the operating profit, notably for the Snus and snuff product area in the first quarter of 2014. At current exchange rates, we would expect to see the negative currency effects to moderate in the coming quarters. Net finance costs for the first quarter declined to SEK126 million from SEK136 million in the previous year due to decreased average debt levels and lower interest rates. As of March 31, 2014, the interest-bearing debt was SEK10 billion versus SEK10.5 billion at December 31, 2013.

For the first quarter, the reported tax rate was 20.7%. The underlying tax rate was 22%. We estimate the full year of 2014 tax rate, excluding one-time items, associated companies and joint ventures, the underlying tax rate, to be around 22%.

Now, for some brief comments to the cash flow and balance sheet. Cash flow from operating activities for the first quarter amounted to SEK1.027 billion compared to SEK643 million in the first quarter of the prior year. The cash flow from operations increased compared to the prior year mainly as a result of positive changes in working capital and timing of income tax payments.

Net cash used in investing activities, which during the quarter was exclusively attributable to investments in property, plant and equipment, amounted to SEK56 million compared to SEK70 million in 2013. We expect that investments in tangible and intangible assets for the full year of 2014 will approximate SEK300 million. It is also good to remember that, in the second quarter of 2013 under investing -- cash flow from investing activities, we received net proceeds of SEK161 million primarily related to the sale of land.

During the first quarter, SEK68 million has been transferred to the shareholders by means of share buybacks. At March 31, 2014, Swedish Match held 2.9 million shares corresponding to 1.4% of the total number of shares. The number of shares outstanding net at March 31, 2014 amounted to 199.1 million. Call options corresponding to 700,000 shares and exercisable through February 2015 were outstanding as of March 31, 2014.

The net debt declined to SEK7.533 billion from SEK8.388 billion at the end of 2013, and the net debt in relation to EBITDA, excluding share of profit in STG, was 2.2 for the 12-month period ending March 31, 2014. During the first quarter, we issued no new bonds and repaid loans of SEK485 million. During the remainder of 2014, SEK406 million of loans fall due for repayment. The average maturity duration of the bond portfolio is now 3.9 years and the weighted average interest rate on the bonds is 4.69% with about 95% of the portfolio at fixed interest rates.

I will now turn the conference call back to Lars.

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

Thank you, Tom. And before we start the Q&A session, I'd just like to thank Tom, who has done an outstanding job as an acting CFO since last September. Marlene Forsell will assume the role of CFO as of June 1 when she returns from parental leave.

With that said, let's go ahead and open up the line for questions.



## QUESTIONS AND ANSWERS

### Operator

Andreas Lundberg from ABG Sundal Collier.

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### Andreas Lundberg - ABG Sundal Collier - Analyst

Good afternoon, gentlemen. I know it's still a little bit premature, maybe, but what -- while you now seen the FDA proposal here in the US for cigars and so forth, what's your initial take on it for potential implications? Thank you.

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

The question was surrounding the FDA regulation of cigars?

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### Andreas Lundberg - ABG Sundal Collier - Analyst

Correct.

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

In the US?

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### Lars Dahlgren - Swedish Match AB - President & CEO

Yes, Emmett, do you want to take it, or should I take it?

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

You [go ahead].

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### Lars Dahlgren - Swedish Match AB - President & CEO

Yes. No, I mean, let's remember that now they've proposed their deeming regulations, and there's a commentary period. And it's a -- we expect there to be some changes, and we expect the implementation, at the earliest, 2015.

And so, we have to wait and see. I mean, we note what has been said in these deeming regulations, everybody can see that, contrary maybe to what some people had thought, that from the beginning there is no ban on flavors. On the other hand, there are relatively complicated registration procedures for products out there in the marketplace that we need to take a close look at and what the implications would be for our portfolio. And it's the same for the whole industry, because this is a category where you have had a lot of news out there.

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

Okay, we need to wait and see, then, yes. On [STG], did you say, Lars, that you had some restructuring costs, around DKK20 million, in the numbers? So, underlying EBITDA was around SEK240 million, is that correct?

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

Yes. We don't give an exact number, but it's about (multiple speakers) when you strip out the currency and the difference, were some small one-timers in the first quarter of last year, and there were some one-timers of around SEK20 million this year.

