

# Philip Morris Acquires Swedish Match for \$16bn

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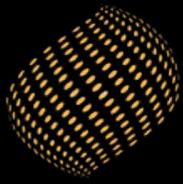
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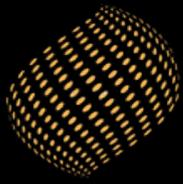


Source: Richmond Times Dispatch



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# DEAL INTRODUCTION

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## DETAILS ABOUT THE DEAL

Philip Morris International Inc (PMI) has announced it will acquire Swedish Match AB in a \$16bn deal.

The agreement was reached on May 2022, and was expected to be finalised in Q4 2022.

PMI will pay kr106 (\$10.57), a 39% premium in comparison to Swedish Match's share price on May 9th.

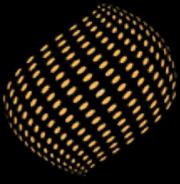
When negotiations between the companies became public, Swedish Match's share price skyrocketed, increasing 36% in 2 days.

This could be a sign of shareholder optimism, however, in reality, the deal has been postponed as PMI has not reached a 90% *acceptance threshold*, with some investors betting on a higher bid.

A high acceptance threshold would allow Philip Morris to *take* Swedish Match *private* more easily, by squeezing out opposing investors.

Now, the company is considering lowering the threshold, a solution that would allow PMI to hold a *majority stake* in the company whilst maintaining it publicly traded for the time being.

This leaves the deal in great uncertainty, as the deadline of October 21st fast approaches.

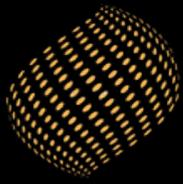


## REASONS FOR M&A

- Philip Morris are focused on a shift from cigarettes to smoke-free products, and thus, the acquisition of Swedish Match, who are a Scandinavian market leader in nicotine pouches, snus and chewing tobacco, presented itself as a key opportunity.
- With Swedish Match already having significant market shares of chewing tobacco (40%) and nicotine pouches (65%) in the US, PMI is hoping to strengthen the distribution channels, generating synergies from the deal.
- PMI also hopes to use Swedish Match's market reach to promote its own reduced-risk products in the US.
- The deal would aid Philip Morris in reaching its goal of having the majority of its net revenue from cigarette alternatives by 2025, reflecting PMI's commitment to diversifying its sources of revenue.



Source: Wallpaper Flare



# INDUSTRY OVERVIEW: SMOKELESS TOBACCO

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## WHAT IS SMOKELESS TOBACCO?

The smokeless tobacco industry is comprised of tobacco products that are not burned, and usually can be chewed on or inhaled. These products do contain nicotine, and some of the most popular are:

- **Chewing Tobacco:** this product is placed between cheek and gums, and at times can be swallowed. In the US, close to 20% of smokeless products sold are chewing tobacco.
- **Moist Snuff:** Ground tobacco, which can also be dry, is either inhaled or placed in the mouth.
- **Snus:** A snuff variation which is moist and extremely popular in Scandinavian countries, and also in the US, where it has been growing.

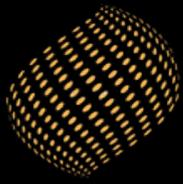
## HISTORICAL INDUSTRY TRENDS

70% of global snus is sold in Sweden alone, where Swedish Match retains 60% market share. In the US, it is the 2nd largest player, behind British American Tobacco (BAT), PMI's largest rival.

Historically, the *Big 4 Tobacco Companies* have invested in snus, however, it is only sold in Scandinavian countries and the US, with the European Union banning the product in other EU states.

The reasoning behind tobacco companies' investment in alternative products is to diversify its sources of revenue, as there have been increased health concerns over traditional cigarettes.

Although products such as e-cigarettes, vapes, snus, heated tobacco products and nicotine patches are deemed as healthier alternatives, in practice this may not be the case.



**Studies have shown that the consumption of alternative products can lead to different types of cancers. This could suggest that these 'healthier' products may simply be a way for big tobacco to maintain its market over the long run, by appealing to younger audiences.**

**This has been done through the offering of slim and ultra-slim cigarettes as well as e-cigarettes and a larger variety of smoke-free products.**

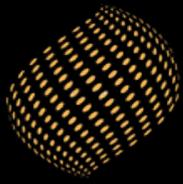
**There has been increased evidence showing that young people who use vapes are 2-4x more likely to transition to traditional forms of smoking later on in life, reflecting companies' interest in investing in 'tobacco alternatives'.**

## **PRODUCT TRENDS**

**Overall, the global snus market has increased 40%, from 7,000 tonnes to 10,000 tonnes, over the period of 2008-2019, reflecting the potential of this industry.**

