Scandinavian Tobacco Group A/S

CVR-No. 31 08 01 85

Sydmarken 42, 2860 Søborg

# Annual Report 2017

The Annual Report has been considered and adopted on the Company´s Annual General Meeting 26 April 2018

Chairman

Christian Lundgren

SCANDINAVIAN TOBACCO GROUP

SCANDINAVIAN TOBACCO GROUP

# WE CREATE MOMENTS OF GREAT ENJOYMENT FOR SMOKERS

SCANDINAVIAN TOBACCO GROUP IS A WORLD LEADING MANUFACTURER OF CIGARS AND PIPE TOBACCO. OUR BUSINESS IS FOUNDED ON EXTENSIVE TOBACCO EXPERTISE AND CONSUMER INSIGHTS AIMED AT CREATING AND MAINTAINING OUR PORTFOLIO OF LEADING, INTERNATIONAL AND REGIONAL BRANDS.

FUELLED BY CURIOSITY, WE SOURCE NATURE'S FINEST AND PASSIONATELY NURTURE OUR TOBACCOS AND BRANDS WITH THE PROMISE TO CREATE MOMENTS OF GREAT ENJOYMENT FOR SMOKERS.

WE BELIEVE THAT THIS PROMISE WILL MAKE US THE UNDISPUTED LEADER IN CIGARS AND PIPE TOBACCO.

ANNUAL REPORT 2017

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## MANAGEMENT REPORT



## FINANCIAL STATEMENTS



**Forward-looking Statements**
Our Annual Report contains forward-looking statements. Such statements are subject to risk and uncertainties as various factors, many of which are beyond Scandinavian Tobacco Group's control, may cause actual development and results to differ materially from the expectations laid out in our Annual Report.

# 5-YEAR SUMMARY[1]

| DKK MILLION | 2017 | 2016 | 2015 | 2014 | 2013 |
|---|---|---|---|---|---|
| **INCOME STATEMENT** | | | | | |
| Net sales | 6,464 | 6,746 | 6,732 | 6,126 | 5,925 |
| Gross profit | 3,095 | 3,225 | 3,239 | 2,947 | 2,915 |
| EBITDA | 1,232 | 1,279 | 1,247 | 1,177 | 1,175 |
| EBIT | 913 | 957 | 941 | 908 | 775 |
| Net financial items[2] | -77 | -72 | -67 | -68 | -104 |
| Profit before tax | 852 | 895 | 884 | 846 | 676 |
| Income taxes | -140 | -213 | -216 | -206 | -103 |
| Net profit | 712 | 681 | 668 | 640 | 573 |
| **BALANCE SHEET** | | | | | |
| Total assets | 12,990 | 14,264 | 14,544 | 14,162 | 13,196 |
| Equity | 8,448 | 9,273 | 8,998 | 9,087 | 8,333 |
| Net interest-bearing debt (NIBD) | 2,247 | 2,469 | 3,011 | 2,698 | 2,808 |
| Investment in property, plant and equipment | 54 | 190 | 210 | 192 | 271 |
| Total capital expenditures | 109 | 235 | 236 | 215 | 302 |
| **CASH FLOW STATEMENT** | | | | | |
| Cash flow from operating activities | 1,049 | 1,358 | 1,285 | 1,056 | 745 |
| Cash flow from investing activities | -94 | -219 | -229 | -471 | -318 |
| Free cash flow | 955 | 1,139 | 1,057 | 585 | 427 |

| | 2017 | 2016 | 2015 | 2014 | 2013 |
|---|---|---|---|---|---|
| **KEY RATIOS** | | | | | |
| Net sales growth | -4.2% | 0.2% | 9.9% | 3.4% | -0.9% |
| Gross margin | 47.9% | 47.8% | 48.1% | 48.1% | 49.2% |
| EBITDA margin | 19.1% | 19.0% | 18.5% | 19.2% | 19.8% |
| Effective tax percentage | 16.4% | 23.8% | 24.5% | 24.3% | 15.2% |
| Equity ratio | 65.0% | 65.0% | 61.9% | 64.2% | 63.1% |
| Cash conversion | 110.2% | 122.4% | 119.0% | 112.0% | 85.0% |
| Organic net sales growth[3] | -2.2% | 0.4% | 0.3% | 2.9% | 0.7% |
| Adjusted gross margin[4] | 48.5% | 49.1% | 48.7% | 48.1% | 49.2% |
| Organic EBITDA growth[5] | -7.4% | 4.0% | 2.2% | 4.8% | -5.6% |
| Adjusted EBITDA[6] (DKK million) | 1,283 | 1,440 | 1,385 | 1,247 | 1,198 |
| Adjusted EBITDA margin[7] | 19.9% | 21.4% | 20.5% | 20.3% | 20.2% |
| NIBD / Adjusted EBITDA | 1.8 | 1.7 | 2.2 | 2.2 | 2.3 |
| ROIC | 7.9% | 7.8% | 7.4% | 7.7% | 6.5% |
| ROIC ex. goodwill and trademarks from 2010 merger | 14.8% | 14.2% | 13.3% | 13.7% | 11.8% |
| Basic earnings per share (DKK) | 7.1 | 6.8 | 6.7 | 6.4 | 5.7 |
| Diluted earnings per share (DKK) | 7.1 | 6.8 | 6.7 | 6.4 | 5.7 |
| Number of shares issued ('000) | 100,000 | 100,000 | 100,000 | 100,000 | 100,000 |
| Number of treasury shares ('000) | 367 | 412 | - | - | - |
| Share price at year-end (DKK) | 120.0 | 118.9 | - | - | - |
| Dividend per share (DKK) | 9.3 | 5.5 | 14.0 | 4.3 | 3.8 |
| Pay-out ratio | 130.0% | 80.7% | 209.7% | 66.7% | 66.7% |

1. See definition/explanation of financial ratios in note 5.7.
2. Excluding share of profit of associated companies.
3. Organic net sales growth is defined as growth in net sales excluding non-recurring items and impact from currencies and acquisitions.
4. Adjusted gross margin is defined as gross profit excluding non-recurring items as a percentage of net sales excluding non-recurring items.
5. Organic EBITDA growth is defined as growth in EBITDA excluding non-recurring items and impact from currencies and acquisitions.
6. Adjusted EBITDA is defined as EBITDA excluding non-recurring items.
7. Adjusted EBITDA margin is defined as adjusted EBITDA as a percentage of net sales, excluding non-recurring items.

# FINANCIAL PERFORMANCE 2017

**NET SALES** (DKKm)

**6,464**

▼ 4.2%

| | | |
|---|---|---|
| **2017** | **6,464** |
| 2016 | 6,746 |
| 2015 | 6,732 |

**EBITDA** (DKKm)

**1,232**

▼ 3.7%

| | |
|---|---|
| **2017** | **1,232** |
| 2016 | 1,279 |
| 2015 | 1,247 |

**CASH FLOW FROM OPERATING ACTIVITIES** (DKKm)

**1,049**

▼ 22.8%

| | |
|---|---|
| **2017** | **1,049** |
| 2016 | 1,358 |
| 2015 | 1,285 |

**NET PROFIT** (DKKm)

**712**

▲ 4.4%

| | |
|---|---|
| **2017** | **712** |
| 2016 | 681 |
| 2015 | 668 |

## NET SALES PER CATEGORY

**HANDMADE CIGARS** (DKKm)

**1,921**

| | |
|---|---|
| **2017** | **1,921** |
| 2016 | 2,067 |
| 2015 | 1,935 |

**MACHINE-MADE CIGARS** (DKKm)

**2,491**

| | |
|---|---|
| **2017** | **2,491** |
| 2016 | 2,593 |
| 2015 | 2,702 |

**PIPE TOBACCO** (DKKm)

**544**

| | |
|---|---|
| **2017** | **544** |
| 2016 | 569 |
| 2015 | 629 |

**FINE-CUT TOBACCO** (DKKm)

**598**

| | |
|---|---|
| **2017** | **598** |
| 2016 | 652 |
| 2015 | 583 |

**OTHER** (DKKm)

**909**

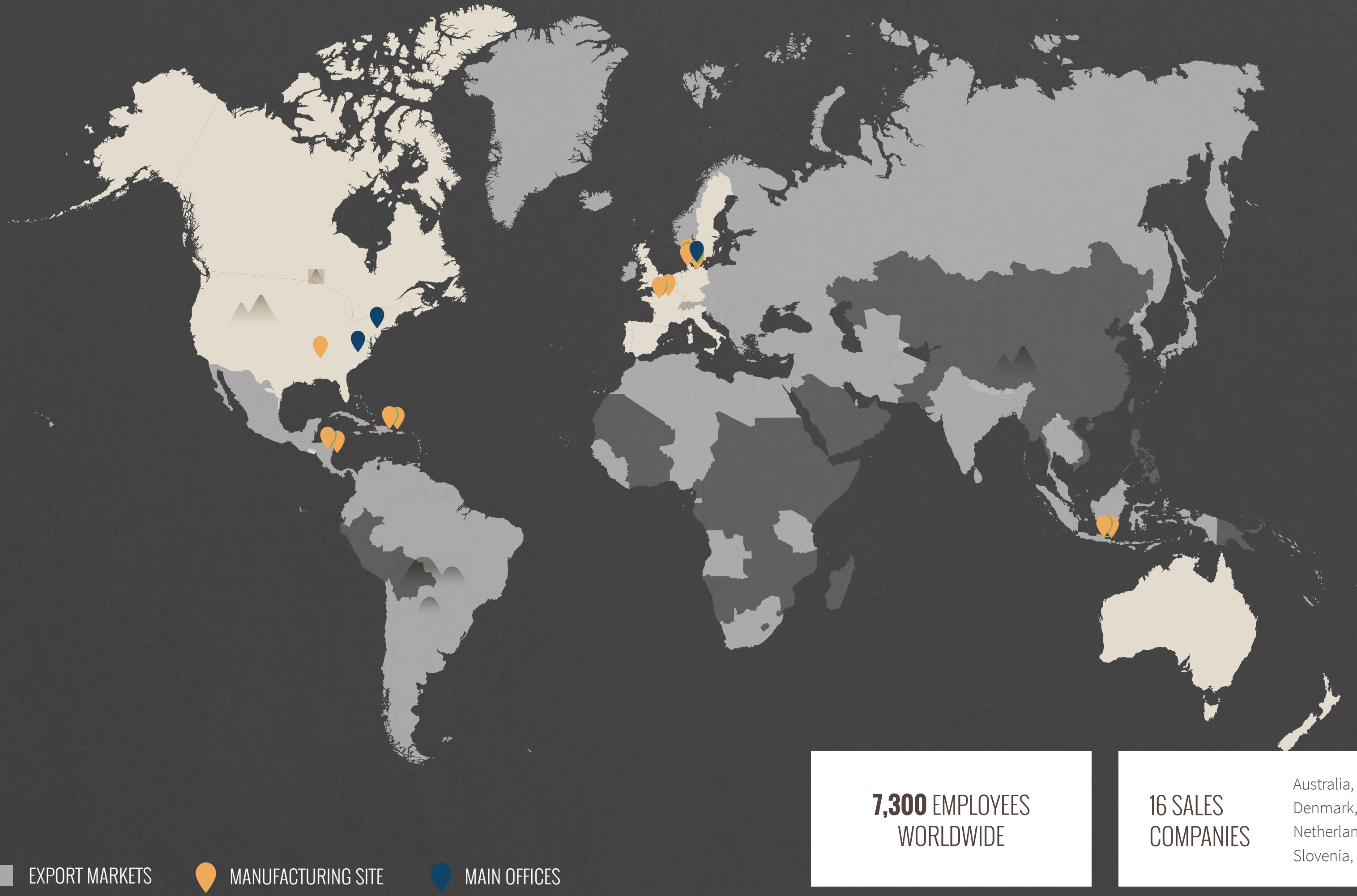
| | |
|---|---|
| **2017** | **909** |
| 2016 | 864 |
| 2015 | 882 |

# OUR PRESENCE

RELENTLESS FOCUS ON SMOKING ENJOYMENT AND ON BECOMING THE UNDISPUTED LEADER IN CIGARS AND PIPE TOBACCO. THIS IS KEY TO HOW WE ENSURE SUSTAINABLE SHAREHOLDER VALUE.

**1**
No. 1 in handmade cigars in the US

**1**
No. 1 in online retail of handmade cigars in the US




**1**
No. 1 in fine-cut tobacco in the US and Denmark

**1**
No. 1 in traditional pipe tobacco globally

**7,300** EMPLOYEES WORLDWIDE

16 SALES COMPANIES

Australia, Belgium, Canada, Croatia, Denmark, France, Germany, Italy, The Netherlands, New Zealand, Portugal, Slovenia, Spain, Sweden, UK and the USA

LETTER FROM THE CHAIRMAN

# DELIVERING FOR SHAREHOLDERS

SCANDINAVIAN TOBACCO GROUP CONTINUES ITS TRADITION OF DELIVERING ATTRACTIVE SHAREHOLDER RETURNS DESPITE FINANCIAL HEADWINDS.

Welcome to our Annual Report for 2017. I am pleased to be reporting for the first time as Chairman of the Board of Directors, particularly as Scandinavian Tobacco Group continues its tradition of delivering high cash flow whilst allowing for attractive shareholder returns.

In 2017, we saw a number of changes to the Board of Directors. We were delighted to welcome Henrik Brandt while Conny Karlsson stepped down ending seven years of service as Swedish Match completed their divestment of shares in Scandinavian Tobacco Group.

2017 was a difficult year for the Group. Early on we encountered issues in our online business in Cigars International, which led to profit downgrade. The business did recover from the weak start and has since improved quarter by quarter. Simultaneously, the Group has consistently delivered on its strategy and significantly improved operational performance.

Despite financial headwinds, we are able to deliver a dividend of DKK 925 million to shareholders – of which DKK 350 million was extraordinary. This is indeed testament to the strong underlying business and cash flow in Scandinavian Tobacco Group.

**MAXIMISING TOTAL SHAREHOLDER RETURN**

Scandinavian Tobacco Group has become one of the world's largest manufacturers of cigars and pipe tobacco through organic growth and acquisitions – and we continue to operate in attractive niche segments of the global tobacco industry with significant consolidation potential. We are committed to maximising total shareholder return and will pursue the options available to us in the form of organic growth, value-creating strategic acquisitions and returning cash to shareholders.

We continue to invest both in the future of our business to create greater long-term value and drive cost and operational efficiency to optimise cash flow. This balance is key to creating shareholder value.

**POSITIVE OUTLOOK**

We are looking forward to 2018 with confidence. The work that has been carried out in recent years to increase efficiencies across the organisation means that we have the right building blocks in place to support the long-term success of the Group.

On behalf of the Board of Directors, I would like to thank senior management and colleagues around the globe for their efforts in 2017 and for their hard work in ensuring that Scandinavian Tobacco Group will continue to generate value for shareholders in the years ahead.

On behalf of Scandinavian Tobacco Group's Board of Directors, Executive Management and all employees, we would like to thank our shareholders, business partners and customers for the interest and trust they have shown in our company in 2017. We are looking forward to 2018 where we expect to leverage our growth opportunities, to progress our innovative product pipeline and to expand our lead in the market.

**Nigel Northridge**
CHAIRMAN

LETTER FROM THE CEO

# FACING THE FUTURE WITH CONFIDENCE

2017 WAS YET ANOTHER YEAR THAT SCANDINAVIAN TOBACCO GROUP LEFT STRONGER THAN WHEN WE ENTERED IT.

2017 was a financially challenging year for Scandinavian Tobacco Group. We delivered a financial performance with a negative organic EBITDA growth of 7.4% based on a 2.2% negative organic growth in our net sales. The results were significantly affected by the IT implementation in Cigars International, which prompted a profit downgrade in May 2017.

However, despite these challenges, we have continued to deliver a strong free cash flow allowing us to pay out DKK 925 million to our shareholders. And throughout the year we have strengthened significantly in areas that are prerequisites for future success. As a consequence, 2017 was yet another year that Scandinavian Tobacco Group left stronger than when we entered it.

**DELIVERING ON THE STRATEGY**

In 2017, we saw significant progress in all parts of our strategy.

To **OUTPERFORM** the market, to win market share and to unlock the value in market leadership, we established a new business unit covering our largest market, North America. This keeps us well positioned to develop and expand business opportunities in this region – either organically or in the form of mergers or acquisitions.

In 2017, we continued to **GLOBALISE** by expanding our geographical footprint. In September, we established a new sales organisation in Sweden. We also launched Granger, an innovative filter cigarillo, in key markets across Europe. The launch of Granger follows a ramping up of our innovation pipeline and showcases our strong pipeline of products, pack formats and innovations to be deployed in 2018.

To **SIMPLIFY** our business processes we have steadily improved efficiency and reduced complexity. We have continued our strong track record of successful cost-saving initiatives and finalised the 140/500 programme a year ahead of schedule. We have also improved our global manufacturing footprint by reducing the number of factories and SKUs.

To **EMPOWER** our people and enable a winning organisation, we have invested in stronger HR capabilities and have increased focus on enhancing a performance culture. This work will continue in 2018 and will further strengthen the winning mindset in our organisation.

**FACING THE FUTURE WITH CONFIDENCE**

The long-term prospects of the Group remain positive. Simply put: We have the right strategy, the right people and the right brands – and that leaves us in a strong position to create further value for shareholders in 2018 and over the coming years.

In 2018, we will continue to deliver on our strategy to be able to fulfil our vision in becoming the undisputed, global leader in cigars and pipe tobacco. To succeed, we need the same levels of energy and passion as all our 7,300 employees have demonstrated in 2017. I would like to thank them all for their commitment and support. I am confident that we can continue our success in the future.

**Niels Frederiksen**

CEO

# EVENTS OF THE YEAR

2017 WAS AN EVENTFUL YEAR FOR SCANDINAVIAN TOBACCO GROUP. WE HAVE LISTED SOME OF THE DEFINING EVENTS OF THE YEAR BELOW.

2017 MAR

## LAUNCH OF GRANGER

The first launch of our modern and innovative filter cigarillo brand "Granger" took place in Germany. The launch followed a ramping up of our innovation programme and is an example of our strong pipeline of new products and pack formats. Granger was well-received in Germany and launched in other key markets such as Spain, Finland and Denmark throughout 2017.

2017 MAY

## PROFIT WARNING

The implementation of a new IT infrastructure in Cigars International impacted sales negatively. As a consequence, we had to downward revise our financial guidance for 2017 to slightly negative organic net sales growth and negative organic growth in EBITDA of 4-8%.

2017 JUL

## LAUNCH OF MACANUDO INSPIRADO WHITE AND BLACK

Two new collections of the internationally acclaimed Macanudo brand was launched: Macanudo Inspirado White and Black. The new collections continue the brand's evolution by offering a wider range of flavours while capturing the attention of tenured cigar smokers in the US.

MACANUDO

2017 SEP

## MARKET EXPANSION: INTRODUCING STG SWEDEN

In September, we established a new sales organisation in Sweden. With our strong portfolio of brands, we are confident that we will be able to grow Scandinavian Tobacco Group's business in the market.

2017 DEC

## DELIVERING ON OUR OPTIMISATION AND EFFICIENCY PROGRAMMES

The closure of two cigar factories in Denmark and Belgium, respectively, marked the completion of our optimisation and efficiency programmes announced in 2015 and 2016. The cost optimisation programmes have delivered cost savings of DKK 200 million with full effect for 2018. Our inventory reduction programmes have delivered DKK 667 million in accumulated inventory reduction, well beyond the original plan and one year ahead of time.

2018 JAN

**EVENTS AFTER 31 DECEMBER 2017**

## JANUARY 2018 - ACQUISITION OF LEADING US ONLINE CIGAR RETAILER

In a deal worth USD 62 million, Scandinavian Tobacco Group signed an agreement to acquire the business of Thompson and Co. of Tampa, Inc., a leading online retail cigar business in the US. The acquisition strengthens our position in the online retail channel in the US, a market where approximately two thirds of all handmade cigars are sold online.

# FINANCIAL HIGHLIGHTS 2017

## NET SALES

**Reported net sales** for 2017 amounted to DKK 6,464 million (DKK 6,746 million), a decrease of 4.2%.

### NET SALES 2017 VS. 2016

| | Growth | DKKm |
|---|---|---|
| Net sales 2016 | - | 6,746 |
| Exchange rate development | -2.0% | -131 |
| Organic growth | -2.2% | -151 |
| **Net sales 2017** | **-4.2%** | **6,464** |

The negative development in net sales was driven by the IT implementation in Cigars International and the volume fluctuations caused by the Tobacco Product Directive transition in the EU having a negative impact on the machine-made cigars category in Q1. Finally, the reported net sales were impacted by unfavourable exchange rate developments.

Despite the negative development in Cigars international, Americas remained our largest market accounting for a 45% share of reported Group net sales. Europe and the Rest of the World accounted for 44% and 11%, respectively.

## GROSS PROFIT

**Reported gross profit** was DKK 3,095 million (DKK 3,225 million), a decrease of 4.0%.

### ADJUSTED GROSS PROFIT 2017 VS. 2016

| | Growth | DKKm |
|---|---|---|
| Adjusted gross profit 2016 | - | 3,314 |
| Exchange rate development | -2.4% | -78 |
| Organic growth | -3.0% | -101 |
| **Adjusted gross profit 2017** | **-5.4%** | **3,134** |

Adjusted gross profit decreased by 5.4% to DKK 3,134 million. The decline in gross profit was primarily driven by the lost sales related to the IT implementation in Cigars International, the lower margin caused by their customer win-back initiatives as well as the volume drop in the machine-made cigar category. Unfavourable exchange rate developments also affected gross profit.

Adjusted gross margin decreased by 0.6 percentage points to 48.5% (49.1%)

### NON-RECURRING ITEMS

| DKK million | 2017 | | |
|---|---|---|---|
| | Reported | Non-recurring items | Adjusted |
| Net sales | 6,464 | - | 6,464 |
| Gross profit | 3,095 | 39 | 3,134 |
| Gross margin | 47.9% | - | 48.5% |
| EBITDA | 1,232 | 52 | 1,283 |
| EBITDA margin | 19.1% | - | 19.9% |

| DKK million | 2016 | | |
|---|---|---|---|
| | Reported | Non-recurring items | Adjusted |
| Net sales | 6,746 | - | 6,746 |
| Gross profit | 3,225 | 89 | 3,314 |
| Gross margin | 47.8% | - | 49.1% |
| EBITDA | 1,279 | 162 | 1,440 |
| EBITDA margin | 19.0% | - | 21.4% |

**REPORTED VS. ADJUSTED EBITDA**

| DKK million | 2017 | 2016 |
|---|---|---|
| **Reported EBITDA** | 1,232 | 1,279 |
| TPD related costs | 37 | 29 |
| Restructuring, 140 programme | -3 | 77 |
| Gain from sale of buildings | -15 | - |
| Restructuring, New Operational Model | 19 | 45 |
| Cost related to Initial Public Offering (IPO) | - | 11 |
| FDA related costs | 12 | - |
| Transaction cost related to acquisitions | 2 | - |
| **Adjusted EBITDA** | **1,283** | **1,440** |

## OPEX

**Reported operating expenses (OPEX)** were DKK 1,877 million (DKK 1,951 million), equivalent to an OPEX ratio of 29.0% (28.9%).

**ADJUSTED OPEX 2017 VS. 2016**

| | Growth | DKKm |
|---|---|---|
| Adjusted OPEX 2016 | - | 1,878 |
| Exchange rate development | -1.5% | -28 |
| Organic growth | 0.0% | -1 |
| **Adjusted OPEX 2017** | **-1.5%** | **1,850** |

Adjusted OPEX decreased by 1.5% due to favorable exchange rate developments. Organic OPEX development was flat versus last year as the negative one-time impact from the loss of DKK 26 million on the UK distributor Palmer & Harvey going into administration was offset by lower staff cost including bonus accruals and a restraint on spend in general.

## EBITDA

**Reported EBITDA** decreased by 3.7% to DKK 1,232 million (DKK 1,279 million).

**ADJUSTED EBITDA 2017 VS. 2016**

| | Growth | DKKm |
|---|---|---|
| Adjusted EBITDA 2016 | - | 1,440 |
| Exchange rate development | -3.4% | -50 |
| Organic growth | -7.4% | -107 |
| **Adjusted EBITDA 2017** | **-10.8%** | **1,283** |

Adjusted EBITDA decreased by 10.8% to DKK 1,283 million. The organic EBITDA growth was negative by 7.4%.

The negative organic EBITDA development was driven by the lower gross profit.

Reported EBITDA margin ended at 19.1% (19.0%), whereas the adjusted EBITDA margin dropped from 21.4% to 19.9% due to the decline in gross profit.

## EBIT

**Reported EBIT** was DKK 913 million (DKK 957 million).

Reported EBIT was negatively impacted by lower earnings, full effect of depreciation from TPD investments made in 2016 and non-recurring items and impairments of total DKK 69 million (DKK 200 million) as well as unfavourable exchange rate developments.

**ADJUSTED EBIT 2017 VS. 2016**

| | Growth | DKKm |
|---|---|---|
| Adjusted EBIT 2016 | - | 1,157 |
| Exchange rate development | -4.1% | -48 |
| Organic growth | -11.0% | -127 |
| **Adjusted EBIT 2017** | **-15.1%** | **982** |

Adjusted EBIT decreased by 15.1% to 982 million (DKK 1,157 million).

**Income taxes** were DKK 140 million (DKK 213 million). The effective tax rate was 16.4% (23.8%).

The effective tax rate was lower than 2016 due to lower earnings from US entities and impact from the enacted US and Belgian tax reforms which led to a net decrease in deferred tax assets and liabilities.

**Reported net profit** increased by 4.4% to DKK 712 million (DKK 681 million) as the lower EBIT was offset by the lower income taxes. Basic earnings per share increased by 4.6% to DKK 7.1 (DKK 6.8).

## BALANCE SHEET

**Total assets** were DKK 12,990 million at year end 2017 (DKK 14,264 million).

**Net working capital** was impacted by our continued focus on inventory reduction as part of the DKK 500 million programme, and ended 6.6% below last year at DKK 2,122 million (DKK 2,273 million) being 32.8% (33.7%) of full year net sales. In 2017, the inventory was reduced by DKK 263 million adjusted for currency impact and movement in provision for obsolete stock.

## CASH FLOW

**Cash flow from operating activities** was DKK 1,049 million (DKK 1,358 million). The decline was mainly due to lower earnings offset by lower tax payments and a tough comparison base in 2016 which included a one-time cash inflow of DKK 158 million from the transfer of selected trade receivables. Adjusted for this inflow, the cash flow from operating activities dropped by DKK 151 million versus last year.

**Cash flow from investing activities** was DKK 94 million (DKK 219 million). CAPEX was DKK 109 million (DKK 235 million). The comparison base was impacted by TPD-related investments of DKK 108 million. The cash flow was positively impacted by DKK 16 million from disposal of non-core buildings.

**Free cash flow** amounted to DKK 955 million (DKK 1,139 million), which adjusted for the transfer of selected receivables were almost in line with last year, as lower earnings were offset by lower investing activities.

## FINANCING

**Net interest bearing debt (NIBD)** amounted to DKK 2,247 million (DKK 2,469 million) at year end 2017. The decrease of DKK 222 million was primarily driven by the continued strong free cash flow and favourable exchange rate development which was partly offset by the dividend payments of DKK 900 million.

NIBD/adjusted EBITDA ended at 1.8X (1.7X) as the lower NIBD was offset by the lower adjusted EBITDA.

## DIVIDEND

For the financial year 2017, the Board of Directors proposes a dividend of DKK 5.75 per share on top of the extraordinary dividend of DKK 3.5 per share previously distributed in November 2017, corresponding to a total dividend of DKK 925 million and a pay-out ratio of 130% (81%).

## OPTIMISATION AND EFFICIENCY PROGRAMMES

The closing of the factories in Nykøbing Falster, Denmark and Wuustwezel, Belgium by September 2017 marked the completion of our optimisation and efficiency programmes which we announced in 2015 and 2016. As part of the programmes, we reduced our global factory footprint from 14 to 12 sites, simplified processes and reduced management layers in supply chain and sales and support functions.

The targets of the original programmes were achieved according to plan. However, the expected cost savings have been diluted by the volume drop in the machine-made cigar business. The programmes deliver cost savings of DKK 200 million on a 2018 run-rate basis versus the 2014 base year.

The working capital programme which aimed to reduce inventory by DKK 500 million on a like-for-like basis versus 2014 has delivered DKK 667 million in inventory reduction by end of 2017, well beyond the original plan and one year ahead of time.

### 2017 GUIDANCE FOLLOW-UP

| Financial guidance for 2017 | 2017 Guidance | Actual |
|---|---|---|
| Organic growth net sales | Slightly negative* | -2.2% |
| Organic growth EBITDA | Negative 4-8%* | -7.4% |

* Guidance was revised in May 2017

| Other financial expectations for 2017 | 2017 Expectation | Actual |
|---|---|---|
| Maintenance CAPEX | ~DKK 125m | DKK 109m |
| Net financial expenses, excluding currency losses/gains | DKK 80-90m | DKK 82m |
| Effective tax rate | 23-24% | 16.4% |
| Non-recurring costs, optimation & efficiency programmes etc. | ~DKK 50m | DKK 52m |

# OUR STRATEGY

RELENTLESS FOCUS ON SMOKING ENJOYMENT AND ON BECOMING THE UNDISPUTED LEADER IN CIGARS AND PIPE TOBACCO. THIS IS KEY TO HOW WE ENSURE SUSTAINABLE SHAREHOLDER VALUE.

