

Scandinavian Tobacco Group A/S
Extract from
Annual Report for
1 January – 31 December 2009



Scandinavian Tobacco Group
Annual Report for 1 January - 31 December 2009

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Management's Statement on the Annual Report

The Extract from Annual Report for 1 January – 31 December 2009 is an extract from the Annual Report of Scandinavian Tobacco Group A/S provided with the following Management's Statement:

The Executive and Supervisory Boards have today considered and adopted the Annual Report of Scandinavian Tobacco Group A/S for the financial year 1 January – 31 December 2009.

The Annual Report is prepared in accordance with the Danish Financial Statements Act. We consider the accounting policies applied appropriate and the estimates made reasonable.

Therefore, in our opinion the Consolidated Financial Statements and the Parent Company Financial Statements give a true and fair view of the financial position of the Group and the Parent Company, of the results of the Group and Parent Company operations and of consolidated cash flows.

In our opinion, Management's Review includes a true and fair account of the matters described as well as a description of the most significant risks and elements of uncertainty facing the Group.

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

Søborg, 22 April 2010

Executive Board:

Anders Colding Friis
CEO

Christian Hother Sørensen

Sisse Fjelsted Rasmussen

Rob Zwarts

Supervisory Board:

Jørgen Tandrup
Chairman

Henning Kruse Petersen
Deputy Chairman

Anders Colding Friis

Kurt Asmussen

Lindy Larsen

Hanne Malling

Charlotte Lückstadt Nielsen

Anders Obel

Tommy Pedersen

Independent Auditor's Report

The Extract from Annual Report for 1 January – 31 December 2009 is an extract from the Annual Report of Scandinavian Tobacco Group A/S provided with the following Auditor's Report:

To the Shareholder of Scandinavian Tobacco Group A/S

We have audited the Parent Company Financial Statements, the Consolidated Financial Statements and Management's Review of Scandinavian Tobacco Group A/S for the financial year 1 January – 31 December 2009. The Parent Company Financial Statements and the Consolidated Financial Statements comprise Income Statement, Balance Sheet, Statement of Changes in Equity, Notes and Accounting Policies as well as a Cash Flow Statement for the Group. The Parent Company Financial Statements, the Consolidated Financial Statements and Management's Review are prepared in accordance with the Danish Financial Statements Act.

Management's Responsibility

Management is responsible for the preparation and fair presentation of the Parent Company Financial Statements and the Consolidated Financial Statements in accordance with the Danish Financial Statements Act. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of Parent Company Financial Statements and Consolidated Financial Statements that are free from material misstatement, whether due to fraud or error. The responsibility also includes selecting and applying appropriate accounting policies, and making accounting estimates that are reasonable in the circumstances. Furthermore, Management is responsible for preparing a Management's Review that includes a true and fair account in accordance with the Danish Financial Statements Act.

Auditor's Responsibility and Basis of Opinion

Our responsibility is to express an opinion on the Parent Company Financial Statements, the Consolidated Financial Statements and Management's Review based on our audit. We conducted our audit in accordance with Danish Auditing Standards. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the Parent Company Financial Statements, the Consolidated Financial Statements and Management's Review are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Parent Company Financial Statements, the Consolidated Financial Statements and Management's Review. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the Parent Company Financial Statements, the Consolidated Financial Statements and Management's Review, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the Parent Company Financial Statements and the Consolidated Financial Statements and to the preparation of a Management's Review that includes a true and fair account 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 Company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by Management, as well as evaluating the overall presentation of the Parent Company Financial Statements, the Consolidated Financial Statements and Management's Review.

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

Our audit has not resulted in any qualification.

Opinion

In our opinion, the Parent Company Financial Statements and the Consolidated Financial Statements give a true and fair view of the financial position of the Company and the Group at 31 December 2009 and of the results of the Company and the Group operations as well as consolidated cash flows for the financial year 1 January - 31 December 2009 in accordance with the Danish Financial Statements Act, and Management's Review includes a true and fair account in accordance with the Danish Financial Statements Act.

