

SWEDISH MATCH CORP
Form 20-F
June 03, 2004
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As filed with the Securities and Exchange Commission on June 3, 2004

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

REGISTRATION STATEMENT PURSUANT TO SECTION 12(B) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2003

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the period from _____ to _____

Commission file number 0-28038

Swedish Match AB (publ)

(Exact name of Registrant as specified in its charter)

Swedish Match Corporation

(Translation of Registrant's name into English)

Kingdom of Sweden

(Jurisdiction of incorporation or organization)

Rosenlundsgatan 36

S-118 85 Stockholm, Sweden

(Address of principal executive offices)

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered or to be registered pursuant to Section 12(g) of the Act:

Shares, nominal value SEK 2.40 per share

(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report:

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Shares, nominal value SEK 2.40 per share

351,596,181

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark which financial statement item the registrant has elected to follow. Item 17 Item 18

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INTRODUCTION AND USE OF CERTAIN TERMS

Swedish Match AB (publ) is a public limited liability company incorporated under the laws of the Kingdom of Sweden (Sweden). References in this Annual Report on Form 20-F (this Annual Report) to Swedish Match AB are to Swedish Match AB and its predecessors, and references to Swedish Match , the Group , the Registrant or the Company are to Swedish Match AB and its subsidiaries, unless the context requires otherwise. Swedish Match publishes its consolidated financial statements in Swedish kronor. In this Annual Report, references to SEK or Swedish kronor are to the currency of Sweden, references to EUR or euro are to the currency of the European Monetary Union, references to INR or Indian rupees are to the currency of India and references to U.S. dollars or USD are to the currency of the United States. On December 31, 2003, the exchange rate between Swedish kronor and U.S. dollars based on the noon buying rate in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York (the Noon Buying Rate) was USD 1.00 = SEK 7.1950. The Noon Buying Rate on May 28, 2004, was USD 1.00 = SEK 7.4579.

The Company s consolidated financial statements are prepared in accordance with generally accepted accounting principles in Sweden (Swedish GAAP), which differ in certain respects from generally accepted accounting principles in the United States (U.S. GAAP). For a narrative discussion of the principal differences between Swedish GAAP as currently in effect and U.S. GAAP, see Note 26 of the Notes to the Consolidated Financial Statements.

Except where otherwise indicated, all references to tobacco, matches and lighters market sizes and market shares are based on Swedish Match management estimates.

The Company is incorporated in Sweden. Its principal executive offices are located at Rosenlundsgatan 36, S-118 85 Stockholm, Sweden, telephone +46-8-658-0200.

FORWARD-LOOKING STATEMENTS

Some of the statements in this document that are not historical facts are forward-looking statements, including, without limitation those regarding:

the timing of product deliveries;

the Company s ability to develop new products and technologies;

expectations regarding market growth and developments;

expectations for growth and profitability; and

statements preceded by believes , expects , anticipates , foresees , hold the view or similar expressions.

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Because these statements involve risks and uncertainties, actual results may differ materially from the results that the Company currently expects. Factors that could cause these differences include, but are not limited to:

general economic conditions, such as the rate of economic growth in the Company's principal geographic markets or fluctuation in exchange rates;

industry conditions, such as the strength of product demand, the intensity of competition, pricing pressures, the acceptability of new product introductions;

the availability and pricing of raw materials, and of tobacco in particular;

currency fluctuations;

the commencement or unfavorable outcome of litigation against the Company;

political and economic instability, especially in emerging and developing markets; and

changes in the regulatory environment for tobacco products, including changes in taxes imposed on tobacco products;

as well as the risk factors specified in this document under Item 3.D. Risk Factors .

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Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION**3.A Selected Financial Data**

The financial data set forth below for each of the years in the five-year period ended December 31, 2003 have been derived from the Consolidated Financial Statements of Swedish Match that have been audited by Öhrlings PricewaterhouseCoopers. Consolidated balance sheets at December 31, 2003 and 2002 and the related consolidated statements of income and of cash flows for the three years ended December 31, 2003 and notes thereto appear elsewhere in this annual report. The Consolidated Financial Statements from which the financial data below were derived were prepared in accordance with Swedish GAAP, which differ in certain respects from U.S. GAAP. See Note 26 of the Notes to Consolidated Financial Statements.