We operate in attractive niche segments of the global tobacco industry and we are a world leader in the attractive categories of cigars and pipe tobacco. We are a global company with strongholds in North America, Europe and Australia, and we are proud of our recognised and diversified brand portfolio with several hundred brands in our product ranges.

We have an innovative and consumer-focused approach to our brand portfolio management resting on a strong understanding of our consumers across markets and categories, and we are committed to developing our brands, concepts and products for markets all over the world.

We benefit from having a global supply chain and a continuous focus on outperforming the overall market, simplifying for efficiency, optimising our cost base and becoming more efficient while leveraging our growth opportunities enabled by a winning mindset across our organisation. By leveraging our platforms to maximise sales, cost and cash opportunities, we want to be able to deliver sustainable shareholder returns.

Our strategy focuses on four business priorities. Across categories and markets, these priorities help us create value from our recognised brands, extensive tobacco expertise, global scale, market footprint and supply chain.

The strategy consists of a simple framework. Our vision describes what we strive to achieve; our four business priorities outline the strategic focus for decisions; and our six must win battles describe how we execute our strategy.

## OUR VISION

Be the undisputed, global leader in cigars and pipe tobacco.

## OUR BUSINESS PRIORITIES

### OUTPERFORM

**Outperform the overall market where we compete**
We focus on winning market share and unlocking the value in market leadership.

### GLOBALISE

**Globalise the geographical footprint**
We expand our business into new markets by building, acquiring or merging.

### SIMPLIFY

**Simplify for efficiency**
We want to do more with less by improving efficiency and reducing complexity.

### EMPOWER

**Empower for speed, accountability and motivation**
We want people with a winning mindset who are engaged and enabled.

## OUR MUST WIN BATTLES

**1. Win in machine-made cigars**

**2. Accelerate North America**

**3. Drive M&A**

**4. Lead performance to the Next level**

**5. Enable a winning organisation**

**6. Raise IT capabilities**

## OUR MUST WIN BATTLES

Our six must win battles are about execution of the strategy. They represent our highest priorities and they dictate the prioritisation of time and resources.

1

### WIN IN MACHINE-MADE CIGARS

Increase market share and optimise and manage prices effectively.

2

### ACCELERATE NORTH AMERICA

With the creation of one American business unit we are well positioned to accelerate growth and improve efficiency.

3

### DRIVE M&A

Develop and execute M&A strategy to strengthen our position.

4

### LEAD PERFORMANCE TO THE NEXT LEVEL

Improve efficiencies by developing leaner, faster and more agile operations.

5

### ENABLE A WINNING ORGANISATION

Invest in stronger HR capabilities, create global excellence centres and increase focus on accountability and performance.

6

### RAISE IT CAPABILITIES

Bring IT to the next level to fully support and guide the business.

# OUR CATEGORIES

2017 PERFORMANCE

# HANDMADE CIGARS

Total market volumes were relatively stable with slightly more than 300 million cigars sold in the US. The long-term trend with online and catalogue retail taking share from physical retailing continued, although the industry has started to direct more resources towards the physical sales channels.

**During the year, we announced the intention to expand our US retailing platform in handmade cigars. In 2018, two stores are planned to open in Texas and will be added to the existing three stores we have in Pennsylvania.**

For handmade cigars, our net sales were DKK 1,921 million (DKK 2,067 million) with an organic decline of 4.0%. For the first time in more than a decade our handmade cigar category experienced a negative annual development driven by the IT implementation in Cigars International. Volume impact was negative by 1.8% and price/mix impact was negative by 2.3%.

General Cigar had a good year and continued to increase market share across all sales channels. Key words for the positive development are our strong brand portfolio, successful product launches and a continuous effort to optimise relations with the trade.

Cigars International had a difficult year and lost market share as the implementation of new IT systems caused disruptions to our otherwise high-quality customer service. In order to solve the issue, Cigars International temporarily operated with a higher cost base and increased promotion level resulting in a negative impact on profitability. The performance improved quarter by quarter and Cigars International now has a fully scalable and well-functioning IT system.

Our international sales outside the US continued to deliver double-digit growth rates, although still from a small base.

The gross profit was DKK 795 million (DKK 903 million). The decline relates to a lower USD as well as lost sales due to the IT implementation in Cigars International. Gross margin was 41.4% (43.7%) caused by customer win-back initiatives in Cigars International following the IT implementation.

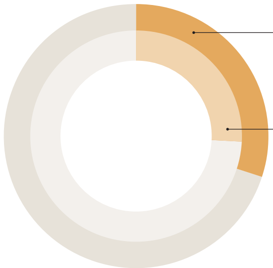
**2/3**

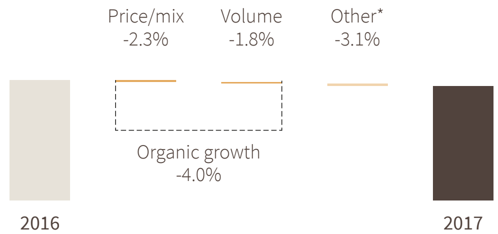
Two thirds of the global sales of handmade cigars take place in the US.

**No.1**

We have leading positions in sales to wholesalers and retailers through General Cigar and to consumers through Cigars International.


### SHARE OF NET SALES & GROSS PROFIT




| DKK MILLION | 2017 | 2016 |
|---|---|---|
| Net sales | 1,921 | 2,067 |
| Gross profit | 795 | 903 |
| Gross margin, % | 41.4% | 43.7% |

*Exchange rates etc.

SELECTED HANDMADE CIGAR BRANDS

COHIBA

MACANUDO 1968

CAO

5 Vegas

2017 PERFORMANCE

# MACHINE-MADE CIGARS

In 2017, we saw progress and regained market shares in a number of important markets. In 2015 and 2016, our machine-made cigars business performed below the overall market, partly due to a heavy SKU-rationalisation and partly due to performance issues in certain markets.

In 2017, we have intensified our strategic focus on innovation and on winning with core brands in key markets.

**We have launched Granger in several markets and redesigned La Paz as well as introduced Signature in France. Core brands, like Café Crème and La Paz, supported our improved market performance in the category.**

The EU Tobacco Products Directive is now fully implemented in most European countries, and the low market transparency and high level of volume fluctuations of the past few years have started to ease. Total market volume development is currently estimated to be negative by 3-5% per year across the markets where we operate.

Our net sales for machine-made cigars were DKK 2,491 million (DKK 2,593 million) with an organic decline of 2.4%. Volume impact was negative by 3.7% and price/mix improved by 1.3%.

Reported gross profit was DKK 1,268 million (DKK 1,280 million) with a gross margin of 50.9% (49.3%). Excluding non-recurring items, the adjusted gross margin was 52.4% (52.6%). Our efficiency programmes were concluded by the end of the year and have secured a healthy level of profitability despite the severe volume decline in the past three years.

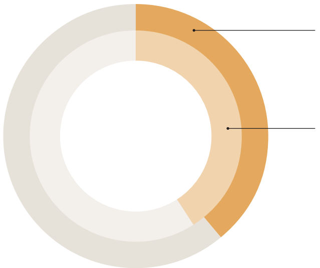
**~50%**

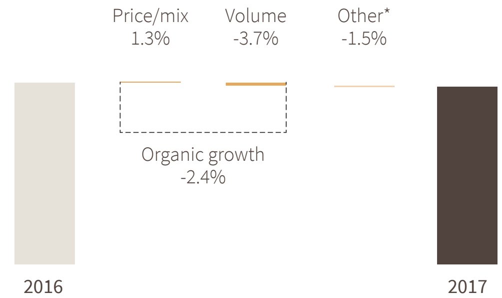
Approx. 50% of the global sales of machine-made cigars are in Europe.

**No.1**

We have a leading position in the European, Australian and Canadian markets for machine-made cigars.

### SHARE OF NET SALES & GROSS PROFIT




| DKK MILLION | 2017 | 2016 |
|---|---|---|
| Net sales | 2,491 | 2,593 |
| Gross profit | 1,268 | 1,280 |
| Gross margin, % | 50.9% | 49.3% |
| Gross margin, % (adjusted)** | 52.4% | 52.6% |

* Exchange rates etc. **Adjusted for non-recurring items

SELECTED MACHINE-MADE CIGAR BRANDS

Café Crème

La Paz

Mercator

Henri Wintermans

2017 PERFORMANCE

# PIPE TOBACCO

Total markets for traditional pipe tobacco continued their long-term trends; high consumer loyalty to the category and to brands, with volumes declining and pricing relatively strong.

In 2017, our net sales for the category were DKK 544 million (DKK 569 million) with an organic decline of 2.6%. Volumes were negatively impacted by 2.3% and price/mix was negative by 0.3%.

Deliveries to the Middle East and Africa resumed to more normal levels after the significant volume decline in 2016 following the macro-economic developments in Nigeria.

**The positive volume impact from these markets relates to the normalisation in Nigeria and to stronger demand in other markets, like Asia. The volume development in the US was negative following a total market decline.**

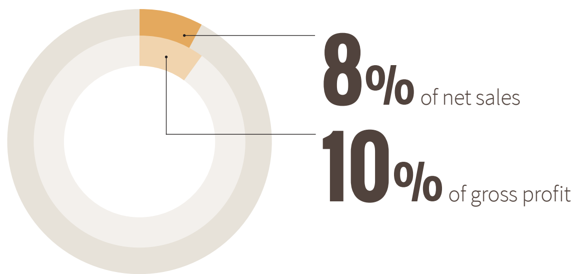
Pricing in traditional pipe tobacco in mature markets remains strong and in line with the trend from the past years. Changes in geographical mix have brought the price/mix impact below the long-term trend for the category.

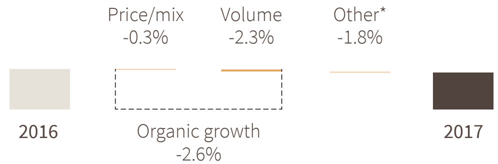
Reported gross profit was DKK 326 million (DKK 346 million) with a gross margin of 59.9% (60.8%). The decline relates to a shift in mix towards low-margin markets like the Middle East /Africa and a lower price level in Nigeria. Adjusted gross margin was 60.1% (61.2%).

**No.1**

Traditional pipe tobacco is predominantly sold in Europe and the US. We have leading positions in traditional pipe tobacco with a market share of approx. 50% in Europe and the US.

### SHARE OF NET SALES & GROSS PROFIT




| DKK MILLION | 2017 | 2016 |
|---|---|---|
| Net sales | 544 | 569 |
| Gross profit | 326 | 346 |
| Gross margin, % | 59.9% | 60.8% |
| Gross margin, % (adjusted)** | 60.1% | 61.2% |

* Exchange rates etc. **Adjusted for non-recurring items


## SELECTED PIPE TOBACCO BRANDS

W.Ø.LARSEN

ERINMORE

BORKUM RIFF

Captain Black

2017 PERFORMANCE

# FINE-CUT TOBACCO

Total volume development in our key markets in Europe for fine-cut tobacco was down and varied between the countries. Norway, Denmark and the US had negative market growth, whereas Israel realised positive growth.

**Our net sales from fine-cut tobacco were DKK 598 million (DKK 652 million) with an organic decline of 7.0%. Volume impact was negative by 14.0% and price/mix positive by 7.0%.**

The overall trend in consumer demand turned negative in 2017 and, due to strong quarterly and annual fluctuations in deliveries, we experienced a significant, negative volume impact in 2017 against tough comparison in 2016. In the increasingly important German market, we continued to take market share and realised good volume growth.

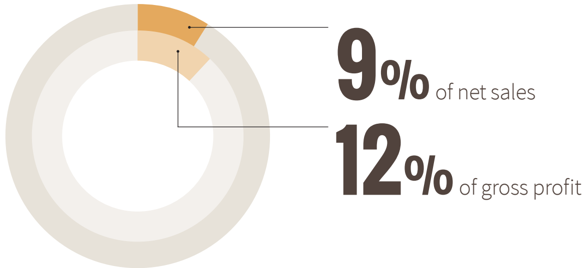
The price/mix remained very strong throughout the year with good price increases in key markets and also influenced by positive mix changes.

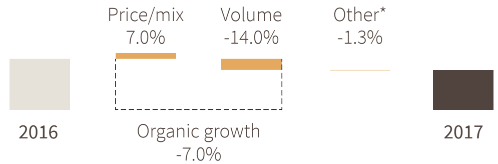
Reported gross profit was DKK 364 million (DKK 378 million) with a gross margin at 60.9% (57.9%). Adjusted gross margin was 61.1% (58.3%). The improvement was driven by a geographical mix and strong pricing and, to a lesser extent, impacts from the cost saving programmes.

## No.1

We are market leader in the US and Denmark and have significant positions in Norway, Switzerland and Israel. In Germany, we are building our position.

### SHARE OF NET SALES & GROSS PROFIT




| DKK MILLION | 2017 | 2016 |
|---|---|---|
| Net sales | 598 | 652 |
| Gross profit | 364 | 378 |
| Gross margin, % | 60.9% | 57.9% |
| Gross margin, % (adjusted)** | 61.1% | 58.3% |

* Exchange rates etc. **Adjusted for non-recurring items


SELECTED FINE-CUT TOBACCO BRANDS

TIEDEMANNS

Bali Shag

BUGLER

ESCORT

2017 PERFORMANCE

# OTHER

The category “Other” comprises several activities including contract manufacturing, fire products, distribution of lighters and matches, licenses, etc.

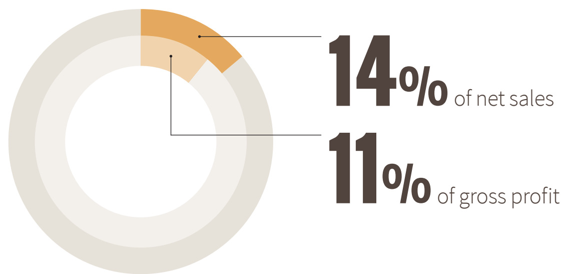
Market dynamics are complex. In contract manufacturing, we are dependent on total market developments and the brand owners’ market share performance. For distribution of lighters, matches, filters and papers we operate in non-core businesses and markets where we have limited influence. However, we believe our geographical reach within these categories does offer valuable contributions to our partners.

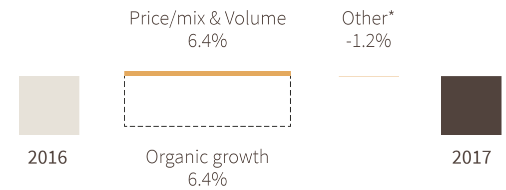
## In 2017, our net sales increased organically by 6.4% to DKK 909 million (DKK 864 million).

During the year, we have experienced a positive development both within our contract manufacturing for handmade cigars and our accessories businesses with fire products still doing very well. However, we saw declining volumes in markets where we have significant distribution activities within lighters and matches.

Gross profit increased to DKK 342 million (DKK 318 million) with a gross margin of 37.6% (36.8%) reflecting improved mix.


### SHARE OF NET SALES & GROSS PROFIT




| DKK MILLION | 2017 | 2016 |
|---|---|---|
| Net sales | 909 | 864 |
| Gross profit | 342 | 318 |
| Gross margin, % | 37.6% | 36.8% |

*Exchange rates etc.

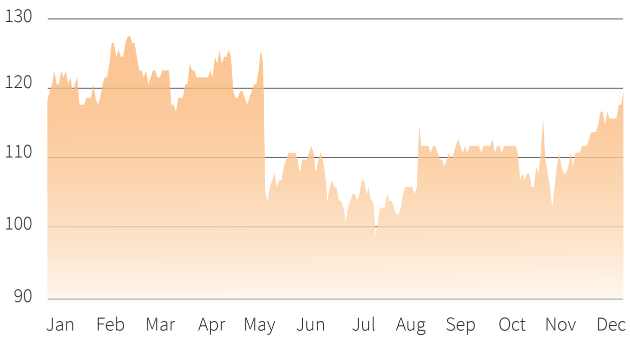
# SHAREHOLDER INFORMATION

## HIGHLIGHTS 2017

Scandinavian Tobacco Group is listed on the Nasdaq Copenhagen Stock Exchange. In 2017, the share price increased by 1%. In the same period, the Nasdaq OMX20 index increased by 16%. Including dividend payments, the total return for Scandinavian Tobacco Group shareholders was 10%.

## SHAREHOLDERS

**SHARE PRICE DEVELOPMENT**




Scandinavian Tobacco Group had almost 3,700 shareholders by the end of 2017. The Company owns 0.4% of the share capital. As of 1 March 2018, the following investors have reported holdings of more than 5% of Scandinavian Tobacco Group's share capital and voting rights:

| | |
|---|---|
| Chr. Augustinus Fabrikker Aktieselskab | 25.1% |
| C.W.Obel A/S | 11.6% |
| FMR LLC | 6.5% |
| Franklin Templeton Institutional, LLC | 5.0% |
| FIL Limited | 5.0% |

## SHARE DATA

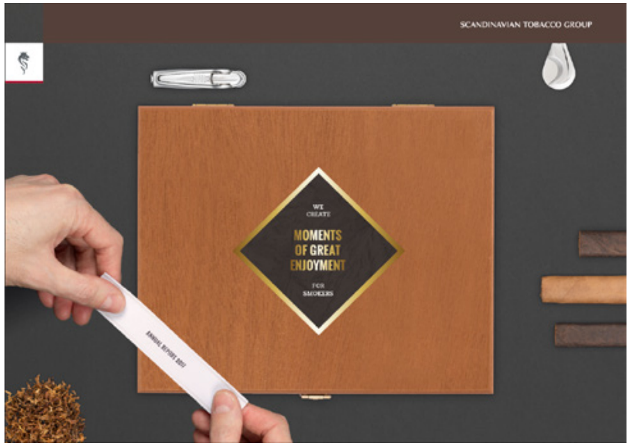
| | |
|---|---|
| Trading symbol | STG |
| ISIN | DK0060696300 |
| Share capital (DKK) | 100,000,000 |
| Number of shares | 100,000,000 |
| Nominal value (DKK) | 1 per share |
| Votes per share | 1 |

## DIVIDENDS

Scandinavian Tobacco Group's shareholder return policy includes a dividend policy with a pay-out ratio of at least 70% of consolidated net profit for the year. In addition to ordinary dividends, the Board of Directors may decide on extraordinary dividends and/or share buybacks.

On 26 April 2017, the shareholders approved an ordinary dividend of DKK 5.50 per share to be paid out for the financial year 2016. On 8 November 2017, the Board of Directors decided to distribute an additional DKK 3.50 per share as an extraordinary dividend.

For the financial year 2017, the Board of Directors proposes that the Annual General Meeting approves an ordinary dividend of DKK 5.75 per share. This will be equivalent to a total payment of DKK 925 million and a payout ratio of 130% based on the 2017-results. The proposed dividend of DKK 5.75 per share corresponds to an increase of 4.5% versus last year's ordinary dividend.



# SHAREHOLDER INFORMATION

## ST-GROUP.COM FOR FAST AND TIMELY INFORMATION

We strive to ensure that relevant, accurate, balanced and timely information is made available to investors. Our website **investor.st-group.com** is the hub for information about Scandinavian Tobacco Group. All company announcements are published through Nasdaq Copenhagen and, when required, the Financial Supervisory Authority.

Our Investor Relations Policy contains the main principles for the communication with our investors, analysts and other stakeholders in the capital market. The policy is available in the Governance section at **investor.st-group.com**.

## FINANCIAL INFORMATION

Scandinavian Tobacco Group publishes interim and annual reports, which are available on our Group's website. The interim reports are exclusively available electronically and can be subscribed to via our website: **investor.st-group.com**.

Following our quarterly financial reports, the Executive Management delivers investor presentations and conference calls to provide participants with the opportunity to ask questions. Webcasts of such presentations by the Executive Management will subsequently be available online.

### FINANCIAL CALENDAR

2018 17 MAY **Interim Report Q1**

2018 30 AUG **Interim Report Q2**

2018 09 NOV **Interim Report Q3**

IR silence periods start four weeks prior to release dates.

### ANNUAL GENERAL MEETING

Scandinavian Tobacco Group's Annual General Meeting will be held

2018 26 APR

AT 16.30, BOJESEN AXELBORG
VESTERBROGADE 4A
1620 COPENHAGEN V

### CONTACT

For additional information, investors may contact:

TORBEN SAND
Head of Investor Relations
Tel: +45 72 20 71 26
investor@st-group.com

# SOCIAL RESPONSIBILITY

RESPONSIBILITY IS ONE OF OUR FIVE CORE VALUES AND EMBEDDED IN HOW WE CONDUCT OUR BUSINESS.

We want Scandinavian Tobacco Group's business to be conducted to the highest standards. We are committed to honest and ethical behaviour, and we want commercial partners, employees, civil society, regulators and others with whom we engage, to consider us to be trustworthy and transparent.

Our Code of Conduct describes the behaviour we expect from every one of our employees in order to ensure compliance and high ethical standards across our business. The Code of Conduct also comprises our fundamental beliefs and overall policies in the area of social responsibility, including our commitment to respect human rights and labour rights, to limit our impact on the environment and our will to provide safe and healthy working conditions for our employees.

**Based on the Code of Conduct, we have developed internal policies, guidelines and projects to turn the Code into actions and to continuously improve in terms of sustainability. Our Code of Conduct is available on st-group.com/codeofconduct.**

For the statutory statement on corporate social responsibility in compliance with section 99a of the Danish Financial Statements Act, see the Corporate Social Responsibility Report for 2017, which is available on **st-group.com/csrreport2017**.

# RISK MANAGEMENT

Uncertainties in the global market place are part of our everyday business activities. We monitor and manage our exposure to various risks in a structured and proactive way. We seek to identify, prioritise and manage key risks at all levels of the business. The aim of our enterprise risk management process is to support better decision making through a good understanding of risks and the likely impact.

## GOVERNANCE

Our Board of Directors has the oversight responsibility for the governance of risks in the Group. Appointed by the Board of Directors, the Audit Committee assists on its behalf in monitoring the effectiveness of our Group's risk management and internal control systems. In addition, it performs an annual review of the key risk profiles and risk response. The Executive Management ensures risk identification, reporting and discussions with the Audit Committee.

Our risk assessment for 2017 has been reviewed and discussed with the Audit Committee and subsequently the Board of Directors. The main risks identified for 2017 are identical with previous years and consist of regulation, excise taxes, total market developments and manufacturing disruption. The identified financial risks, including foreign exchange, interest rate, credit and liquidity risks can be found in note 4.2 on page 80-85.

RISK MANAGEMENT MAP

# RISK MANAGEMENT

## REGULATION

Due to the health risks associated with smoking, governments and health officials have taken regulatory measures. The regulations related to the tobacco industry continue to increase. The most recent regulatory initiatives in selected markets include neutral packaging without branding, ban on certain flavourings, significant reporting obligations in respect of ingredients and ban on display of tobacco products at the point of sale.

**Mitigating actions**
Tobacco regulation may impact our industry's ability to compete and differentiate its products, entail substantial costs for our Group, adversely affect our results of operations and increase complexity in our operations.

In collaboration with various national trade organisations, we engage with regulators and stakeholders to help facilitate reasonable and balanced regulations that meet their objectives. We have dedicated resources to identify and monitor ongoing regulatory initiatives and spend significant resources on the preparation for and implementation of increasing regulations.

## TOTAL MARKET DEVELOPMENT

Even though cigar volumes have demonstrated higher resilience than cigarettes in the markets where we operate, the total tobacco market volumes have declined for decades. In our machine-made cigars and pipe tobacco categories, the total market continues to decline and may continue to do so in the future.

Though we have diversified our market to more than 100 countries, a significant decrease in demand for tobacco products in one or more core markets would impact our Group net sales and earnings negatively.

**Mitigating actions**
We monitor the market trends on a monthly basis, collect market research data and conduct regular forecast projections in order to ascertain market developments. This enables us to promptly address adverse market conditions. Furthermore, we are continuously exploring new markets with a view to spreading the geographical risk.

## EXCISE TAXES

Excise taxes are a major component of the retail price of tobacco products. Governments may decide to increase the excise tax on our products to increase tax revenue or as a means to limit tobacco consumption.

Increases in the tobacco excise tax rates – in particular an alignment of excise tax rates across tobacco product categories – would impact the consumer price of our products and thus potentially the demand.

If such an increase is implemented at a time or in a frequency we did not expect, our ability to adjust to this increase would be limited.

**Mitigating actions**
We actively monitor potential changes to the excise taxes imposed on our products and together with trade industry partners we engage in dialogue with regulators to limit the risk of disruption in the market.

We aim to pass on excise tax increases to consumers wherever possible in light of the market conditions.

## MANUFACTURING DISRUPTION

Interruptions in our Group's supply of products to the market could have a material adverse effect on our business. Our manufacturing footprint has changed as a result of the decline in volumes in machine-made cigars and pipe tobacco categories. The dependency on specific manufacturing sites has therefore increased.

Political and economic unrest, extreme variations in weather patterns in tobacco growing areas and labour instability may arise in countries and regions in which we manufacture our products.

**Mitigating actions**
Our operation setup is global with production facilities on four continents. We monitor geopolitical and economic policy developments where it is relevant and avoid overdependence on specific manufacturing sites.

We carry inventory to safeguard against bad crops. We carefully consider our location of raw materials and continuously update our manufacturing sites with defense mechanisms such as alarms and sprinkler systems. Finally, we continuously assess the adequacy of our insurance coverage.

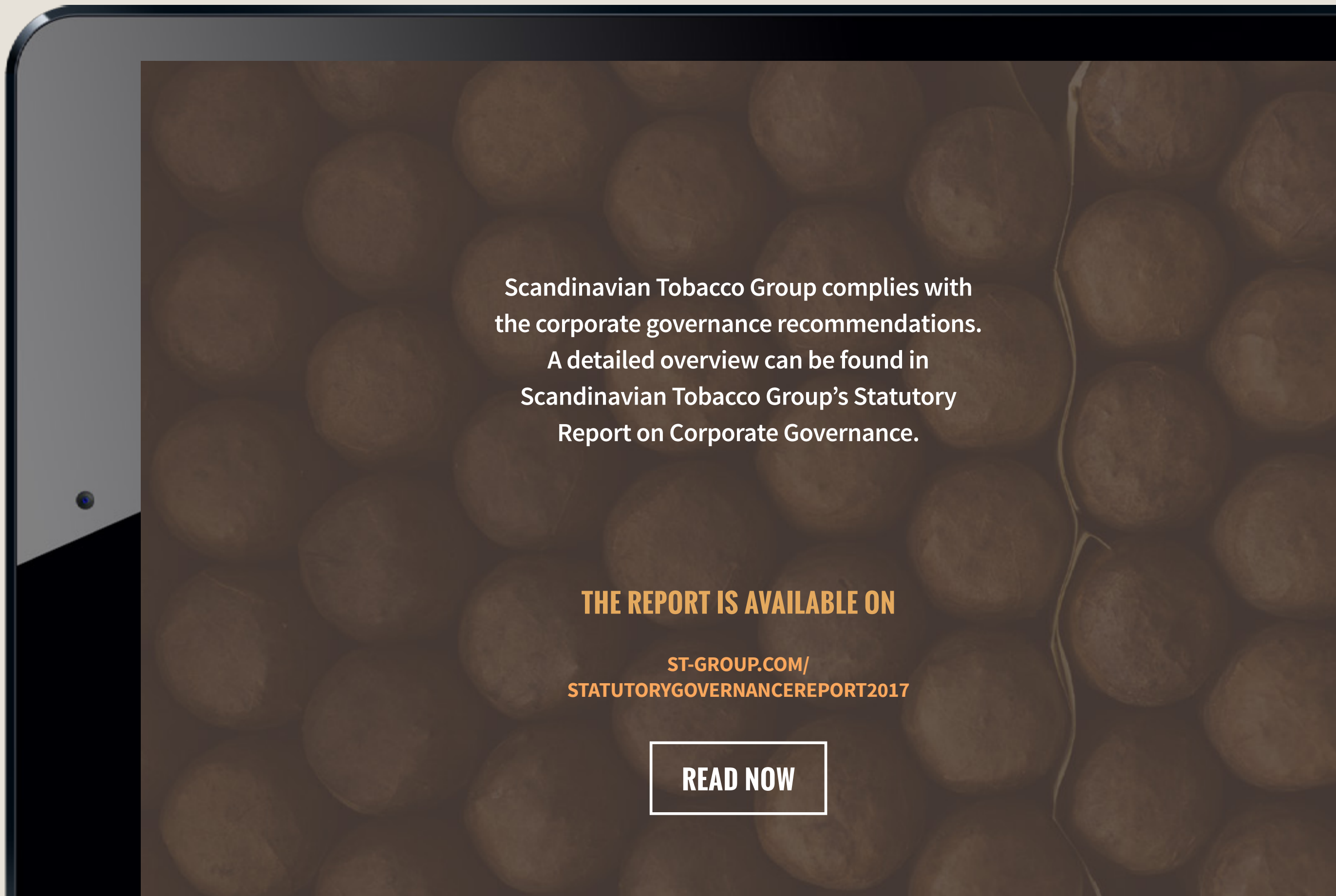
# CORPORATE GOVERNANCE

SCANDINAVIAN TOBACCO GROUP A/S IS INCORPORATED IN DENMARK UNDER DANISH LAW. ON 10 FEBRUARY 2016 THE COMPANY'S SHARES BECAME PUBLICLY LISTED ON NASDAQ COPENHAGEN.