**It is likely that big tobacco will push for the UK government and the EU to reverse the snus ban, due to its appeal to current consumers. Historically, Big Tobacco have had substantial economic power for lobbying governments, which could aid them in this process.**

**Finally, the global tobacco market is expected to grow to \$252bn in 2022 from \$234bn in 2021 (annual growth rate of 8%), when supply chain issues hampered some of the production of cigarettes.**



# ACQUIRER OVERVIEW



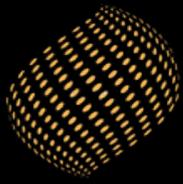
TICKER: PM

## PHILIP MORRIS INTERNATIONAL INC.

- Philip Morris International (PMI) is a leading international tobacco company engaged in the manufacture and sale of cigarettes, tobacco and other nicotine-related products.
- It was founded in 1847 by Philip Morris and is currently headquartered in New York City and listed in the NYSE.
- Nowadays, PMI boasts a market cap of \$148.5B, employs 69,600 people and is present in 180 markets across the world.

## BUSINESS MODEL

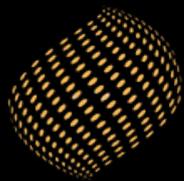
- Philip Morris' product portfolio can be divided into: cigarettes and smoke-free products, with a share of 14% of the global cigarette market.
- PMI are increasingly shifting away from their historical presence in cigarettes to smoke-free products, and 'as fast as possible'. Their managements vision is that their new line of products will replace conventional cigarettes, a dramatic historical shift for the firm.
- PMI's heat-not-burn, vapour, and oral nicotine products as well as its IQOS are their main areas of growth accounting for 29% of net revenue in 2021. Its e-cigarette sales have increased close to 400% since 2015.
- Philip Morris employs a team of 400 scientists, engineers, and technicians to develop less harmful alternatives to cigarettes at two research facilities in Switzerland and Singapore.



- **As for cigarettes, PMI owns 6 of top 15 international cigarette brands, namely the world's bestselling international brand, Marlboro and products such as Merit, Parliament, Virginian S and L&M.**
- **In order to help customers quit smoking, PMI offers heated tobacco alternatives, which do not produce fire, ash or smoke, and contain less nicotine.**
- **One of the flagship products is the IQOS Heated tobacco units (HTU), a flavoured nicotine and smoke-free product available in 68 markets worldwide. It is estimated 13.2 million adults have switched from smoking to IQOS products.**
- **HTU shipment hit a volume of 95 billion units in 2021, an increase in the number of users of 3.6 million in 2021, reaching 21.2 million in total.**
- **PMI's current offerings are different to snus, Swedish Match's flagship product, complementing the current portfolio.**
- **PMI's main competitors are British American Tobacco, Altria Group, Japan Tobacco Inc., companies that comprise Big Tobacco.**

## **RECENT M&A ACTIVITY**

- **In 2021, PMI acquired Vectura, a UK based inhaler company, for £1.1bn. This acquisition was made in an attempt to broaden PMI's horizon, potentially transitioning it into a health and wellness company.**
- **Many consider this as dangerous since it brings about trust in cigarette companies and allows them to become more mainstream in decision making e.g. PMI is securing a partnership with the Canadian government on the COVID vaccine it is helping to fund.**



## ESG PRACTICES

- Philip Morris is committed to increasing its smoke-free products by 2025, which compared to cigarettes, reduce the chance of serious health effects, such as cancer, heart disease, lung disease and diabetes.
- The company also aims to recycle all of its IQOS devices (heated tobacco), with the aim of restricting the waste of plastic and heavy metals from electronic cigarettes, as they do not biodegrade. It is estimated that 84 million vapes are disposed yearly.
- PMI also seeks to decrease its plastic use by 50% until 2025 through its 'Our World Is Not an Ashtray' campaign, which has been criticised due to the company being responsible for producing 700 billion cigarettes yearly.
- Additionally, the company's product range is far from being risk-free to consumers, as chemicals released from its products contain cancer-causing substances, generating a *negative externality* for society.

## KEY FINANCIALS

### Revenue

- \$31.4 billion

### EBITDA

- \$14 billion

### EBIT

- \$13 billion

### Net Income

- \$9.1 billion

### Market Capitalisation

- \$148.5 billion

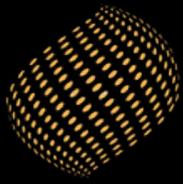
### Share Price

- \$99.87

### P/E Ratio

- 17.13

Financial data correct as of latest annual report and market data correct as of 22/09/2022.