Søborg, 22 April 2010

PricewaterhouseCoopers
Statsautoriseret Revisionsaktieselskab

Carsten Gerner
State Authorised Public Accountant

Torben Jensen
State Authorised Public Accountant

Company Information

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Municipality of registered office: Gladsaxe

Supervisory Board Jørgen Tandrup, Director, Chairman
Henning Kruse Petersen, Director, Deputy Chairman
Anders Colding Friis, Director
Kurt Asmussen, Engineering Worker *
Lindy Larsen, Group Chief Accountant *
Hanne Malling, Trademark Administrator *
Charlotte Lückstadt Nielsen, Tobacco Worker *
Anders Obel, Director
Tommy Pedersen, Director
* elected by the employees

Executive Board Anders Colding Friis, CEO
Christian Hother Sørensen
Sisse Fjelsted Rasmussen
Rob Zwarts

Deputy Executives Jacob Bjerre
Knud Erik Foged
Mette Valentin
Lars Wassberg

Auditors PricewaterhouseCoopers Statsautoriseret Revisionsaktieselskab

Shareholder Skandinavisk Holding A/S (100%)
Gladsaxe

The Company's Financial Statements are included in the Consolidated Financial Statements of Skandinavisk Holding A/S, Gladsaxe as the lowest level group and in the Consolidated Financial Statements of The Augustinus Foundation, Copenhagen as the ultimate group.

Consolidated Financial Highlights of STG

Financial highlights (DKK million)	2009	2008	2007/08	2006/07	2005/06
	(6 months)				
Income statement					
Net revenue ¹⁾	2,373	1,141	27,419	26,174	25,025
Depreciation, amortisation and impairment	162	635	504	387	348
Operating profit/loss	367	-682	2,345	2,251	2,275
Net financials	665	18,138	25	97	66
Profit before tax	1,032	17,455	2,370	2,348	2,341
STG's share of profit after tax	885	17,449	1,620	1,616	1,547
Balance sheet					
Balance sheet total	4,960	13,434	15,516	12,879	12,603
Equity	3,906	12,331	4,023	5,234	5,104
Cash flows					
Cash flows from:					
- operating activities	893	295	1,937	1,716	1,857
- investing activities	345	19,281	-2,049	-903	-588
- invested in property, plant and equipment	-38	-24	-336	-397	-403
- financing activities	-1,698	-20,589	201	-1,190	-979
Change in cash and cash equivalents for the year	-460	-1,013	88	-376	290
Number of employees at year end	3,286	2,757	13,111	13,640	12,216
Ratios (%)					
Profit margin (on operating profit)	15.5	-59.8	8.6	8.6	9.1
Return on net assets	7.4	-5.1	15.1	17.5	18.1
Solvency ratio	78.8	91.8	25.9	40.6	40.5
Return on equity	10.9	213.4	35.0	31.3	31.7

¹⁾ The development in STG's activities from 2007/08 to 2008 is materially affected by the divestment of cigarette activities and some roll-your-own (RYO) and snus activities to BAT in June 2008 and by the sale of Dagrofa to SH in 2009 (2008 restated).

Management's Review

Scandinavian Tobacco Group (STG) is Europe's largest and the world's third largest supplier of cigars, the world-leading manufacturer of pipe tobacco and a key manufacturer of RYO tobacco.

The 2009 financial year was STG's first 12-month financial year following the divestment of the cigarette activities and some roll-your-own (RYO) and snus activities to British American Tobacco (BAT) at 1 July 2008. In the following 2008 financial year, the financial year was changed to match the calendar year, therefore covering the period 1 July – 31 December 2008.

The profit for 2009 amounted to DKK 885.4 million, which exceeds expectations. The profit for 2008 (6 months) amounting to DKK 17,449.0 million was materially affected by a profit of DKK 17.9 billion on the divestment to BAT.

STG's consolidated equity at 31 December 2009 amounted to DKK 3,906.4 million before distribution of proposed dividend.

At 1 July 2009, STG sold its shares of Tivoli to Skandinavisk Holding (SH). A profit of DKK 424.9 million was realised on the sale, which has been recognised in profit from sale of investments. Moreover, STG sold its shares of Dagrofa A/S. Comparative figures and equity at 1 July 2008 have been restated to the effect that, at that date, Dagrofa is recognised at the value at which the shares were sold.