The Group's corporate governance is based on the Danish Companies Act, the Danish Financial Statement Act, the International Financial Reporting Standards (IFRS), the Danish Securities Trading Act, Nasdaq Copenhagen A/S' Rules for Issuers of Shares and the Company's articles of association.

The ultimate authority over the Company is held by the shareholders who exercise their rights at general meetings. The annual report and amendments to the articles of association are approved by the general meeting which also elects members of the Board of Directors and the independent auditor. The general meeting exercises its powers pursuant to the provisions of Scandinavian Tobacco Group's articles of association which are available on **st-group.com**. In 2017, the Annual General Meeting was held on 26 April.

As a publicly listed company, Scandinavian Tobacco Group is required by law to report on its compliance with the Danish Recommendations on Corporate Governance, which can be found at **corporategovernance.dk.** The Company is required to report whether it complies with the Recommendations, and if it does not comply, an explanation must be provided ("comply-or-explain principle").



# CORPORATE GOVERNANCE

## REMUNERATION

Scandinavian Tobacco Group's remuneration policy lays down the principles governing remuneration of the Board of Directors and Executive Management and provides general guidelines for incentive pay to the members of the Executive Management in accordance with the Danish Companies Act and the Corporate Governance Recommendations.

The overall objective of the remuneration policy is to attract, motivate and retain qualified members of the Board of Directors and Executive Management. The policy aims at aligning the interests of shareholders, Board of Directors and Executive Management and rewards both short term and long-term contributions and results. The remuneration policy can be found on **st-group.com.**

A detailed description of the main elements of the remuneration of the Board of Directors and the Executive Management and the remuneration paid in the financial year 2017 are included in note 2.2 of the consolidated financial statements.

## DIVERSITY AND INCLUSION

The Board of Directors believes that members of the Board should be elected based on their professional experience and qualifications, but also that diversity improves the quality of discussions and decision-making not only in the Board of Directors but in the Group as a whole. Diversity brings strength to our Group. The Board of Directors has adopted the Group's Diversity and Inclusion Policy, which is available at **st-group.com.**

A description of the company's activities to ensure relevant diversity at management levels, including the goals and accounting for its objectives and progress made in achieving the objectives can be found on **st-group.com/diversityandinclusionreport.**

# FINANCIAL GUIDANCE 2018

| NET SALES | EBITDA | ORDINARY DIVIDEND |
|---|---|---|
| **ORGANIC NET SALES GROWTH FLAT TO SLIGHTLY POSITIVE** | **ORGANIC EBITDA GROWTH >3%** | **ORDINARY DIVIDEND 2018 > 2017 (DKK 575 MILLION)** |

## OUR 2018 FINANCIAL GUIDANCE IS BASED ON THE ASSUMPTIONS LISTED BELOW:

### Net sales assumptions

- The overall total market volumes for machine-made cigars are assumed to continue the current estimated average decline rates of 3-5%, with some of our key markets declining faster.
- The market volume development for handmade cigars in the US is expected to be flat to slightly positive.
- We continue to see price opportunities across our categories above inflation.

### EBITDA assumptions

- General cost inflation remains unchanged versus last year.
- The opening of two retail stores in Texas during Q3 and Q4 will only have limited impact on our 2018 EBITDA.
- Limited impact on adjusted EBITDA from the announced signed agreement regarding acquisition of Thompson & Co. of Tampa, Inc. Closing of the acquisition is expected to take place by the end of March 2018.

### Cigars International

- Our net sales and EBITDA margin will continue to be affected by the negative impact on the customer base in CI following the IT implementation in early 2017. However, as the issues have been resolved and customer win-back activities are carried out, CI is assumed to deliver growth in both net sales and EBITDA margins during 2018.

### Seasonality

- Year on year our business is relatively stable reflecting the stable consumption pattern by our consumers, but net sales as well as profit and cash flow are distributed unevenly over the quarters with the first quarter being the lowest.

### New IFRS requirements

- The new requirements for revenue recognition (IFRS 15) became effective from 1 January 2018. The new standard will not have any impact on the 2018 Financial Guidance as the reclassification of selected import duties in net sales will be adjusted in the organic growth.

### Other financial expectations

- Financial expenses, excluding currency losses or gains, are expected to be in the range of DKK 80-90 million.
- The effective tax rate is expected to be in the range of 22-23%.
- Capital expenditure is expected to be in the level of DKK 215 million, whereof DKK 65 million relates to special investments in retail stores and implementation of TPD required Track & Trace functionality for the fine-cut business.

### ORDINARY DIVIDEND 2017

- The Board of Directors proposes a 4.5% increase of the ordinary dividend to DKK 5.75 per share, corresponding to a total ordinary dividend of DKK 575 million and a payout ratio of 81% (81%) of net profit.
- Including the extraordinary dividend of DKK 3.50 per share paid out in November 2017, the total dividend for 2017 is DKK 9.25 per share, corresponding to a distribution of DKK 925 million and a payout ratio of 130%
- The Board of Directors will continuously evaluate the distribution of excess cash to shareholders. The evaluation will be based on a comparison of the projected leverage ratio (measured as NIBD/Adjusted EBITDA) against the target of 2.5 keeping the flexibility to temporarily go above target in connection with ordinary dividend payments or acquisitions.

# BOARD OF DIRECTORS

## NIGEL NORTHRIDGE

Chairman

Born in 1956. Nationality, Irish. Election period 2017-2018. Joined the Board in 2016 and was elected Vice-Chairman in 2016 and Chairman in 2017.

HND in Business Studies from Northern Ireland Polytechnic, Sullivan Upper School, Belfast

**COMPETENCIES**

- Long professional experience as an executive director in the international tobacco industry
- Experience as executive and non-executive director in managing publicly listed companies
- Sales and marketing of fast-moving consumer goods

**SELECTED FORMER EMPLOYMENT POSITIONS**

- CEO of Gallaher Group PLC 2000-2007
- Held a number of sales, marketing and then general management positions within the group of Gallaher Tobacco Ltd. (subsequently Gallaher Group PLC) in the UK and overseas, before being appointed to the Board of Directors in 1993, a position held 1993-2000

**BOARD POSITIONS**

Chairman of the Board of Hogg Robinson Group PLC., Senior Independent Director at Inchcape PLC., Belfast City Airport (Non-Executive Chairman)

**COMMITTEES**

Member of Nomination and Remuneration Committees.

**CONSIDERED INDEPENDENT**

Yes

## HENRIK BRANDT

Vice-Chairman

Born in 1955. Nationality, Danish. Election period 2017-2018. Joined the Board in 2017 and was elected Vice-Chairman.

Master of Business Administration – MBA, Business Administration and Management, General, Stanford University, Graduate School of Business
Master of Science (Econ), Copenhagen Business School

**COMPETENCIES**

- Extensive experience in leading international, publicly listed and private equity businesses
- Sales and marketing of fast-moving consumer goods
- Strategic business development

**SELECTED FORMER EMPLOYMENT POSITIONS**

- President and CEO Royal Unibrew A/S 2008-2017
- President and CEO of Unomedical a/s 2003-2008
- President and CEO of Sophus Berendsen Group 1999-2002
- CEO of House of Prince A/S and Group Executive of Skandinavisk Tobakskompagni A/S 1992-1999
- President and CEO of Fritz Hansen A/S 1989-1992
- President and CEO of Kevi A/S 1987-1989

**BOARD POSITIONS**

Chairman of the Boards of Toms Gruppen A/S, Rockwool International A/S, Intervare A/S, nemlig.com A/S, Uno Equity ApS, Cidron Hold-Co Aps, Artisan Bake Invest ApS and Sour Dough Equity ApS.
Member of the Boards of Fritz Hansen A/S, Ferd Holding, Gerda & Victor B. Strands Fond, Gerda & Victor B. Strand Holding.

**COMMITTEES**

Member of Nomination and Remuneration Committees.

**CONSIDERED INDEPENDENT**

Yes

## SØREN BJERRE-NIELSEN

Born in 1952. Nationality, Danish. Election period 2016-2017. Joined the Board in 2016.

State-Authorised Public Accountant and Master's degree in Economics and Business Administration from Copenhagen Business School

**COMPETENCIES**

- Long professional experience in general and international management, including management of listed companies
- Expertise in economic and financial management
- Risk management
- Strategic business development

**SELECTED FORMER EMPLOYMENT POSITIONS**

- Executive Officer and Chief Financial Officer of Danisco A/S (now Dupont Nutrition Biosciences ApS). 1995-2011
- Managing Director at Deloitte 1986-1995
- Partner at Deloitte State Authorised Public Accountants 1981-1995

**BOARD POSITIONS**

Chairman of the Board of Danmarks Nationalbank, MT Højgaard A/S, Højgaard Holding A/S, Højgaard Industri A/S, VKR Holding A/S and VELUX A/S.

**COMMITTEES**

Chairman of the Audit Committee.
Member of Nomination and Remuneration Committees.

**CONSIDERED INDEPENDENT**

Yes

# BOARD OF DIRECTORS

## DIANNE NEAL BLIXT

Born in 1959. Nationality, American. Election period 2017-2018. Joined the Board in 2016.

Master's degree in Business Administration and Finance from University of North Carolina at Greensboro

**COMPETENCIES**

- Significant experience in business analysis
- Financial management and reporting expertise
- Considerable insight into the US tobacco industry

**SELECTED FORMER EMPLOYMENT POSITIONS**

- Member of the board of directors of Lorillard, Inc. 2011-2015
- Executive Vice President and Chief Financial Officer of Reynolds American, Inc. 2004-2007
- Various positions in Reynolds American and its subsidiaries 1988 until 2003
- Executive Vice President and Chief Financial Officer of R. J. Reynolds Tobacco Holdings, Inc. 2003-2004

**BOARD POSITIONS**

Member of the Board of Directors of Ameriprise Financial Services, Inc. Director on the Board for the non-profit entity Reynolda House Museum of American Art.

**COMMITTEES**

Member of Audit Committee.

**CONSIDERED INDEPENDENT**

Yes

## LUC MISSORTEN

Born in 1955. Nationality, Belgian. Election period 2017-2018. Joined the Board in 2016.

Law degree from the Catholic University of Leuven. Certificate of Advanced European Studies from the College of Europe, Bruges. Master of Laws from the University of California, Berkeley

**COMPETENCIES**

- Executive and non-executive general management experience
- Substantial experience in financial management of international corporations

**SELECTED FORMER EMPLOYMENT POSITIONS**

- CEO of Corelio NV 2007-2014
- Group CFO and Executive Vice President for Finance at UCB S.A. 2004-2007
- Executive Vice President and CFO at Inbev S.A. (now ABI) 1995-2003

**BOARD POSITIONS**

Chairman of the Board of Ontex Group NV. Member of the Boards of Barco NV, Recitel NV/SA, GIMV NV and Corelio NV.

**COMMITTEES**

Member of Audit Committee.

**CONSIDERED INDEPENDENT**

Yes

## HENNING KRUSE PETERSEN

Born in 1947. Nationality, Danish. Election period 2017-2018. Joined the Board in 2010.

Master's degree in Law from Aarhus University

**COMPETENCIES**

- Extensive management experience as CEO and board member of large private, public and state-owned entities
- Considerable experience in economics and financing matters

**SELECTED FORMER EMPLOYMENT POSITIONS**

- Group Managing Director of Nykredit 1995-2007

**BOARD POSITIONS**

Chairman of the Boards of C.W Obel A/S, Erhvervsinvest Management A/S, Santa Fe Group A/S, Den Danske Forskningsfond, Scandinavian Private Equity A/S, Midgard Denmark K/S, Howart University A/S, Lunar Holding ApS, Lunar Way A/S, Firstaiders A/S and The Financial Compliance Group A/S. Deputy Chairman of the Boards of Fritz Hansen A/S, Skandinavisk Holding A/S and Asgard Ltd. Member of the Board of Cursum A/S, Proactive A/S, Det Østasiatiske Kompagnis Almennyttige Fond, Midgard Group Inc. and Dekka Holdings Ltd.

**COMMITTEES**

-

**CONSIDERED INDEPENDENT**

Yes

# BOARD OF DIRECTORS

## KURT ASMUSSEN

Born in 1963. Nationality, Danish. Election period 2015-2019. Joined the Board in 2011.

Technician
Machinist degree from Teknisk Skole, Odense

COMPETENCIES
Elected by the employees

SELECTED FORMER EMPLOYMENT POSITIONS
-

BOARD POSITIONS
-

COMMITTEES
-

CONSIDERED INDEPENDENT
No

## LINDY LARSEN

Born in 1955. Nationality, Danish. Election period 2015-2019. Joined the Board in 2016.

Manager, Financial Controller
MSc. Business Administration & Auditing from Copenhagen Business School

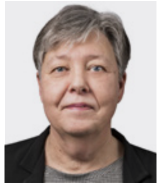
COMPETENCIES
Elected by the employees

SELECTED FORMER EMPLOYMENT POSITIONS
-

BOARD POSITIONS
Member of the Board of Directors and Manager of Scandinavian Tobacco Group Nykøbing ApS.

COMMITTEES
-

CONSIDERED INDEPENDENT
No



## HANNE MALLING

Born in 1960. Nationality, Danish. Election period 2015-2019. Joined the Board in 2010.

Trademark Manager
Bi-lingual Commercial Correspondent degree from Aarhus School of Business

COMPETENCIES
Elected by the employees

SELECTED FORMER EMPLOYMENT POSITIONS
-

BOARD POSITIONS
-

COMMITTEES
-

CONSIDERED INDEPENDENT
No

## MOGENS OLSEN

Born in 1967. Nationality, Danish. Election period 2015-2019. Joined the Board in 2017.

Operator Primary

COMPETENCIES
Elected by the employees

SELECTED FORMER EMPLOYMENT POSITIONS
-

BOARD POSITIONS
-

COMMITTEES
-

CONSIDERED INDEPENDENT
No

# EXECUTIVE MANAGEMENT

The Board of Directors appoints the CEO and other members of the Executive Management. The Executive Management prepares for the Board of Directors' approval and implements the Group's overall strategy. The Executive Management is responsible for the day-to-day management of the business.

Effective 1 January 2018, the Executive Management, i.e. the formally registered management of the Company, consists of the CEO and the CFO. The day-to-day operations of the Company are managed by a wider group, namely the Executive Board.

## THE EXECUTIVE BOARD HAS THE FOLLOWING MEMBERS:

### NIELS FREDERIKSEN
CEO

Niels Frederiksen (1964) became CEO of Scandinavian Tobacco Group in March 2015 and has held various positions in the Group since 1999, including as Senior Vice President and Executive Vice President. Niels Frederiksen is currently also the chairman of the Board of Directors of Boman A/S and on the Board of Directors of Ingeniør Kaptajn Aage Nielsens Familiefond. Niels Frederiksen is a member of the registered Executive Management of the Company.

### SISSE FJELSTED RASMUSSEN
GROUP CFO

Sisse Fjelsted Rasmussen (1967) has been with Scandinavian Tobacco Group since 2008. Prior to joining the Group, she held positions at Grey Nordic Group, Deloitte and Arthur Andersen. Sisse Fjelsted Rasmussen serves as Executive Vice President and Chief Financial Officer responsible for Group Finance, Group IT and Group Communications. Sisse Fjelsted Rasmussen is on the Board of Directors of Inwido AB. Sisse Fjelsted Rasmussen is a member of the registered Executive Management of the Company.

### CHRISTIAN HOTHER SØRENSEN
EXECUTIVE VICE PRESIDENT, SALES & MARKETING

Christian Hother Sørensen (1964) joined Scandinavian Tobacco Group in 2003. From 2003 to 2008 he held positions as Sales and Marketing Director, Senior Vice President for Exports and President of House of Prince. He has been Executive Vice President for Sales and Marketing since 2006. Christian Hother Sørensen serves as deputy chairman of the Board of Directors of Toms Gruppen A/S. Christian Hother Sørensen was until 31 December 2017 a member of the registered Executive Management of the Company.

### VINCENT CREPY
EXECUTIVE VICE PRESIDENT, SUPPLY CHAIN

Vincent Crepy (1966) became Executive Vice President of Operations in September 2015. Vincent Crepy has held leading supply chain positions in Europe and the United States since 2001, including for Ventura Foods LLC, Reckitt Benckiser and Procter & Gamble. Vincent Crepy was until 31 December 2017 a member of the registered Executive Management of the Company.

### CRAIG REYNOLDS
EXECUTIVE VICE PRESIDENT,
HANDMADE CIGARS AND NORTH AMERICA

Craig Reynolds (1955) joined Cigars International as Executive Vice President in 2009. In 2011, he became President of Cigars International and has since 2015 been Executive Vice President for the global handmade cigar business of Scandinavian Tobacco Group. In January 2017, Craig Reynolds became responsible for the whole North American business unit, i.e. our Group's US and Canadian businesses.

### HANNE BERG
CHRO & SENIOR VICE PRESIDENT

Hanne Berg (1966) joined Scandinavian Tobacco Group as Senior Vice President of HR in May 2017. Prior to this, she was 10 years with the LEGO Group as an HR executive. Hanne Berg has held leading HR positions in various companies since 1996, including If Forsikring and Energinet.

# FINANCIAL STATEMENTS

SCANDINAVIAN TOBACCO GROUP A/S

# CONTENTS

# CONSOLIDATED INCOME STATEMENT AND STATEMENT OF COMPREHENSIVE INCOME

## 1 JANUARY - 31 DECEMBER

| DKK million | Note | 2017 | 2016 |
|---|---|---|---|
| **CONSOLIDATED INCOME STATEMENT** | | | |
| **Net sales** | 2.1 | **6,463.5** | **6,745.6** |
| Cost of goods sold | 2.1 | -3,368.2 | -3,520.7 |
| **Gross profit** | 2.1 | **3,095.3** | **3,224.9** |
| Other external costs | | -1,141.5 | -1,137.6 |
| Staff costs | 2.2 | -735.5 | -813.4 |
| Other income | | 13.4 | 4.6 |
| **Earnings before interest, tax, depreciation and amortisation (EBITDA)** | | **1,231.7** | **1,278.5** |
| Depreciation and impairment | 3.2 | -148.2 | -154.5 |
| **Earnings before interest, tax and amortisation (EBITA)** | | **1,083.5** | **1,124.0** |
| Amortisation and impairment | 3.1 | -170.5 | -167.2 |
| **Earnings before interest and tax (EBIT)** | | **913.0** | **956.8** |
| Share of profit of associated companies, net of tax | 4.3 | 16.1 | 10.4 |
| Financial income | 4.4 | 23.5 | 32.8 |
| Financial costs | 4.4 | -100.9 | -105.1 |
| **Profit before tax** | | **851.7** | **894.9** |
| Income taxes | 2.5 | -140.1 | -213.4 |
| **Net profit for the year** | | **711.6** | **681.5** |
| **Earnings per share** | | | |
| Basic earnings per share (DKK) | 4.5 | 7.1 | 6.8 |
| Diluted earnings per share (DKK) | 4.5 | 7.1 | 6.8 |

| DKK million | Note | 2017 | 2016 |
|---|---|---|---|
| **OTHER COMPREHENSIVE INCOME** | | | |
| Items that will not be recycled subsequently to the Consolidated Income Statement: | | | |
| Actuarial gains and losses on pension obligations | | 17.8 | -32.6 |
| Tax of actuarial gains and losses on pension obligations | | -10.7 | 10.1 |
| Items that will be recycled subsequently to the Consolidated Income Statement, when specific conditions are met: | | | |
| Cash flow hedges, realisation of previously deferred (gains)/ losses to financial items | | 26.8 | 41.3 |
| Cash flow hedges, realisation of previously deferred (gains)/ losses to net sales and cost of goods sold | | -0.9 | -25.5 |
| Cash flow hedges, deferred gains/(losses) incurred during the year | | 16.2 | -12.2 |
| Tax of hedging instruments | | -10.6 | -0.8 |
| Foreign exchange rate adjustments | | -680.3 | 149.3 |
| **Other comprehensive income for the year, net of tax** | | **-641.7** | **129.6** |
| **Total comprehensive income for the year** | | **69.9** | **811.1** |

# CONSOLIDATED BALANCE SHEET AT 31 DECEMBER

| DKK million | Note | 2017 | 2016 |
|---|---|---|---|
| **ASSETS** | | | |
| Goodwill | | 4,255.8 | 4,592.0 |
| Trademarks | | 3,013.9 | 3,259.6 |
| IT software | | 99.4 | 85.5 |
| Other intangible assets | | 181.9 | 204.5 |
| **Total intangible assets** | 3.1 | **7,551.0** | **8,141.6** |
| Property, plant and equipment | 3.2 | 1,217.3 | 1,356.4 |
| Investments in associated companies | 4.3 | 127.7 | 134.6 |
| Deferred income tax assets | 2.5 | 96.0 | 137.2 |
| Other financial fixed assets | 4.3 | 20.6 | 0.0 |
| **Total non-current assets** | | **9,012.6** | **9,769.8** |
| Inventories | 3.3 | 2,421.0 | 2,824.1 |
| Trade receivables | 3.4 | 712.8 | 700.4 |
| Other receivables | | 78.7 | 116.9 |
| Corporate tax | 2.5 | 76.9 | 210.4 |
| Prepayments | 3.5 | 83.2 | 71.8 |
| Cash and cash equivalents | | 605.2 | 570.3 |
| **Total current assets** | | **3,977.8** | **4,493.9** |
| **Total assets** | | **12,990.4** | **14,263.7** |

| DKK million | Note | 2017 | 2016 |
|---|---|---|---|
| **EQUITY AND LIABILITIES** | | | |
| Share capital | 4.5 | 100.0 | 100.0 |
| Reserve for hedging | | 4.0 | -27.5 |
| Reserve for currency translation | | 480.4 | 1,160.7 |
| Treasury shares | | -40.5 | -45.5 |
| Retained earnings | | 7,904.3 | 8,085.2 |
| **Total equity** | | **8,448.2** | **9,272.9** |
| Bank loans | 4.1 | 2,606.3 | 2,730.7 |
| Deferred income tax liabilities | 2.5 | 571.5 | 637.1 |
| Pension obligations | 3.7 | 237.8 | 263.8 |
| Other provisions | 3.6 | 33.7 | 36.3 |
| Other liabilities | | 22.4 | 64.8 |
| **Total non-current liabilities** | | **3,471.7** | **3,732.7** |
| Trade payables | | 365.4 | 385.5 |
| Corporate tax | 2.5 | 170.5 | 183.0 |
| Other provisions | 3.6 | 27.4 | 113.9 |
| Other liabilities | | 507.2 | 575.7 |
| **Total current liabilities** | | **1,070.5** | **1,258.1** |
| **Total liabilities** | | **4,542.2** | **4,990.8** |
| **Total equity and liabilities** | | **12,990.4** | **14,263.7** |

# CONSOLIDATED CASH FLOW STATEMENT

## 1 JANUARY - 31 DECEMBER

| DKK million | Note | 2017 | 2016 |
|---|---|---|---|
| Net profit for the year | | 711.6 | 681.5 |
| Adjustments | 5.1 | 498.7 | 742.3 |
| Changes in working capital | 4.6 | 168.1 | 323.3 |
| Non-recurring costs, paid | | -122.3 | -134.8 |
| **Cash flow from operating activities before financial items** | | **1,256.1** | **1,612.3** |
| Financial income received | | 8.3 | 32.8 |
| Financial costs paid | | -148.9 | -105.1 |
| **Cash flow from operating activities before tax** | | **1,115.5** | **1,540.0** |
| Tax payments | 2.5 | -67.0 | -182.2 |
| **Cash flow from operating activities** | | **1,048.5** | **1,357.8** |
| Acquisitions | | -7.9 | 0.0 |
| Investment in intangible assets | 3.1 | -54.4 | -44.6 |
| Investment in property, plant and equipment | 3.2 | -54.1 | -190.4 |
| Sale of property, plant and equipment | | 15.9 | 10.1 |
| Dividend from associated companies | 4.3 | 6.8 | 6.3 |
| **Cash flow from investing activities** | | **-93.7** | **-218.6** |
| **Free cash flow** | | **954.8** | **1,139.2** |

| DKK million | Note | 2017 | 2016 |
|---|---|---|---|
| Instalment and repayment bank loans | | 0.0 | -632.2 |
| Dividend payment | | -896.7 | -500.0 |
| Purchase of treasury shares | | 0.0 | -45.5 |
| **Cash flow from financing activities** | | **-896.7** | **-1,177.7** |
| **Net cash flow for the year** | | **58.1** | **-38.5** |
| Cash and cash equivalents, net at 1 January | | 570.3 | 608.8 |
| Exchange gains/(losses) on cash and cash equivalents | | -23.2 | 0.0 |
| Net cash flow for the year | | 58.1 | -38.5 |
| **Cash and cash equivalents, net at 31 December** | | **605.2** | **570.3** |

# STATEMENT OF CHANGES IN GROUP EQUITY

## 1 JANUARY - 31 DECEMBER

| DKK million | Share capital | Reserve for hedging | Reserve for currency translation | Treasury shares | Retained earnings | Total |
|---|---|---|---|---|---|---|
| Equity at 1 January 2017 | 100.0 | -27.5 | 1,160.7 | -45.5 | 8,085.2 | 9,272.9 |
| **COMPREHENSIVE INCOME FOR THE YEAR** | | | | | | |
| Net profit for the year | 0.0 | 0.0 | 0.0 | 0.0 | 711.6 | 711.6 |
| **OTHER COMPREHENSIVE INCOME** | | | | | | |
| Cash flow hedges | - | 42.1 | - | - | - | 42.1 |
| Tax of cash flow hedges | - | -10.6 | - | - | - | -10.6 |
| Foreign exchange adjustments on net investments in foreign operations | - | - | -680.3 | - | - | -680.3 |
| Actuarial gains and losses on pension obligations | - | - | - | - | 17.8 | 17.8 |
| Tax of actuarial gains and losses on pension obligations | - | - | - | - | -10.7 | -10.7 |
| **Total other comprehensive income** | 0.0 | 31.5 | -680.3 | 0.0 | 7.1 | -641.7 |
| **Total comprehensive income for the year** | 0.0 | 31.5 | -680.3 | 0.0 | 718.7 | 69.9 |
| **TRANSACTIONS WITH SHAREHOLDERS** | | | | | | |
| Purchase of treasury shares | - | - | - | 0.0 | - | 0.0 |
| Share-based payments | - | - | - | - | 2.1 | 2.1 |
| Settlement of vested PSUs | - | - | - | 5.0 | -5.0 | 0.0 |
| Dividend paid to shareholders (note 4.5) | - | - | - | - | -900.0 | -900.0 |
| Dividend, treasury shares | - | - | - | - | 3.3 | 3.3 |
| **Total transactions with shareholders** | 0.0 | 0.0 | 0.0 | 5.0 | -899.6 | -894.6 |
| Equity at 31 December 2017 | 100.0 | 4.0 | 480.4 | -40.5 | 7,904.3 | 8,448.2 |

| DKK million | Share capital | Reserve for hedging | Reserve for currency translation | Treasury shares | Retained earnings | Total |
|---|---|---|---|---|---|---|
| Equity at 1 January 2016 | 100.0 | -30.3 | 1,011.4 | 0.0 | 7,916.8 | 8,997.9 |
| **COMPREHENSIVE INCOME FOR THE YEAR** | | | | | | |
| Net profit for the year | 0.0 | 0.0 | 0.0 | 0.0 | 681.5 | 681.5 |
| **OTHER COMPREHENSIVE INCOME** | | | | | | |
| Cash flow hedges | - | 3.6 | - | - | - | 3.6 |
| Tax of cash flow hedges | - | -0.8 | - | - | - | -0.8 |
| Foreign exchange adjustments on net investments in foreign operations | - | - | 149.3 | - | - | 149.3 |
| Actuarial gains and losses on pension obligations | - | - | - | - | -32.6 | -32.6 |
| Tax of actuarial gains and losses on pension obligations | - | - | - | - | 10.1 | 10.1 |
| **Total other comprehensive income** | 0.0 | 2.8 | 149.3 | 0.0 | -22.5 | 129.6 |
| **Total comprehensive income for the year** | 0.0 | 2.8 | 149.3 | 0.0 | 659.0 | 811.1 |
| **TRANSACTIONS WITH SHAREHOLDERS** | | | | | | |
| Purchase of treasury shares | - | - | - | -45.5 | - | -45.5 |
| Share-based payments | - | - | - | - | 9.4 | 9.4 |
| Dividend paid (note 4.5) | - | - | - | - | -500.0 | -500.0 |
| **Total transactions with shareholders** | 0.0 | 0.0 | 0.0 | -45.5 | -490.6 | -536.1 |
| Equity at 31 December 2016 | 100.0 | -27.5 | 1,160.7 | -45.5 | 8,085.2 | 9,272.9 |

SECTION 1

# BASIS OF PREPARATION OF THE CONSOLIDATED FINANCIAL STATEMENTS

Scandinavian Tobacco Group presents its Consolidated Financial Statements on the basis of the latest developments in international financial reporting.

All affiliated companies within the Group follow the same Group accounting policies.

This section describes the significant accounting policies and other accounting policies in general, including Management's key accounting estimates and the new IFRS requirements. A detailed description of accounting policies and key accounting estimates related to specific reported amounts is presented in the note to the relevant financial item.

NOTE 1.1

# SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Consolidated Financial Statements of Scandinavian Tobacco Group have been prepared in accordance with the International Financial Reporting Standards (IFRS), as adopted by the European Union (EU) and additional Danish disclosure requirements for listed companies and further requirements in the Danish Financial Statements Act.