# TARGET OVERVIEW

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## **SWEDISH MATCH AB**

Ticker: SWMA

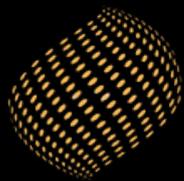
- Swedish Match AB is a leading smokeless tobacco company which was founded in 1905 and is currently based in Stockholm, Sweden.
- It employs approximately 7,500 people and is traded in the Stockholm Stock Exchange (SSE) under the SWMA ticker.
- In 2021 Swedish Match completely spun off its combustible tobacco products, becoming completely smoke-free as a business.
- It currently has production units across 7 countries, including Sweden, Brazil and The Philippines and generates the majority of its revenue from its Scandinavian and US sales.

## **BUSINESS MODEL**

Swedish Match's products are divided into 3 main categories:

1. **Smoke-Free Products**
  - a. Chewing Tobacco, Nicotine Pouches, Snus -> US + Scandinavia
  - b. Chew Bags, Tobacco Bits -> Europe
2. **Cigars (US)**
3. **Lighters (Worldwide)**

In Scandinavian markets, Swedish Match retains 60% of snus market share, in the US it retains 64% of nicotine pouches and it is a market leader in matches and lighters in many countries across the world.



## ESG PRACTICES

Swedish Match's vision is to have a world without cigarettes, in which its smokeless alternatives can dominate a larger portion of market share, and potentially improving public health as a result.

**Environmental Considerations:** Swedish Match's goal is to reduce its environmental impact and carbon footprint. Currently, it is considered as an industry leader considering MSCI rankings and 94% of electricity it uses in Europe is green.

**Social Considerations:** Many people believe that smokeless alternatives (snus, chewing tobacco) are better socially in comparison to cigarettes or vapes, as it does not impact third parties with second-hand smoke.

**Governance Considerations:** Swedish Match is committed to ensuring ethical business practices by providing equal opportunities and having women in leadership positions. Currently 28% of its leaders are female, a number that has been increasing, with the ultimate goal being to reach at least 40%.

## KEY FINANCIALS

### Revenue

- \$2 billion

### EBITDA

- \$930.9 million

### EBIT

- \$873.6 million

### Net Income

- \$846.6 million

### Market Capitalisation

- \$15 billion

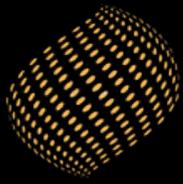
### Share Price

- \$9.89

### P/E Ratio

- 17.13

Financial data correct as of latest annual report and market data correct as of 22/09/2022.



# DEAL ANALYSIS

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## STRENGTHS

- PMI acquiring Swedish Match diversifies, and expands its portfolio, by entering a region (Scandinavia) where they have little presence.
- In a growing and trendy market (smoke-free products), this will enable PMI to access a wider range of customers ultimately growing their business enterprise.
- Deal can aid PMI in reaching a portfolio of majority cigarette-alternatives products by 2025, in line with shifting ESG practices.

## WEAKNESSES

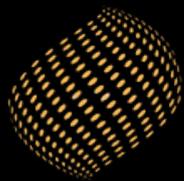
- Shifting global ESG practices, and negative research into the impacts of smoke-free products, could have harmful effects on PMI's revenues. This is especially the case in developed nations where governments attempt to phase out smoking, and similar goods.
- Swedish Match's current flagship product, the snus, is currently banned in UK and EU markets.

## OPPORTUNITIES

- PMI can capitalise on Swedish Match's 50% share of the global tobacco-free nicotine market, a competitive advantage over PMI's competitors.
- Swedish Match will benefit from PMI's resources and global presence; additionally, PMI's research into ENDS (Electronic Nicotine Delivery Systems) will add another avenue for Swedish Match to venture into.

## THREATS

- Products must be tested and approved by the FDA and other national drug regulators. This, coupled with ongoing research and regulatory uncertainties, could cause products in PMI's portfolio to be discontinued.
- This acquisition is heavily complex and is subject to numerous conditions. Should these not be fulfilled, the deal may not go through.
- Additionally, investors and large shareholders in Swedish Match have rejected the terms of the deal. A deadline of September 30th is in place.



# VALUATION ANALYSIS

## PUBLIC COMPARABLES MODEL

<u>Tobacco Enterprises</u>	Low	High
Selected EBITDA Multiple	12.54	14.86
Implied Enterprise Value	11,673.19	13,830.09
Net Debt	2,288.30	2,288.30
Implied Equity Value	13,961.49	16,118.39
Implied Share Price	<b>9.12</b>	<b>10.53</b>
Premium (Discount) %	<b>15.93</b>	<b>0.00</b>

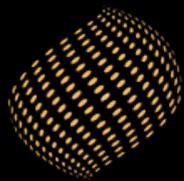
Please click on the table to access full model.

