



Interim Report

January - September 1997

- ⌋ **Increase in consolidated net earnings.**
- ⌋ **Snuff and Matches report strong increases in earnings.**
- ⌋ **Higher sales reported by several divisions compensated for a decline in Cigarettes Division sales.**
- ⌋ **Joint-venture agreement reached in Turkey with KAV for match production and sales.**

Swedish Match sales during the first nine months of 1997 rose 3% to SEK 5 580 M, compared with SEK 5 436 M during the corresponding period last year. Expressed in local currencies, that is, less currency effects, sales were largely unchanged, compared with the first nine months of 1996. Higher sales by several divisions, particularly the Snuff Division, compensated for lower sales by the Cigarettes Division. This decline was caused mainly by hoarding toward year-end 1996 and the new agreement regarding Prince cigarettes which became effective in May 1997, as well as a general decline in the Swedish cigarette market.

Operating income increased from SEK 1 100 M to SEK 1 201 M. Before nonrecurring items, operating income amounted to SEK 1 201 M, a marginal decline compared with SEK 1 223 M during the first nine months of 1996. Lower operating income reported by the Cigarettes Division was offset largely by higher income reported by the Snuff, Matches and Chewing Tobacco divisions.

Swedish Match

| SEK M | First nine months | |
|--|-------------------|--------------|
| | 1997 | 1996 |
| Sales | 5 580 | 5 436 |
| Operating income before nonrecurring items | 1 201 | 1 223 |
| Operating income | 1 201 | 1 100 |
| Income before taxes and minority interests | 1 195 | 1 037 |
| Net income | 812 | 715 |

Sales by division

| SEK M | First nine months | | Percent change | 12 months | Full year |
|--|-------------------|--------------|----------------|--------------|--------------|
| | 1997 | 1996 | | ended | |
| | | | | Sept 30,97 | 1996 |
| Chewing Tobacco | 868 | 811 | 7 | 1 100 | 1 043 |
| Cigarettes | 1 193* | 1 419 | -16 | 1 757 | 1 983 |
| Cigars | 498 | 495 | 1 | 681 | 678 |
| Lighters | 647 | 634 | 2 | 859 | 846 |
| Matches | 949 | 907 | 5 | 1 283 | 1 241 |
| Pipe Tobacco | 122 | 142 | -14 | 176 | 196 |
| Snuff | 786 | 651 | 21 | 1 035 | 900 |
| Group-wide operations and eliminations | 517* | 377 | 37 | 669 | 529 |
| Total | 5 580 | 5 436 | 3 | 7 560 | 7 416 |

*After May 1, 1997, external invoicing of Prince cigarettes is reported under Group-wide operations. Subcontracted production remains within the Cigarettes Division. The change resulted in a decline of SEK 147 M in sales of the Cigarettes Division for the period. This amount is included in Group-wide operations.

Operating income before nonrecurring items, by division

| SEK M | First nine months | | Percent change | 12 months | Full year |
|--|-------------------|--------------|----------------|--------------|--------------|
| | 1997 | 1996 | | ended | |
| | | | | Sept 30,97 | 1996 |
| Chewing Tobacco | 320 | 268 | 19 | 420 | 368 |
| Cigarettes | 413* | 555 | -26 | 647 | 789 |
| Cigars | 96 | 91 | 5 | 141 | 136 |
| Lighters | 39 | 37 | 5 | 50 | 48 |
| Matches | 109 | 82 | 33 | 145 | 118 |
| Pipe Tobacco | 23 | 28 | -18 | 36 | 41 |
| Snuff | 370 | 303 | 22 | 498 | 431 |
| Group-wide operations and eliminations | -169* | -141 | | -236 | -208 |
| Total | 1 201 | 1 223 | -2 | 1 701 | 1 723 |

*Most of the contribution from sales of Prince cigarettes is reported under the Cigarettes Division.