**RECOGNITION AND MEASUREMENT**

The Consolidated Financial Statements have been prepared under the historical cost basis except when IFRS explicitly requires the use of fair value. Danish kroner is the Group's presentation currency. The principal accounting policies set out below have been applied consistently in the preparation of the Consolidated Financial Statements for all the years presented with the exception of the early adoption of IFRS 9 described in note 1.2.

**PRINCIPAL ACCOUNTING POLICIES**

The Group's accounting policies are described in relation to the individual notes to the Consolidated Financial Statements. Considering all the accounting policies applied in the preparation of the Consolidated Financial Statements, Management regards the following as the most significant accounting policies for the recognition and measurement of reported amounts as well as relevant to an understanding of the Consolidated Financial Statements:

- Net sales (note 2.1)
- Income and deferred taxes (note 2.5)
- Intangible assets and property, plant and equipment including impairment (notes 3.1 and 3.2)
- Inventories (note 3.3)
- Trade receivables and allowances for doubtful trade receivables (note 3.4)

**CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS**

In preparing the Group's Consolidated Financial Statements, Management makes various accounting estimates, judgments and assumptions which form the basis of presentation, recognition and measurement of the Group's assets and liabilities. Accounting estimates and underlying assumptions are reviewed on an ongoing basis. In some circumstances a change in the estimates may be necessary because of changes in the underlying assumptions.

**ESTIMATION UNCERTAINTY**

Determining the carrying amount of some assets and liabilities requires judgments, estimates and assumptions concerning future events.

The judgments, estimates and assumptions made are based on historical experience and other factors which Management assesses to be reliable, but which by their very nature are associated with uncertainty and unpredictability. These assumptions may prove incomplete or incorrect, and unexpected events or circumstances may arise.

The Group is also subject to risks and uncertainties which may lead to actual results differing from these estimates, both positively and negatively. Assumptions about the future and estimation uncertainty on the balance sheet date are described in the notes where there is a significant risk of changes that could result in material adjustments to the carrying amount of assets or liabilities within the next financial year.

Management regards the following areas to include the key accounting estimates and assumptions used in the preparation of the Consolidated Financial Statements:

- Income and deferred taxes (note 2.5)
- Goodwill (note 3.1)
- Trademarks (note 3.1)
- Inventories (note 3.3)
- Pension obligations (note 3.7)

Please refer to the specific notes for further information on the key accounting estimates and assumptions applied.

**DEFINING MATERIALITY**

The Consolidated Financial Statements are a result of processing large numbers of transactions and aggregating those transactions into classes according to their nature or function. When aggregated, the transactions are presented in classes of similar items in the Consolidated Financial Statements. If a line item is not individually material, it is aggregated with other items of a similar nature in the Consolidated Financial Statements or in the notes. There are substantial disclosure requirements throughout IFRS. Management provides specific disclosures required by IFRS unless the information is considered immaterial to the economic decision-making of the users of these financial statements or not applicable.

NOTE 1.2

# OTHER ACCOUNTING POLICIES

## CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES

### IMPACT OF NEW ACCOUNTING STANDARDS

Based on an assessment of new or amended and revised accounting standards and interpretations ('IFRS') issued by the International Accounting Standards Board (IASB) and IFRS endorsed by the European Union effective on or after 1 January 2017, it has been assessed that the application of these new IFRS have not had a material impact on the Consolidated Financial Statements in 2017, and the Group does not anticipate any significant impact on future periods from the adoption of these new IFRS.

As of 1 January 2017 Scandinavian Tobacco Group has early adopted IFRS 9. IFRS 9 is part of the IASB's project to replace IAS 39 and includes new impairment requirements to financial assets that include forward-looking expected credit losses. Furthermore, IFRS 9 includes changed requirements for hedge accounting, now objective-based effectiveness testing instead of specific range, which can result in use of hedge accounting on financial instruments the previously did not classify for hedge accounting. The Group has applied the exemption given in IFRS 9 and hence does not restate comparative information in the period.

| AREA | FINANCIAL IMPACT |
|---|---|
| Classification and measurement | The Group does not hold any financial assets or liabilities affected by the new classification and measurement. |
| Bad debt provision | The use of expected credit loss model has not had any significant financial impact. |
| General hedge Accounting | Existing hedging relationships all qualify as continuing hedging relationships and continue to be effective. |

### NEW OR AMENDED IFRS THAT HAVE BEEN ISSUED BUT HAVE NOT YET COME INTO EFFECT AND HAVE NOT BEEN EARLY ADOPTED

In addition to the above, IASB has issued a number of new or amended and revised accounting standards and interpretations that have not yet come into effect. The following are the most significant:

- IASB has issued IFRS 15 'Revenue from contracts with customers' with effect for financial years beginning on or after 1 January 2018. The new standard will establish a single, comprehensive framework for revenue recognition. The Group has assessed the impact of the standard and determined that it will not have any significant impact on the Consolidated Financial Statements. However, the implementation is expected to result in extended revenue disclosures.

  In connection with our assessment of the impact of implementing IFRS 15, we have decided to change the classification of import duty in selected markets since it is perceived equal to normal excise but previously recognised in both net sales and cost of goods sold. From 1 January 2018 net sales will be recognised exclusive this "excise like" import duty. The impact on the Consolidated Financial Statements for 2017 would be a reduction of reported net sales of approximately 2% and an increase of approximately 1%-point in reported gross margin. The reclassification has no impact on reported or adjusted EBITDA.

- IASB has issued IFRS 16 'Leasing' with effective date 1 January 2019. The standard was endorsed by the EU in 2017, and Scandinavian Tobacco Group plans to adopt it on the effective date.
  The standard will change accounting for leases, as it is to require capitalisation of the majority of the Group's operational lease contracts. To assess the impact from implementing the standard we have commenced a review and analysis of the Group's contracts containing leases. The full impact of the new standard has not yet been determined but based on the ongoing analysis we expect Property, plant and equipment and other liabilities to increase and impact total assets/liabilities of approximately 1-3%. Furthermore, an improvement in EBITDA is expected as the lease costs will be classified as depreciation and financial costs. Net profit is not expected to be materially impacted. As a result, the related key ratios such as equity ratio, NIBD/adjusted EBITDA, EBITDA margins, cash conversion and ROIC will be impacted.

  The implementation of IFRS 16 will impact accounting policies and note disclosures. The Group's operational lease obligations are disclosed in note 5.2.

- IASB has issued IFRIC 23 'Uncertainty over income tax treatment' with effective date 1 January 2019. It currently awaits EU endorsement. The interpretation clarifies the accounting for uncertainties in income taxes and is to be applied to the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments under IAS 12. The Group has assessed the impact of the standard and determined that it will not have any significant impact on the Consolidated Financial Statements.

NOTE 1.3

# OTHER GENERAL ACCOUNTING POLICIES

**BASIS OF CONSOLIDATION**

Subsidiaries are all entities (including structured entities) which the Group controls. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entitiy. Enterprises in which the Group holds between 20% and 50% of the votes and exercises significant influence but not control are classified as associated companies. At consolidation, items of a uniform nature are combined. Elimination is made of intercompany income and expenses, shareholdings, dividends and accounts as well as of realised and unrealised profits and losses on transactions between the consolidated enterprises.

The Parent Company's investments in the consolidated subsidiaries are set off against the Parent Company's share of the net asset value of subsidiaries stated at the time of consolidation.

On the acquisition of subsidiaries, the difference between cost and net asset value of the enterprise acquired is determined at the date of acquisition after the individual assets and liabilities have been adjusted to fair value (the purchase method). Transaction costs relating to the acquisition of subsidiaries are not included in the value of the acquired assets. All acquisition-related costs are expensed in the period they incur. Any remaining positive differences are recognised as goodwill in intangible assets in the balance sheet. Goodwill is not amortised, but instead tested for impairment on an annual basis and when there is an indication of impairment.

Positive and negative differences from enterprises acquired may, due to changes to the recognition and measurement of net assets, be adjusted until one year from the acquisition date. These adjustments are also reflected in the value of goodwill.

**TRANSLATION POLICIES**

Transactions in foreign currencies are translated at the exchange rates at the dates of transaction. Gains and losses arising due to differences between the transaction date rates and the rates at the dates of payment are recognised in financial income and expenses in the income statement.

Receivables, payables and other monetary items in foreign currencies that have not been settled at the balance sheet date are translated at the exchange rates at the balance sheet date. Any differences between the exchange rates at the balance sheet date and the transaction date rates are recognised in financial income and expenses in the income statement.

Income statements of foreign subsidiaries and associated companies are translated at transaction date rates or approximated average exchange rates. Balance sheet items are translated at the exchange rates at the balance sheet date. Exchange adjustments arising on the translation of the opening equity and exchange adjustments arising from the translation of the income statements at the exchange rates at the balance sheet date are recognised directly in equity.

**OTHER EXTERNAL COSTS**

Other external costs comprise expenses for premises, sales, marketing, distribution and bad debt allowance as well as office expenses, fee to statutory auditor, etc.

**OTHER INCOME**

Other income consists mainly of items of a secondary nature to the core activities, including gains on the sale of intangible assets, property, plant and equipment.

**EQUITY**

Proposed dividend is recognised as a liability at the time of approval by the general meeting. Dividend which is expected to be distributed for the year is disclosed in the statement of changes in Group equity.

The reserve for currency translation in the Consolidated Financial Statements comprises foreign exchange differences arising from translation of financial statements of foreign enterprises from their functional currencies to the presentation currency of the Group (Danish kroner). On full or partial disposal of the net investment, the foreign exchange adjustments are recognised in the income statement.

The reserve for hedges includes the accumulated net change in the fair value of hedging transactions qualifying for hedge accounting.

Cost of acquisition and proceeds from sale of treasury shares are recognised in reserve for treasury shares. Dividend received in relation to treasury shares are recognised in retained earnings.

**CASH FLOW STATEMENT**

The cash flow statement shows the Group's cash flows for the year broken down by operating, investing and financing activities, changes for the year in cash and cash equivalents as well as the Group's cash and cash equivalents at the beginning and end of the year.

Cash flow from operating activities is calculated as the net profit/loss for the year adjusted for changes in working capital and non-cash operating items such as depreciation, amortisation and impairment losses and provisions. Working capital comprises current assets less short-term debt excluding items included in cash and cash equivalents, prepaid tax and corporate tax liabilities.

Cash flow from investing activities comprises cash flows from acquisitions and disposals of intangible assets, property, plant and equipment, fixed asset investments as well as dividend from associated companies.

Cash flow from financing activities comprises cash flows from the raising and repayment of long-term debt as well as payments to and from shareholders.

Cash and cash equivalents comprises 'Cash at bank and in hand'.

The cash flow statement cannot be derived directly from the consolidated financial statements.

## SECTION 2
# RESULTS FOR THE YEAR

This section comprises notes in relation to the results for the year, including disclosure on product segments. The Financial Highlights on page 10 gives a detailed description of the results for the year.

NOTE 2.1

# GROSS PROFIT (NET SALES AND COST OF GOODS SOLD)

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## ACCOUNTING POLICIES

**NET SALES**

Revenue from the sale of goods is measured at the fair value of the consideration received or receivable. Revenue is recognised exclusive of VAT, excise and net of discounts relating to sales. Revenue from our retail activities includes excise.

Revenue from the sale of goods is recognised in the income statement when the following conditions are met:

- The Group has transferred the significant risks and rewards of ownership of the goods to the buyer.
- The amount of revenue can be measured reliably.
- It is probable that the economic benefits associated with the transaction will flow to the entity.

**COST OF GOODS SOLD**

Cost of goods sold comprises costs incurred to achieve revenue for the year. Cost comprises raw materials, consumables, direct labour costs and indirect production costs such as maintenance etc. as well as operation, administration and management of factories.

**SEGMENT REPORTING**

The Group operates in five different segments: Handmade cigars, machine-made cigars, pipe tobacco, fine-cut tobacco and other.

The 'handmade cigars' segment includes sales of handmade cigars (own and 3rd party).

The 'machine-made cigars' segment includes sales of machine-made cigars (own and 3rd party).

The 'pipe tobacco' segment includes sales of pipe tobacco (own and 3rd party).

The 'fine-cut tobacco' segment includes sales of fine-cut tobacco (own and 3rd party).

The 'other' segment includes sales of other tobacco, contract manufacturing (CMA) tobacco, CMA cigars, fire products, tubes/paper, other products and licence income.

Segment performance is evaluated on the basis of gross profit. Operating expenses, depreciation, amortisation and financial items are not allocated to the different segments.

The segment allocation has been based on internal management reporting.

There have been no material transactions between the different segments.

No operating segments have been aggregated to form the reported business segments.

No assets and liabilities are allocated to segments in the internal reporting. Goodwill allocated to operating segments is provided as additional information.

NOTE 2.1

# GROSS PROFIT (NET SALES AND COST OF GOODS SOLD) (CONTINUED)

## SEGMENT INFORMATION

## 2017

| DKK million | Handmade cigars | Machine-made cigars | Pipe tobacco | Fine-cut tobacco | Other | Not allocated | Total |
|---|---|---|---|---|---|---|---|
| Net sales | 1,920.7 | 2,491.5 | 544.3 | 597.9 | 909.1 | 0.0 | 6,463.5 |
| Cost of goods sold | -1,125.9 | -1,223.3 | -218.4 | -233.6 | -567.0 | 0.0 | -3,368.2 |
| **Gross profit** | **794.8** | **1,268.2** | **325.9** | **364.3** | **342.1** | **0.0** | **3,095.3** |
| Other external costs | | | | | | -1,141.5 | -1,141.5 |
| Staff costs | | | | | | -735.5 | -735.5 |
| Other income | | | | | | 13.4 | 13.4 |
| **EBITDA** | | | | | | **-1,863.6** | **1,231.7** |
| Depreciation and impairment | | | | | | -148.2 | -148.2 |
| Amortisation and impairment | | | | | | -170.5 | -170.5 |
| **EBIT** | | | | | | **-2,182.3** | **913.0** |
| Share of profit of associated companies, net of tax | | | | | | 16.1 | 16.1 |
| Financial income | | | | | | 23.5 | 23.5 |
| Financial costs | | | | | | -100.9 | -100.9 |
| **Profit before tax** | | | | | | **-2,243.6** | **851.7** |
| **Goodwill allocated to segments** | **1,681.1** | **1,489.8** | **632.3** | **272.1** | **180.5** | **0.0** | **4,255.8** |

NOTE 2.1

# GROSS PROFIT (NET SALES AND COST OF GOODS SOLD) (CONTINUED)

SEGMENT INFORMATION

## 2016

| DKK million | Handmade cigars | Machine-made cigars | Pipe tobacco | Fine-cut tobacco | Other | Not allocated | Total |
|---|---|---|---|---|---|---|---|
| Net sales | 2,066.8 | 2,593.3 | 569.4 | 652.1 | 864.0 | 0.0 | 6,745.6 |
| Cost of goods sold | -1,163.6 | -1,313.7 | -223.2 | -274.5 | -545.7 | 0.0 | -3,520.7 |
| **Gross profit** | **903.2** | **1,279.6** | **346.2** | **377.6** | **318.3** | **0.0** | **3,224.9** |
| Other external costs | | | | | | -1,137.6 | -1,137.6 |
| Staff costs | | | | | | -813.4 | -813.4 |
| Other income | | | | | | 4.6 | 4.6 |
| **EBITDA** | | | | | | **-1,946.4** | **1,278.5** |
| Depreciation and impairment | | | | | | -154.5 | -154.5 |
| Amortisation and impairment | | | | | | -167.2 | -167.2 |
| **EBIT** | | | | | | **-2,268.1** | **956.8** |
| Share of profit of associated companies, net of tax | | | | | | 10.4 | 10.4 |
| Financial income | | | | | | 32.8 | 32.8 |
| Financial costs | | | | | | -105.1 | -105.1 |
| **Profit before tax** | | | | | | **-2,330.0** | **894.9** |
| **Goodwill allocated to segments** | **1,989.0** | **1,496.9** | **646.4** | **272.1** | **187.6** | **0.0** | **4,592.0** |

NOTE 2.1

# GROSS PROFIT (NET SALES AND COST OF GOODS SOLD) (CONTINUED)

## SEGMENT INFORMATION

### GEOGRAPHIC INFORMATION

In the table below, sales to external customers are attributable to the country of the customers' domicile and non-current assets are based on the country of the entities' domicile. External sales and non-current assets are distributed by geographic region as follows:

| DKK million | 2017 | 2016 |
|---|---|---|
| Americas | 2,933.4 | 3,143.3 |
| Europe | 2,843.5 | 2,912.9 |
| Rest of world | 686.6 | 689.4 |
| **Total net sales** | **6,463.5** | **6,745.6** |

The Group is domiciled in Denmark. Net sales from external customers in Denmark amount to DKK 200.2 million (DKK 203.2 million), and net sales from external customers outside Denmark amount to DKK 6,263.3 million (DKK 6,542.4 million). Individual, material countries (>10% of total net sales) are the US DKK 2,648.0 million (DKK 2,842.1 million).

Licence income and other sales of DKK 36.2 million (DKK 28.8 million) are included in the total net sales.

| DKK million | 2017 | 2016 |
|---|---|---|
| **Non-current assets[1]** | | |
| Americas | 3,860.1 | 4,374.0 |
| Europe | 5,009.6 | 5,223.7 |
| Rest of world | 26.3 | 34.9 |
| **Total non-current assets** | **8,896.0** | **9,632.6** |

1. Non-current assets other than deferred income tax and other financial fixed assets.

Total non-current assets in Denmark amount to DKK 1,947.5 milion (DKK 2,037.2 million).

Individual, material countries (>10% of total non-current assets) are the US DKK 3,807.6 million (DKK 4,309.6 million) and the Netherlands DKK 2,189.3 million (DKK 2,370.7 million).

NOTE 2.2
# STAFF COSTS

| DKK million | 2017 | 2016 |
|---|---|---|
| Wages and salaries | 1,141.4 | 1,328.8 |
| Pensions – defined contribution plans | 49.5 | 46.3 |
| Pensions – defined benefit plans* | 17.3 | -8.4 |
| Social security costs | 152.8 | 166.8 |
| **Total staff costs for the year** | **1,361.0** | **1,533.5** |
| Staff cost included in intangible assets and property, plant and equiptment | -4.7 | -21.7 |
| Change in employee costs included in inventories | 3.7 | 11.2 |
| **Total staff costs expensed to the income statement** | **1,360.0** | **1,523.0** |
| **Included in the income statement:** | | |
| Cost of goods sold | 624.5 | 709.6 |
| Staff costs | 735.5 | 813.4 |
| **Total included in the income statement** | **1,360.0** | **1,523.0** |
| **Average number of employees in the Group** | **7,579** | **7,944** |

* Gains on curtailments in 2016 are offset against the service cost for defined benefit pension plans (note 3.7). Main part or the curtailments in 2016 related to close-down of pension schemes primarily for Executive Management which was converted into a stay-on bonus programme and recognised within salaries.

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## ACCOUNTING POLICIES

Staff costs comprise wages and salaries as well as payroll expenses other than production wages.

NOTE 2.2

# STAFF COSTS (CONTINUED)

## REMUNERATION OF THE BOARD OF DIRECTORS AND EXECUTIVE BOARD**

Total fees to the Board of Directors and Executive Board amounted to DKK 47.5 million (DKK 65.4 million).

**Executive Board**

The Executive Board's remuneration is assessed annually and compared to the remuneration level of similar international companies in terms of size and complexity.

The members of the Executive Board are subject to the Group's long-term incentive programme (LTIP) according to which the participants receive an annual grant of performance share units (PSUs). The CEO receives an annual grant of PSUs corresponding in value to 40% of his current annual base salary, whereas the CFO receives a grant of PSUs corresponding to 30% of the annual base salary. Key employees (i.e. members of the Executive Board who are not members of the Executive Management) receive an annual grant of PSUs corresponding in value to 15-30% of the current annual base salary. The value of the PSUs follows the trading value of the Scandinavian Tobacco Group shares during the three-year performance period.  The shares, if any, to be allocated to each participant under the LTIP following the performance period will be determined on the basis of the initial PSUs, with the addition of any dividend PSUs granted, adjusted by the performance in the performance period against the pre-defined KPI multiplier (between 0.0 and 2.0). For the financial years 2016 and 2017 a transition share programme (TSP) has been in place for the members of the Executive Management and certain key employees to strengthen their retention in the transition period until the LTIP is operating on a three-year rolling basis (i.e. in 2019 with a potential allocation of shares based on PSUs granted in 2016). The terms of the TSP are identical to those applicable to the LTIP, except from the performance and vesting period for the TSP which is 2016 and 2017, respectively. The one-time grant of the PSU's vests with one half after 2016 and one half after 2017, subject to the fulfilment of the KPI multipliers. For a further description of the share based incentive programmes please refer to note 2.3.

Members of the Executive Board are subject to a short-term incentive programme (STIP) according to which they may receive an annual target bonus of 20% with a potential bonus of up to 40% of the annual base salary for the CEO and 25% target bonus with a potential bonus of up to 50% for the CFO. Other members of the Executive Board may receive an annual target bonus of 25-30% with a potential bonus up to 50-60%. Both the Executive Management's bonus and the bonus for other Executive Board members are based on two parameters: EBITDA growth and cash related KPI's being either inventory reduction or cash conversion.

The individual employment contracts for members of the Executive Management may be terminated with 24 months' notice and for other Executive Board members with 6-24 months' notice.

In the event that the CEO, the CFO or EVP sales & marketing terminates his or her employment with the company within 12 months of any material change in ownership of the company, and such termination is due to the material change, such individual will be entitled to receive his or her most recent gross monthly salary for a 24-month notice period and will be eligible to receive a proportionate share of his or her stay-on bonus, cf. below.

The CEO, the CFO and Executive Vice President Christian Hother Sørensen are entitled to a stay-on bonus payable on each 1 January of 2018, 2021 and 2024, provided that the Executive Manager continues to be employed in the same position in the company. If the Executive Manager terminates his or her position, or is terminated for breach of contract, he/she is no longer entitled to the stay-on bonus. If the employment is terminated by the company for a reason other than breach of contract by the Executive Manager, or if the Executive Manager terminates the employment due to breach by the company, the Executive Manager will be entitled to a proportionate share of any unpaid stay-on bonus.

Executive Vice President Vincent Crepy is entitled to loyalty payments, if he is employed by the company on each of the third, sixth and ninth anniversary of the start of his employment (September 2015). He will, in that case, be entitled to a lump sum payment corresponding, to twelve, nine and nine times his gross monthly salary applicable on such dates. If the company terminates the Executive Manager's employment without adequate cause, he will be entitled to a proportionate part of the next upcoming loyalty payment.

A key employees is entitled to a stay-on bonus based on continued employment in the same position beyond 31 May 2020 corresponding to 12 months' base salary applicable at that time and a proportionate share if the employment is terminated earlier.

For the year 2017, the total cost of remuneration for the Executive Board amount to DKK 40.5 million (DKK 57.9 million).

NOTE 2.2

# STAFF COSTS (CONTINUED)

## 2017

| DKK million<br>Executive Management | Salary | Bonus | Pension | Stay-on bonus/loyalty programme | Share-based incentive programme | Total |
|---|---|---|---|---|---|---|
| Niels Frederiksen | 6.7 | 0.7 | 0.0 | 3.1 | 0.3 | 10.8 |
| Christian Hother Sørensen | 4.6 | 0.6 | 0.0 | 1.5 | 0.1 | 6.8 |
| Sisse Fjelsted Rasmussen | 3.8 | 0.5 | 0.0 | 1.6 | 0.1 | 6.0 |
| Rob Zwarts*** | 3.9 | 0.1 | 0.2 | 0.0 | 0.4 | 4.6 |
| Vincent Crepy | 3.6 | 0.4 | 0.0 | 0.9 | 0.2 | 5.1 |
| **Total** | **22.6** | **2.3** | **0.2** | **7.1** | **1.1** | **33.3** |
| Other key management | 5.1 | 0.6 | 0.5 | 0.9 | 0.1 | 7.2 |
| **Total Executive Board** | **27.7** | **2.9** | **0.7** | **8.0** | **1.2** | **40.5** |

## 2016

| DKK million<br>Executive Management | Salary | Bonus | Pension | IPO incentive bonus | Stay-on bonus/loyalty programme | Share-based incentive programme | Total |
|---|---|---|---|---|---|---|---|
| Niels Frederiksen | 6.4 | 1.8 | 0.0 | 1.5 | 3.1 | 2.5 | 15.3 |
| Christian Hother Sørensen | 4.6 | 1.6 | 0.0 | 1.5 | 1.5 | 1.4 | 10.6 |
| Sisse Fjelsted Rasmussen | 3.8 | 1.3 | 0.0 | 1.5 | 1.6 | 1.1 | 9.3 |
| Rob Zwarts | 3.9 | 1.0 | 0.2 | 1.5 | 0.0 | 0.8 | 7.4 |
| Vincent Crepy | 3.7 | 1.2 | 0.0 | 1.6 | 0.9 | 0.9 | 8.3 |
| **Total** | **22.4** | **6.9** | **0.2** | **7.6** | **7.1** | **6.7** | **50.9** |
| Other key management | 3.7 | 1.1 | 0.3 | 0.0 | 0.8 | 1.1 | 7.0 |
| **Total Executive Board** | **26.1** | **8.0** | **0.5** | **7.6** | **7.9** | **7.8** | **57.9** |

** Executive Board comprise the Executive Management (registered members) and other key management (not registered members).

*** Rob Zwarts left his position as Executive Vice President Special Projects on 1 May 2017.

NOTE 2.2

# STAFF COSTS (CONTINUED)

## BOARD OF DIRECTORS

Members of the Board of Directors receive fixed annual fees. Remuneration of the members of the Board of Directors may not include any incentive element. Ordinary members receive a fixed annual fee while the Chairman and Vice Chairman receive multiples thereof. Board members who are also members of a board committee as chairperson or ordinary committee member receive an additional fixed fee reflecting the additional work and responsibility that follows from being on a committee.

In 2017, members of the Board of Directors and the board committees received fixed annual fees in the aggregate amount of DKK 6.7 million (DKK 7.2 million). Furthermore DKK 0.3 million were paid during 2017 related to social security taxes and similar taxes imposed by non-Danish authorities in relation to the remuneration (2016: DKK 0.3 million).

**DKK thousand**

| Board of Directors | Position | Joined the Board | Left the Board | Board | Committees | Total |
|---|---|---|---|---|---|---|
| Jørgen Tandrup | Chairman | October 2010 | April 2017 | 400 | 67 | 467 |
| Nigel Northridge | Chairman/Vice-chairman | April 2016 | | 1,039 | 168 | 1,207 |
| Henrik Brandt | Vice-chairman | April 2017 | | 475 | 68 | 543 |
| Conny Karlsson | Board member | October 2010 | December 2017 | 400 | 100 | 500 |
| Søren Bjerre-Nielsen | Board member | February 2016 | | 400 | 368 | 768 |
| Marlene Forsell | Board member | June 2014 | April 2017 | 133 | 50 | 183 |
| Dianne Neal Blixt | Board member | February 2016 | | 400 | 150 | 550 |
| Luc Missorten | Board member | February 2016 | | 400 | 102 | 502 |
| Henning Kruse Petersen | Board member | October 2010 | | 400 | | 400 |
| Kurt Asmussen | Group employee representative | October 2010 | | 400 | | 400 |
| Charlotte Lückstadt Nielsen | Group employee representative | October 2010 | July 2017 | 200 | | 200 |
| Hanne Malling | Group employee representative | October 2010 | | 400 | | 400 |
| Lindy Larsen | Group employee representative | July 2016 | | 400 | | 400 |
| Mogens Olsen | Group employee representative | July 2017 | | 200 | | 200 |
| **Total 2017** | | | | **5,647** | **1,073** | **6,720** |
| **Total 2016** | | | | **6,160** | **1,070** | **7,230** |

Social security taxes and similar taxes:
In addition to the above remuneration to the Board of Directors, the company may pay social security taxes and similar taxes imposed by non-Danish authorities in relation to the remuneration. In 2017 the company paid TDKK 264 compared to TDKK 300 in 2016.

NOTE 2.3

# SHARE-BASED PAYMENTS

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## ACCOUNTING POLICIES

Scandinavian Tobacco Group operates a number of equity-settled, share-based compensation plans.

The value of services received in exchange for granted performance-based share units (PSUs) is measured at fair value at the grant date and recognised in the income statement under staff costs over the vesting period with a corresponding increase in equity.

The fair value of granted PSUs is measured using a generally accepted valuation model taking into consideration the terms and conditions upon which the PSUs were granted.

On initial recognition, an estimate is made of the number of PSUs expected to vest. The estimated number is subsequently revised for changes in the number of PSUs expected to vest due to non-market based vesting conditions.

**SHARE-BASED INCENTIVE PROGRAMMES**

Scandinavian Tobacco Group has two equity-settled share-based incentive programmes;

i) a long-term incentive programme (LTIP) for members of the Executive Board and certain members of senior management, and
ii) a transition share programme (TSP) for certain members of the Executive Board and certain members of senior management.

Upon vesting, each PSU entitles the holder to receive one share in Scandinavian Tobacco Group at no cost. The actual number of shares vesting may range between 0 and 200% of the grant and is determined by a service period (TSP: 2 years; LTIP: 3 years) and the achievement of certain performance indicators in the financial years 2017-2019 for the LTIP 2017, 2016-2018 for the LTIP 2016 and the financial years 2016-2017 for the TSP.