When choosing similar firms for the comparable company analysis (CCA), there were 3 major factors influencing the choice, namely size, geography and industry classification. All companies chosen operate in multiple markets across the world, have revenue of over \$2bn and provide customers with smokeless/tobacco-free alternatives

In terms of the valuation multiples, Swedish Match's EV/EBITDA multiple seems to be 14.86x. When calculating the firm's implied equity value, the low and high EBITDA multiples were chosen to be 12.54x (mean) and 14.86x (median), providing implied enterprise values of \$11.7bn and \$13.8bn, respectively. At the end of the valuation, the implied share price was found to be between \$9.12 and \$10.53.

According to the implied share price of our model, Swedish Match was purchased at a **premium** of between 0 and 15.93%, which could reflect a relatively fair purchase price paid by Philip Morris.

Based on metrics evaluated across the peer group chosen, it seems that the companies chosen were a good comparison, due to similar EV multiples presented across the board.



# VALUATION ANALYSIS

## DISCOUNTED CASH FLOW MODEL

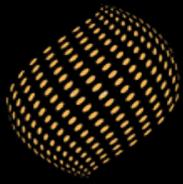
<b>Enterprise Value</b>	25,915,683,908
(+) Cash	234,370,500
(-) Debt	204,425,000
Equity Value	26,354,479,408
# of Shares	1,531,000,000
Share Price	17.21

Please click on the table to access full model.

As calculated by the Discounted Cash Flow (DCF) Analysis, the Swedish Match stock was significantly undervalued at the time of Philip Morris' offer of acquisition (\$10.57). As a result, Philip Morris has offered to pay 61.4% less than the implied share price (\$17.21).

As reference, the closing share price of Swedish Match on the 9th of May 2022 was \$7.54. This could be a reason why many Swedish Match shareholders do not want the deal to go through, as they believe their shares are worth significantly more.

To build the model, various assumptions were taken into consideration to be able to obtain the Terminal Growth Rate (2.0% in the base case based on the GDP growth of Sweden), and the Weighted Average Cost of Capital (3.9% in the base case). Therefore, it must be noted that the share price obtained from the model was affected by these assumptions.



# CONCLUSION

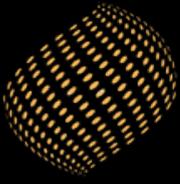
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## IMPACT ON THE CLOSE COMPETITORS

- Deal may increase PMI's profitability and revenue sources, diversifying its products in the non-cigarette range.
- Allows Philip Morris to bridge the gap to some of the Big Tobacco companies who had a larger presence in the segment.
- Gives PMI upper hand on snus distribution compared to other companies, a high potential product.
- Philip Morris' innovation and regulatory capabilities can help Swedish Match gain access to wider markets, as well as expand in the US.
- Could prompt other competitors to seek deals with different international partners to compete with PMI's acquisition of snus products.

## IMPACT ON THE INDUSTRY

- Deal allows PMI to acquire one of the largest players in the tobacco industry as a whole, moving the company closer to its smoke-free objective.
- Generates competition between cigarette producers, pushing them closer to smoke-free products.
- Pushes tobacco industry's 'pro health transformation'.
- Increase in lower risk tobacco products → increases competitiveness of industry in more health conscious world (helps to sustain tobacco companies' growth trajectories).
- Consumers need access to low-risk alternatives (Swedish Match had enormous role in reducing smoking rates through snus sales).



## GLOSSARY

**Big Tobacco:** Historically, tobacco production has been largely dominated by 5 companies: British American Tobacco (BAT), China National Tobacco Company, Imperial Brands, Japan Tobacco International (JTI) and Philip Morris.

**Market Capitalisation:** Total value of a publicly traded company's outstanding common shares owned by the stockholders.

**Majority Shareholder:** Investor holding more than 50% of a company, giving it significant influence over a company's decisions and strategies.

**(Minimum) Acceptance Threshold:** Minimum percentage of shareholder approval needed for deal to go through.

**Negative Externality:** The cost (harm) generated to third-parties by the production or consumption of a good or service.

**Outstanding Shares:** Number of shares issued and purchased by investors, representing ownership of the company.

**Premium:** increased amount paid per share in comparison to the share price at the time of the M&A transaction, often presented as a percentage.

**Publicly-Listed Company:** A company whose shares are traded publicly on a stock market.

**Tender Offer:** A public offer to buy most or all of a company's shares.

**To Take a Company Private:** A transaction(s) that transform a publicly-listed company into a private entity, which in this case, is through a **tender offer**.