| | <u>1999</u> | <u>2000</u> | <u>2001</u> | <u>2002</u> | <u>2003</u> | <u>2003</u> |
|---|---|-------------|-------------|-------------|-------------|--------------------|
| | SEK | SEK | SEK | SEK | SEK | USD ⁽¹⁾ |
| | Millions unless otherwise stated | | | | | |
| | Amounts in accordance with Swedish GAAP | | | | | |
| Income statement data | | | | | | |
| Net sales | 9,420 | 11,533 | 13,635 | 13,643 | 13,036 | 1,812 |
| Operating income | 5,396 | 1,886 | 2,113 | 2,371 | 2,224 | 309 |
| Net income | 4,656 | 1,144 | 1,228 | 1,429 | 1,558 | 217 |
| Balance sheet data | | | | | | |
| Total assets | 16,670 | 16,281 | 16,623 | 15,447 | 15,102 | 2,099 |
| Share capital | 949 | 969 | 892 | 868 | 844 | 117 |
| Shareholders' equity | 5,898 | 4,584 | 4,105 | 4,007 | 4,010 | 557 |
| Bond loans, long- and short-term liabilities to credit institutions | 6,029 | 5,699 | 6,016 | 5,508 | 5,381 | 748 |
| Per share data | | | | | | |
| Basic net income per share, SEK ⁽²⁾ | 10.56 | 2.76 | 3.40 | 4.10 | 4.68 | 0.65 |
| Diluted net income per share, SEK ⁽²⁾ | 10.56 | 2.76 | 3.38 | 4.07 | 4.66 | 0.65 |
| Basic weighted average shares, in thousands | 431,340 | 410,177 | 361,506 | 348,295 | 332,679 | |
| Diluted weighted average shares, in thousands | 431,340 | 410,177 | 363,016 | 350,894 | 334,162 | |
| Cash dividend declared per share, SEK ⁽²⁾ | 1.22 | 1.35 | 1.45 | 1.60 | 1.70 | 0.24 |

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Amounts in accordance with U.S. GAAP⁽³⁾

| | 1999 | 2000 | 2001 | 2002 | 2003 | 2003 |
|--|---|-------|-------|-------|-------|--------------------|
| | SEK | SEK | SEK | SEK | SEK | USD ⁽¹⁾ |
| | Millions unless otherwise stated | | | | | |
| | Amounts in accordance with U.S. GAAP ⁽³⁾ | | | | | |
| Net income | 1,701 | 915 | 981 | 1,461 | 1,680 | 234 |
| Shareholders' equity | 7,838 | 6,319 | 5,587 | 5,391 | 5,521 | 767 |
| Basic net income per share, SEK ⁽²⁾ | 3.86 | 2.21 | 2.71 | 4.19 | 5.05 | 0.70 |
| Diluted net income per share, SEK ⁽²⁾ | 3.86 | 2.21 | 2.70 | 4.16 | 5.03 | 0.70 |

Notes to Selected Consolidated Financial Data

(1) Translated, solely for the convenience of the reader, at the Noon Buying Rate on December 31, 2003 of USD 1.00 = SEK 7.1950.

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- (2) Since the redemption price per share exceeded the stock market price at the time of redemption in 2000, net income per share for the previous period have been adjusted for comparative purposes. The correction factor is 0.97831 for 1999.
- (3) See Note 26 of the Notes to Consolidated Financial Statements for a reconciliation of net income and shareholders' equity reported under Swedish GAAP to the corresponding amounts under U.S. GAAP and for a discussion of certain differences between U.S. GAAP and Swedish GAAP.

Dividends

The Company considers it desirable that funds not vital for the expansion and consolidation of the Group be transferred to the shareholders in the form of dividends and other forms, such as a share buybacks. Swedish Match policy is that the amount of a dividend should largely follow the trend of the Company's net profit. When establishing a dividend, the size of planned repurchases of shares is also taken into account. It is estimated that the dividend amount will be between 30 percent and 50 percent of net profit. A buyback of shares is, in principle, a reverse new share issue and makes it possible to work continuously to optimize the capital structure in the balance sheet. In view of Swedish Match's stable and positive cash flow, the Board of Directors' position with regard to buyback of shares is positive. The size and scope of share buybacks depends on the same factors as the size and the scope of the dividend, namely on Swedish Match's financial position, net profit, anticipated future cash flow, as well as investments and expansion plans and also availability of non-restricted equity. Other factors that affect a repurchase are the price of the shares and the Company's interest and tax expenses.