In April 2017, part of the PSUs granted under the TSP vested and the participants received shares in Scandinavian Tobacco Group A/S at no cost.

Under the LTIP, new PSUs were granted to plan participants in 2017. This was the second grant following the IPO in 2016.

Prior to vesting, holders of PSUs are not entitled to any of the rights which shareholders hold, except from the right to dividends which will be converted into additional PSUs (both ordinary and extraordinary dividends).

For a further description of the programme, please refer to note 2.2.

NOTE 2.3
# SHARE-BASED PAYMENTS (CONTINUED)

## VALUE OF THE PROGRAMMES AND IMPACT ON THE INCOME STATEMENT

| | TSP | LTIP 2016 | LTIP 2017 |
|---|---|---|---|
| Total PSU's granted | 100,282 | 119,985 | 95,889 |
| Fair value of PSU's expected to vest at grant date, DKK million | 10.7 | 11.6 | 5.5 |
| Fair value of PSU's expected to vest at 31 December 2017, DKK million | 0.0 | 6.2 | 5.9 |
| Recognised in the income statement in 2017, DKK million* | -1.3 | 1.7 | 1.7 |
| Not yet recognised in respect of PSU's expected to vest, DKK million | 0.0 | 2.3 | 4.2 |

* DKK 2.1 million (DKK 8.6 million) was recognised in Staff costs and DKK 0.0 million (DKK 0.8 million) was capitalised under property, plant and equipment.

## OUTSTANDING PSUS

| | Executive Board | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **TSP (number of PSUs)** | **Niels Frederiksen** | **Christian Hother Sørensen** | **Sisse Fjelsted Rasmussen** | **Rob Zwarts** | **Vincent Crepy** | **Other Key Management** | **Senior Management** | **Total** |
| Outstanding at 1 January 2016 | - | - | - | - | - | - | - | - |
| Granted | 26,336 | 14,266 | 11,726 | 8,775 | 10,411 | 11,714 | 13,199 | 96,427 |
| **Outstanding at 31 December 2016** | **26,336** | **14,266** | **11,726** | **8,775** | **10,411** | **11,714** | **13,199** | **96,427** |
| Outstanding at 1 January 2017 | 26,336 | 14,266 | 11,726 | 8,775 | 10,411 | 11,714 | 13,199 | 96,427 |
| Adjustment | 2,304 | 1,248 | 1,026 | 769 | 912 | 1,025 | 1,153 | 8,436 |
| Granted | 1,053 | 571 | 469 | 351 | 416 | 468 | 527 | 3,855 |
| Vested | -15,472 | -8,381 | -6,889 | -5,156 | -6,117 | -6,882 | -7,725 | -56,649 |
| **Outstanding at 31 December 2017** | **14,221** | **7,704** | **6,332** | **4,739** | **5,622** | **6,325** | **7,127** | **52,069** |

NOTE 2.3

# SHARE-BASED PAYMENTS (CONTINUED)

## OUTSTANDING PSUS

| | Executive Board | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| LTIP 2016 (number of PSUs) | Niels Frederiksen | Christian Hother Sørensen | Sisse Fjelsted Rasmussen | Rob Zwarts | Vincent Crepy | Other Key Managementt | Senior Management | Total |
| Outstanding at 1 January 2016 | - | - | - | - | - | - | - | - |
| Granted | 26,336 | 14,266 | 11,726 | 8,775 | 10,411 | 11,714 | 27,923 | 111,151 |
| **Outstanding at 31 December 2016** | **26,336** | **14,266** | **11,726** | **8,775** | **10,411** | **11,714** | **27,923** | **111,151** |
| Outstanding at 1 January 2017 | 26,336 | 14,266 | 11,726 | 8,775 | 10,411 | 11,714 | 27,923 | 111,151 |
| Granted | 2,106 | 1,140 | 937 | 701 | 833 | 937 | 2,180 | 8,834 |
| Cancelled | - | - | - | - | - | - | -673 | -673 |
| **Outstanding at 31 December 2017** | **28,442** | **15,406** | **12,663** | **9,476** | **11,244** | **12,651** | **29,430** | **119,312** |

| | Executive Board | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| LTIP 2017 (number of PSUs) | Niels Frederiksen | Christian Hother Sørensen | Sisse Fjelsted Rasmussen | Rob Zwarts | Vincent Crepy | Other Key Managementt | Senior Management | Total |
| Outstanding at 1 January 2017 | - | - | - | - | - | - | - | - |
| Granted | 24,001 | 12,396 | 10,321 | 2,557 | 9,279 | 12,571 | 24,764 | 95,889 |
| **Outstanding at 31 December 2017** | **24,001** | **12,396** | **10,321** | **2,557** | **9,279** | **12,571** | **24,764** | **95,889** |

All outstanding PSUs are hedged by treasury shares.

## APPLIED ASSUMPTIONS AT THE TIME OF GRANT

| | LTIP 2017 | TSP 2016 | LTIP 2016 |
|---|---|---|---|
| Share price (DKK) | 124.40 / 110.20 | 103.50 / 108.97 | 103.50 / 108.97 |
| | 110.70 / 107.00 | 107.00 / 112.00 | 107.00 / 112.00 |
| | 112.00 | | |
| Risk-free interest rate | 0.3% – 0.5% | 0.3% – 0.5% | 0.3% – 0.5% |

NOTE 2.4

# MANAGEMENT'S HOLDINGS OF STG SHARES

| Management's Holdings of Shares | At the beginning of the year[1] | Additions during the year | Disposals during the year | At the end of the year | Market value[2] DKK million |
|---|---|---|---|---|---|
| Nigel Northridge | 5,000 | 0 | 0 | 5,000 | 0.6 |
| Henrik Brandt | 67,112 | 0 | 0 | 67,112 | 8.1 |
| Søren Bjerre-Nielsen | 2,000 | 0 | 0 | 2,000 | 0.2 |
| Henning Kruse Petersen | 30,000 | 0 | 0 | 30,000 | 3.6 |
| Luc Missorten | 0 | 0 | 0 | 0 | 0.0 |
| Dianne Neal Blixt | 1,700 | 0 | 0 | 1,700 | 0.2 |
| Kurt Asmussen | 500 | 0 | 0 | 500 | 0.1 |
| Lindy Larsen | 242 | 0 | 0 | 242 | 0.0 |
| Hanne Malling | 250 | 0 | 0 | 250 | 0.0 |
| Mogens Olsen | 460 | 0 | 0 | 460 | 0.1 |
| **Board of Directors in total** | **107,264** | **0** | **0** | **107,264** | **12.9** |
| | | | | | |
| Niels Frederiksen | 25,000 | 25,474 | 0 | 50,474 | 6.1 |
| Christian Hother Sørensen | 20,000 | 8,381 | 0 | 28,381 | 3.4 |
| Sisse Fjelsted Rasmussen | 15,756 | 8,311 | 0 | 24,067 | 2.9 |
| Vincent Crepy | 2,250 | 2,150 | 0 | 4,400 | 0.5 |
| Other key management | 700 | 6,882 | 6,000 | 1,582 | 0.2 |
| **Executive Board in total** | **63,706** | **51,198** | **6,000** | **108,904** | **13.1** |
| | | | | | |
| **Total Board of Directors and Executive Board** | **170,970** | **51,198** | **6,000** | **216,168** | **25.9** |

1) Following the change in the Board of Directors and the retirement of members of Executive Board, the holding of shares at the beginning of the year has been updated compared with the Annual Report 2016.

2) Calculation of market value is based on the quoted share price of DKK 120 at the end of the year.

NOTE 2.5

# INCOME AND DEFERRED INCOME TAXES

| DKK million | 2017 | 2016 |
|---|---|---|
| **Tax expense** | | |
| Current income tax | -183.3 | -165.2 |
| Deferred income tax | 21.9 | -38.9 |
| **Total** | **-161.4** | **-204.1** |
| **Tax is allocated as follows:** | | |
| Income taxes | -140.1 | -213.4 |
| **Tax on other comprehensive income related to:** | | |
| Hedging instruments | -10.6 | -0.8 |
| Actuarial gains and losses on pension obligations | -10.7 | 10.1 |
| **Total** | **-161.4** | **-204.1** |
| **Income tax receivable/payable (net) - in the balance sheet:** | | |
| Corporate tax receivables | 76.9 | 210.4 |
| Corporate tax payables | 170.5 | 183.0 |
| **Total** | **93.6** | **-27.4** |
| **Income tax receivable/payable (net):** | | |
| Balance at 1 January | -27.4 | -146.5 |
| Currency adjustments | 4.7 | -2.9 |
| Prior-year tax adjustment | -12.1 | 1.9 |
| Tax paid on account in current year | -203.2 | -312.3 |
| Received regarding previous years | 162.0 | 161.9 |
| Paid regarding previous years | -25.8 | -31.8 |
| Current income tax | 195.4 | 163.3 |
| Reclassification of provision for uncertain tax positions from deferred tax | 0.0 | 139.0 |
| **Balance at 31 December** | **93.6** | **-27.4** |

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## ACCOUNTING POLICIES

### INCOME TAXES

The tax expense for the period comprises current and deferred tax including adjustments to previous years and changes in provision for uncertain tax positions. Tax is recognised in the income statement, except to the extent that it relates to items recognised in other comprehensive income.

Any changes in deferred tax due to changes in tax rates are recognised in the income statement or in other comprehensive income depending on the original recognition.

### CURRENT TAX RECEIVABLES AND LIABILITIES

Current tax receivables and liabilities are recognised in the balance sheet at the amount calculated on the basis of the expected taxable income for the year and prior year adjustments. Tax receivables and liabilities are offset if there is a legally enforceable right of set-off and an intention to settle on a net basis or simultaneously.

NOTE 2.5

# INCOME AND DEFERRED INCOME TAXES (CONTINUED)

| DKK million | 2017 | 2016 |
|---|---|---|
| **Deferred tax (net) – in the balance sheet** | | |
| Deferred income tax assets | 96.0 | 137.2 |
| Deferred income tax liabilities | 571.5 | 637.1 |
| **Deferred income tax liabilities (net)** | **475.5** | **499.9** |
| | | |
| **Deferred tax (net)** | | |
| Balance 1 January | 499.9 | 599.6 |
| Currency adjustments | -2.5 | 0.4 |
| Change in deferred tax charge | -21.9 | 38.9 |
| Reclassification of provision for uncertain tax positions to income tax | 0.0 | -139.0 |
| **Balance at 31 December** | **475.5** | **499.9** |
| | | |
| **Breakdown of deferred income tax liabilities (net):** | | |
| Intangible assets | 584.0 | 637.8 |
| Property, plant and equipment | 47.1 | 54.5 |
| Inventories | -45.6 | -60.6 |
| Receivables | -2.3 | -1.7 |
| Pensions | -47.9 | -60.1 |
| Other liabilities | -19.8 | -58.4 |
| Tax losses to be carried forward | -6.5 | -7.1 |
| Other | -33.5 | -4.5 |
| **Total** | **475.5** | **499.9** |

## ACCOUNTING POLICIES

### DEFERRED TAX ASSETS AND LIABILITIES

Deferred tax is recognised in respect of all temporary differences between the carrying amount and the tax base of assets and liabilities.

Deferred tax is measured on the basis of the tax rules and tax rates that will be effective under the legislation at the balance sheet date when the deferred tax is expected to crystallise as current tax. In cases where the computation of the tax base may be made according to alternative tax rules, deferred tax is measured on the basis of the intended use of the asset and settlement of the liability, respectively.

Deferred tax assets, including the tax base of tax loss carryforwards, are measured at the value at which the asset is expected to be realised, either by elimination in tax on future earnings or by set-off against deferred tax liabilities.

## KEY ACCOUNTING ESTIMATES

Management has made estimates in determining the provisions for uncertain tax positions, deferred tax assets and deferred tax liabilities and the extent to which deferred tax assets are recognised. The Group recognises only deferred tax assets if these tax assets can be offset against positive taxable income in the foreseeable future. The estimates are made on the basis of business plans for the forthcoming years.

NOTE 2.5

# INCOME AND DEFERRED INCOME TAXES (CONTINUED)

| DKK million | 2017 | 2016 |
|---|---|---|
| **Breakdown of tax on profit for the year:** | | |
| Tax calculated at 22.0% of profit before tax | -187.4 | -196.9 |
| Tax according to income statement | -140.1 | -213.4 |
| **Total** | **47.3** | **-16.5** |
| **Tax effect of:** | | |
| Non-deductable costs | -10.5 | -9.2 |
| Income from associated companies | 3.5 | 2.3 |
| Non-taxable income | 1.3 | 4.4 |
| Prior-year adjustments | 4.3 | -2.9 |
| Other tax percentages in foreign jurisdictions | 13.3 | 3.2 |
| Effect of enacted changes of tax rates in foreign jurisdictions | 29.3 | 0.0 |
| Other | 6.1 | -14.3 |
| **Total** | **47.3** | **-16.5** |

At 31 December 2017 the Group has no unrecognised tax assets (DKK 0.0 million).

**UNCERTAIN TAX POSITIONS**

As an international business the Group is exposed to uncertain tax positions and changes in legislation in the jurisdictions in which it operates. The Group's uncertain tax positions principally include cross-border transfer pricing, interpretation of new or complex tax legislation and tax arising on the valuation of assets. The assessment of uncertain tax positions is subjective and significant management judgement is required. This judgement is based on interpretation of legislation, management experience and professional advice.

Provisions arising from uncertain tax positions reflected in the calculation of tax assets and liabilities are included in current corporate tax liabilities. Prior to 2016 the provisions relating to uncertain tax positions were included in deferred tax liabilities, but in 2016 these were reclassified to current corporate tax liabilities, in accordance with IFRIC's Interpretation. The reclassification amounted to DKK 139.0 million.
It is possible that amounts paid will be different from the amounts provided.

SECTION 3

# OPERATING ASSETS AND LIABILITIES

This section specifies the operating assets that form the basis for the activities of the Group and the related liabilities.

NOTE 3.1

# INTANGIBLE ASSETS

## 2017

| DKK million | Goodwill | Trademarks | IT software | Other intangible assets | Total |
|---|---|---|---|---|---|
| Accumulated cost at 1 January | 4,592.9 | 4,262.5 | 317.2 | 322.0 | 9,494.6 |
| Exchange rate adjustment | -341.7 | -158.5 | -7.0 | -6.2 | -513.4 |
| Acquisition | 5.5 | 0.0 | 0.0 | 0.0 | 5.5 |
| Addition | 0.0 | 0.0 | 51.6 | 2.8 | 54.4 |
| Disposal | 0.0 | 0.0 | -18.8 | 0.0 | -18.8 |
| Accumulated cost at 31 December | 4,256.7 | 4,104.0 | 343.0 | 318.6 | 9,022.3 |
| | | | | | |
| Accumulated amortisation and impairment at 1 January | 0.9 | 1,002.9 | 231.7 | 117.5 | 1,353.0 |
| Exchange rate adjustment | 0.0 | -25.8 | -1.9 | -6.1 | -33.8 |
| Amortisation and impairment | 0.0 | 113.0 | 32.2 | 25.3 | 170.5 |
| Disposal | 0.0 | 0.0 | -18.4 | 0.0 | -18.4 |
| Accumulated amortisation and impairment at 31 December | 0.9 | 1,090.1 | 243.6 | 136.7 | 1,471.3 |
| | | | | | |
| **Carrying amount at 31 December** | **4,255.8** | **3,013.9** | **99.4** | **181.9** | **7,551.0** |

### Other intangible assets

Other intangible assets mainly comprise acquired distribution rights.

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## ACCOUNTING POLICIES

### GOODWILL

Goodwill represents any cost in excess of identifiable net assets, measured at fair value, in the acquired company. Goodwill is valued at acquisition value less any accumulated impairment losses. Goodwill is tested annually, or upon indication, for impairment.

### TRADEMARKS

Trademarks are measured at cost less accumulated amortisation and less any accumulated impairment losses. Strategic trademarks with indefinite lives are not amortised, but are reviewed annually for impairment. Strategic trademarks are defined as trademarks of a sizeable significance measured on contribution and the trademarks have the potential to grow across geographies. Other trademarks are amortised on a straight-line basis over the estimated useful lives determined on the basis of Management's experience with the individual trademarks. The amortisation period is typically in the range of 10–25 years.

### IT SOFTWARE

IT software is measured at cost less accumulated amortisation and less any accumulated impairment losses. Amortisation is calculated on a straight-line basis over the expected useful lives of the assets, which are 5 years.

### OTHER INTANGIBLE ASSETS

Other intangible assets are measured at cost less accumulated amortisation and less any accumulated impairment losses. Amortisation is based on cost reduced by any residual value and is calculated on a straight-line basis over the expected useful lives of the assets, which are between 5–20 years.

NOTE 3.1
# INTANGIBLE ASSETS (CONTINUED)

## 2016

| DKK million | Goodwill | Trademarks | IT software | Other intangible assets | Total |
|---|---|---|---|---|---|
| Accumulated cost at 1 January | 4,505.1 | 4,214.7 | 271.4 | 321.3 | 9,312.5 |
| Exchange rate adjustment | 87.8 | 47.8 | 1.3 | 0.7 | 137.6 |
| Addition | 0.0 | 0.0 | 44.6 | 0.0 | 44.6 |
| Disposal | 0.0 | 0.0 | -0.1 | 0.0 | -0.1 |
| Accumulated cost at 31 December | 4,592.9 | 4,262.5 | 317.2 | 322.0 | 9,494.6 |
| Accumulated amortisation and impairment at 1 January | 0.9 | 883.2 | 201.9 | 90.6 | 1,176.6 |
| Exchange rate adjustment | 0.0 | 7.8 | 0.2 | 1.3 | 9.3 |
| Amortisation and impairment | 0.0 | 111.9 | 29.7 | 25.6 | 167.2 |
| Disposal | 0.0 | 0.0 | -0.1 | 0.0 | -0.1 |
| Accumulated amortisation and impairment at 31 December | 0.9 | 1,002.9 | 231.7 | 117.5 | 1,353.0 |
| **Carrying amount at 31 December** | **4,592.0** | **3,259.6** | **85.5** | **204.5** | **8,141.6** |

The goodwill and trademarks with indefinite useful lives within the Group are tested for impairment annually and whenever there is an indication of impairment.

When carrying out the impairment test for goodwill, the Group is seen as several cash generating units split according to the internal segment reporting. The carrying values of the individual cash generating units are compared to the values in use. If the carrying values are higher, the difference is charged to the income statement.

The values in use are calculated using a valuation model based on discounted expected future cash flows (DCF-model covering a 5-year budget period) based on Management's projections.

Management has used an overall expectation of moderate growth in EBITDA in the budget period (also in 2016).

The terminal growth is based on adjusted historical development taking into account the general level of inflation. Discount rates are based on the risk-free rate adjusted for the inherent risk and industry comparisons for each individual cash generating unit. The applied assumptions for each individual cash generating unit are illustrated in the table below. For trademarks Management has used a discount rate (WACC after tax) between 6.7% and 17.8% (pre-tax WACC between 8.3% and 23.6%) and the terminal growth in EBITDA is set between 0% and 1.0%. The discount rates are based on the risk inherent in the related activity's current business model and industry comparisons.

NOTE 3.1

# INTANGIBLE ASSETS (CONTINUED)

## 2017

| | Handmade cigars | Machine-made cigars | Pipe tobacco | Fine-cut tobacco | Other | Total |
|---|---|---|---|---|---|---|
| Allocated goodwill (DKK million) | 1,681.1 | 1,489.8 | 632.3 | 272.1 | 180.5 | 4,255.8 |
| WACC after-tax (%) | 6.7 | 6.7 | 6.8 | 6.7 | 6.7 | n.a. |
| WACC pre-tax (%) | 8.3 | 8.3 | 8.4 | 8.3 | 8.3 | n.a. |
| Terminal growth (%) | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 | n.a. |
| Allocated trademarks with indefinite useful lives (DKK million) | 165.6 | 963.5 | 247.1 | 249.7 | 40.4 | 1,666.2 |

## 2016

| | Handmade cigars | Machine-made cigars | Pipe tobacco | Fine-cut tobacco | Other | Total |
|---|---|---|---|---|---|---|
| Allocated goodwill (DKK million) | 1,989.0 | 1,496.9 | 646.4 | 272.1 | 187.6 | 4,592.0 |
| WACC after-tax (%) | 6.4 | 6.4 | 6.5 | 6.4 | 6.4 | n.a. |
| WACC pre-tax (%) | 8.0 | 8.0 | 8.1 | 8.0 | 8.0 | n.a. |
| Terminal growth (%) | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 | n.a. |
| Allocated trademarks with indefinite useful lives (DKK million) | 184.4 | 1,072.7 | 275.0 | 278.0 | 45.0 | 1,855.0 |

When goodwill and trademarks with indefinite useful lives were tested for impairment in 2017 (and 2016), the value in use exceeded the carrying value for the individual cash generating units and no basis for impairment was found. When performing sensitivity analysis by increasing the discount rate by 1 percentage point, the value in use still exceeded the carrying value per segment.

The key assumptions used in all cash generating units in the impairment testing is the EBITDA expectation, which includes underlying assumptions about declining overall volumes in tobacco markets offset by increasing market shares continued effective pricing strategies supported by historically price increases above inflation rates and effective cost of goods sold and operating cost management.

NOTE 3.1

# INTANGIBLE ASSETS (CONTINUED)

## KEY ACCOUNTING ESTIMATES

### IMPAIRMENT OF INTANGIBLE ASSETS

The carrying amounts of intangible assets are reviewed on an annual basis to determine whether there is any indication of impairment other than that expressed by amortisation. If so, an impairment test is carried out to determine whether the recoverable amount is lower than the carrying amount and the asset is written down to its lower recoverable amount.

The impairment test includes significant judgments made by Management, such as assumption of projected future cash flows used in the valuation of the intangible assets. Future events could cause Management to conclude that impairment indicators exist and that intangible assets are impaired. Any resulting impairment loss could have a material impact on the financial condition and result of operations.

### GOODWILL AND TRADEMARKS WITH INDEFINITE USEFUL LIVES

In the annual impairment test of goodwill and trademarks with indefinite useful lives, an estimate is made to determine how the enterprise/trademarks will be able to generate sufficient positive net cash flow in the future to support the value of goodwill, trademarks and other net assets of the enterprise/trademark in question. For the purpose of the annual impairment test of goodwill, the costs and income in segment note (2.1) have been allocated to each cash generating unit based on relevant allocation keys. The estimates of the anticipated future net cash flow are based on Management's projections for the coming years. Contribution expectations are based upon projections made on the development in volume, average sales and cost prices for each market in each of the defined cash generating units. The carrying value of goodwill amounted to DKK 4,255.8 million (DKK 4,592.0 million). The carrying value of trademarks with indefinite useful lives amounted to DKK 1,666.2 million (DKK 1,855.0 million).

### OTHER TRADEMARKS

Acquired trademarks have been deemed to have definite useful lives which are in general amortised over a period of 10–25 years. Trademarks are tested for impairment when circumstances indicate that the value of a trademark is impaired. The carrying value of other trademarks amounted to DKK 1,347.7 million (DKK 1,404.6 million). Amortisation amounted to DKK 113.0 million (DKK 111.9 million). During 2017, Management did not identify any indications of impairment.

NOTE 3.1

# INTANGIBLE ASSETS (CONTINUED)

### Trademarks

The main part of the Group's trademarks is attributable to the merger between Scandinavian Tobacco Group and Swedish Match in 2010 and the acquisition of Lane Ltd. in 2011. In connection with the merger and the acquisition, intangible assets were identified and measured at fair value at the date of the merger/acquisition. Strategic trademarks with indefinite useful lives are not amortised but are reviewed annually for impairment. Other trademarks are amortised in a straight line over the expected useful lives. Trademarks with the highest accounting value are listed below:

| | | | Carrying amount | |
|---|---|---|---|---|
| **DKK million** | **Indefinite trademarks allocated to segment*** | **Remaining amortisation period** | **2017** | **2016** |
| Captain Black, Bugler and Kite | 2,3,4,5 | Indefinite / 13 years | 741.3 | 830.4 |
| Café Crème | 2 | Indefinite | 482.4 | 482.4 |
| Tiedemanns | | 18 years | 196.0 | 223.4 |
| Mercator, Cubero and Schimmelpenninck | | 10 years | 177.2 | 186.1 |
| La Paz | 2 | Indefinite | 215.2 | 215.2 |
| Other trademarks | 1,2,3,4 | Indefinite / 1-18 years | 1,201.8 | 1,322.1 |
| **Total** | | | **3,013.9** | **3,259.6** |

* 1) Handmade cigars, 2) machine-made cigars, 3) pipe tobacco, 4) fine-cut tobacco, 5) other

NOTE 3.2

# PROPERTY, PLANT AND EQUIPMENT

## 2017

| DKK million | Land and buildings | Plant and machinery | Equipment, tools and fixtures | Leasehold improvements | Construction in progress | Total |
|---|---|---|---|---|---|---|
| Accumulated cost at 1 January | 843.0 | 791.8 | 226.8 | 76.6 | 48.5 | 1,986.7 |
| Exchange rate adjustment | -18.7 | -25.3 | -15.3 | -8.0 | -1.9 | -69.2 |
| Addition | 0.0 | 1.4 | 2.4 | 0.2 | 50.1 | 54.1 |
| Transfers | 8.9 | 27.7 | 23.9 | 3.3 | -63.8 | 0.0 |
| Disposals | -44.9 | -74.2 | -28.8 | -0.6 | 0.0 | -148.5 |
| Accumulated cost at 31 December | 788.3 | 721.4 | 209.0 | 71.5 | 32.9 | 1,823.1 |
| Accumulated depreciation and impairment at 1 January | 220.9 | 236.2 | 143.3 | 29.9 | 0.0 | 630.3 |
| Exchange rate adjustment | -5.4 | -11.1 | -9.3 | -3.4 | 0.0 | -29.2 |
| Depreciation | 31.9 | 62.6 | 26.0 | 5.3 | 0.0 | 125.8 |
| Depreciation on disposals | -44.9 | -69.2 | -28.8 | -0.6 | 0.0 | -143.5 |
| Impairment | 0.0 | 18.9 | 0.7 | 0.0 | 2.8 | 22.4 |
| Accumulated depreciation and impairment at 31 December | 202.5 | 237.4 | 131.9 | 31.2 | 2.8 | 605.8 |
| **Carrying amount at 31 December** | **585.8** | **484.0** | **77.1** | **40.3** | **30.1** | **1,217.3** |

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## ACCOUNTING POLICIES

Property, plant and equipment are measured at cost less accumulated depreciation and less any accumulated impairment losses.

Cost comprises the cost of acquisition and expenses directly related to the acquisition up until the asset is ready for use. In the case of assets of own construction, cost comprises direct and indirect expenses for labour, materials, components and subsuppliers.

Depreciation based on cost reduced by any residual value is calculated on a straight-line basis over the expected useful lives of the assets, which are:

| | |
|---|---|
| Buildings | 10–40 years |
| Plant and machinery | 12–20 years |
| Equipment, tools and fixtures | 3–10 years |
| Leasehold improvements | 1–10 years |

Assessment of residual value and useful life is performed annually for assets under property, plant and equipment.

**Impairment of property, plant and equipment**

The carrying amounts of property, plant and equipment are reviewed on an annual basis to determine whether there is any indication of impairment other than that expressed by depreciation. If so, an impairment test is carried out to determine whether the recoverable amount is lower than the carrying amount and the asset is written down to its lower recoverable amount.

NOTE 3.2

# PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

## 2016

| DKK million | Land and buildings | Plant and machinery | Equipment, tools and fixtures | Leasehold improvements | Construction in progress | Total |
|---|---|---|---|---|---|---|
| Accumulated cost at 1 January | 826.9 | 545.5 | 208.5 | 69.1 | 152.3 | 1,802.3 |
| Exchange rate adjustment | 3.4 | 7.6 | 4.0 | 2.0 | -0.5 | 16.5 |
| Addition | 0.0 | 0.0 | 5.5 | 2.7 | 182.2 | 190.4 |
| Transfers | 13.2 | 252.9 | 14.8 | 2.8 | -283.7 | 0.0 |
| Disposals | -0.5 | -14.2 | -6.0 | 0.0 | -1.8 | -22.5 |
| Accumulated cost at 31 December | 843.0 | 791.8 | 226.8 | 76.6 | 48.5 | 1,986.7 |
| Accumulated depreciation and impairment at 1 January | 154.9 | 188.9 | 116.3 | 22.4 | 0.0 | 482.5 |
| Exchange rate adjustment | 1.2 | 3.0 | 2.6 | 0.8 | 0.0 | 7.6 |
| Depreciation | 35.0 | 47.6 | 25.6 | 5.2 | 0.0 | 113.4 |
| Depreciation on disposals | 0.0 | -9.0 | -5.3 | 0.0 | 0.0 | -14.3 |
| Impairment | 29.8 | 5.7 | 4.1 | 1.5 | 0.0 | 41.1 |
| Accumulated depreciation and impairment at 31 December | 220.9 | 236.2 | 143.3 | 29.9 | 0.0 | 630.3 |
| **Carrying amount at 31 December** | **622.1** | **555.6** | **83.5** | **46.7** | **48.5** | **1,356.4** |

NOTE 3.3

# INVENTORIES

**Inventories at 31 December, net of allowances for obsolescence, comprised the following items:**

| DKK million | 2017 | 2016 |
|---|---|---|
| Raw materials and consumables | 1,187.2 | 1,414.5 |
| Work in progress | 319.7 | 394.3 |
| Finished goods, goods for resale and excise stamps | 914.1 | 1,015.3 |
| **Total** | **2,421.0** | **2,824.1** |
| Movements in the Group provision for obsolete stock are as follows: | | |
| Provision for obsolete stock 1 January | -133.7 | -173.9 |
| Additions for the year | -50.3 | -24.3 |
| Reversals for the year | 7.8 | 4.9 |
| Write-downs during the year | 61.0 | 60.8 |
| Effect of exchange rate adjustments | 4.9 | -1.2 |
| **Total provision at 31 December** | **-110.3** | **-133.7** |

The net movement in the year in respect of inventory provision is included in ‘cost of goods sold’. The cost of inventories recognised as cost and included in ‘cost of goods sold’ amounted to DKK 2,743.7 million (DKK 2,811.1 million).

