Company Announcement
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H1 | INTERIM REPORT
1 JANUARY-30 JUNE 2017

FINANCIAL PERFORMANCE IN LINE WITH EXPECTATIONS - FY GUIDANCE MAINTAINED

HIGHLIGHTS FOR THE SIX MONTHS TO 30 JUNE 2017

- Reported net sales of DKK 3,052 million (DKK 3,199 million) – organic growth negative at 5.0%
- Reported EBITDA of DKK 515 million (DKK 632 million) – organic growth negative at 11.8%
- Net profit of DKK 241 million (DKK 346 million)
- Free cash flow of DKK 299 million (DKK 165 million)

HIGHLIGHTS FOR THE SECOND QUARTER OF 2017

- Reported net sales of DKK 1,673 million (DKK 1,699 million) – organic growth negative at 1.1%
- Reported EBITDA of DKK 315 million (DKK 366 million) – organic growth negative at 3.8%
- Net profit of DKK 166 million (DKK 208 million)
- Free cash flow of DKK 251 million (DKK 369 million)

FINANCIAL GUIDANCE 2017

FY 2017 guidance of slightly negative organic net sales growth and negative organic growth in adjusted EBITDA of 4-8% unchanged.

STATEMENT BY CEO NIELS FREDERIKSEN:

“Our overall financial performance in the second quarter was in line with our expectations. We are seeing an improved trajectory for machine-made cigars in Europe supported by more stable market dynamics. Our branded handmade cigars business is performing well, but the category remains impacted by the challenges in Cigars International. We are making steady but slow progress in our efforts to remedy the situation. Our cash generation remains strong, and we delivered a free cash flow of DKK 251 million in the quarter.”

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Scandinavian Tobacco Group - Key Figures[1]

DKK million	Q2 17	Q2 16	H1 17	H1 16	2016
INCOME STATEMENT					
Net sales	1,673	1,699	3,052	3,199	6,746
Gross profit	786	840	1,434	1,579	3,225
EBITDA	315	366	515	632	1,279
EBIT	236	296	353	493	957
Net financial items[2]	-23	-24	-45	-40	-72
Profit before tax	216	275	314	459	895
Income taxes	-49	-68	-73	-113	-213
Net profit	166	208	241	346	681
BALANCE SHEET					
Total assets			13,580	14,162	14,264
Equity			8,554	8,660	9,273
Net interest-bearing debt (NIBD)			2,630	3,379	2,469
Investment in property, plant and equipment	10	80	26	134	190
Total capital expenditures	21	87	48	148	235
CASH FLOW STATEMENT					
Cash flow from operating activities	270	452	343	304	1,358
Cash flow from investing activities	-19	-83	-45	-139	-219
Free cash flow	251	369	299	165	1,139
KEY RATIOS					
Net sales growth	-1.5%	-2.8%	-4.6%	-0.8%	0.2%
Gross margin	47.0%	49.4%	47.0%	49.4%	47.8%
EBITDA margin	18.8%	21.5%	16.9%	19.8%	19.0%
Effective tax percentage	22.9%	24.5%	23.3%	24.6%	23.8%
Equity ratio			63.0%	61.1%	65.0%
Cash conversion	110.6%	137.7%	80.7%	68.0%	122.4%
Organic net sales growth	-1.1%	-1.5%	-5.0%	0.1%	0.4%
Adjusted gross margin	48.5%	49.9%	48.0%	49.6%	49.1%
Organic EBITDA growth	-3.8%	-2.7%	-11.8%	0.1%	4.0%
Adjusted EBITDA (DKK million)	349	374	561	653	1,440
Adjusted EBITDA margin	20.9%	22.0%	18.4%	20.4%	21.4%
NIBD / Adjusted EBITDA			2.0	2.4	1.7
ROIC					7.8%
ROIC ex. goodwill and trademarks from 2010 merger					14.2%
Basic earnings per share (DKK)	1.7	2.1	2.4	3.5	6.8
Diluted earnings per share (DKK)	1.7	2.1	2.4	3.5	6.8
Dividend per share (DKK)					5.5
Pay-out ratio					80.7%

1. See definition/explanation of financial ratios in note 5.7 in the Annual Report 2016.
2. Excl. share of profit of associated companies.