Dividends are expected to be paid following the end of the relevant financial year, if proposed by the Board and approved by the Company's shareholders at the relevant Annual General Meeting. Subject to the foregoing, and consistent with Swedish practice, the Board would expect to propose only one dividend per year. The Annual General Meeting in April 2004 resolved that shareholders shall receive a dividend of SEK 1.70 per share, for a total amount of approximately SEK 558 million (compared with net income for the year of SEK 1,558 million), and the balance shall be retained in the business.

At the level of dividends proposed in the Board's policy, the Company believes it will have adequate cash flow to fund future anticipated capital expenditures.

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The table below shows the amount of dividends paid on each share in respect of each fiscal year indicated, translated into U.S. dollars per ADS on the basis of one ADS for every ten shares and at the Noon Buying Rate on each of the respective payment dates and, in the case of ADSs, after deduction of withholding taxes referred to below and under Item 10.E. Taxation Taxation of Dividends .

| | <u>SEK per Share</u> | <u>U.S. dollars per ADS</u> |
|------|----------------------|-----------------------------|
| 1999 | 1.25 | 1.5 |
| 2000 | 1.35 | 1.3 |
| 2001 | 1.45 | 1.4 |
| 2002 | 1.60 | 1.4 |
| 2003 | 1.70 | 1.9 |

Certain holders of shares or ADSs may be subject to U.S. federal income tax consequences on dividends paid in respect of shares or ADSs. See Item 10.E. Taxation .

Exchange Rate Data

The following table sets forth, for the years and dates indicated, certain information concerning the rate of exchange of the Swedish kronor to the U.S. dollar based on the Noon Buying Rate. The Noon Buying Rate in effect on May 28, 2004 was SEK 7.4579 = USD 1.00.

| <u>Year ended December 31,</u> | <u>Period End</u> | <u>Average⁽¹⁾</u> | <u>High</u> | <u>Low</u> |
|--------------------------------|-------------------|------------------------------|-------------|------------|
| 1999 | 8.5050 | 8.2469 | 8.6140 | 7.7060 |
| 2000 | 9.4440 | 9.2251 | 10.3600 | 8.3530 |
| 2001 | 10.4571 | 10.4328 | 11.0270 | 9.3250 |
| 2002 | 8.6950 | 9.6570 | 10.7290 | 8.6950 |
| 2003 | 7.1950 | 8.0351 | 8.7920 | 7.1950 |
| November 2003 | | | 7.9150 | 7.5200 |
| December 2003 | | | 7.5420 | 7.1950 |
| January 2004 | | | 7.4120 | 7.0850 |
| February 2004 | | | 7.4330 | 7.1295 |
| March 2004 | | | 7.6620 | 7.3660 |
| April 2004 | | | 7.7510 | 7.4650 |
| May 2004 (through May 28) | | | 7.7725 | 7.4170 |

(1) Represents the average of the exchange rates on the last day of each full month during the year.

3.B Capitalization and Indebtedness

Not applicable.

3.C Reasons for the Offer and Use of Proceeds

Not applicable.

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3.D Risk Factors

The Company is subject to legislation relating to tobacco, labeling, marketing and advertising and trade barriers

Increasing health concerns related to tobacco smoking followed by increasingly severe restrictions on marketing and advertising of tobacco products and on smoking in public places is evident in most countries where the Group sells its products. Furthermore, there is a trend towards increasingly severe regulations related to permissible ingredients in tobacco products and reporting on ingredients. Increasingly severe restrictions could have a negative impact on consumption of the Company's products and on the Company's results of operations.

Changes in excise taxes may reduce the Company's sales

Tobacco products are subject to substantial taxes in most countries where Swedish Match has significant sales. In many of those countries, the taxes on tobacco are generally increasing but the rate of increase varies between different types of tobacco products. Increased excise taxes or changes in relative tax rates for different tobacco products may result in decline in overall sales volume for the Company's products that in turn could adversely affect Swedish Match's results of operations.

Competition

Swedish Match faces intense competition in each of its geographical markets and for each of its products. In order to be successful it must promote brand equity successfully and anticipate and respond to new customer trends. Restrictions on advertising and promotion may, however, make it more difficult to counteract loss of consumer loyalty to any particular brand or product. There can be no assurance that branding or new product launches by the Company's competitors will not be successful in persuading consumers of the Company's products to switch to competitors' products, which could have a material adverse effect on the Company's results of operations.