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## ACCOUNTING POLICIES

Inventories are measured at the lower of cost under the FIFO method and net realisable value. The net realisable value of inventories is calculated at the amount expected to be generated by sale in the process of normal operations with deduction of selling expenses and costs of completion. The net realisable value is determined allowing for marketability, obsolescence and development in expected sales prices.

The cost of goods for resale, raw materials and consumables equals landed cost.

The cost of finished goods and work in progress comprises the cost of raw materials, consumables and direct labour with addition of indirect production costs. Indirect production costs comprise the cost of indirect materials and labour, maintenance and depreciation of the machinery, factory buildings and equipment used in the manufacturing process as well as costs of factory administration and management.

## KEY ACCOUNTING ESTIMATES

Inventories are stated at the lower of cost price under the FIFO method and net realisable value. The cost price includes direct production costs and indirect production costs. Direct production costs comprise raw materials, consumables and direct labour, whereas indirect production costs (IPO) consist of indirect materials, labour, maintenance, depreciation etc. Calculations of the IPO are reviewed yearly in order to ensure that relevant assumptions such as prices, production yield and measures of utilisation are incorporated correctly. Changes in the parameters, assumed production yield and utilisation levels etc. could have a significant impact on the cost price and, in turn, on the valuation of inventories and production costs.

Furthermore, the estimated uncertainty in inventories is related to the write-down to net realisable value. Inventories are written down in accordance with Group policy, including individual assessment of inventories for possible losses due to obsolescence.

NOTE 3.4

# TRADE RECIEVABLES

| DKK million | 2017 | 2016 |
|---|---|---|
| **Trade receivables (net) at 31 December comprised the following:** | | |
| Trade receivables (gross) | 755.9 | 722.5 |
| Provision for bad debt | -43.1 | -22.1 |
| **Trade receivables (net)** | **712.8** | **700.4** |
| **Movements in the Group provision for bad debt are as follows:** | | |
| Provision for bad debt at 1 January | -22.1 | -20.9 |
| Additions for the year | -33.3 | -4.0 |
| Reversals for the year | 3.1 | 1.2 |
| Confirmed losses | 8.8 | 1.7 |
| Effect of exchange rate adjustments | 0.4 | -0.1 |
| **Total provision at 31 December** | **-43.1** | **-22.1** |

| DKK million | 2017 | 2016 |
|---|---|---|
| **Non-impaired trade receivables can be specified as follows:** | | |
| Current | 529.4 | 506.4 |
| Overdue < 30 days | 164.4 | 129.4 |
| Overdue 31 – 60 days | 13.5 | 58.6 |
| Overdue 61 – 90 days | 3.1 | 3.9 |
| Overdue 91 – 180 days | 1.0 | 0.2 |
| Overdue > 180 days | 1.4 | 1.9 |
| **Total** | **712.8** | **700.4** |
| **Provision for bad debt can be specified as follows:** | | |
| Current | -3.8 | -4.0 |
| Overdue < 30 days | -21.5 | -1.4 |
| Overdue 31 – 60 days | -10.8 | -0.9 |
| Overdue 61 – 90 days | -2.5 | -1.9 |
| Overdue 91 – 180 days | -1.2 | -1.5 |
| Overdue > 180 days | -3.3 | -12.4 |
| **Total** | **-43.1** | **-22.1** |

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## ACCOUNTING POLICIES

Trade receivables are measured in the balance sheet at the lower of amortised cost and net realisable value, which corresponds to nominal value less provisions for bad debts. Provisions for bad debts are determined by using the simplified expected credit loss model (ECL).

The ECLs on trade receivables are estimated by using a matrix by reference to geography, past default experience, analysis of the debtor's current financial position, adjusted for factors that are specific to the debtors, general economic conditions in which the debtors operate and an assessment of the forecast direction of developments at the reporting date.

NOTE 3.5
# PREPAYMENTS

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## ACCOUNTING POLICIES

Prepayments are measured at cost and comprise prepaid costs concerning rent, licences, insurance premiums, subscriptions, etc.

NOTE 3.6
# OTHER PROVISIONS

| DKK million | 2017 | 2016 |
|---|---|---|
| Balance at 1 January | 150.2 | 62.8 |
| Exchange rate adjustment | -0.2 | 0.3 |
| Discounting cost | 0.7 | 1.0 |
| Additions | 1.5 | 103.6 |
| Utilised | -70.5 | -16.7 |
| Reversals | -20.6 | -0.8 |
| **Carrying amount at 31 December** | **61.1** | **150.2** |
| Non-current | 33.7 | 36.3 |
| Current | 27.4 | 113.9 |
| **Total** | **61.1** | **150.2** |

Other provisions mainly consist of restructuring costs in relation to the close-down of factories and restruction expenses related to the new operating model in the Group. The restructuring costs are primarily related to redundancy payments.

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## ACCOUNTING POLICIES

Provisions are recognised when – in consequence of an event occurred before or on the balance sheet date – the Group has a legal or constructive obligation and it is probable that economic benefits must be given up to settle the obligation.

Provisions are measured at the present value of the anticipated expenditure for settlement of the legal or constructive obligation based on Management's best estimate. If considered material, the anticipated future expenditure is discounted, using a pretax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to the passage of time is recognised as interest expense.

NOTE 3.7

# PENSION OBLIGATIONS

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## ACCOUNTING POLICIES

The Group operates a number of defined contribution plans throughout the world. In a few countries, the Group operates defined benefit plans; these are primarily located in Belgium, Germany, France, Indonesia, the Dominican Republic and the US. The defined benefit plans for Belgium total six different step-rate plans and cover both blue and white collar employees. New employees will be included in defined contribution plans. The defined benefit plans for Germany cover employees who entered service before August 1991 and have since then been closed for new employees. The defined benefit plan in France is mandatory for all employees and has no minimum requirements for years of service with the company. The defined benefit plans for Indonesia cover all employees in the form of severance and gratuity in accordance with labour regulation (Labour Law 13/2013). The defined benefit plans for the Dominican Republic are enacted by law and cover all employees with at least three months of service. The defined benefit plans in the US are non-qualified plans that cover a small group of inactive employees where benefits are paid out of corporate assets.

Under a defined benefit plan, the amount of retirement benefit that will be received by an employee is defined with respect to period of service and final salary. The amount recognised in the balance sheet is the difference between the present value of the defined benefit obligation at the balance sheet date and the fair value of the scheme assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows.

The service cost of providing retirement benefits to employees during the year is charged to operating profit. The costs for the year for defined benefit plans are determined using the projected unit credit method.

Past service costs are recognised immediately in the income statement.

All actuarial gains and losses are recognised immediately in full in the statement of other comprehensive income for the period in which they arise.

Pension assets are only recognised to the extent that the Group is able to derive future economic benefits such as refunds from the plan or reductions of future contributions.

The Group's most significant defined benefit pension plans are funded by payments from Group companies and by employees to funds independent of the Group.

Contributions for defined contribution plans are reported as expenses in the income statement when they occur.

**Post-employment employee benefits**
The Group has defined benefit pension plans in a number of subsidiaries, through which the employees are entitled to post-employment benefits based on their pensionable income and the number of years of service.

Provisions for post-employment defined benefit plans are reported based on actuarial valuations. The Group recognises the full amount of actuarial gains and losses in other comprehensive income, i.e. the net pension liability in the balance sheet includes all cumulative actuarial gains and losses.

The Group does not plan for any new defined benefit plans.

NOTE 3.7

# PENSION OBLIGATIONS (CONTINUED)

**Post-employment defined benefit – recognised in the balance sheet**

| DKK million | 2017 | 2016 |
|---|---|---|
| Present value of funded obligations | 228.5 | 216.6 |
| Fair value of plan assets | -106.2 | -111.6 |
| Deficit (+) / surplus (-) | 122.3 | 105.0 |
| | | |
| Present value of unfunded obligations | 115.5 | 158.8 |
| **Net asset (-) / liability (+) in the balance sheet** | **237.8** | **263.8** |
| | | |
| Amounts in the balance sheet | | |
| Liabilities | 237.8 | 263.8 |
| Assets | 0.0 | 0.0 |
| **Net asset (-) / liability (+) in the balance sheet** | **237.8** | **263.8** |

| DKK million | 2017 | 2016 |
|---|---|---|
| **Movement during the period in the net asset (-)/ liability (+)** | | |
| Balance at 1 January | 263.8 | 241.0 |
| Recognised in the income statement | 26.3 | 1.8 |
| Actuarial gain/loss recognised in comprehensive income, financial assumptions | -17.7 | 33.0 |
| Actuarial gain/loss recognised in comprehensive income, demographic assumptions | -0.1 | -0.4 |
| Benefit payments to employees | -18.4 | -10.3 |
| Employer contributions | -2.8 | -4.8 |
| Currency effect | -13.3 | 3.5 |
| **Balance at 31 December** | **237.8** | **263.8** |

## KEY ACCOUNTING ESTIMATES

### ACTUARIAL ASSUMPTIONS

The discount rate is set per country with reference to high quality corporate bond yields of appropriate duration or government bond yields for countries where a deep market of high quality corporate bonds is not available.

Assumptions regarding future mortality experience are based on advice in accordance with published statistics and experience in each country.

| Actuarial assumptions used for valuation (expressed as weighted averages and in %) | 2017 | 2016 |
|---|---|---|
| Discount rate | 3.4 | 3.4 |
| Future salary increases | 4.1 | 4.2 |

Significant actuarial assumptions regarding the determination of the pension obligation are the discount rate and future salary increase. The sensitivity analysis below has been determined based on likely changes in the discount rate and future salary increase occurring at the end of the period.

| | 2017 | | 2016 | |
|---|---|---|---|---|
| DKK million | 1%-point increase | 1%-point decrease | 1%-point increase | 1%-point descrease |
| Discount rate | -38.9 | 46.1 | -44.4 | 52.4 |
| Future salary increase | 49.6 | -35.1 | 30.8 | -25.6 |

NOTE 3.7

# PENSION OBLIGATIONS (CONTINUED)

| DKK million | 2017 | 2016 |
|---|---|---|
| **CHANGE IN THE DEFINED BENEFIT OBLIGATIONS AND PLAN ASSETS** | | |
| **Defined benefit obligations – movement** | | |
| Balance at 1 January | 375.4 | 356.6 |
| Current service costs | 16.8 | 16.1 |
| Interest cost | 10.3 | 12.8 |
| Recognised past-service costs | -0.1 | 0.0 |
| Actuarial losses (+)/gains (-) | -15.6 | 34.6 |
| Benefits paid | -25.8 | -23.3 |
| Curtailments | 0.0 | -24.5 |
| Settlements | 0.6 | 0.0 |
| Currency effect | -13.2 | 3.1 |
| Other | 14.2 | 0.0 |
| **Balance at 31 December** | **362.6** | **375.4** |
| **Plan assets – movement in fair value** | | |
| Balance at 1 January | 111.6 | 115.6 |
| Interest income | 1.3 | 2.6 |
| Actuarial losses (-)/gains (+) | 2.2 | 2.0 |
| Employer contributions | 5.6 | 8.3 |
| Benefits paid | -10.2 | -16.5 |
| Currency effect | 0.1 | -0.4 |
| Other | 14.2 | 0.0 |
| **Balance at 31 December** | **124.8** | **111.6** |

Curtailments relates to conversion/termination of pension schemes.

The actual return on plan assets in 2017 was a gain of DKK 3.5 million (DKK 4.7 million).

NOTE 3.7

# PENSION OBLIGATIONS (CONTINUED)

| | 2017 | | 2016 | | 2017 | 2016 |
|---|---|---|---|---|---|---|
| **DKK million** | **Quoted** | **Unquoted** | **Quoted** | **Unquoted** | **Total** | **Total** |
| **Categories of plan assets** | | | | | | |
| Equity securities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Bonds | 27.9 | 95.9 | 23.9 | 86.7 | 123.8 | 110.6 |
| Other | 1.0 | 0.0 | 1.0 | 0.0 | 1.0 | 1.0 |
| **Total** | **28.9** | **95.9** | **24.9** | **86.7** | **124.8** | **111.6** |

The weighted average duration of the defined benefit obligation is 12.2 years (12.2 years).

| DKK million | 2017 | 2016 |
|---|---|---|
| **Post-employment benefit plans recognised in income statement** | | |
| Current service costs | 16.8 | 16.1 |
| Interest on net obligation | 9.0 | 10.2 |
| Recognised past-service costs | -0.1 | 0.0 |
| Curtailments | 0.0 | -24.5 |
| Settlements | 0.6 | 0.0 |
| **Net income (-)/expense (+) reported in the income statement** | **26.3** | **1.8** |
| **The income/costs for defined benefit plans are reported under the following headings in the income statement:** | | |
| Staff costs | 17.3 | -8.4 |
| Financial costs | 9.0 | 10.2 |
| **Net income (-)/expense (+) reported in the income statement** | **26.3** | **1.8** |
| **Amounts recognised in other comprehensive income** | | |
| For the post-employment defined benefit plans, all actuarial gains and losses are recognised in other comprehensive income as they occur in accordance with the year-end valuation. | | |
| Net actuarial losses (+)/ gains (-) | -17.8 | 32.6 |
| Effect of asset limit | 0.0 | 0.0 |
| Cumulative net actuarial losses (+)/ gains (-) | 156.6 | 180.1 |

**Expected contribution next year**

Expected contributions for post-employment benefit plans for the year ending 31 December 2017 amount to DKK 10.7 million (DKK 13.9 million).

**Defined contribution plans**

The Group has certain obligations under defined contribution plans. Contributions to these plans are determined by provisions in the relevant plan. Costs for defined contribution plans charged to the income statement for the year ending 31 December 2017 amount to DKK 49.5 million (DKK 46.3 million).

# SECTION 4
# CAPITAL STRUCTURE AND FINANCING ITEMS

This section encompasses notes related to the Group's capital structure and financing items.

NOTE 4.1

# FINANCIAL INSTITUTIONS

| DKK million | 2017 | 2016 |
|---|---|---|
| **Financial institutions are recognised in the balance sheet as follows:** | | |
| Non-current liabilities | 2,606.3 | 2,730.7 |
| **Total** | **2,606.3** | **2,730.7** |

The Group has the following external loans as at 31 December:

| | | | | Carrying amount | | Fair value* Level 2 | |
|---|---|---|---|---|---|---|---|
| **Currency** | **Fixed/floating** | **Term/revolving credit facility** | **Maturity date** | **2017** | **2016** | **2017** | **2016** |
| EUR | Floating | Term | 30/09/2021 | 558.4 | 557.6 | 574.6 | 577.3 |
| EUR | Floating | Term | 30/09/2022 | 1,116.7 | 1,115.2 | 1,156.6 | 1,163.1 |
| USD | Floating | Term | 30/09/2021 | 310.4 | 352.6 | 319.5 | 364.4 |
| USD | Floating | Term | 30/09/2022 | 620.8 | 705.3 | 643.5 | 734.7 |
| EUR | Floating | RCF | 30/09/2022 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Total** | | | | **2,606.3** | **2,730.7** | **2,694.2** | **2,839.5** |

* The fair value of the financial liabilities is the present value of the expected future instalments and interest payments. The zero coupon interest rate for similar maturities is used as the capitalisation rate.

100% (100%) of the interest rate risk related to EUR and USD loans has been hedged by entering into fixe interest rate swap contracts. Please refer to note 4.2 for additional information.

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## ACCOUNTING POLICIES

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently carried at amortised cost.

Fees paid on the establishment of loan facilities are recognised as transaction costs of the loan and are amortised over the period of the borrowings.

NOTE 4.2

# FINANCIAL RISKS AND INSTRUMENTS

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## ACCOUNTING POLICIES

**DERIVATIVE FINANCIAL INSTRUMENTS**

Derivative financial instruments are initially recognised in the balance sheet at fair value and are subsequently remeasured at their fair values. Positive and negative fair values of derivative financial instruments are classified as other receivables/financial fixed assets and other liabilities, respectively.

Changes in the fair values of derivative financial instruments are recognised in the income statement unless the derivative financial instrument is designated and qualifies as hedge accounting, see below.

**HEDGE ACCOUNTING**

Changes in the fair values of financial instruments that are designated and qualify as fair value hedges of a recognised asset or a recognised liability are recognised in the income statement like changes in the fair value of the hedged asset or the hedged liability related to the hedged risk.

Changes in the fair values of derivative financial instruments that are designated and qualify as hedges of expected future transactions are recognised directly in other comprehensive income as regards the effective portion of the hedge. The ineffective portion is recognised in the income statement. If the hedged transaction results in an asset or a liability, the amount deferred in other comprehensive income is transferred from other comprehensive income and recognised in the cost of the asset or the liability, respectively. If the hedged transaction results in an income or an expense, the amount deferred in other comprehensive income is transferred from other comprehensive income to the income statement in the period in which the hedged transaction is recognised. The amount is recognised in the same item as the hedged transaction.

**FINANCIAL RISK MANAGEMENT POLICY AND STRATEGY**

The Group manages financial risks based on financial strategies and policies approved by the Board of Directors.

As a general policy, the Group is not allowed to engage in financial transactions or manage risk exposures that are not related to the underlying business driven risks, and consequently the Group does not enter into any speculative transactions.

The Group's financial risks must be managed with the aim of protecting the value and financial stability of the Group, taking into consideration the cost and accounting consequences of such transactions.

The risk management activities of the Group are managed centrally by Group Treasury and primarily involve the following different financial risks.

NOTE 4.2

# FINANCIAL RISKS AND INSTRUMENTS (CONTINUED)

## FINANCIAL RISKS

**FOREIGN EXCHANGE RISK**

Fluctuating currency rates influence the Group's reported income statement, balance sheet and value of future cash flows denominated in foreign currencies.

Foreign exchange exposure in the Group consists of two types of risk (a) translation risk and (b) transaction risk.

**TRANSLATION RISK**

Translation risk arises from the translation of subsidiaries' income statement and net assets into DKK. The single most significant currency is USD.

The Group does not hedge with financial contracts against translation effects, although borrowings in currencies other than DKK are used to partly mitigate translation risk.

**TRANSACTION RISK**

Transaction risk arises from cash flows in currencies other than the functional currencies of the Group's subsidiaries. Transaction risk is as a general rule not hedged with financial contracts as the impact from transaction risks is considered to be within the Group's risk appetite.

The Group closely monitors foreign exchange risk mainly related to the following currencies: USD, NOK, SEK, GBP, CAD, AUD, RUB and IDR. The Group considers both DKK and EUR as base currencies due to the historically fixed currency band between DKK and EUR.

A 5% increase/decrease in the USD rate versus DKK and EUR would impact net earnings before tax positively/negatively by DKK 2.5 million (DKK 0.1 million) and impact other comprehensive income positively/negatively by DKK 1.0 million (DKK 0.7 million) arising from financial assets and liabilities. The sensitivity analysis does not include financial assets and liabilities in the functional currency of the Group's subsidiaries and translation risk from consolidation of income statement.

**INTEREST RATE RISK**

Fluctuating interest rates influence the Group's income statement, balance sheet and the present value of future cash flows resulting from changes in interest rates. The objective of actively managing the Group's interest rate exposure is to maintain the interest rate risk at a known and acceptable level and to minimise the Group's cost of borrowing requirements.

The Group's consolidated interest rate risk is measured at group level only.

The Group has an active approach to managing the interest rate risk.

Types of interest rate risks: Cash flow risk, where future cash flows is uncertain due to future interest rate movements. Fair value risk, where the underlying asset or liability's value is impacted by the future interest rate level.

It is the aim of the Group to hedge its known and certain interest rate exposures. Cash flow risk is hedged while Fair value risk is not hedged. Therefore, the Group only actively hedges the floating rate interest payments on long term debt, meaning term loans with a maturity exceeding one year. The cash flow risk on these term loans are hedged up to 100%.

Hedging instruments: Hedging of the ineterst exposure is mitigated via financial derivatives where there is a direct economic relation to the underlying risk – Interest rate fluctuations. The Group therefore engage in interest derivatives such as interest rate swaps (IR swap), with the aim to hedge the cash flow risk arising from paying floating interest on underlying term loans. IR swap, is an agreement where STG exchange futures payments flows from either floating rate denominated interest payments for a fixed rate interest payment for a given period or vice versa. Thus by engaging in an IRS, STG then effectually exchanges its floating denominated interest payments to a fixed rate and thus mitigate the uncertainty regarding interest rate movements effect on loan payments. STG use IR swap to fix the future interest rates via matching the floating interest on the loan in exchange for a fixed rate for the reminder of the hedged period.

As long as the fixing rate and terms on the floating leg of IR swap and loan are the same the hedge will be 100% effective.

Ineffectiveness in the hedge arises from deviations in underlying terms between the loan and IR swap. Sources of ineffectiveness are mismatch in terms, such as a floor or cap on the interest in either the loan or hedge. In such case, a miss match in terms, then this will result in ineffectiveness which will impact the income statement as described under Hedge Accounting.

As at the balance sheet date, the Group has interest rate swap agreements totalling a notional amount of EUR 225.0 million (EUR 225.0 million) and USD 150.0 million (USD 150.0 million), which relates to bank loans.

Ineffectiveness has impacted the income statement by a cost of DKK 3.3m (DKK 0.0m).

NOTE 4.2

# FINANCIAL RISKS AND INSTRUMENTS (CONTINUED)

Assuming the current portfolio of swap contracts remains the same, an increase in the EUR and USD rate of interest by one percentage point would impact (before tax) other comprehensive income positively by DKK 52.1 million (DKK 38.7 million) and DKK 45.6 million (DKK 41.4 million), respectively and a positive impact on the financial items of DKK 17.1 million (DKK 34.1 million).

**CREDIT RISK**

The Group's credit risk is primarily related to receivables, bank deposits and derivative financial instruments and can be divided into two main risk types.

**OPERATIONAL CREDIT RISK**

The Group's balance sheet at 31 December 2017 included trade receivables with a net book value of DKK 712.8 million (DKK 700.4 million), representing a gross receivable balance of DKK 755.9 million (DKK 722.5 million) and a bad debt provision of DKK 43.1 million (DKK 22.1 million), based on the expected credit loss model (ECL). The ECLs on trade receivables are estimated by using a matrix by reference to geography, past default experience, analysis of the debtor's current financial position, adjusted for factors that are specific to the debtors, general economic conditions in which the debtors operate and an assessment of the forecast direction of developments at the reporting date.

In addition, overdue but not impaired receivables as at 31 December 2017 which have not been written down totalled DKK 183.4 million (DKK 194.0 million). Please refer to note 3.4.

The Group's net sales primarily comprise sales of tobacco to different distributors and retailers. The Group has historically experienced limited risk with regard to the solvency of its customers. As part of the Group's internal procedures regarding risk management, the operational credit risk relating to customers is monitored on a monthly basis. The Group has no significant concentration of credit exposure as the exposure has been spread on a large number of creditworthy trading partners.

**FINANCIAL CREDIT RISK**

Financial credit risk management has the objective of minimising financial loss through a financial distress or the default of a financial counterparty whether due to the financial insolvency of the counterparty, the inability of the counterparty to perform due to changed national legislation or any other circumstance.

The Group's exposure to counterparty risk is managed by establishing approved counterparty limits detailing the maximum exposure that the Group is prepared to accept with respect to the individual counterparty.

In the event of bankruptcy among the lending banks, the Group has in accordance with the Danish Bankruptcy Act the right to offset cash deposits in the counterparty bank debt totalling DKK 7.9 million at 31 December 2017 (DKK 45.0 million).

**LIQUIDITY RISK**

The Group ensures the availability of the required liquidity through a combination of cash management and uncommitted as well as committed credit facilities. To centralise and optimise liquidity the Group utilises cash pooling in addition to inter-company lending and borrowing as well as currency swaps.

The Group has a committed revolving credit facility of EUR 155.0 million (EUR 155.0 million), which matures in 2021 and 2022 with EUR 51.7 million and EUR 103.3 million, respectively. The undrawn amount of the credit facility at 31 December 2017 was EUR 155.0 million (EUR 155.0 million).

To reduce refinancing risk the Group ensures that term loans and committed credit facilities are split between providers and that maturity dates are diversified.

NOTE 4.2

# FINANCIAL RISKS AND INSTRUMENTS (CONTINUED)

| Maturity at 31 december 2017 | 0-1 Year | 2-5 Years | After 5 years | Total* | Fair value level 2** | Carrying amount |
|---|---|---|---|---|---|---|
| **LIQUIDITY** | | | | | | |
| **Recognised at amortised cost** | | | | | | |
| Financial institutions | 34.6 | 2,701.4 | | 2,736.0 | 2,694.2 | 2,606.3 |
| Trade payables | 365.4 | | | 365.4 | | 365.4 |
| Other liabilities | 493.2 | | | 493.2 | | 493.2 |
| **Total** | **893.2** | **2,701.4** | **0.0** | **3,594.6** | | **3,464.9** |
| **Recognised at fair value** | | | | | | |
| Interest rate swaps | 17.6 | 46.3 | | 63.9 | 31.0 | 31.0 |
| Currency swaps | 5.4 | | | 5.4 | 5.4 | 5.4 |
| **Total** | **23.0** | **46.3** | **0.0** | **69.3** | | **36.4** |
| **Total financial liabilities** | **916.2** | **2,747.7** | **0.0** | **3,663.9** | | **3,501.3** |
| **Recognised at amortised cost** | | | | | | |
| Cash and cash equivalents | 605.2 | | | 605.2 | | 605.2 |
| Trade receivables | 712.8 | | | 712.8 | | 712.8 |
| Other receivables | 70.8 | | | 70.8 | | 70.8 |
| **Total** | **1,388.8** | **0.0** | **0.0** | **1,388.8** | | **1,388.8** |
| **Recognised at fair value** | | | | | | |
| Interest rate swaps | 1.3 | 3.5 | | 4.8 | 28.4 | 28.4 |
| Forward contracts | 0.1 | | | 0.1 | 0.1 | 0.1 |
| **Total** | **1.4** | **3.5** | **0.0** | **4.9** | | **28.5** |
| **Total financial assets** | **1,390.2** | **3.5** | **0.0** | **1,393.7** | | **1,417.3** |

* All cash flows are non-discounted and include all liabilities according to contracts. The DKK values of future interest and principal of loans in foreign currencies are calculated based on the rates at the balance sheet date.

** The fair value of the financial liabilities is the present value of the expected future instalments and interest payments except for trade payables, other liabilities, receivables and other receivables which are stated at the net carrying amount at year-end.

NOTE 4.2

# FINANCIAL RISKS AND INSTRUMENTS (CONTINUED)

| Maturity at 31 december 2016 | 0-1 Year | 2-5 Years | After 5 years | Total* | Fair value level 2** | Carrying amount |
|---|---|---|---|---|---|---|
| **LIQUIDITY** | | | | | | |
| **Recognised at amortised cost** | | | | | | |
| Financial institutions | 33.1 | 2,854.7 | | 2,887.8 | 2,839.5 | 2,730.7 |
| Trade payables | 385.5 | | | 385.5 | | 385.5 |
| Other liabilities | 550.3 | 26.6 | | 576.9 | | 576.9 |
| **Total** | **968.9** | **2,881.3** | **0.0** | **3,850.2** | | **3,693.1** |
| **Recognised at fair value** | | | | | | |
| Interest rate swaps | 23.1 | 41.2 | | 64.3 | 55.7 | 55.7 |
| Currency swaps | 7.9 | | | 7.9 | 7.9 | 7.9 |
| **Total** | **31.0** | **41.2** | **0.0** | **72.2** | | **63.6** |
| **Total financial liabilities** | **999.9** | **2,922.5** | **0.0** | **3,922.4** | | **3,756.7** |
| **Recognised at amortised cost** | | | | | | |
| Cash and cash equivalents | 570.3 | | | 570.3 | | 570.3 |
| Trade receivables | 700.4 | | | 700.4 | | 700.4 |
| Other receivables | 98.3 | | | 98.3 | | 98.3 |
| **Total** | **1,369.0** | **0.0** | **0.0** | **1,369.0** | | **1,369.0** |
| **Recognised at fair value** | | | | | | |
| Interest rate swaps | 6.0 | 22.4 | | 28.4 | 17.7 | 17.7 |
| Forward contracts | 0.9 | | | 0.9 | 0.9 | 0.9 |
| **Total** | **6.9** | **22.4** | **0.0** | **29.3** | | **18.6** |
| **Total financial assets** | **1,375.9** | **22.4** | **0.0** | **1,398.3** | | **1,387.6** |

* All cash flows are non-discounted and include all liabilities according to contracts. The DKK values of future interest and principal of loans in foreign currencies are calculated based on the exchange rate as at the balance sheet date.