FINANCIAL HIGHLIGHTS

SECOND QUARTER 2017

NET SALES

We delivered net sales of DKK 1,673 million (DKK 1,699 million) in the second quarter of 2017, a 1.5% decline versus same period of last year. Organic growth was negative at 1.1%.

Net sales breakdown:

DKKm	Q2 2017	Q2 2016	Q2 2017	Q2 2016
Handmade cigars	519	536	31%	32%
Machine-made cigars	635	647	38%	38%
Pipe tobacco	134	140	8%	8%
Fine-cut tobacco	148	148	9%	9%
Other	237	229	14%	13%
Total	**1,673**	**1,699**	**100%**	**100%**

The performance in our handmade cigar category was reasonable overall, as our branded business delivered healthy growth. Cigars International, our US online and catalogue business continues to be affected by the operational constraints resulting from the implementation of new IT infrastructure in the first quarter and which has mainly had a negative impact on the handmade cigars category. We see steady but slow progress and recovery in this respect and we continue our efforts to remedy the situation.

As a result, our handmade cigars category delivered negative organic growth of 3.2%. In machine-made cigars, we improved our performance versus previous quarters and delivered negative organic growth of 0.8%, mainly driven by stronger net sales in France, UK and Belgium. Pipe tobacco reported negative organic growth of 3.4% while fine-cut tobacco reported organic growth of 0.2%. The “Other” category showed positive organic growth of 3.5% driven by an increase in net sales from accessories and fire products as well as distribution of snuff in Canada.

GROSS PROFIT AND GROSS MARGIN

Reported gross profit was DKK 786 million (DKK 840 million), a decline of 6.3%. Gross profit was impacted by negative sales growth across categories as well as win-back activities in Cigars International. Finally, the reported gross profit for the quarter includes costs related to the announced optimisation and efficiency programmes and costs related to the impact from the TPD transition in the trade in May 2017. Adjusted for non-recurring items of DKK 26 million (DKK 8 million), gross profit was down 4.1%.

The adjusted gross margin was 48.5%, down 1.4pp from 49.9% in the same period of last year. The adjusted gross margin was adversely affected by lower production volumes, win-back activities in Cigars International as well as exchange rate developments, which reduced the gross margin by 0.5pp.

NON-RECURRING ITEMS

DKKm	Q2 2017			Q2 2016		
	Reported	Non-Recurring Items	Adjusted	Reported	Non-Recurring Items	Adjusted
Net Sales	1,673	-	1,673	1,699	-	1,699
Gross Profit	786	26	812	840	8	847
Gross-margin	47.0%		48.5%	49.4%		49.9%
EBITDA	315	35	349	366	8	374
EBITDA-margin	18.8%		20.9%	21.5%		22.0%

REPORTED EBITDA

DKKm	Q2 2017	Q2 2016
EBITDA Reported	**315**	**366**
TPD related costs	14	8
FDA related costs	3	-
Restructuring, optimisation and effiency programmes	17	-
EBITDA Adjusted	**349**	**374**

Non-recurring costs in the quarter were related to the implementation of previously announced restructuring programmes, which included the closure of our machine-made cigars factory in Nykøbing, Denmark at the end of the second quarter and in Wuustwezel, Belgium in the third quarter. Furthermore, we incurred TPD-related costs in the quarter arising from the deadline in May, after which older non-compliant products could no longer be sold to consumers.

As previously communicated, we estimate total non-recurring net costs for the full year 2017 of about DKK 50 million related to the final implementation of previously announced restructuring programmes and costs related to regulatory changes.

EBITDA

Reported EBITDA was DKK 315 million (DKK 366 million), down 14.1% due to the negative developments in net sales and gross profit, which were only partly offset by the lower OPEX. OPEX improved slightly to DKK 472 million (DKK 476 million). Adjusted for non-recurring costs, OPEX amounted to DKK 463 million (DKK 476 million). The positive change in OPEX was driven by the optimisation and efficiency programmes initiated in 2016 in combination with reduced marketing spend.

Our reported EBITDA margin was 18.8% (21.5%), a decline of 2.7pp. Adjusted EBITDA was DKK 349 million (DKK 374 million), a decline of 6.7% primarily driven by the lower net sales and lower gross profit margin as well as negative currency impact of DKK 11 million. In the quarter, organic EBITDA growth was negative at 3.8%.