At 1 January 2009, STG acquired two cigar factories in Danli, Honduras, and Esteli, Nicaragua, respectively. The factories have a total of 950 employees and an annual production of approximately 17 million hand-rolled, premium long filler cigars, mainly for the US market.

STG has terminated the commission agreement with Imperial Tobacco for the distribution of Café Crème in the UK market and thus took over distribution in the UK market itself as from 10 January 2009 through its UK subsidiary.

In March 2009, STG acquired the Tiedemanns brand from British American Tobacco thus achieving a key position in the Norwegian market for RYO tobacco.

In Q1 2010, in line with its strategic vision to become the world-leading cigar business and a leading player within smoking tobacco, STG signed a letter of intent with Swedish Match (SM) with a view to establishing a jointly owned company. The company will comprise the total tobacco business of STG, SM's cigar business (except for SM's so-called mass market cigars in the USA) as well as SM's activities within pipe tobacco and smoking accessories. STG will hold 51% of the shares of the new company, whereas SM will hold the remaining 49%. Following the performance of a due-diligence review, a final agreement is expected to be signed in H1 2010.

At year end, 31 December 2009, the ST Group entities had 3,286 employees.

Distribution of profit

Proposed distribution of profit for the year:

(DKK million)	2009	2008
Reserve for net revaluation under the equity method	323.5	-313.4
Interim dividend paid to shareholders (excluding treasury shares)	1,100.0	9,136.0
Dividend paid to shareholders (excluding treasury shares)	700.0	8,200.0
Other reserves	-1,238.1	426.4
Profit for the year	885.4	17,449.0

Financial risks

STG has centralised the Group's financial risk and cash management, including the investment of excess liquidity, with the Parent Company.

STG remains active in respect of the Group's financial risks, which are hedged at an overall level.

When hedging risks, STG hedges only commercial financial risks and, in consequence, does not enter into speculative transactions.

The activities of STG involve different financial risks: currency, interest rate and credit risks, the most material being currency risks.

Currency exposure is caused by inconsistencies between income and expenses in the respective currencies and by the Group holding net assets in foreign subsidiaries. A large part of the Group's business is EUR-based; therefore, the currency risk is limited.

The Group's currency risks are primarily caused by net income denominated in GBP, CAD and NOK as well as net expenses denominated in USD.

Strategy and objective

It is STG's objective to grow and to achieve even stronger market positions. Targeted efforts are directed at becoming the world-leading cigar business, at enhancing the Group's position as the strongest player within pipe tobacco and at achieving growth within the production and sale of RYO tobacco.

Corporate social responsibility

Responsibility is one of the core values of STG, which endeavours to be a responsible community participant. The focus on tobacco by our surroundings and the often critical stance on tobacco products make special demands on STG in terms of responsibility.

STG accepts and supports the establishment of special rules for tobacco products which are far more restrictive than those applying to other industries, and STG endeavours to comply at all times with the rules applying to the Groups' products and business.

Against this background, STG has, among other things, formulated a clear stance on smoking. STG believes that smoking is injurious to health, and that young people should abstain from smoking.

STG's stance on smoking

Over the past 50 years or so, everyone has been met over and over again in the media and campaigns by information about the harmful effects of smoking; effects which have been proved by scientific research and through statistics. STG shares the opinion that smoking involves a risk of contracting a number of diseases, and all our tobacco products are labelled with warnings about the risk of smoking.

However, not everyone contracts diseases from smoking; some do, others do not. Science has not yet provided us with a final answer as to why this is so. The risk does, however, increase the more you smoke and with the number of years you smoke. Also those who smoke mild tobacco products are at risk.

Everyone should take the risk seriously, balance the pleasure in smoking against the risk and then make their personal choice to smoke or not.

We know that many people find it difficult to stop smoking. Some would use the expression that they get addicted to smoking. We believe that everyone can stop smoking. Millions of people throughout the world stop smoking every year simply because they decide to do so and put their mind to it. There can hardly, however, be any doubt that smoking is habit-forming.

Smoking involves a health risk and is habit-forming. Therefore, the choice to smoke should be made only by adults. In our view, no one below the age of 18 should smoke.