** The fair value of the financial liabilities is the present value of the expected future instalments and interest payments except for trade payables, other liabilities, receivables and other receivables which are stated at the net carrying amount at year-end.

NOTE 4.2

# FINANCIAL RISKS AND INSTRUMENTS (CONTINUED)

Financial instruments measured at fair value are broken down according to the following measuring hierarchy:

Level 1: Observable market prices of identical instruments

Level 2: Valuation models primarily based on observable prices or traded prices of comparable instruments

Level 3: Valuation models primarily based on non-observable prices

The fair value of the Group's forward exchange contracts and other derivative financial instruments (interest rate and currency swaps) are considered a level 2 fair value measurement as the fair value is determined directly based on the published exchange rates and quoted swap and forward rates on the balance sheet date. There are no financial instruments in level 3 (none).

**HEDGING TRANSACTIONS**

The net fair value as at 31 December 2017 of outstanding derivative contracts was negative by DKK 2.6 million (negative by DKK 37.1 million of which DKK 0.9 million was related to currency forward contracts, while negative DKK 38.0 million was related to interest rate swaps), all related to interest rate swaps. Income statement was impacted by DKK 3.3 million related to the ineffectiveness part of interest rate swaps.

Interest rate swaps have been used to hedge the floating rate on bank loans. As at the balance sheet date, the Group has outstanding interest rate swaps with a notional amount of EUR 225.0 million and USD 150.0 million (EUR 225.0 million and USD 150.0 million). Interest rate swaps follow the maturity profile of the bank term loans (see note 4.1).

The net fair value stated will be transferred from the reserve for hedging (other comprehensive income) to the income statement when the hedged transactions are realised.

**OTHER TRANSACTIONS**

The Group uses financial transactions which do not qualify as hedge accounting according to IFRS.

Currency swaps are used to manage group liquidity over the short term. The net fair value as at 31 December 2017 of outstanding currency swaps was negative by DKK 5.3 million (negative by DKK 7.9 million). As at the balance sheet date, the Group has outstanding currency swaps with a notional amount of DKK 863.7 million (DKK 876.0 million).

NOTE 4.3

# FINANCIAL FIXED ASSETS

## 2017

| DKK million | Investments in associated companies |
|---|---|
| Cost at 1 January 2017 | 92.6 |
| Addition | 0.0 |
| Deduction | 0.0 |
| Accumulated cost at 31 December 2017 | 92.6 |
| | |
| Accumulated revaluation and impairment at 1 January 2017 | 42.0 |
| Dividends | -6.8 |
| Currency translation | -16.2 |
| Profit after tax | 16.1 |
| Accumulated revaluation and impairment at 31 December 2017 | 35.1 |
| | |
| **Carrying amount at 31 December 2017** | **127.7** |

Other financial fixed assets amount to DKK 20.6m (DKK 0.0 million) and comprise non-current part of the positive marketvalue of financial instruments.

## 2016

| DKK million | Investments in associated companies | Other |
|---|---|---|
| Cost at 1 January 2016 | 92.6 | 0.5 |
| Addition | 0.0 | 0.0 |
| Deduction | 0.0 | -0.5 |
| Accumulated cost at 31 December 2016 | 92.6 | 0.0 |
| | | |
| Accumulated revaluation and impairment at 1 January 2016 | 33.5 | 0.1 |
| Dividend | -6.3 | 0.0 |
| Currency translation | 4.4 | -0.1 |
| Profit after tax | 10.4 | 0.0 |
| Accumulated revaluation and impairment at 31 December 2016 | 42.0 | 0.0 |
| | | |
| **Carrying amount at 31 December 2016** | **134.6** | **0.0** |

§

### ACCOUNTING POLICIES

Investments in associated companies are recognised and measured under the equity method.

The item 'Investments in associated companies' in the balance sheet includes the proportionate ownership share of the net asset value of the enterprises with deduction or addition of unrealised intercompany profits or losses and with addition of any remaining value of positive differences (goodwill) and deduction of any remaining value of negative differences (negative goodwill) calculated on the basis of the fair values of identifiable net assets at the time of acquisition.

The item 'Share of profit of associated companies, net of tax' in the income statement includes the proportionate share of the profit after tax for the year regarding the associated companies.

NOTE 4.3

# FINANCIAL FIXED ASSETS (CONTINUED)

## NAME AND COUNTRY OF INCORPORATION

Caribbean Cigar Holdings Group Co. S.A, Panama

| DKK million | 2017 | 2016 |
|---|---|---|
| **Profit & loss** | | |
| Revenue | 342.6 | 379.1 |
| Profit for the year | 79.4 | 52.0 |
| Other comprehensive income | 0.0 | 0.0 |
| **Total comprehensive income** | **79.4** | **52.0** |
| **Financial position** | | |
| Non-current assets | 43.2 | 37.8 |
| Current assets | 429.3 | 461.4 |
| Non-current liabilities | 1.3 | 2.1 |
| Current liabilities | 64.9 | 86.8 |
| % Interest held | 20% | 20% |

The financial information stated above is based on estimates.

| Reconciliation carrying amount | 2017 | 2016 |
|---|---|---|
| Scandinavian Tobacco Group's share of Caribbean Cigar Holdings Group's equity | 81.2 | 82.1 |
| Goodwill concerning Caribbean Cigar Holdings Group | 51.3 | 58.2 |
| Elimination of internal profit | -4.8 | -5.7 |
| **Carrying amount at 31 December** | **127.7** | **134.6** |

NOTE 4.4

# FINANCIAL INCOME AND COSTS

| DKK million | 2017 | 2016 |
|---|---|---|
| **FINANCIAL INCOME** | | |
| Interest on deposits in financial institutions etc. | 3.3 | 3.4 |
| Exchange gains, net | 15.2 | 26.6 |
| Other financial income | 5.0 | 2.8 |
| **Total** | **23.5** | **32.8** |

| DKK million | 2017 | 2016 |
|---|---|---|
| **FINANCIAL COSTS** | | |
| Interest to financial institutions etc. | 67.2 | 80.6 |
| Interest part of pension cost | 9.0 | 10.0 |
| Exchange losses, net | 10.2 | 2.8 |
| Other financing costs | 14.5 | 11.7 |
| **Total** | **100.9** | **105.1** |

Interest on debt to financial institutions etc. includes realisation of previously deferred losses from interest rate swaps of DKK 26.8 million (DKK 41.3 million).

Other financing costs include discounting effect of provisions of DKK 0.7 million (DKK 1.0 million) and ineffectiveness of interest rate swaps of DKK 3.3 million (DKK 0.0 million).

§

## ACCOUNTING POLICIES

Financial income and costs comprise interests, realised and unrealised exchange adjustments, hedging costs, interest part of pension costs and other financial income and costs.

## NOTE 4.5

# SHARE CAPITAL, TREASURY SHARES, DIVIDEND AND EARNINGS PER SHARE

### Development in share capital:

| DKK million | |
|---|---|
| 2013-2016 | 0.0 |
| **At the beginning of the year** | **100.0** |
| 2017 | 0.0 |
| **At the end of the year** | **100.0** |

The share capital consists of 100,000,000 shares of a nominal value of DKK 1. No shares carry any special rights.

| Treasury shares: | Nominal value (DKK million) | Number of shares (in thousands) | Purchase price (DKK million) | % of share capital |
|---|---|---|---|---|
| Treasury shares at 1 January 2017 | 0.4 | 412 | 45.5 | 0.4 |
| Addition | 0.0 | 0 | 0.0 | 0.0 |
| Settlement of vested PSU's | -0.0 | -45 | -5.0 | -0.0 |
| **Treasury shares at 31 December 2017** | **0.4** | **367** | **40.5** | **0.4** |

The market value of treasury shares at 31 December 2017 was DKK 44.1 million (DKK 49.0 million).

The holding of treasury shares are regarded as hedge for the share-based incentive prgrammes.

According to the authorisation of the General Meeting, the Board of Directors may allow the Company to acquire treasury shares up to a total holding of 10% of the nomimal share capital at a price quoted on Nasdaq Copenhagen at the time of acquisition with a deviation of up to 10%. In addition, the Board of Directors is authorised to increase the share capital b y up to 10%. The authorisation to the Board of Directors will be in force until 31 December 2020.

NOTE 4.5

# SHARE CAPITAL, TREASURY SHARES, DIVIDEND AND EARNINGS PER SHARE (CONTINUED)

| | Dividend | Per share |
|---|---|---|
| **Net cash distribution to shareholders (dividend):** | **DKK million** | **DKK** |
| 2013 (proposed dividend in 2012 Annual Report) | 412.0 | 4.1 |
| 2014 (proposed dividend in 2013 Annual Report) | 382.0 | 3.8 |
| 2015 (proposed dividend in 2014 Annual Report) | 427.0 | 4.3 |
| 2015 (extraordinary dividend) | 900.0 | 9.0 |
| 2016 (proposed dividend in 2015 Annual Report) | 500.0 | 5.0 |
| 2017 (proposed dividend in 2016 Annual Report) | 550.0 | 5.5 |
| 2017 (extraordinary dividend) | 350.0 | 3.5 |

Retained earnings end of 2017 include proposed dividend of DKK 575 million (DKK 5.8 per share).

**Earnings per share:**

Earnings per share is presented as both basic and diluted earnings per share. Basic earnings per share is calculated as net profit divided by the average number of shares outstanding. Diluted earnings per share is calculated as net profit divided by the sum of average number of shares outstanding, including the dilutive effect of outstanding share bonus programmes. Please refer to note 5.7 'Explanation of financial ratios' for a description of the calculation of basic and diluted earnings per share.

| DKK million | 2017 | 2016 |
|---|---|---|
| Net profit for the year | 711.6 | 681.5 |
| Average number of shares outstanding (in 1,000 shares) | 100,000 | 100,000 |
| Average number of treasury shares (in 1,000 shares) | -379 | -225 |
| Average number of shares - basic (in 1,000 shares) | 99,621 | 99,775 |
| Dilutive effect of outstanding PSUs (in 1,000 shares) | 113 | 97 |
| Average number of shares outstanding, including dilutive effect of PSUs (in 1,000 shares) | 99,735 | 99,872 |
| Basic earnings per share (DKK) | 7.1 | 6.8 |
| Diluted earnings per share (DKK) | 7.1 | 6.8 |

NOTE 4.6
# CHANGES IN WORKING CAPITAL (CASH FLOW STATEMENT)

| DKK million | 2017 | 2016 |
|---|---|---|
| Change in receivables | -33.9 | 92.8 |
| Change in inventories | 263.0 | 256.9 |
| Change in liabilities | -61.0 | -26.4 |
| **Total** | **168.1** | **323.3** |

## ACCOUNTING POLICIES

Working capital is defined as current assets less current liabilities. It measures how much in liquid assets the Group has available for the business.

NOTE 4.7
# NET INTEREST-BEARING DEBT

| DKK million | 2017 | 2016 |
|---|---|---|
| Interest-bearing liabilities, net | 2,614.2 | 2,775.7 |
| Pensions | 237.8 | 263.8 |
| Cash equivalents | -605.2 | -570.3 |
| **Total** | **2,246.8** | **2,469.2** |

### Financial Policy

According to the financial policy, the Group has a leverage ratio target of 2.5 (measured as net interest-bearing debt divided by adjusted EBITDA) while maintaining flexibility to increase leverage temporarily, for example to pursue acquisitions. At 31 December 2017 the ratio was 1.8 (1.7).

NOTE 4.8
# CHANGES IN FINANCING LIABILITIES

| DKK million | 2017 | 2016 |
|---|---|---|
| Balance at 1 January | 2,730.7 | 3,337.9 |
| Exchange rate adjustment | -124.4 | 25.0 |
| Instalment and repayment | 0.0 | -632.2 |
| **Carrying amount at 31 December** | **2,606.3** | **2,730.7** |

# SECTION 5
# OTHER DISCLOSURES

This section includes other statutory notes or notes that are of secondary importance for understanding the financial performance of the Group.

NOTE 5.1
# CASH FLOW ADJUSTMENTS

For the purpose of presenting the cash flow statement, non-cash items with effect on the income statement must be reversed to identify the actual cash flow effect from the income statement. The adjustments are specified as follows:

| DKK million | 2017 | 2016 |
|---|---|---|
| Financial items | 77.4 | 72.3 |
| Share of profit of associated companies, net of tax | -16.1 | -10.4 |
| Depreciation and impairment | 148.2 | 154.5 |
| Amortisation and impairment | 170.5 | 167.2 |
| Income taxes | 140.1 | 213.4 |
| (Gains)/losses from sale of property, plant and equipment | -13.4 | -4.6 |
| Non-recurring costs, paid | 122.3 | 134.8 |
| Other provisions movement | -89.1 | 87.4 |
| Bad debt allowance and provision for obselete stock movements | -2.5 | -39.0 |
| Other adjustments | -38.8 | -33.3 |
| **Total** | **498.7** | **742.3** |

NOTE 5.2
# CONTINGENT LIABILITIES

### LEASE OBLIGATIONS
The Group has entered into operating lease agreements for offices and warehouses, cars and equipment. The lease terms are between 1 and 10 years, and the majority of the lease agreements are renewable at the end of the lease period at market rate.

| DKK million | 2017 | 2016 |
|---|---|---|
| Lease expenditures charged to the income statement during the year | 117.7 | 127.1 |
| **Future minimum lease payment under operating lease contracts and rent commitments amounts to:** | | |
| Within 1 year | 87.8 | 93.9 |
| Between 1 and 5 years | 125.3 | 131.0 |
| After 5 years | 6.0 | 13.4 |
| **Total** | **219.2** | **238.3** |

### GUARANTEE OBLIGATIONS
The Group has (via 3rd parties) issued guarantees totalling DKK 539.8 million (DKK 545.8 million), primarily issued towards local tax authorities in relation to excise and tax stamps.

### LAWSUITS ETC.
From time to time the Group faces legal claims and disputes as part of the ordinary course of business, mainly related to employees and trademarks. At present there are no ongoing legal actions, claims or disputes that represent any material risk to the future financial results of the Group.

### DISCLOSURE REGARDING CHANGE OF CONTROL
The Group's loan facilities are subject to change-of-control clauses.

The Group's investment in associated companies is subject to change-of-control clauses.

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## ACCOUNTING POLICIES

All leases are classified as operating leases. Payments made under operating leases are recognised in the income statement on a straight-line basis over the lease term.

NOTE 5.3

# RELATED-PARTY TRANSACTIONS

Related parties comprise companies controlled by the Augustinus Foundation, key management and Caribbean Cigar Holdings Group Co. S.A. Key management are Scandinavian Tobacco Group A/S' Board of Directors and Executive Board as well as management in the controlling companies.

The Group has had the following material transactions with related parties, income/expense (+/-):

| DKK million | 2017 | 2016 |
|---|---|---|
| **Swedish Match AB (significant influence from key management until 7 December 2017)** | | |
| Purchase of products by Scandinavian Tobacco Group | -87.8 | -77.2 |
| Sale of products from Scandinavian Tobacco Group | 75.7 | 68.0 |
| **Caribbean Cigar Holdings Group Co. S.A (associated company)** | | |
| Purchase of products by Scandinavian Tobacco Group | -46.4 | -34.0 |
| **Skandinavisk Holding A/S (controlled by the Augustinus Foundation)** | | |
| Services provided by Scandinavian Tobacco Group A/S | 2.5 | 2.5 |
| **Tivoli (controlled by the Augustinus Foundation)** | | |
| Purchase of products and sponsorship | -0.5 | -0.6 |

For information on remuneration to the Management of Scandinavian Tobacco Group A/S, please refer to note 2.2 and note 2.3. For an overview of Group companies, please refer to note 5.6. There have not been and there are no loans to key management personnel in 2017 or 2016.

Dividends to shareholders have not been included in the above overview.

**OWNERSHIP AND CONSOLIDATED FINANCIAL STATEMENTS**

For information concering major shareholders, please refer to Shareholder information in the Management Report, page 25-26. No major shareholders have controlling influence of STG.

## NOTE 5.4
# EVENTS AFTER THE REPORTING PERIOD

On 31 January 2018 the Group signed an agreement to acquire the business of Thompson and Co. of Tampa, Inc. ("Thompson"). The purchase price amounts to USD 62 million and the acquisition will be financed by existing cash at hand. The closing of the deal is expected to take place by the end of March 2018.

The Group has not experienced any other significant events after 31 December 2017 which have an impact on the annual report.

## NOTE 5.5
# FEE TO STATUTORY AUDITOR

| DKK million | 2017 | 2016 |
|---|---|---|
| Statutory audit | 5.5 | 5.1 |
| Audit-related services | 1.8 | 0.3 |
| Tax advisory services | 1.4 | 2.1 |
| Other services | 0.4 | 1.4 |
| **Total fee to statutory auditors** | **9.1** | **8.9** |

Fees for non-audit services in addition ot the statutory audit of the financial statements, which were provided by PricewaterhouseCoopers Statsautoriseret Revisionspartnerselskab to the Group amounted to DKK 1.7 million. Non-audit services in addition to the statutory audit of the financial statements comprise due diligence services relating to the aquisition of Thompson and Co. of Tampa, Inc., review of interim balance sheet, agreed-upon procedures related to new IT system as well as other general accounting and tax consultancy services.

NOTE 5.6

# ENTITIES IN SCANDINAVIAN TOBACCO GROUP

| | | | Activity | | | |
|---|---|---|---|---|---|---|
| Company | Country | Ownership | Production | Sales and marketing | Administration | Finance |
| **PARENT COMPANY** | | | | | | |
| Scandinavian Tobacco Group A/S | Denmark | – | | ✓ | ✓ | ✓ |
| **SUBSIDIARIES BY REGION** | | | | | | |
| **EUROPE** | | | | | | |
| Bogaert Cigars N.V. | Belgium | 100% | | ✓ | | |
| Scandinavian Tobacco Group Belux N.V. | Belgium | 100% | | ✓ | | |
| Scandinavian Tobacco Group Lummen N.V. | Belgium | 100% | ✓ | | | |
| Scandinavian Tobacco Group Belgium Services N.V. | Belgium | 100% | | | ✓ | |
| Scandinavian Tobacco Group Wuustwezel N.V. | Belgium | 100% | ✓ | | | |
| Scandinavian Tobacco Group Zagreb d.o.o. | Croatia | 100% | | ✓ | | |
| Scandinavian Tobacco Group Assens A/S | Denmark | 100% | ✓ | ✓ | | |
| Scandinavian Tobacco Group Denmark A/S | Denmark | 100% | | ✓ | | |
| Scandinavian Tobacco Group Nykøbing ApS | Denmark | 100% | ✓ | | | |
| STG Finans ApS | Denmark | 100% | | | | ✓ |
| STG Latin Holding ApS | Denmark | 100% | | | ✓ | |
| Peter Stokkebye Tobaksfabrik A/S | Denmark | 100% | | ✓ | | |
| Scandinavian Tobacco Group France S.A.S | France | 100% | | ✓ | | |
| Scandinavian Tobacco Group Deutschland GmbH | Germany | 100% | | ✓ | | |
| Scandinavian Tobacco Group Italy S.R.L. | Italy | 100% | | ✓ | | |
| Scandinavian Tobacco Group Norway AS | Norway | 100% | | ✓ | | |
| STG Portugal S.A. | Portugal | 100% | | ✓ | | |
| Scandinavian Tobacco Group d.o.o. | Slovenia | 100% | | ✓ | | |
| Scandinavian Tobacco Group Spain S.A.U. | Spain | 100% | | ✓ | | |
| Intermatch Sweden AB | Sweden | 100% | | | ✓ | |
| STG Sweden AB | Sweden | 100% | | ✓ | | |
| P.G.C. Hajenius B.V. | The Netherlands | 100% | | ✓ | | |
| Scandinavian Tobacco Group Eersel B.V. | The Netherlands | 100% | ✓ | ✓ | ✓ | |
| Scandinavian Tobacco Group Nederland B.V. | The Netherlands | 100% | | ✓ | | |
| Scandinavian Tobacco Group Tobacco Service B.V. | The Netherlands | 100% | | ✓ | | |
| ST Cigar Group Holding B.V. | The Netherlands | 100% | | | ✓ | |
| STG Finance B.V. | The Netherlands | 100% | | | | ✓ |
| Scandinavian Tobacco Group Bethlehem Holdings B.V. | The Netherlands | 100% | | | ✓ | |
| Scandinavian Tobacco Group Bethlehem Sales B.V. | The Netherlands | 100% | | ✓ | ✓ | |
| Scandinavian Tobacco Group United Kingdom Limited | United Kingdom | 100% | | ✓ | | |
| **ASIA** | | | | | | |
| Scandinavian Tobacco Group Hong Kong Limited | Hong Kong | 100% | | ✓ | | |
| PT Scandinavian Tobacco Group Indonesia | Indonesia | 100% | ✓ | | | |
| **AUSTRALIA AND NEW ZEALAND** | | | | | | |
| Scandinavian Tobacco Group Australia Pty Ltd | Australia | 100% | | ✓ | | |
| Scandinavian Tobacco Group New Zealand Ltd | New Zealand | 100% | | ✓ | | |
| **AFRICA** | | | | | | |
| Scandinavian Tobacco Nigeria Ltd. | Nigeria | 100% | | | ✓ | |

NOTE 5.6

# ENTITIES IN SCANDINAVIAN TOBACCO GROUP (CONTINUED)

| | | | Activity | | | |
|---|---|---|---|---|---|---|
| Company | Country | Ownership | Production | Sales and marketing | Administration | Finance |
| **AMERICA** | | | | | | |
| Scandinavian Tobacco Group Canada Holding Inc. | Canada | 100% | | | ✓ | |
| Scandinavian Tobacco Group Canada Inc. | Canada | 100% | | ✓ | | |
| General Cigar Dominicana S.A.S. | The Dominican Republic | 100% | ✓ | | | |
| Honduras American Tabaco SA de CV | Honduras | 100% | ✓ | | | |
| Scandinavian Tobacco Group Danli S.A. | Honduras | 100% | ✓ | | | |
| Scandinavian Tobacco Group Esteli, S.A. | Nicaragua | 100% | ✓ | | | |
| Scandinavian Tobacco Group Moca S.A. | Panama | 100% | ✓ | | | |
| Scandinavian Tobacco Group US Holding, Inc. | United States | 100% | | | ✓ | |
| General Cigar Co., Inc. | United States | 100% | | ✓ | | |
| Cigar Masters Inc. | United States | 100% | | ✓ | | |
| General Cigar Sales Co., Inc. | United States | 100% | | ✓ | | |
| GCMM Co., Inc. | United States | 100% | | ✓ | | |
| Club Macanudo (Chicago), Inc. | United States | 100% | | ✓ | | |
| Club Macanudo, Inc. | United States | 100% | | ✓ | | |
| Henri Wintermans Cigars USA, Inc. | United States | 100% | | | ✓ | |
| Schell Acquistion Inc. | United States | 100% | | ✓ | | |
| M&D Wholesale Distributors, Inc. | United States | 100% | | ✓ | | |
| Bethlehem Shared Services, LLC | United States | 100% | | | ✓ | |
| Bethlehem Sales, LLC | United States | 100% | | | ✓ | |

| | | | Activity | | | |
|---|---|---|---|---|---|---|
| Company | Country | Ownership | Production | Sales and marketing | Administration | Finance |
| BPA Sales, LP | United States | 100% | | ✓ | | |
| Bethlehem IP Holdings, LLC | United States | 100% | | ✓ | | |
| Scandinavian Tobacco Group Lane Holding, Inc. | United States | 100% | | | ✓ | |
| Scandinavian Tobacco Group Lane Ltd | United States | 100% | ✓ | ✓ | | |
| Cigar Smokers Restaurant Holdings, Inc. | United States | 100% | | | ✓ | |
| Cigars International Texas, LLC | United States | 100% | | ✓ | | |
| Bethlehem Restaurant Corporation, Inc. | United States | 100% | | ✓ | | |
| CI Hamburg Superstore Lounge, LLC | United States | 100% | | ✓ | | |

NOTE 5.7

# EXPLANATION OF FINANCIAL RATIOS

**GROSS MARGIN** = Gross profit / Net sales

**EBIT MARGIN** = EBIT / Net sales

**CASH CONVERSION** = CFFO before interest and tax, excluding payment of non-recurring items - Maintenance CAPEX / Adjusted operating profit (Adjusted EBITA)

**NET INTEREST-BEARING DEBT** = Interest-bearing liabilites and pensions less cash equivalents and interest-bearing receivables

* Average invested capital comprises intangible assets, property, plant and equipment, inventories, receivables (excluding receivables recognised at fair value) and prepayments less trade creditors, provisions and other liabilities (excluding other liabilities recognised at fair value).

** Scandinavian Tobacco Group was established in 2010 through a merger, where assets and liabilities were distributed at fair value to the Group. Consequently, non-recognised goodwill and trademarks were recognised in the balance sheet of the Group.

**BASIC EARNINGS PER SHARE** = Net profit / Average number of shares outstanding

**DIVIDEND PER SHARE** = Proposed and interim dividend / Average number of shares outstanding

**EBITDA MARGIN** = EBITDA / Net sales

**TAX PERCENTAGE** = Tax / Profit before tax

**EQUITY RATIO** = Equity / Total assets

**ROIC** = EBIT / 12 months average invested capital*

**ROIC EX. GOODWILL AND TRADEMARKS FROM 2010 MERGER*** = EBIT / 12 months average invested capital** ex. goodwill and trademarks from 2010 merger

**DILUTED EARNINGS PER SHARE** = Net profit / Average number of shares outstanding + dilutive effect of the outstanding performance stock units (PSUs)

**PAY-OUT RATIO** = Proposed and interim dividend / Net profit

# FINANCIAL STATEMENTS

## THE PARENT COMPANY

# CONTENTS

# INCOME STATEMENT - PARENT COMPANY

## 1 JANUARY - 31 DECEMBER

| DKK million | Note | 2017 | 2016 |
|---|---|---|---|
| **Other income** | | **224.8** | **261.6** |
| Other external costs | | -122.2 | -115.0 |
| Staff costs | 2 | -115.9 | -119.4 |
| **Earnings before interest, tax, depreciation and amortisation (EBITDA)** | | **-13.3** | **27.2** |
| Depreciation | 3 | -0.6 | -2.2 |
| **Earnings before interest, tax and amortisation (EBITA)** | | **-13.9** | **25.0** |
| Amortisation | 3 | -11.5 | -8.6 |
| **Earnings before interest and tax (EBIT)** | | **-25.4** | **16.4** |
| Result of investments in affiliated companies, net of tax | 4 | 435.2 | 383.4 |
| Financial income | 5 | 91.3 | 81.9 |
| Financial costs | 6 | -99.8 | -94.6 |
| **Profit before tax** | | **401.3** | **387.1** |
| Income taxes | 7 | 8.4 | -2.4 |
| **Net profit for the year** | | **409.7** | **384.7** |

| DKK million | Note | 2017 | 2016 |
|---|---|---|---|
| **DISTRIBUTION OF PROFIT** | | | |
| **Proposed distribution of profit:** | | | |
| Proposed dividend | | 575.0 | 550.0 |
| Reserve for retained earnings - equity method | | 0.0 | 0.0 |
| Retained earnings | | -165.3 | -165.3 |
| **Total** | | **409.7** | **384.7** |

# BALANCE SHEET AT 31 DECEMBER - PARENT COMPANY

| DKK million | Note | 2017 | 2016 |
|---|---|---|---|
| **ASSETS** | | | |
| Other intangible assets | | 41.6 | 40.6 |
| **Intangible assets** | **8** | **41.6** | **40.6** |
| Leasehold improvements | | 0.0 | 0.6 |
| **Property, plant and equipment** | **9** | **0.0** | **0.6** |
| Investments in affiliated companies | 10 | 10,309.9 | 10,706.5 |
| Other financial fixed assets | | 20.6 | 0.0 |
| **Financial fixed assets** | | **10,330.5** | **10,706.5** |
| **Fixed assets** | | **10,372.1** | **10,747.7** |
| Receivables from affiliated companies | | 2,776.1 | 2,973.3 |
| Other receivables | | 10.5 | 21.9 |
| Income tax receivable | | 56.1 | 84.3 |
| Prepayments | 11 | 24.1 | 23.3 |
| **Total receivables** | | **2,866.8** | **3,102.8** |
| **Cash and cash equivalents** | | **475.9** | **351.2** |
| **Current Assets** | | **3,342.7** | **3,454.0** |
| **Assets** | | **13,714.8** | **14,201.7** |

| DKK million | Note | 2017 | 2016 |
|---|---|---|---|
| **EQUITY, PROVISIONS AND LIABILITIES** | | | |
| Share capital | | 100.0 | 100.0 |
| Retained earnings | | 5,932.4 | 6,942.1 |
| Treasury shares | | -40.5 | -45.5 |
| Proposed dividend | | 575.0 | 550.0 |
| **Equity** | | **6,566.9** | **7,546.6** |
| Deferred income tax liabilities | 7 | 8.5 | 48.6 |
| Other provisions | 12 | 4.7 | 4.7 |
| **Provisions** | | **13.2** | **53.3** |
| Bank loans | | 2,606.3 | 2,730.7 |
| Other liabilities | | 22.4 | 26.6 |
| **Long-term liabilities** | | **2,628.7** | **2,757.3** |
| Liabilities to affiliated companies | | 4,396.0 | 3,703.5 |
| Trade creditors | | 45.3 | 38.0 |
| Other liabilities | | 64.7 | 103.0 |
| **Current liabilities** | | **4,506.0** | **3,844.5** |
| **Liabilities** | | **7,134.7** | **6,601.8** |
| **Equity, provisions and liabilities** | | **13,714.8** | **14,201.7** |
| Contingent liabilities | 13 | | |
| Financial instruments | 14 | | |
| Related-party transations | 15 | | |
| Fee to statutory auditor | 16 | | |
| Ownership | 17 | | |

# STATEMENT OF CHANGES IN EQUITY - PARENT COMPANY

## 1 JANUARY - 31 DECEMBER

| DKK million | Share capital | Retained earnings | Treasury shares | Proposed dividend | Total |
|---|---|---|---|---|---|
| Equity at 1 January 2017 | 100.0 | 6,942.1 | -45.5 | 550.0 | 7,546.6 |
| Cash flow hedges | - | 42.1 | - | - | 42.1 |
| Tax of cash flow hedges | - | -10.6 | - | - | -10.6 |
| Purchase of treasury shares | - | - | 0.0 | - | 0.0 |
| Share-based payments | - | 2.1 | - | - | 2.1 |
| Settlement of vested PSUs | - | -5.0 | 5.0 | - | 0.0 |
| Equity movement in subsidiaries | - | 7.1 | - | - | 7.1 |
| Foreign exchange adjustments of net investments in foreign subsidiaries | - | -533.4 | - | - | -533.4 |
| Dividend paid to shareholders | - | -350.0 | - | -550.0 | -900.0 |
| Dividend, treasury shares | - | 3.3 | - | - | 3.3 |
| Profit / loss for the year | - | -165.3 | - | 575.0 | 409.7 |
| **Equity at 31 December 2017** | **100.0** | **5,932.4** | **-40.5** | **575.0** | **6,566.9** |

| DKK million | Share capital | Retained earnings | Treasury shares | Proposed dividend | Total |
|---|---|---|---|---|---|
| Equity at 1 January 2016 | 100.0 | 7,000.9 | 0.0 | 500.0 | 7,600.9 |
| Cash flow hedges | - | 3.6 | - | - | 3.6 |
| Tax of cash flow hedges | - | -0.8 | - | - | -0.8 |
| Purchase of treasury shares | - | - | -45.5 | - | -45.5 |
| Share-based payments | - | 9.4 | - | - | 9.4 |
| Equity movement in subsidiaries | - | -22.5 | - | - | -22.5 |
| Foreign exchange adjustments of net investments in foreign subsidiaries | - | 116.8 | - | - | 116.8 |
| Dividend paid | - | - | - | -500.0 | -500.0 |
| Profit / loss for the year | - | -165.3 | - | 550.0 | 384.7 |
| **Equity at 31 December 2016** | **100.0** | **6,942.1** | **-45.5** | **550.0** | **7,546.6** |

The share capital consists of 100,000,000 shares of a nominal value of DKK 1. No shares carry any special rights. There has been no changes to share capital in the past five years.