Division Chewing Tobacco

The Chewing Tobacco Division operates in the North American market. Sales during the first nine months of 1997 rose 7%, compared with the corresponding period last year, to SEK 868 M. The increase was attributable to the strong U.S. dollar. Expressed in local currencies, sales were down 5%. The volume decline for chewing tobacco, due to the declining total market, was offset to some extent by higher prices.

Operating income during the period under review rose to SEK 320 M, an increase of SEK 52 M compared with the corresponding period last year. Expressed in local currencies, operating income increased 6%. Cost savings yielded favorable effects on the division's operating margin.

Division Cigarettes

The Swedish market accounts for most sales invoiced by the Cigarettes Division. Sales during the first nine months of 1997 amounted to SEK 1 193 M, down 16% compared with the corresponding period a year earlier. As a result of hoarding in the Swedish market toward year-end 1996, triggered by the increase in tobacco tax and prices that took effect on January 1, 1997, estimated sales of SEK 75 M that would normally have been booked in 1997 were invoiced toward year-end 1996. The sharp price increase, necessitated by a

29% increase in Swedish tobacco tax, effective August 1, 1997, resulted in a strong increase in sales during July. This resulted in a sharp sales decline in August and September. Effects of hoarding will also be reflected in sales during the fourth quarter. The total market for cigarettes in Sweden declined 21% during the first nine months of 1997, compared with the corresponding period last year, of which 5% was caused by hoarding prior to last year's tax increase. The market share of Swedish Match products was down marginally to 50%, compared with 51% during the first nine months of 1996. It is still too early to estimate sustained effects of the recent price increase on delivery volumes and consumption.

The new agreement with Skandinavisk Tobakskompagni A/S (STK) regarding sales of Prince cigarettes came into effect on May 1, 1997. Under terms of the new agreement, Swedish Match is responsible for production and distribution of Prince cigarettes, and STK, through its subsidiary House of Prince, is responsible for marketing.

Operating income during the first nine months of 1997 amounted to SEK 413 M, a decline of SEK 142 M. The effects of hoarding on operating income toward year-end 1996 have been estimated at approximately SEK 45 M. The new Prince agreement, higher marketing expenses and lower volumes affected the division's operating income adversely which, however, was offset largely by higher prices.

During the past 12-month period, total tobacco tax and value-added tax on tobacco products paid by Swedish Match in Sweden amounted to SEK 9 555 M (8 767).

Division Cigars

Western Europe is the most important market for the Cigars Division. Sales during the first nine months of 1997 totaled SEK 498 M, an increase of SEK 3 M compared with the corresponding period last year. Operating income rose from SEK 91 M to SEK 96 M. Changes in the division's product mix, marked by a shift toward the higher-price segment, yielded favorable effects on sales and earnings.

The introductory sales of premium cigars in the U.S. continued and hand-rolled cigar capacity in Indonesia was increased further.

Division Lighters

The most important markets for the Lighters Division are Western Europe, Eastern Europe, the U.S. and certain parts of Asia. Sales during the first nine months of the year amounted to SEK 647 M, a modest increase compared with sales of SEK 634 M during the corresponding period last year. Volumes remained largely unchanged. Sales were affected favorably by currency trends. Volume growth in Eastern Europe continued. The volume decline in the U.S. continued pending introduction of a new child-resistant disposable lighter. It is expected to be on the market by mid-1998.

Operating income was affected favorably by currency trends, rising by SEK 2 M to SEK 39 M during the nine-month period under review.

Division Matches

Sales by the Matches Division are concentrated primarily in Europe and Brazil, but it also has large export volumes in markets around the world. Division sales during the first nine months of 1997 amounted to SEK 949 M (907). Expressed in local currencies, sales were largely unchanged compared with the first nine months of 1996. Higher prices and

currency gains compensated for a marginal volume decline. Operating income rose by SEK 27 M to SEK 109 M. In addition to factors mentioned above, production rationalization measures implemented mainly in Brazil also had favorable effects on the division's operating income.

After the close of the nine-month period under review, the Matches Division reached a joint venture agreement with KAV of Turkey. Reference is also made to the heading below, "Important business transactions after September 30, 1997."