Environment and working environment

STG wants a good and safe working environment for all its employees. Particularly in connection with production, STG is moreover concerned that the environmental impact should be as limited as possible. For a number of years, a comprehensive programme has been regularly carried out at the factories of STG's production entities with a view to measuring the status and development in the areas of working environment, safety and environmental impact. The programme ensures compliance with the legislation applying to the respective areas as well as STG's compliance with the higher standards established by STG itself in certain areas. The comprehensive and systematic internal scrutiny of the entities which takes place under the programme is usually performed every 3 years.

Since 2008 supply chain focus has been and will continue to be on a major production reorganisation with the number of European cigar factories in the Group being reduced from five to three. Once this reorganisation has been completed during 2010, the cross-entity programme will be resumed. In connection with the said reorganisation of cigar production, STG will put into operation its newly built Belgian factory in 2010. The factory is the largest in Europe, and working environment, safety and environmental issues have been pivotal factors in designing the factory.

A note on child labour

Children have the right to be protected against child labour. STG does not employ child labour.

It is, however, a fact that tobacco is grown in third world countries where children are often sent into the fields to work and work at the farms because a contribution is needed from everyone to the often difficult task of supporting the family. Child labour is a result of poverty, and education is one of the ways in which both families and the poverty-ridden communities can fight poverty. However, eliminating poverty in the countries in which tobacco is grown is a difficult task that can only be solved in the long term.

STG's efforts to combat child labour in tobacco growing are primarily carried out through the Eliminating Child Labour in Tobacco Growing (ECLT) Foundation. The Foundation was established in 2001 and is based on cooperation between the international organisations of tobacco growers and tobacco workers as well as a number of the world-leading distributors of raw tobacco and manufacturers of tobacco products. Through a number of projects in, among other places, Africa and Asia, the Foundation is, alongside other organisations and local authorities, involved in creating awareness of the issue of child labour and taking steps to fight the phenomenon, eg by establishing schools. Further information on the ECLT activities is provided on the Foundation's website, www.eclt.org.

Regulatory developments

The framework conditions for tobacco are continuously tightened. Restrictions and actual bans on tobacco advertisements are seen in by far the majority of the markets in which STG's products are sold. Moreover, legislation restricting access to smoking at restaurants and other establishments serving food and beverages has also become common in recent years in a number of our main markets. Recently, legislation has been introduced in Canada, Norway and Iceland, among other countries, to the effect that tobacco products may not be displayed to consumers at points of sale. In England and Scotland similar legislation has been passed which will enter into force gradually in the coming period.

Product liability suit

In 2003 a smoker sued STG (and House of Prince A/S (HoP)) at the Eastern Division of the Danish High Court, and the lawsuit is still pending. The plaintiff claims damages of just below DKK 0.5 million for the consequences of a disease which is allegedly caused by his smoking of Prince cigarettes. Firstly, the plaintiff claims that STG/HoP have used additives in the Prince cigarettes, which have made it impossible for the plaintiff to quit smoking. Furthermore, the plaintiff believes that the companies have misled users as to the contents of tar and nicotine in the declarations on the cigarette packets. The case has been set down for trial in November 2010. In Management's opinion the courts are unlikely to sustain the plaintiff's claim. However, if, contrary to expectations, judgment is given against STG in this lawsuit creating a precedent, this could have a considerable effect on the financial standing of the Group.

In addition, as part of its day-to-day operations, the Group is involved in a number of other disputes which are considered immaterial to the overall financial position.

Significant subsequent events

Other than the above-mentioned letter of intent concerning the potential establishment of a jointly owned company in cooperation with SM, no significant events have occurred after year end.

Prospects for 2010

For 2010, the Group's level of activity and earnings before items of a non-recurring nature are expected to be at the 2009 level disregarding any effect of the letter of intent with SM. Heavy investments in the foreign markets are expected to continue.

Cigars

STG is Europe's largest and the world's third largest supplier of cigars.

Cigars are manufactured in Holland, Belgium, Denmark, Nicaragua and Honduras. Punching of wrappers and binders is made in the Dominican Republic and Indonesia.