# NOTES

NOTE 1

# ACCOUNTING POLICIES

§

The Parent Company has prepared its Financial Statements in accordance with the provisions of the Danish Financial Statements Act (Class D) and other accounting regulations for companies listed on NASDAQ Copenhagen.

The Consolidated Financial Statements have been prepared in accordance with IFRS. The accounting policies applied for the Consolidated Financial Statements regarding recognition and measurement have also been applied for the Parent Company with the below exceptions.

No separate statement of cash flows has been prepared for the Parent Company. Please refer to the Statement of cash flows for the Group.

**Result of investments in affiliated companies, net of tax**

The item 'Result of investments in affiliated companies, net of tax' in the income statement includes the proportionate share of the profit for the year after tax less goodwill amortisation.

**Goodwill**

Goodwill is amortised on a straight-line basis over the estimated useful life determined on the basis of Management's experience with the individual business areas. The maximum amortisation period is 20 years, the longest period applying to enterprises acquired for strategic purposes with a strong market position and a long earnings profile.

**Trademarks**

Trademarks are amortised on a straight-line basis over the estimated useful life determined on the basis of Management's experience. The maximum amortisation period is 20 years, the longest period applying to strategic trademarks with a strong market position and a long earnings profile.

**Investments in affiliated companies**

Investments in affiliated companies are recognised and measured under the equity method.

The item 'Investments in affiliated companies' in the balance sheet includes the proportionate ownership share of the net asset value of the enterprises calculated on the basis of the fair values of identifiable net assets at the time of acquisition with deduction or addition of unrealised intercompany profits or losses and with addition of any remaining value of positive differences (goodwill) and deduction of any remaining value of negative differences (negative goodwill).

The total net revaluation of investments in subsidiaries is transferred upon distribution of profit to 'Reserve for retained earnings – equity method' under equity. The reserve is reduced by dividend distributed to the Parent Company and adjusted for other equity movements in subsidiaries.

**Defined benefit pension plans**

In relation to defined benefit plans, the company follow the requirements in the Danish Financial Statement Act (dated 1 July 2015 for financial statements starting 1 January 2016), meaning that actuarial gains and losses are recognised directly in other comprehensive income instead of directly in the income statement. For the monetary impact, please refer to the statement of changes in equity and note 3.7 "pension obligation" for the group.

**Share based payments**

In relation to share-based payments, the provisions in IFRS 2 have been adopted as the Danish Financial Statements Act does not regulate share-based payments settled via equity instruments, but only cash-settled share-based payments. Derogation from the Danish Financial Statements Act for share based payments means that the year's cost for share-based payments are not recognised as a liability in the balance sheet, but directly in the statement of equity. For the monetary impact, please refer to the statement of changes in equity and note 2 'Staff costs'.

NOTE 2
# STAFF COSTS

| DKK million | 2017 | 2016 |
|---|---|---|
| Salaries | 108.5 | 134.1 |
| Pensions* | 7.4 | -14.3 |
| Social security costs | 0.0 | -0.4 |
| **Total** | **115.9** | **119.4** |
| | | |
| **Average number of employees** | **92** | **84** |

* In 2016 pensions were impacted by curtailments related to conversion of a pension scheme for Executive Management (defined benefit pension plan) converted into a stay-on bonus programme and recognised within salaries. The conversion did not have any net impact on total staff cost for the year.

NOTE 2

# STAFF COSTS (CONTINUED)

**Remuneration of the Board of Directors and Executive Board****

Total fees to the Board of Directors and Executive Board amounted to DKK 47.5 million (DKK 65.4 million).

## 2017

DKK million

| Executive Management | Salary | Bonus | Pension | Stay-on bonus/loyalty programme | Share-based incentive programme | Total |
|---|---|---|---|---|---|---|
| Niels Frederiksen | 6.7 | 0.7 | 0.0 | 3.1 | 0.3 | 10.8 |
| Christian Hother Sørensen | 4.6 | 0.6 | 0.0 | 1.5 | 0.1 | 6.8 |
| Sisse Fjelsted Rasmussen | 3.8 | 0.5 | 0.0 | 1.6 | 0.1 | 6.0 |
| Rob Zwarts*** | 3.9 | 0.1 | 0.2 | 0.0 | 0.4 | 4.6 |
| Vincent Crepy | 3.6 | 0.4 | 0.0 | 0.9 | 0.2 | 5.1 |
| **Total** | **22.6** | **2.3** | **0.2** | **7.1** | **1.1** | **33.3** |
| Other key management | 5.1 | 0.6 | 0.5 | 0.9 | 0.1 | 7.2 |
| **Total Executive Board** | **27.7** | **2.9** | **0.7** | **8.0** | **1.2** | **40.5** |

## 2016

DKK million

| Executive Management | Salary | Bonus | Pension | IPO incentive bonus | Stay-on bonus/loyalty programme | Share-based incentive programme | Total |
|---|---|---|---|---|---|---|---|
| Niels Frederiksen | 6.4 | 1.8 | 0.0 | 1.5 | 3.1 | 2.5 | 15.3 |
| Christian Hother Sørensen | 4.6 | 1.6 | 0.0 | 1.5 | 1.5 | 1.4 | 10.6 |
| Sisse Fjelsted Rasmussen | 3.8 | 1.3 | 0.0 | 1.5 | 1.6 | 1.1 | 9.3 |
| Rob Zwarts | 3.9 | 1.0 | 0.2 | 1.5 | 0.0 | 0.8 | 7.4 |
| Vincent Crepy | 3.7 | 1.2 | 0.0 | 1.6 | 0.9 | 0.9 | 8.3 |
| **Total** | **22.4** | **6.9** | **0.2** | **7.6** | **7.1** | **6.7** | **50.9** |
| Other key management | 3.7 | 1.1 | 0.3 | 0.0 | 0.8 | 1.1 | 7.0 |
| **Total Executive Board** | **26.1** | **8.0** | **0.5** | **7.6** | **7.9** | **7.8** | **57.9** |

** Executive Board comprise the Executive Management (registered members) and other key management (not registered members).

*** Rob Zwarts left his position as Executive Vice President Special Projects on 1 May 2017.

In the event that an executive member is dismissed, the ordinary salary up to a 24-month notice period and a proportional part of the retention allowance is paid.

For a further description of the Performance Share Units programme (PSU) please refer to Group note 2.3.

For a detailed description of remuneration of the Board of Directors and Executive Management please refer to Group note 2.2.

NOTE 2

# STAFF COSTS (CONTINUED)

DKK thousand

| Board of Directors | Position | Joined the Board | Left the Board | Board | Committees | Total |
|---|---|---|---|---|---|---|
| Jørgen Tandrup | Chairman | October 2010 | April 2017 | 400 | 67 | 467 |
| Nigel Northridge | Chairman/Vice-chairman | April 2016 | | 1,039 | 168 | 1,207 |
| Henrik Brandt | Vice-chairmam | April 2017 | | 475 | 68 | 543 |
| Conny Karlsson | Board member | October 2010 | December 2017 | 400 | 100 | 500 |
| Søren Bjerre-Nielsen | Board member | February 2016 | | 400 | 368 | 768 |
| Marlene Forsell | Board member | June 2014 | April 2017 | 133 | 50 | 183 |
| Dianne Neal Blixt | Board member | February 2016 | | 400 | 150 | 550 |
| Luc Missorten | Board member | February 2016 | | 400 | 102 | 502 |
| Henning Kruse Petersen | Board member | October 2010 | | 400 | | 400 |
| Kurt Asmussen | Group employee representative | October 2010 | | 400 | | 400 |
| Charlotte Lückstadt Nielsen | Group employee representative | October 2010 | July 2017 | 200 | | 200 |
| Hanne Malling | Group employee representative | October 2010 | | 400 | | 400 |
| Lindy Larsen | Group employee representative | July 2016 | | 400 | | 400 |
| Mogens Olsen | Group employee representative | July 2017 | | 200 | | 200 |
| **Total 2017** | | | | **5,647** | **1,073** | **6,720** |
| | | | | | | |
| **Total 2016** | | | | **6,160** | **1,070** | **7,230** |

**Social security taxes and similar taxes**

In addition to the above remuneration to the Board of Directors, the company may pay social security taxes and similar taxes imposed by non-Danish authorities in relation to the remuneration. In 2017 the company paid TDKK 264 compared to TDKK 300 in 2016.

NOTE 3
# DEPRECIATION AND AMORTISATION

| DKK million | 2017 | 2016 |
|---|---|---|
| **Depreciation** | | |
| Leasehold improvements | 0.6 | 2.2 |
| **Total** | **0.6** | **2.2** |
| **Amortisation** | | |
| Other intangible assets | 11.5 | 8.6 |
| **Total** | **11.5** | **8.6** |

NOTE 4
# RESULT OF INVESTMENTS IN AFFILIATED COMPANIES, NET OF TAX

| DKK million | 2017 | 2016 |
|---|---|---|
| Result of investments in affiliated companies, net of tax | 435.2 | 383.4 |
| **Total** | **435.2** | **383.4** |

NOTE 5

# FINANCIAL INCOME

| DKK million | 2017 | 2016 |
|---|---|---|
| Interest on deposits in financial institutions, etc. | 1.2 | 0.5 |
| Interest on balances with affiliated companies | 75.2 | 65.6 |
| Exchange gains, net | 14.9 | 15.8 |
| **Total** | **91.3** | **81.9** |

NOTE 6

# FINANCIAL COSTS

| DKK million | 2017 | 2016 |
|---|---|---|
| Interest on debt to financial institutions, etc. | 65.7 | 80.3 |
| Interest on balances with affiliated companies | 21.6 | 13.4 |
| Other financing costs | 8.0 | 0.9 |
| Exchange losses, net | 4.5 | 0.0 |
| **Total** | **99.8** | **94.6** |

NOTE 7
# INCOME TAXES

| DKK million | 2017 | 2016 |
|---|---|---|
| Current income tax | 32.9 | -9.1 |
| Deferred income tax | -41.5 | 11.3 |
| Adjustment regarding prior years, current income tax | -1.2 | 2.6 |
| Adjustment regarding prior years, deferred income tax | 1.4 | -2.4 |
| **Total** | **-8.4** | **2.4** |

Scandinavian Tobacco Group A/S and its Danish subsidiaries are jointly taxed why all the Danish companies are jointly and individually liable for the joint taxation. The tax for the individual companies is allocated in full on the basis on the expected taxable income. STG A/S is the management company of the jointly taxed companies and settles corporate taxes with the tax authorities.

| DKK million | 2017 | 2016 |
|---|---|---|
| **BREAKDOWN OF DEFERRED INCOME TAX:** | | |
| Intangible assets | 8.6 | 8.8 |
| Property, plant and equipment | -0.4 | -0.4 |
| Receivables | 7.3 | 46.5 |
| Treasury shares | -7.0 | -6.3 |
| **Total** | **8.5** | **48.6** |
| **BREAKDOWN OF INCOME TAXES:** | | |
| Tax calculated at 22% of profit before tax | **88.3** | **85.2** |
| **TAX EFFECT OF:** | | |
| Adjustment regarding prior years | 0.2 | 0.2 |
| Non-deductable costs | 0.2 | 1.4 |
| Other | -1.4 | 0.0 |
| Result of investments in affiliated companies | -95.7 | -84.4 |
| **Total** | **-8.4** | **2.4** |
| Deferred income tax 1 January | 48.6 | 39.8 |
| Deferred income tax in income statement | -40.1 | 8.8 |
| **Deferred income tax 31 December** | **8.5** | **48.6** |

NOTE 8
# INTANGIBLE ASSETS

## 2017

| DKK million | Other intangible assets |
|---|---|
| Accumulated cost at 1 January | 97.4 |
| Addition | 12.5 |
| Accumulated cost at 31 December | 109.9 |
| | |
| Accumulated amortisation at 1 January | 56.8 |
| Amortisation | 11.5 |
| Accumulated amortisation at 31 December | 68.3 |
| | |
| **Carrying amount at 31 December** | **41.6** |

NOTE 9
# PROPERTY, PLANT AND EQUIPMENT

## 2017

| DKK million | Equipment, tools and fixtures | Leasehold improvements | Total |
|---|---|---|---|
| Accumulated cost at 1 January | 0.2 | 6.7 | 6.9 |
| Accumulated cost at 31 December | 0.2 | 6.7 | 6.9 |
| | | | |
| Accumulated depreciation at 1 January | 0.2 | 6.1 | 6.3 |
| Depreciation | 0.0 | 0.6 | 0.6 |
| Accumulated depreciation at 31 December | 0.2 | 6.7 | 6.9 |
| | | | |
| **Carrying amount at 31 December** | **0.0** | **0.0** | **0.0** |

NOTE 10

# INVESTMENTS IN AFFILIATED COMPANIES

| DKK million | 2017 | 2016 |
|---|---|---|
| Accumulated cost at 1 January | 13,026.6 | 13,023.5 |
| Addition | 0.0 | 3.1 |
| Disposal | -15.0 | 0.0 |
| Accumulated cost at 31 December | 13,011.6 | 13,026.6 |
| | | |
| Accumulated revaluation and impairment at 1 January | -2,320.1 | -2,572.3 |
| Dividends | -290.5 | -225.5 |
| Currency translation | -533.4 | 116.8 |
| Equity adjustments | 7.1 | -22.5 |
| Profit after tax | 435.2 | 383.4 |
| Accumulated revaluation and impairment at 31 December | -2,701.7 | -2,320.1 |
| | | |
| **Carrying amount at 31 December** | **10,309.9** | **10,706.5** |

Goodwill of DKK 2,647.1 million (DKK 2,848.3 million) is included in the carrying amount at 31 December 2017.

**Investments in affiliated companies can be specified as follows:**

| Name | Country | Ownership |
|---|---|---|
| Scandinavian Tobacco Group Australia Pty Ltd. | Australia | 100% |
| Scandinavian Tobacco Group Zagreb d.o.o. | Croatia | 100% |
| Scandinavian Tobacco Group Assens A/S | Denmark | 100% |
| Scandinavian Tobacco Group Denmark A/S | Denmark | 100% |
| STG Finans ApS | Denmark | 100% |
| STG Latin Holding ApS | Denmark | 100% |
| General Cigar Dominicana S.A. | The Dominican Republic | 100% |
| Scandinavian Tobacco Group Deutschland GmbH | Germany | 100% |
| Scandinavian Tobacco Group Hong Kong Limited | Hong Kong | 100% |
| Scandinavian Tobacco Group Italy S.R.L. | Italy | 100% |
| ST Cigar Group Holding B.V. | The Netherlands | 100% |
| STG Finance B.V. | The Netherlands | 100% |
| Scandinavian Tobacco Group Norway AS | Norway | 100% |
| STG Portugal S.A. | Portugal | 100% |
| Scandinavian Tobacco Group d.o.o. | Slovenia | 100% |
| Scandinavian Tobacco Group Spain S.A.U. | Spain | 100% |
| Intermatch Sweden AB | Sweden | 100% |
| STG Sweden AB | Sweden | 100% |
| Cigar Smokers Restaurant Holdings, Inc. | United States | 100% |
| Scandinavian Tobacco Group Lane Holding, Inc. | United States | 100% |
| Scandinavian Tobacco Group US Holding, Inc. | United States | 100% |

For a complete list of all entities in the Group please refer to note 5.6 pages 97-98.

NOTE 11
# PREPAYMENTS

Prepayments comprise prepaid costs relating to up-front fee, licences, etc.

NOTE 12
# OTHER PROVISIONS

| DKK million | Other provisions |
|---|---|
| Balance at 1 January 2017 | 4.7 |
| **Balance at 31 December 2017** | **4.7** |
| Expected due: | |
| Within 1 year | 4.7 |
| Between 1 and 5 years | 0.0 |
| After 5 years | 0.0 |
| **Total** | **4.7** |

NOTE 13
# CONTINGENT LIABILITIES

**Guarantee obligations**

The Company has guarantee obligations totalling DKK 532 million at 31 December 2017 (DKK 538 million).

**Lease obligations**

Minimum lease payment under operating lease contracts and rent commitments amounts to:

| DKK million | 2017 | 2016 |
|---|---|---|
| Within 1 year | 26.6 | 27.4 |
| Between 1 and 5 years | 2.0 | 2.2 |
| After 5 years | 0.0 | 0.1 |
| **Total** | **28.6** | **29.7** |

NOTE 14
# FINANCIAL INSTRUMENTS

Reference is made to note 4.2 regarding the group.

NOTE 15
# RELATED-PARTY TRANSACTIONS

Related parties comprise companies controlled by the Augustinus Foundation and key management. Key management are Scandinavian Tobacco Group A/S' Board of Directors and Executive Board (Executive Management and other key management) as well as management in the controlling companies.

The income statement include the following transactions with related parties:

| DKK million | 2017 | 2016 |
|---|---|---|
| **Affiliated companies** | | |
| Services provided by Scandinavian Tobacco Group A/S | 224.1 | 234.1 |
| Services provided to Scandinavian Tobacco Group A/S | -5.2 | -4.9 |
| Financial income | 75.2 | 65.6 |
| Financial cost | -21.6 | -13.4 |
| **Skandinavisk Holding A/S (controlled by the Augustinus Foundation)** | | |
| Services provided by Scandinavian Tobacco Group A/S | 2.5 | 2.5 |
| **Tivoli (controlled by the Augustinus Foundation)** | | |
| Purchase of products and sponsorship | -0.5 | -0.6 |

For information on remuneration to the Management of Scandinavian Tobacco Group A/S, please refer to note 2. For an overview of affiliated companies, please refer to note 10. There have not been and there are no loans to key management personnel in 2017 or 2016.

NOTE 16
# FEE TO STATUTORY AUDITOR

| DKK million | 2017 | 2016 |
|---|---|---|
| Statutory audit | 0.9 | 0.7 |
| Audit-related services | 1.3 | 0.2 |
| Tax advisory services | 0.1 | 0.4 |
| **Total** | **2.3** | **1.3** |

NOTE 17
# OWNERSHIP

As of 1 March 2018 the following investors have reported holdings of more than 5% of Scandinavian Tobacco Group's share capital/voting rights:

| | |
|---|---|
| Chr. Augustinus Fabrikker Aktieselskab | 25.1% |
| C.W.Obel A/S | 11.6% |
| FMR LLC | 6.5% |
| Franklin Templeton Institutional, LLC | 5.0% |
| FIL Limited | 5.0% |

# MANAGEMENT'S STATEMENT

Executive Management and Board of Directors have today considered and adopted the Annual Report of Scandinavian Tobacco Group A/S for the financial year 1 January – 31 December 2017.

The Consolidated Financial Statements are prepared in accordance with International Financial Reporting Standards as adopted by the EU and additional requirements in the Danish Financial Statements Act. The Financial Statements are prepared in accordance with the Danish Financial Statements Act. Moreover, the Consolidated Financial Statements and the Financial Statements are prepared in accordance with additional Danish disclosure requirements for listed companies. Management's Report is also prepared in accordance with Danish disclosures requirements for listed companies.

In our opinion, the Consolidated Financial Statements and the Financial Statements give a true and fair view of the financial position at 31 December 2017 of the Group and the Parent Company and of the results of the Group and Parent Company operations and consolidated cash flows for the financial year 1 January – 31 December 2017.

In our opinion, Management's Report includes a true and fair account of the development in the operations and financial circumstances of the Group and the Parent Company, of the results for the year and of the financial position of the Group and the Parent Company as well as a description of the most significant risks and elements of uncertainty facing the Group and the Parent Company.

We recommend that the Annual Report be adopted at the Annual General Meeting.

Soeborg, 8 March 2018

## Executive management

Niels Frederiksen
CEO

Sisse Fjelsted Rasmussen
CFO

## Board of Directors

Nigel Northridge
Chairman

Henrik Brandt
Vice chairman

Søren Bjerre-Nielsen

Dianne Neal Blixt

Luc Missorten

Henning Kruse Petersen

Kurt Asmussen

Lindy Larsen

Hanne Malling

Mogens Olsen

# INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Scandinavian Tobacco Group A/S

## OUR OPINION

In our opinion, the Consolidated Financial Statements give a true and fair view of the Group's financial position at 31 December 2017 and of the results of the Group's operations and cash flows for the financial year 1 January to 31 December 2017 in accordance with International Financial Reporting Standards as adopted by the EU and further requirements in the Danish Financial Statements Act.

Moreover, in our opinion, the Parent Company Financial Statements give a true and fair view of the Parent Company's financial position at 31 December 2017 and of the results of the Parent Company's operations for the financial year 1 January to 31 December 2017 in accordance with the Danish Financial Statements Act.

Our opinion is consistent with our Auditor's Long-form Report to the Audit Committee and the Board of Directors.

### WHAT WE HAVE AUDITED

The Consolidated Financial Statements of Scandinavian Tobacco Group A/S for the financial year 1 January to 31 December 2017 comprise the consolidated income statement and statement of comprehensive income, the consolidated balance sheet, the consolidated statement of changes in equity, the consolidated cash flow statement and the notes, including summary of significant accounting policies.

The Parent Company Financial Statements of Scandinavian Tobacco Group A/S for the financial year 1 January to 31 December 2017 comprise the income statement, the balance sheet, the statement of changes in equity and the notes, including summary of significant accounting policies.

Collectively referred to as the "Financial Statements".

## BASIS FOR OPINION

We conducted our audit in accordance with International Standards on Auditing (ISAs) and the additional requirements applicable in Denmark. Our responsibilities under those standards and requirements are further described in the Auditor's responsibilities for the audit of the Financial Statements section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### INDEPENDENCE

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the additional requirements applicable in Denmark. We have also fulfilled our other ethical responsibilities in accordance with the IESBA Code.

To the best of our knowledge and belief, prohibited non-audit services referred to in Article 5(1) of Regulation (EU) No 537/2014 were not provided.

### APPOINTMENT

Following the admission of shares of Scandinavian Tobacco Group A/S for the listing on Nasdaq Copenhagen, we were first appointed auditors of Scandinavian Tobacco Group A/S on 26 April 2017. We have been reappointed annually by shareholder resolution for a total period of uninterrupted engagement of 1 years, including the financial year 2017.

# INDEPENDENT AUDITOR'S REPORT (CONTINUED)

## KEY AUDIT MATTERS

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the Financial Statements for 2017. These matters were addressed in the context of our audit of the Financial Statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

| KEY AUDIT MATTER | HOW OUR AUDIT ADDRESSED THE KEY AUDIT MATTER |
|---|---|
| **IMPAIRMENT OF GOODWILL AND INTANGIBLE ASSETS ASSESSMENT**<br>The principal risk in relation to goodwill and intangible assets is impairment due to for example changes in local regulations, changes to excise duties, and changes in the strategy of the Group.<br><br>Management prepared valuations of the operating segments Handmade cigars, Machine-made cigars, Pipe tobacco, Fine-cut tobacco and Other.<br><br>Values for strategic trademarks with indefinite live and other trademarks are separately tested for impairment.<br><br>The most critical assumptions are the estimation of future cash flows, especially growth in EBITDA, terminal growth and the discount rates.<br><br>We focused on this area as the determination of whether elements of goodwill and intangible assets are impaired involves complex and subjective judgements by the Management about the future results of the relevant parts of the business.<br><br>Refer to Note 3.1 | Our audit procedures included assessing the Group's impairment model.<br><br>We obtained impairment tests prepared by Management and evaluated the reasonableness of estimates and judgements made by Management in preparing these.<br><br>We challenged Management analysis around the key drivers of the cash flow forecasts including the ability to increase market share and achieve price increases in declining markets. We also evaluated the appropriateness of the key assumptions including discount rates, short-term and long-term growth rates and performed sensitivities across the reporting segments.<br><br>We used our own specialist to evaluate the discount rates.<br><br>We tested the reliability of Management's estimates by comparing budgeted figures to actual figures for the past years. |
| **UNCERTAIN TAX POSITIONS**<br>The Group operates in a complex multinational tax environment and related risks in transfer pricing cases with domestic and foreign tax authorities. Management is required to exercise considerable judgement when determining the appropriate provision amount for uncertain tax positions.<br><br>We focused on this area given the number of judgements involved and the complexities of dealing with tax rules and regulations in numerous jurisdictions.<br><br>Refer to Note 2.5 | We evaluated completeness of records of uncertain tax positions and Management's procedure for estimating the provision for uncertain tax positions.<br><br>We discussed with Management issues relating to determining the appropriate provision for uncertain tax positions.<br><br>In addition, we used our own tax specialists and evaluated the adequacy of Management's key assumptions and read relevant correspondence with tax authorities to assess the valuation of uncertain tax positions. |

# INDEPENDENT AUDITOR'S REPORT (CONTINUED)

## STATEMENT ON MANAGEMENT REPORT

Management is responsible for Management Report.

Our opinion on the Financial Statements does not cover Management Report, and we do not express any form of assurance conclusion thereon.

In connection with our audit of the Financial Statements, our responsibility is to read Management Report and, in doing so, consider whether Management Report is materially inconsistent with the Financial Statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

Moreover, we considered whether Management Report includes the disclosures required by the Danish Financial Statements Act.

Based on the work we have performed, in our view, Management Report is in accordance with the Consolidated Financial Statements and the Parent Company Financial Statements and has been prepared in accordance with the requirements of the Danish Financial Statements Act. We did not identify any material misstatement in Management Report.

## MANAGEMENT'S RESPONSIBILITIES FOR THE FINANCIAL STATEMENTS

Management is responsible for the preparation of consolidated financial statements that give a true and fair view in accordance with International Financial Reporting Standards as adopted by the EU and further requirements in the Danish Financial Statements Act and for the preparation of parent company financial statements that give a true and fair view in accordance with the Danish Financial Statements Act, and for such internal control as Management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the Financial Statements, Management is responsible for assessing the Group's and the Parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless Management either intends to liquidate the Group or the Parent Company or to cease operations, or has no realistic alternative but to do so.

# INDEPENDENT AUDITOR'S REPORT (CONTINUED)

## AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE FINANCIAL STATEMENTS

Our objectives are to obtain reasonable assurance about whether the Financial Statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs and the additional requirements applicable in Denmark will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these Financial Statements.

As part of an audit in accordance with ISAs and the additional requirements applicable in Denmark, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the Financial Statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's and the Parent Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by Management.
- Conclude on the appropriateness of Management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's and the Parent Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the Financial Statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group or the Parent Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the Financial Statements, including the disclosures, and whether the Financial Statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the Consolidated Financial Statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the Financial Statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Copenhagen, 8 March 2018

**PricewaterhouseCoopers**
Statsautoriseret Revisionspartnerselskab
CVR-no. 33 77 12 31

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