Division Pipe Tobacco

The most important markets for the Pipe Tobacco Division are the U.S., Sweden and the rest of Western Europe.

Sales during the first nine months of 1997 totaled SEK 122 M, a decline of SEK 20 M compared with the year-earlier period. Substantial deliveries originally planned in the beginning of 1997 were made during the autumn of 1996 instead, which was one reason for the decline in sales this year. Due to its lower invoicing, operating income fell to SEK 23 M (28).

Division Snuff

Sales by the Snuff Division are concentrated primarily in Sweden and the U.S. Total sales during the first nine months of 1997 amounted to SEK 786 M (651), with the American market accounting for 15%. The increase in sales was attributable to higher volumes in the U.S. market, increased tax-free sales and higher prices in Sweden. Stronger volumes were reported in the North American market, and the division's market share rose to 3%. Competition in the U.S. has become more intense, leading to greater price competition and price cuts of more than 35%.

Operating income improved to SEK 370 M, an increase of SEK 67 M, compared with the corresponding period last year. Higher sales of pouched snuff and increased prices in Sweden had favorable effects on operating income.

Group-wide operations

Consolidated expenses charged against operating income during the first nine months of 1997 rose to SEK 169 M (141). The increase in Group-wide operating expenses was caused by sponsorship costs for participation in the Whitbread Round the World Race, an international yachting competition, and costs incurred for the Swedish Match Global Challenge, an internal project. In accordance with the Group's new structure introduced on January 1, 1997, the Swedish Match Global Challenge is designed to strengthen global coordination of Group operations and strengthen worldwide business activities.

Preliminary agreement in the U.S.

Uncertainties continue to surround the so-called "Global Settlement," a preliminary agreement in the U.S. between the tobacco industry and certain states. It is still not known if, and to what extent, new legislation will be enacted, and it seems unlikely that a final decision will be reached during 1997. It's impossible at this time, therefore, to speculate over potential effects of an agreement on the business activities of Swedish Match in the American market.

Group income statement

| SEK M | First nine months | | Percent change | 12 months ended | Full year |
|--|-------------------|--------------|----------------|-----------------|--------------|
| | 1997 | 1996 | | Sept 30, 1997 | 1996 |
| Sales, incl. tobacco tax | 11 348 | 10 891 | 4 | 15 464 | 15 007 |
| Less tobacco tax | -5 768 | -5 455 | -6 | -7 904 | -7 591 |
| Sales | 5 580 | 5 436 | 3 | 7 560 | 7 416 |
| Cost of goods sold | -2 734 | -2 686 | -2 | -3 701 | -3 653 |
| Gross profit | 2 846 | 2 750 | 3 | 3 859 | 3 763 |
| Sales and administration costs, etc | -1 659 | -1 541 | -8 | -2 174 | -2 056 |
| Share in earnings of associated companies | 14 | 14 | 0 | 16 | 16 |
| | 1 201 | 1 223 | -2 | 1 701 | 1 723 |
| Nonrecurring items | - | -123 | | - | -123 |
| Operating income | 1 201 | 1 100 | 9 | 1 701 | 1 600 |
| Net interest expense | -13 | -73 | | -21 | -81 |
| Other financial items, net | 7 | 10 | | 8 | 11 |
| Net financial items | -6 | -63 | | -13 | -70 |
| Income before income taxes and minority interests | 1 195 | 1 037 | 15 | 1 688 | 1 530 |
| Income taxes | -381 | -323 | -18 | -497 | -439 |
| Minority interests | -2 | 1 | | 15 | 18 |
| Net income | 812 | 715 | 14 | 1 206 | 1 109 |