STG is the world's largest exporter of cigars and has a number of subsidiaries throughout the world. The key brands are Café Crème, Nobel Petit, Henri Wintermans, Mercator, Colts and CAO.

Revenue and profit

Profit before tax for the cigar activities amounted to DKK 232.8 million compared to a loss of DKK 335.7 million last year when results were materially affected by impairment of trademarks and goodwill as well as expenses relating to reorganisation.

Net revenue amounted to DKK 1,721.5 million compared to DKK 846.4 million last year covering the period 1 July – 31 December 2008.

Markets

Total cigar sales amounted to 1,409 million cigars compared to 766 million in the period 1 July – 31 December 2008.

The development in STG's sales was positive in the UK, Canada and Spain, whereas the market in France and the market for premium cigars in the USA were under heavy pressure, which affected the Group's US operations negatively.

Pipe and RYO tobacco

STG is the world-leading manufacturer of pipe tobacco and a key manufacturer of RYO tobacco.

STG's smoking tobacco activities comprise the production, marketing and sale of pipe tobacco and RYO tobacco, respectively. Moreover, STG manufactures smokeless tobacco by way of snus and chewing tobacco.

The key pipe tobacco brands are Orlik, Sweet Dublin, Clan, Erinmore and W.Ø. Larsen. The key RYO tobacco brands are Escort, Tiedemanns, Bali and Crossroad.

Revenue and profit

Profit before tax for the pipe and RYO tobacco activities amounted to DKK 184.7 million compared to DKK 236.4 million for the period 1 July – 31 December 2008, which includes a profit on the sale of Fiedler & Lundgren shares of DKK 169.2 million.

Net revenue amounted to DKK 577.6 million compared to DKK 256.3 million for the period 1 July – 31 December 2008.

Markets

STG's pipe and RYO tobacco exports showed an increase of just above 33% from last year, which is particularly attributable to the Tiedemanns brand.

In Denmark, pipe and RYO tobacco sales continued the negative trend. Total Danish pipe and RYO tobacco sales in 2009 showed a decrease of 5% from last year.

Consolidated Income Statement of STG
1 January – 31 December 2009

(DKK million)	<u>2009</u>	<u>2008</u> (6 months)
Net revenue	2,373.2	1,140.6
Other operating income	19.8	98.1
Total income	<u>2,393.0</u>	<u>1,238.7</u>
Product costs and overheads:		
Raw materials, consumables and goods for resale	711.9	361.0
Other external expenses	522.3	452.1
Staff expenses	629.6	473.0
	<u>1,863.8</u>	<u>1,286.1</u>
Profit/loss before depreciation and amortisation	529.2	-47.4
Depreciation, amortisation and impairment	162.3	635.0
Operating profit/loss	<u>366.9</u>	<u>-682.4</u>
Profit from sale of investments	424.9	17,880.6
Income from investments in associates		18.0
Other financial income	292.1	316.7
Other financial expenses	52.0	77.6
Profit before tax	<u>1,031.9</u>	<u>17,455.3</u>
Tax	-146.5	-6.2
Profit after tax	<u>885.4</u>	<u>17,449.0</u>

**Consolidated Balance Sheet of STG
 31 December 2009**

ASSETS

(DKK million)	<u>31/12 2009</u>	<u>31/12 2008</u>
Goodwill	231.6	254.5
Trademarks, know-how, IT software, etc	1,323.4	888.5
Intangible assets	<u>1,555.0</u>	<u>1,143.0</u>
Land and buildings	197.3	220.5
Plant and machinery	147.8	167.7
Other equipment, furniture and fixtures	15.1	15.7
Leasehold improvements	5.8	22.5
Prepayments for fixed assets and assets under construction	238.1	37.7
Property, plant and equipment	<u>604.1</u>	<u>464.2</u>
Investments in associates		184.4
Receivables from group enterprises	200.0	200.0
Fixed asset investments	<u>200.0</u>	<u>384.4</u>
Total fixed assets	<u>2,359.1</u>	<u>1,991.6</u>
Inventories	<u>1,093.2</u>	<u>1,082.0</u>
Trade receivables	415.0	365.2
Receivables from group enterprises	657.1	8,780.4
Receivables from associates		101.3
Prepaid tax	5.7	52.2
Other receivables	60.0	74.7
Deferred tax asset	24.5	43.3
Prepayments	21.9	159.8
Receivables	<u>1,184.2</u>	<u>9,576.8</u>
Cash at bank and in hand	<u>323.2</u>	<u>783.3</u>
Total current assets	<u>2,600.6</u>	<u>11,442.2</u>
Total assets	<u>4,959.7</u>	<u>13,433.8</u>