Volume decline and price pressure

The Company is faced with lower volumes and downward pricing pressure in many of its businesses. The lighters and matches businesses in particular are characterized by volume declines, excess production capacity and fierce price competition in many markets. The Company may have to adjust its production capacity to meet declining sales volumes. In the past the Company has been able to effect price increases in some of its businesses that partly or fully have compensated for volume declines. There can be no assurance that the Company will be able to partly offset volume declines in the future through price increases if at all. The Company is distributing tobacco products in Sweden for a number of other companies, primarily manufacturers of cigarettes. Three companies account for over 97 percent of tobacco products distributed for third parties. The Company may face downward price pressure for its distribution services or loss of volumes to competing distributors in the future.

Import restrictions

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The Company is selling products in countries where potential competition is barred from entering through import restrictions or import bans. Changes in import- or export regulations can affect the Company's sales volumes and prices for its products negatively.

Retailer consolidation

In many markets the grocery trade continues to consolidate and as retailers grow larger and become more sophisticated, they demand lower pricing and increased promotional programs. Furthermore, these customers are reducing their inventories and increasing their emphasis on private label products in many product categories. These trends can have an adverse effect on the Company's results of operations.

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The Company faces litigation in the course of its business

The Company is involved in a number of legal and regulatory proceedings including pending lawsuits related to intellectual property rights and alleged injuries caused by tobacco products. The Company believes, after having consulted with counsels representing the Company with respect to these matters, that it has a number of meritorious defenses to all such pending litigation. However, there can be no assurance that those defenses will be successful in trial and substantial costs may be incurred in defending lawsuits. Although management cannot in any meaningful way estimate the damages that might be awarded, if any, in any ongoing or anticipated disputes these lawsuits individually or in the aggregate, could have an adverse effect on the Company's results of operations.

In 2002 The Securities and Exchange Board of India ordered Swedish Match AB and certain of its subsidiaries to make a public offer to acquire 20 percent of the shares outstanding in Wimco Ltd, in addition to the 74 percent already held by Swedish Match. In accordance with the order, the price per share shall not be less than 35 INR plus 15 percent annual interest from January 27, 2001. The total amount is approximately SEK 58 million plus interest at an exchange rate of SEK 0.1591= INR 1.00. The ruling was appealed to the Securities Appellate Tribunal, which upheld the order. Swedish Match has appealed this decision to the Supreme Court in India which has decided to hear the case. A final decision is expected in 2004 but it can not be ruled out that the decision will be issued later. The Supreme Court of India could, if it finds against Swedish Match, order Swedish Match to sell shares in Wimco or uphold SEBI's order to Swedish Match. There is the risk that shares bought in Wimco pursuant to such order would be bought at a cost substantially higher than the previously written down cost of Swedish Match's shares in Wimco.

Swedish Match is not a party to the Master Settlement Agreement or the Smokeless Tobacco Master Settlement Agreement between various United States states and certain tobacco companies. To date, neither these settlements nor the legislation enacted as a result of them has had any material effect upon the business activities of Swedish Match in the United States. The business is being conducted as it has been in the past but there can be no assurance that Swedish Match will not in the future enter into similar agreements that could have material adverse impact on the Company's business.

Country risks

Swedish Match has substantial operations in emerging or developing markets such as Brazil, the Dominican Republic, India, Indonesia, the Philippines and South Africa. Swedish Match's results of operations and financial condition are influenced by the economic, regulatory and political situations in the countries in which it have operations, which are generally unpredictable and outside the control of the Group. There can be no assurance that political, legal, economic or other developments such as social unrest or terrorism will not have an adverse impact on the Company's investments and businesses or on the Company's consolidated results of operations.

Lack of Insurance

Each of Swedish Match's insurance programs have limitations in coverage and there can be no assurance that any insurable damage caused is covered by insurance. Swedish Match has substantial operations in geographic areas where full insurance coverage against property damage resulting from storm and certain other natural disasters may not be obtainable. Swedish Match may not be able to obtain certain types of insurance in the future.

Loss of production capacity

For product categories where the Company does not have over capacity or where substitution between different production plants is not possible, it may lose market shares and profit in the event of loss of production capacity needed to supply its products.