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

Can you just update us on the synergies for STG? Thank you.

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

Yes. I mean, what you see here is we are -- the supply chain, the major steps have been taken there now, but you haven't started to see the effects, so to say, so they're gradually come in some supply chain synergies this year. And this was -- the charge here was actually a -- it was a relatively large provisions. It was actually related to calibration of that provision. So, it's not a new restructuring that happened in the first quarter. It's part of the overall big supply chain optimization program.

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

What is it, then, EUR10 million left in synergies to be realized?

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

We haven't given an exact number, but when it comes to the sales companies, those were done early, and then the remainder, which was lower than the sales companies but still meaningful coming from the supply chain, that's where we start to see effect during this year.

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

Okay, thanks a lot.

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**Operator**

Anders Hansson from danskebank.com.

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

Thanks. Hi, guys. It's on mass-market cigars, and I was wondering if you could talk a bit on the competitive situation, if it's getting better, worse, given volumes [generally] are quite good and okay price mix.

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

I would say -- this is Lars here again -- we are pleased with especially I'd say our development within natural wrapper cigars. So, there we have definitely gained clear market shares within the HTL cigars. We haven't had the same type of development, but, net-net, it's up 5%. And this reflects the fact that it remains a very competitive marketplace out there.

I think it's fair to say that we haven't seen any -- in that respect any sort of big improvement nor any big deterioration in the first quarter compared to sort of the market situation in the second half of last year. And then, there are some things maybe a little bit better and some things maybe a little bit worse. We have not seen a growth of -- further growth of the deep discount segment in the market. But, on the other hand, the standard -- the value HTL segment remains extremely competitive with a lot of promotional items out there.

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

Okay, thank you.

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**Operator**

Casper Blom from Handelsbanken Capital.

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**Casper Blom** - *Handelsbanken Capital Markets - Analyst*

Thank you. First question relating a bit to the Swedish market. You've had one of your competitors recently coming out with some relatively aggressive statements with regards to the pricing on certain prices. I don't know if you'd be willing to give sort of your view on that.

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

I don't know which competitor you refer to, but generally speaking, we don't comment so much on -- I mean, they need to stand for their comments, so to say.

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**Casper Blom** - *Handelsbanken Capital Markets - Analyst*

Okay. I was referring to Japan Tobacco, but--.

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

--Yes. Again, just a very brief comment to that, there are -- there have been statements in both directions. And if I limit myself to just speaking about Nielsen data, we have seen consumer price changes in both directions for their LD brand, which means that I think the jury is still out there.

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**Casper Blom** - *Handelsbanken Capital Markets - Analyst*

Okay, fair enough. Moving on to the US, a question regards to the snuff -- moist snuff business. We've seen both Reynolds and Altria reporting growth in their market share. Could you explain a little about the dynamics as it's happening on that market right now and what your positioning is in that? Thank you.



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

Yes. I mean, the Nielsen numbers have one indication, and then the manufacturers report their own shipments there. So, we take a look at the overall shipment data that was provided in Q1 and make a calculation based on that. And according to that, we see our market share staying fairly stable, in the range of 9%-plus, 9% to 10% of the overall market.

Now, we have had some declines with our loose products at the higher end of the market, with Timber Wolf and Red Man, but we've seen continued good growth in volume and in share of our pouch products, our Longhorn pouches, as well as our tub products. But, we have to remember that, as a percentage of our overall mix in volume terms, pouches and tubs are a lot smaller than for Timber Wolf and Longhorn. So, that is putting a bit of a pressure on overall volumes for us. But, we're seeing good trends in the areas that are growing the fastest.

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**Casper Blom** - *Handelsbanken Capital Markets - Analyst*

Thanks a lot.

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**Operator**

Stellan Hellstrom from Nordea Stockholm.

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

Yes, hi. I just wanted to know. I know you launched the Jackpot brand in US cigars earlier, and just wanted to know if you could give us some update on your -- the take-up there and your plans for the future.

