

Stockholm  
Protean Funds Scandinavia  
September 12, 2022

# No thank you

## 106 SEK undervalues Swedish Match

Dear partners,

We do not intend to accept the current offer from Philip Morris International (PMI). Since our position in Swedish Match is material for the fund, no less than 9.8% of capital (400,000 shares), we want to explain our rationale. There are multiple possible outcomes, including a headwind, as Swedish Match's share price could decline materially if PMI decide to walk away. Should the bid fail, the fund is likely to take a small short-term stumble. We believe the long-term upside is multiples of this, and a long-term investor should welcome a dip as a buying opportunity.

One of the foremost Swedish quality companies, founded in 1915, risks leaving the stock exchange far too cheaply. It is regrettable that Protean Select is the only Swedish fund to our knowledge willing and able to take this fight. We are obviously aware our statement does not move the needle for the outcome of the bid, given the size of our holding. But we believe we owe it to ourselves and you, our investors, to be transparent that we are making an active and considered decision.

Our analysis indicates the current SEK 106 bid undervalues the long-term prospects for Swedish Match by a wide margin, and by rejecting the bid we stand to potentially capture a material long-term upside. While we acknowledge that predictions, particularly about the future, come with uncertainties attached, our judgment is that a short-term stumble in the value of the Swedish Match stock is a reasonable price to pay for what we believe is likely to be superior long-term returns. Since we optimize for long-term value, we choose to reject the current bid.

The crux of our objection is that the tobacco-free nicotine pouch product ZYN is a unique asset in a fast-growing and still marginal category with substantial runway. In 2018 Swedish Match shipped 12,7m cans of Zyn in the US. In 2021, only three later, the same number was 174m, a growth rate of well over 1000%, and the product is today available in over 130,000 stores. Take a minute and ponder this. It's amazing numbers. And yet, despite the astounding growth and dominant position, the actual ZYN operating profits represent only a small fraction of the overall US Nicotine profit pool. It takes no rocket scientist to see that this product has room to grow at double-digit rates for years to come. ZYN has, despite the intensified competition, continued to not only grow but to keep its overall market share. This is simply not reflected in the current offer price. Our judgment is that Swedish Match, on a stand-alone basis, would have appreciated to SEK 106 or above already during 2023. In fact, applying a reasonable multiple on (our estimated) Zyn EBIT for 2023 justifies no less than 85% of the current bid price.

We could argue until the cows come home about at what rate of growth and at what margin levels Zyn (or indeed the other substantial SWMA non-US and US tobacco products) are going to deliver in the years ahead, but frankly we would not be any wiser. We believe our guesstimates are reasonable, but we may well be wrong by an order of magnitude both on the upside and downside. But this is not the point. The point is that given what we know now already today, the long-term potential for the dominant brand in a high-growth, non-cyclical, non-discretionary, high-margin, cash-generative category is NOT reflected by the bid.

We are bewildered the Board of Directors' recommending shareholders accept the bid and wish to highlight board member Pär-Ola Olausson as an unsung hero. He is the worker's representative and the only board member with integrity enough to say no. Imagine the gumption necessary to alone stand up to a board of suits? It can be argued his agenda is to protect Swedish jobs in light of a take-over attempt from a US giant. Regardless, we still extend our gratitude for his act of bravery, expressing the bid "*does not reflect the long-term fundamental value of the company*". Crucially, this kept the headline "*Board unanimously recommends the bid*" from appearing in press releases, which is significant. All hail Per-Ola. We cannot help but wonder: would another board, with more skin in the game, have come to another conclusion?

We are happy to remain long-term owners of Swedish Match, whether it be in a minority position with PMI as a majority shareholder (the Swedish rules in this instance are reasonable), or as a small shareholder in an independent Swedish Match. True to our protean attitude we are equally happy to sell our stake at a reasonable price, truly reflecting the long-term potential of both ZYN, a Cigar spin-off, and additional balance sheet leverage.

We are convinced the investors in our fund share our view of optimizing for performance by taking a long-term view when called for. The easy way out would be to sell the shares and move on, eliminating the risk of short-term underperformance should the bid fail. But our process is owning undervalued assets with good risk/reward. Swedish Match at the current bid level fits that description well.

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