Group balance sheet summary

| SEK M | Sept 30, 1997 | Dec 31, 1996 |
|---|---------------|--------------|
| Intangible fixed assets | 484 | 516 |
| Tangible fixed assets | 2 047 | 2 034 |
| Financial fixed assets | 289 | 277 |
| Current operating assets | 2 823 | 2 964 |
| Current financial receivables | 164 | 144 |
| Liquid funds | 755 | 942 |
| Total assets | 6 562 | 6 877 |
| Shareholders' equity | 2 652 | 2 314 |
| Minority interests | 19 | 54 |
| Provisions | 502 | 483 |
| Long-term loans | 205 | 4 |
| Other long-term liabilities | 45 | 8 |
| Short-term borrowings | 866 | 1 015 |
| Other current liabilities | 507 | 709 |
| Current operating liabilities | 1 766 | 2 290 |
| Total shareholders' equity and liabilities | 6 562 | 6 877 |
| Operating capital | 3 588 | 3 224 |
| Net debt | 316 | 77 |

Financial result

Net interest items improved compared with the first nine months of 1996 as a result of lower net debt. Other financial items, SEK 7 M (10) net, are attributable primarily to exchange gains on net financial assets and liabilities.

Investments, financing and liquidity

Group investments in tangible assets totaled SEK 194 M, compared with SEK 148 M during the first nine months of 1996. Depreciation according to plan amounted to SEK 202 M (214). Liquid assets, including short-term investments, totaled SEK 755 M at the close of the period under review, compared with SEK 942 M at year-end 1996. Liquid assets include bank deposits and investments in treasury bills. Net debt at the close of the period was SEK 316 M, an increase of SEK 239 M since December 1996. Net debt was low at year-end 1996 because liabilities for income tax and tobacco excise taxes were approximately SEK 500 M higher than normal. These liabilities have since been reduced to a normal level.

In September, the Group raised a three-year, fixed-interest bond loan in the amount of SEK 200 M. The company's main loan financing is a Swedish commercial paper program with a loan framework of SEK 2 000 M, of which SEK 650 M had been utilized as of September 30, 1997.

Average number of Group employees

The average number of Group employees during the first nine months of 1997 was 6 337, compared with 6 646 during the corresponding period last year. The average number of employees in Sweden was 1 408, compared with 1 487 last year.

Important business transactions after September 30, 1997

Swedish Match and Kav Orman San S.A. signed a joint-venture agreement for development of match, lighters and tobacco business operations in Turkey and the Republics of Azerbaijan, Kirghizian, Turkmenistan among others. Under terms of the agreement, a new company will be established in Turkey. Swedish Match will own 60% and Kav 40%. Kav Orman S.A. will make a noncash transfer of its existing match operations to the new company, and Swedish Match will cover its ownership share through a new issue for cash amounting to USD 12 M. Establishment of the new company is pending the approval of government authorities. Based on match sales of more than SEK 100 M in 1996, Kav Orman is the largest match manufacturer in Turkey, with a Turkish market share of 45-50%.

Swedish Match has submitted a public offer to the shareholders of Treab Plus AB. The offer totals SEK 16 M. A Swedish distributor of tobacco products and tobacco-related products, Treab Plus AB reported sales of SEK 105 M in 1996.

Other information

This report has not been reviewed by Swedish Match's auditors.

The report on 1997 operations is scheduled to be released on February 24, 1998.

Göran Lindén
President and Chief Executive Officer

Key Data

| | 12 month ended Sept 30, 1997 | Full year 1996 |
|--|---------------------------------|-------------------|
| Operating margin, %* | 22.5 | 23.2 |
| Return on operating capital, % * | 47.5 | 49.9 |
| Return on shareholders' equity, % | 53.9 | 57.3 |
| Interest coverage ratio, times | 25.9 | 9.6 |
| Debt/equity ratio, % | 11.8 | 3.2 |
| Equity/assets ratio, % | 40.7 | 34.4 |
| Investments, SEK M | 263 | 217 |
| Operating cash flow, SEK M* | 1 571 | 1 968 |
| Average number of employees** | 6 337 | 6 580 |
| <i>Share data</i> | | |
| Income per share after full tax, before nonrecurring items, SEK | 2.60 | 2.59 |
| after nonrecurring items, SEK | 2.60 | 2.39 |
| Shareholders' equity per share, SEK | 5.72 | 4.99 |
| Number of shares outstanding | 463 558 252 | 463 558 252 |