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**Tom Hayes** - *Swedish Match AB - Acting CFO*

I think we're still supporting the Jackpot brand. It obviously plays at that deep discount segment. As Lars mentioned, that we haven't really seen much rapid growth, as much rapid growth in that deep discount segment in the current year, predominantly for -- or predominantly because of more aggressive discounting on more of the traditional HTL product. So, we are continuing to grow that product, but it's not something that we're looking to grow aggressively if the deep discount segment is flat.

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

It sounds that you are maybe then actually seeing at least some kind of improvement in the market, as the deep discount isn't growing as fast as it did previously.

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

As Tom pointed out as well, the levels of promotions for the regular value HTL segment has remained at a very high level, and that's probably what's limited the growth a little bit for the deep discount segment. So, I think you have to see at the overall picture, and I think the fairer description is that it's at similar level compared to last year. And it is a volatile and highly competitive market where we do expect changes in all sorts of directions as the year goes on.

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

Okay. Just also a question on the strong shipment volumes in chewing tobacco. I think last year volumes did not decline as much as they have earlier. How do you see consumption in the first -- do you have any data on the first quarter?

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

The Nielsen rates are not quite as important to us when we look at the US chewing tobacco business because of the stores that are represented by Nielsen that we take a read of. The early indications from Nielsen, however, indicate that the market decline rate is more than the 4% decline rate that we saw last year. Should say that, to repeat, though, that shipment volumes in chewing tobacco are volatile from quarter to quarter. You have different timing effects and just in terms of order activity from the different accounts, and also you have changes in promotional timing and so forth.

Within chewing tobacco, you saw quite good growth. Part of that is also due to contract manufacturing volumes, and those volumes are very volatile, and they'll move around quite a bit from quarter to quarter. So, yes, we had a surprisingly good first quarter in terms of the overall volumes.

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

Fine, thanks. Then also, just finally, if you could say about how much net debt does STG have on their balance sheet?

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

I don't have that number in my head and in front of me. We would have to get back to you on that one. I mean, their Annual Report is publicly available, so you can look at what it was at December 31, and then you can figure it out more or less based on the EBITDA as of now, and then less the dividends paid, or add the dividends to the net debt.

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

Fair enough. Thanks.

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**Operator**

Henry Davies from Bank of America.

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

Hi, thank you. I've got three questions, please. First, within other tobacco products, can you split out what the profit progression in chewing tobacco versus mass-market cigar was in terms of the actual number, or a bit more detail, then just up and down? And then, maybe how much of that 1Q strength in chewing tobacco would you say is due to this quarterly volatility, or do you actually see some improvement underlying versus previous years, as well, that we should kind of extrapolate? That's the first question.

Second question, just on US Snus, I mean, you've talked about product returns, slow store expansion, but this is still a pretty weak quarter. Can you just help us understand what the underlying trends are, perhaps an estimate of volume progression without those two technical impacts? And then just to check I've understood these product returns right, so is it basically that you discounted the product heavily last year and that didn't have the expected impact on consumer demand, and now you're getting returns from that?

And then, lastly, just on -- third question is your latest view on the overall pricing or competitive environment in Sweden and how you're feeling today, let's say, at the last update, at the full-year stage. Thanks.

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

Hi, this is Lars here. Remind me if I forget some of your questions.

We'll start with the -- with other tobacco products. That is our reporting segment, and we stick to indicate the direction there in terms of how much profit we're up or down. When it comes to the strong chewing tobacco result, I think it's a little bit too early to say. Three months is a short period. It is, of course, encouraging to see a strong quarter after a very strong year, because when we sum up last year, in our view, there is a slight improvement in trends. If we strictly look at Nielsen data, which is the sample we look at only 10,000 convenience stores, then it looks like that trend has been broken, but I think it's too early to say. And it was a strong quarter. I mean, we had 1% volume growth of Swedish Match brands in the quarter. We do not expect volume growth. That is very rare that we have volume growth.

So, let's hope that the sort of category streams and also us taking share within the premium segment in chewing tobacco, we think we have a very good offering there, and we have the strongest brands. So, we are hopeful that we can continue to do that, and let's add to that that at least there is some hope that the category shows some more health if you go back a couple of years. But, it is too early.