Environmental risks

The Company endeavors to meet all local environmental controls and regulations but there can be no guarantee that all such controls and regulations are met or have been met in the past. In the event of changes to local regulations or

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of the legal environment or in case of accidental environmental pollution, the Company may have to incur additional costs for compliance.

Legislation on U.S. tobacco buy out quotas

During 2003, the US Congress proposed legislation that would provide for a buy out of farmers and tobacco farm owners who participate in federally supported tobacco growing programs. The buy out was to be funded by annual assessments imposed upon manufacturers of tobacco products. Depending upon the assessment formula, Swedish Match would have been imposed annual assessments which could have significant negative impact on the Company's results of operations. This legislation did not pass, although it is expected that the US Congress will again consider this issue in 2004.

The Company is subject to commodity risks

The raw materials used in the Group's business, primarily tobacco and splintwood, are commodities that experience price volatility caused by factors including weather conditions, growing conditions, local planting decisions, market fluctuations and changes in agricultural regulations. Commodity price changes beyond the Company's control may result in unexpected increases in raw materials and packaging costs and the Company may be unable to increase its prices to offset these increased costs without suffering reduced volume and incomes.

The Company aims to maintain raw materials inventory related to anticipated demand for finished goods. With respect to the Company's cigar business, unanticipated fluctuations in demand and changes between different years in the quality of tobacco grown require relatively high levels of raw tobacco leaf inventory. In some cases inventory for specific grades or types may be several years' supply. In the event of a drop in final demand for finished goods, this inventory may be substantially higher than appropriate levels and lower income due to higher capital costs may result. In some circumstances, some of this inventory may need to be sold at prices below purchase prices or may have to be destroyed.

The Company is exposed to market rate, exchange rate and interest risks

In the normal course of its business, Swedish Match is exposed to market risk, primarily in the forms of risk associated with changes in foreign exchange rates and interest risk but also in the form of financing, liquidity and credit risk. Management actively monitors these risks. To reduce these exposures, Swedish Match enters into a variety of financial instruments to the extent judged necessary by management to achieve a desired level of exposure, although the Company cannot assure that these exposures will be reduced to a desired level, if at all.

The Company manages its exposure to changes in interest rates through a mix of fixed rate debt and variable rate debt in its total debt portfolio. To manage this mix, the Company may enter into interest rate swap agreements. There can be no assurance, however, that existing or future swap agreements will manage the interest rate risk successfully, if at all.

Swedish Match has a substantial part of its production and sales in EU member countries, South Africa, Brazil, India and the United States. Consequently, changes in exchange rates of EUR, South African Rand, Brazilian real, Indian rupees and the U.S. dollar in particular may adversely affect the Company's results of operations, cash flow, financial condition or relative price competitiveness in the future. Such effects

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may occur both in local currencies and when such local currencies are translated into Swedish currency for purposes of reporting. The financing risk comprises risk arising from large borrowing requirements under austere credit market conditions where the Company may be refused to take up new loans or prolong its loans.

Liquidity and credit risks expose the Company to shortages of cash when such cash is needed in the Company's operations. The Company aims to limit these risks by the Company's policy of investing in instruments with high liquidity and credit worthiness. In addition to bank deposits, investments are mainly concentrated in government treasury bills and bonds with counter parties who have high credit ratings. However, the Company cannot assure that it will successfully invest in such instruments in the future, or that the failure to invest successfully will not have a material adverse effect on the Company's liquidity and credit position.

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Furthermore, Swedish Match may show variability in cash flows, due to among others, a changing product portfolio and differing needs for leaf-tobacco, work-in process inventories and finished goods as well as changes in rules on tobacco tax collection.

The Company could face impairment of goodwill and other fixed assets

The value of goodwill and other intangible assets as well as other fixed assets is evaluated regularly to determine whether events or circumstances indicate that the value of the fixed assets are impaired. These evaluations necessarily include significant judgments made by management. Future events could cause the Company to conclude that impairment indicators exist and that a fixed asset is impaired. Any resulting impairment loss could have a material adverse impact on the financial condition and results of operations.

Loss of key personnel

The Company relies on a number of highly experienced and/or long standing employees with a detailed knowledge of tobacco and other business related issues. Unanticipated losses of key employees could result in a substantial loss of expertise, which would negatively affect activities and operating performance.