Earnings per share after full tax for the first nine months of 1997 amounted to SEK 1.75 (1.54)

* Before nonrecurring items

** First nine months

Quarterly data

| SEK M | Q2/96 | Q3/96 | Q4/96 | Q1/97 | Q2/97 | Q3/97 |
|--|------------|------------|------------|------------|------------|------------|
| Sales, incl. tobacco tax | 3 715 | 3 793 | 4 116 | 3 181 | 3 994 | 4 173 |
| Less tobacco tax | -1 867 | -1 938 | -2 136 | -1 497 | -2 052 | -2 219 |
| Sales | 1 848 | 1 855 | 1 980 | 1 684 | 1 942 | 1 954 |
| Cost of goods sold | -900 | -893 | -967 | -807 | -968 | -959 |
| Gross profit | 948 | 962 | 1 013 | 877 | 974 | 995 |
| Sales and administration costs, etc. | -531 | -484 | -515 | -548 | -571 | -540 |
| Shares of earnings in associated companies | 5 | 4 | 2 | 5 | 4 | 5 |
| Operating income before nonrecurring items | 422 | 482 | 500 | 334 | 407 | 460 |
| Nonrecurring items | -123 | - | - | - | - | - |
| Operating income | 299 | 482 | 500 | 334 | 407 | 460 |
| Net interest expense | -26 | -17 | -8 | -3 | -4 | -6 |
| Other financial items, net | 1 | 0 | 1 | 21 | 3 | -17 |
| Net financial items | -25 | -17 | -7 | 18 | -1 | -23 |
| Income before income taxes and minority interests | 274 | 465 | 493 | 352 | 406 | 437 |
| Income taxes | -94 | -149 | -116 | -116 | -110 | -155 |
| Minority interests | -1 | 1 | 17 | -2 | -2 | 2 |
| Net income | 179 | 317 | 394 | 234 | 294 | 284 |

Sales by division

| SEK M | Full year | | | | Q1/97 | Q2/97 | Q3/97 |
|---|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| | Q2/96 | Q3/96 | Q4/96 | 1996 | | | |
| Chewing Tobacco | 267 | 296 | 232 | 1 043 | 295 | 261 | 312 |
| Cigarettes | 489 | 505 | 564 | 1 983 | 349 | 430 | 414 |
| Cigars | 168 | 168 | 183 | 678 | 151 | 186 | 161 |
| Lighters | 217 | 205 | 212 | 846 | 211 | 226 | 210 |
| Matches | 316 | 262 | 334 | 1 241 | 303 | 349 | 297 |
| Pipe Tobacco | 42 | 51 | 54 | 196 | 37 | 41 | 44 |
| Snuff | 221 | 229 | 249 | 900 | 238 | 267 | 281 |
| Group-wide operations and eliminations | 128 | 139 | 152 | 529 | 100 | 182 | 235 |
| Total | 1 848 | 1 855 | 1 980 | 7 416 | 1 684 | 1 942 | 1 954 |

Operating income before nonrecurring items, by division

| SEK M | Full year | | | | Q1/97 | Q2/97 | Q3/97 |
|---|------------|------------|------------|--------------|------------|------------|------------|
| | Q2/96 | Q3/96 | Q4/96 | 1996 | | | |
| Chewing Tobacco | 98 | 111 | 100 | 368 | 104 | 93 | 123 |
| Cigarettes | 189 | 223 | 234 | 789 | 94 | 144 | 175 |
| Cigars | 36 | 30 | 45 | 136 | 30 | 27 | 39 |
| Lighters | 15 | 11 | 11 | 48 | 10 | 13 | 16 |
| Matches | 33 | 24 | 36 | 118 | 26 | 43 | 40 |
| Pipe Tobacco | 5 | 14 | 13 | 41 | 5 | 9 | 9 |
| Snuff | 100 | 117 | 128 | 431 | 115 | 117 | 138 |
| Group-wide operations and eliminations | -54 | -48 | -67 | -208 | -50 | -39 | -80 |
| Total | 422 | 482 | 500 | 1 723 | 334 | 407 | 460 |