In terms of Snus US and product returns and so forth, first of all, in this kind of business where we have a relatively large number of outlets, the category is still novel, and where the terms per store on average is clearly lower than, for example, moist snuff, which is a very established category. I think we have to count on a higher level of, let's say, normal product returns than in the rest of our businesses. But, what we see the effect -- so, it's essentially two effects. There is probably still a little bit of those that bought in the deep discount promotions as long as eight, nine months ago, but that effect should be subsiding. But, there is a sort of return effect from the distribution build as well, as some stores have been overly enthusiastic.

And Tom, you need to correct me if I'm wrong here, but it is tough to make sort of estimates of the net if you adjust for that, but on the gross shipment basis, my recollection is that we did continue to show volume growth in the first quarter. And we definitely think that our model now and the way we deal with the trade, clearly there is some learning in this, so we are much more mindful. So, although we do think that we'll continue to see product returns, it should be higher quality volumes that we ship on a gross basis certainly as of this year.

And then, on the -- the final question was about the Swedish -- was it the--?

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

It was (multiple speakers).

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

I'm sorry?

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**Tom Hayes** - *Swedish Match AB - Acting CFO*

It's pricing and competitive landscape.

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

In Scandinavia?

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

In Sweden.

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

Yes. No, there I would say it's a little bit like mass-market cigar in that it's -- it continues to be very intense price competition at the low end of the market. And we -- as I said, one brand we have seen, in some stores it's gone up according to Nielsen, some stores it's gone down. But, I wouldn't say that there is any major news in terms of product withdrawals or new entries or so in the segment.

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

Perfect, thanks. Can I maybe ask two quick follow-ups, just on Sweden first? Can you give us any color on when you might look to take pricing next? I think sometimes you give historic -- you've given kind of a rough idea of your plans. And secondly, on US snuff, talking on a net volume basis, so all-in, including the returns, do you expect to do volume growth this year?

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

[Take] the pricing, we don't communicate pricing until after we've done them, and now we have -- I mean, to go back, we did a, as you know, about SEK.7 per can, smaller price adjustment in September. We did lower the Kronan pouches just recently. When we look forward, we have to evaluate how our costs develop and what's happening in the marketplace. There is a piece of uncertainty in Sweden this year in terms of the election, and there are effectively, at this point, two different tax proposals out there. And I think it's fair to say that, before there is any pricing that is of -- in either direction or more meaningful, so to say, one would -- it's logical to get some more clarity on the final budget proposal in terms of excise taxation.

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**Tom Hayes** - Swedish Match AB - Acting CFO

Yes. And if your question on the US was as to combined moist snuff and Snus, I would say that it's unlikely that we'll see volume growth. You may recall that we've been historically declining within moist snuff over the course of the last few years. And although tubs and pouches are representing an increasingly larger share of our overall portfolio, we are still experiencing the volume declines with our loose open-stock moist snuff product.

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

Thank you. And maybe--.

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

--If you take Snus specifically, I mean, if you adjust for product returns, it's our clear ambition to grow there, as we have big focus on making sure that the stores where we actually -- we are now are established, that we drive increased sales in those stores.

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

And I'm sorry, does that hold on a -- including -- so, including the returns, do you still think you can do volume growth? So, it sounds like -- are the returns still quite big expected in the coming quarters?



**Tom Hayes** - *Swedish Match AB - Acting CFO*

Well, I would say that the rate of return had peaked following the more rapid trade builds of inventory and the distribution build that was more front-end loaded in 2013. Our rate of returns have progressively declined to lower levels in Q1 than we experienced in Q3 and Q4 of last year. So -- and we're hopeful that, on a volume basis even net of returns, that we'll experience volume growth within Snus in 2014.

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

Perfect. Thank you.

**Operator**

James Bushnell from BNP Paribas.

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

Hi, good afternoon. I have a couple of questions, please. The first one is about your price cut on Kronan pouches. Could you just confirm that you haven't -- or you're not changing the weights of that product? And also, presumably the aim of this is to strengthen your position in the value segment. Do you think this will give you price leadership at that level?

And then, my second question is about US Snus. Please, could you give us your expectation for what's -- the market will grow out this year in terms of the sell-out, and also roughly what your current cans per store, per week rate is? Thank you.