Consolidated Balance Sheet of STG
31 December 2009

LIABILITIES AND EQUITY

(DKK million)	<u>31/12 2009</u>	<u>31/12 2008</u>
Share capital	375.7	375.7
Other reserves	2,830.7	3,755.2
Proposed dividend	700.0	8,200.0
Total equity	<u>3,906.4</u>	<u>12,330.9</u>
Provision for pensions and similar obligations	89.0	94.7
Provisions for deferred tax	121.6	122.8
Other provisions	14.6	103.7
Total provisions	<u>225.2</u>	<u>321.3</u>
Bank debt	52.8	
Trade payables	176.1	237.4
Payables to group enterprises	175.2	150.4
Corporation tax	109.1	32.6
Tobacco excise, duty and VAT	116.2	123.3
Other payables	198.2	230.6
Deferred income	0.5	7.2
Short-term debt	<u>828.1</u>	<u>781.6</u>
Total debt	<u>828.1</u>	<u>781.6</u>
Total liabilities and equity	<u>4,959.7</u>	<u>13,433.8</u>

Consolidated Cash Flow Statement of STG
1 January – 31 December 2009

(DKK million)	<u>2009</u>	<u>2008</u>
Profit before depreciation and amortisation excluding profit from sale of investments	529.2	-47.4
Adjusted for changes in working capital:		
Receivables	310.7	4.0
Inventories	8.1	-4.0
Other short-term debt	-204.1	147.1
Cash flows from primary activities	<u>643.9</u>	<u>99.7</u>
Interest paid etc	-52.0	-77.6
Interest received etc	292.1	316.7
Taxes paid	8.6	-43.9
Total cash flows from operating activities	<u>892.6</u>	<u>294.9</u>
Investment in intangible assets	-408.0	-
Investment in property, plant and equipment	-37.6	-23.8
Prepayments	-225.6	-16.9
Disposal of fixed assets	61.8	5.8
Acquisitions	-125.6	-410.4
Sale of investments	1,080.3	19,726.5
Total cash flows from investing activities	<u>345.3</u>	<u>19,281.2</u>
Bank debt	52.8	-2,126.6
Loan to Parent Company	7,549.2	-8,041.2
Dividend paid	-9,300.0	-10,421.0
Total cash flows from financing activities	<u>-1,698.0</u>	<u>-20,588.8</u>
Net change in cash and cash equivalents	-460.1	-1,012.7
Acquisition of cash and cash equivalents	-	-28.5
Disposal of cash and cash equivalents	-	-251.2
Cash and cash equivalents at the beginning of the year	783.3	2,075.7
Cash and cash equivalents at the end of the year	<u>323.2</u>	<u>783.3</u>

Consolidated Statement of Changes in Equity of STG

31/12 2009 (DKK million)	Share capital	Other reserves	Proposed dividend
Balance at 1 January 2009	375.7	3,755.2	8,200.0
Dividend paid re 2008			-8,200.0
Other adjustments		2.6	
Exchange adjustment		-6.7	
Interim dividend 2009		-1,100.0	
Fair value adjustment of financial instruments		-5.8	
Profit for distribution		185.4	700.0
Balance at 31 December 2009	375.7	2,830.7	700.0

31/12 2008 (DKK million)	Share capital	Other reserves	Proposed dividend
Balance at 1 July 2008	375.7	3,646.9	-
Adjustment Dagrofa		-22.3	
Dividend paid re 2008			-9,136.0
Exchange adjustment		10.2	
Fair value adjustment of financial instruments		7.4	
Profit for distribution		113.0	17,336.0
Balance at 31 December 2008	375.7	3,755.2	8,200.0