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

On the first question, Kronan, there's no changes in weight. I think in terms of price leadership or not, this is -- the important thing here is that we strengthen the Kronan brand and our position with that is successful, we expect to strengthen our overall position. And it's very dynamic and competitive market out there, so let's see what that means in reality.

And the third question I didn't hear. Did you--?

**Tom Hayes** - *Swedish Match AB - Acting CFO*

--I think the question around the overall category of Snus in the US. And if you look at a Nielsen reading, which once again is based on this limited convenience set, it would show growth similar to the total moist snuff category, although one should be aware that, when you look at that number, it is -- it includes very negative development for both Marlboro Snus as well as Skol Snus, so that the -- whether that's a degree of disinterest, but what I would say is those that continue to remain interested in Snus, it could be an adjusted category rate close to, I would say, high single digits.

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

Okay. And your current selling rates, on average?

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

Yes. We're talking less about cans per store per week, partly because of this shift we had in 2013 and now in 2014. Remember, in 2013, there was a big buildup in distribution. A lot of that was in smaller stores. And whenever we go into accounts, early on the rate of cans per store per week is



quite low. So, we're anniversarizing that. In addition, the stores that we're adding right now, the increase of store count is quite low. So, we're pulling back from talking about cans per store per week right now. It's not a really relevant number.

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

Okay.

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

What Nielsen reports in terms of growth, not only in select number of convenience stores but for the general brand, they report their volume growth at 19% for general.

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

In Q1?

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

Yes, year-to-date it's up to (inaudible), actually.

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

Okay, thank you. And could I just ask for a point of clarification for those of us who are outside Sweden, on the tax development? So we're aware that the current government has proposed one thing, which I believe is plus 22% on Snus, and the opposition has said they'd do something slightly less, around 8%. When does that actually get finalized? What happens? And is it a case of the current government's proposal will go ahead unless the opposition wins the election and changes it, or is it completely uncertain until the election is done? Thank you.

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

It's a very good question, because it's -- and unfortunately, it's hard to give an exact answer. But, the current government in their proposal, their proposal is now out for commentary. So -- and they have received quite a lot of commentaries. Some proposals receive rather little commentary and you expect exactly the same proposal going into the final budget proposal. This one has received a fair degree of fact-based commentary, which means that, I say, there is some kind of likelihood -- how big is hard to judge -- that even if the current government wins, that they would change their proposal, and then the likely change would be a more -- let's say more logical distribution of the tax burden increase between cigarettes and Snus. But, it's far from certain that they will do that.

If there is -- if the opposition would win, first of all, we have -- it depends on what we mean by that. The parliamentary situation in Sweden may be rather uncertain, to say the least, if either party wins, by the way. But, that also goes for the Social Democrats. That is the leading opposition party.

But basically, all the parties that are in opposition now have come out and said that they will not take up cigarette taxes less than Snus taxes. So then, we would effectively have to wait until after the election and final budget proposal. If the current government, on the other hand, decides to change something, we don't know when they decide to communicate that. It could be after the election in the final budget proposal, or it could be pre-elections once they're through analyzing the commentaries and so forth. Sorry for the unclear answer, but it's a little bit beyond my control.



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

No, thank you. That's clearer than before, so thank you.

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**Operator**

Erik Bloomquist from Berenberg London.

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

Hi, good afternoon. This is a question for Tom. I was wondering if you could comment on the apparent greater balance sheet flexibility. It was interesting to see net debt to EBITDA at 2.2 times, the cash flow from operations nearly SEK400 million higher, cash up over SEK400 million. I was wondering if that implies that we should expect a greater ability to buy back shares or an increased cash return through dividends. Thanks.

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**Tom Hayes** - *Swedish Match AB - Acting CFO*

Yes. And what I would say is the timing of working capital changes can be volatile from quarter to quarter depending upon quarter-end collections of trade debtors and payments of excise taxes, specifically or especially with regards to the Sweden distribution business. We did finish the quarter on a rolling 12-month net debt to EBITDA of 2.2. We generally finish the first quarter at levels that are below our kind of stated policy rate in anticipation of the dividend that takes place in Q2. So, it's something that I think we will continue to monitor over the course of 2014, but our underlying financial policy really has not changed. It is that we're steering in that range of 2-4 to 2-6, somewhere in that range. So, one can do the math with regards to our financial performance, both in Q1 and future quarters, and that'll give you a good indication of what our buyback plans would be.

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

Great. Thank you.

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**Operator**

Chas Manso from Societe Generale.

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

Yes, thanks. Can I start off with Kronan? Basically I'm trying to get sort of a (inaudible) how big is the impact of the price decrease. I understand that you had a test market, and now you're taking it national, but the test market was quite large anyway. Could you give us a feel for how much national coverage the test market was and when did it -- test market start? And I guess in those test markets, did you see any kind of response from your competitors, and if so, what? And then, finally, on the Kronan bit, have you sort of managed the cost structure so that it has a minimal impact on margins?

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

Yes, if I comment on the test market, and unfortunately I won't comment much in the sense that, as all consumer goods companies, we have our market research methods and so forth. But, I will say it was a meaningful share of the organized trade, but if you think of it as trying to figure out our average price FX between quarters and so forth, it was very far from, like, half the market, or something like that. It was a piece of the market.

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And some of these outlets are very dynamic in terms of activities, and there are different brands offered at special prices with select discounts and so forth from time to time. If we note that something is specific response to this, we don't comment on.

On the cost side, it is exactly the same good old product as before, same weight, same good quality product, which means that costs are the same. An issue before has been the rapid decline, and obviously that's not good for the costs, although it's the same factory with switchovers and so forth. So, if we didn't address it, we would have seen costs coming up.

Now, coming from a relatively bad trend, we cannot guarantee that we will stop there the decline, and certainly we don't know if there will be competitive responses. But, we do work on visibility and additional distribution also for the smallest SKU, and we definitely give the good Kronan brand the type of vitamin injection that it deserves. And it would be a big disappointment if the minimum didn't improve the trends.

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

Right. Can I ask a couple of extra question? One is whether you'd be able to quantify or give us a feeling for the margin impact in your snuff and Snus division of the NOK currency. You mentioned it in the text, so I guess it was enough to be mentioned.

And the second one is on your US cigar business. Could you give us sort of a broad breakdown of the situation today in terms of your sales breakdown by subsegment, and how much is in natural wrappers, how much is in the deep discounts and so on, and what the sort of growth rates are by those subsectors? Thanks.

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

Yes. As Tom deals with the cigar one there, let me look a little bit on that margin question.

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**Tom Hayes** - *Swedish Match AB - Acting CFO*

Yes. I would think that, when you look at the overall category for US mass-market cigars, the natural leaf segment is sub-SEK1 billion in size, where the HTL, which would include not only the traditional HTL but this new deep discount, is in the SEK3 billion range. So, the growth that we've seen within HTL over the course of the last year or so has been more so sourced from the deep discount players. But -- so, the growth trajectory of HTL generally has not been as great. And I would say that the -- when we look at the -- kind of the category growth of the natural leaf segment, that has been a -- it was the fastest-growing segment from 2012 to 2013. So, it is a faster-growing segment, and we're seeing a fair degree of traction with our Game product within natural leaf segment.

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

And this is Lars here. On the margin, we don't give the exact effect. It becomes a little bit peculiar with Norwegian krona, and that's what Tom pointed out, because it actually goes into the technical translation effect on sales, but not on operating profit. And this is just because of the way the product is distributed and invoiced. But, as you [righteously] point out, it is a -- it has a notable effect. You can calculate approximately how big our Norwegian business is, and year-on-year there was a relatively big decline in the Norwegian krona versus the SEK. With the current exchange rates, that year-on-year effect should subdue.

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

Do you expect the effect to unwind, go the other way?

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

No. Tommy, I (inaudible) better in your head, but the biggest fall of the Norwegian krona was in the first half of last year.

**Tom Hayes** - *Swedish Match AB - Acting CFO*

Yes. So, I guess at current rates, our experienced average rates for Q3 and Q4 are reasonably in line with current rates.

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

Great. Thanks.

**Operator**

There are no further questions registered at this time. Please continue.

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

Thank you. Just want to say that the next report will be published in July.

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

Okay, thank you, everybody.

**Operator**

Ladies and gentlemen, that does conclude our conference for today. Thank you for participating. You may all disconnect. Speakers, please stand by.

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