NET PROFIT

Net profit was DKK 166 million (DKK 208 million), a 19.9% decline driven by the lower net sales and gross profit and partly offset by the reduced OPEX and income taxes.

CASH FLOW

The free cash flow in the second quarter was DKK 251 million (DKK 369 million), for a cash conversion rate of 110.6% (137.7%). The cash flow remains strong, but the quarterly performance relative to the year-before period was affected by lower earnings, payment of non-recurring restructuring costs and a less positive impact from the change in net working capital, which was only partly offset by a reduced level of investing activities, for which last years' comparative figures included TPD-related investments in new machinery.

1 JANUARY-30 JUNE 2017

NET SALES

Reported net sales for the six months period amounted to DKK 3,052 million (DKK 3,199 million), a 4.6% decline. Organic growth was negative at 5.0%.

Net sales breakdown:

DKKm	H1 2017	H1 2016	H1 2017	H1 2016
Handmade cigars	920	960	30%	30%
Machine-made cigars	1,158	1,246	38%	39%
Pipe tobacco	266	278	9%	9%
Fine-cut tobacco	274	300	9%	9%
Other	434	416	14%	13%
Total	**3,052**	**3,199**	**100%**	**100%**

Our overall performance in the six months period was adversely impacted by the implications of Cigars International's implementation of new IT infrastructure already mentioned. As a result, our handmade cigars category reported negative organic growth of 5.6%. Machine-made cigars reported negative organic growth of 6.4%. Net sales of machine-made cigars were affected by the total market decline and by inventory movements in France in the first quarter. Volumes in France normalised in the second quarter. Pipe tobacco and fine-cut tobacco reported negative organic growth of 4.9% and 9.2%, respectively, while our "Other" category showed positive organic growth of 3.5% driven by increased net sales from accessories like fire products.

GROSS PROFIT AND GROSS MARGIN

Reported gross profit was DKK 1,434 million (DKK 1,579 million), a drop of 9.1%. Gross profit was mainly impacted by negative sales growth, the IT-related implications in Cigars International and non-recurring costs related to the implementation of our optimisation and efficiency programmes as well as regulatory costs related mainly to the TPD transition. Adjusted for non-recurring items of DKK 31 million (DKK 8 million), gross profit was down by 7.6%.

The adjusted gross margin was 48.0%, down 1.6pp from 49.6% in the same period of last year. The adjusted gross margin was adversely affected by the issues mentioned above and by exchange rate developments which reduced the gross margin by 0.5pp.

NON-RECURRING ITEMS

DKKm	H1 2017			H1 2016		
	Reported	Non-Recurring Items	Adjusted	Reported	Non-Recurring Items	Adjusted
Net Sales	3,052	-	3,052	3,199	-	3,199
Gross Profit	1,434	31	1,466	1,579	8	1,586
Gross-margin	47.0%		48.0%	49.4%		49.6%
EBITDA	515	46	561	632	21	653
EBITDA-margin	16.9%		18.4%	19.8%		20.4%

REPORTED EBITDA

DKKm	H1 2017	H1 2016
EBITDA Reported	**515**	**632**
TPD related costs	16	10
FDA related costs	8	-
Restructuring, optimisation and effiency programmes	22	-
Cost related to Initial Public Offering (IPO)	-	11
EBITDA Adjusted	**561**	**653**

Non-recurring costs for the reporting period were related to the implementation of previously announced restructuring programmes covering the closure of our machine-made cigars factory in Nykøbing, Denmark at the end of the half-year and in Wuustwezel, Belgium in the third quarter. The reporting period also included TPD-related costs arising from the deadline in May, after which older non-compliant products could no longer be sold to consumers.

As previously communicated, we estimate total non-recurring net costs for the full year 2017 of about DKK 50 million related to the final implementation of previously announced restructuring programmes and costs related to regulatory changes.

EBITDA

Reported EBITDA was DKK 515 million (DKK 632 million), down 18.5%. Reported EBITDA was adversely affected by the developments in net sales and gross profit, which were only partly offset by the DKK 31 million improvement in OPEX to DKK 919 million (DKK 950 million). Adjusted for non-recurring costs, OPEX amounted to DKK 904 million (DKK 936 million). The positive development in OPEX was primarily driven by the optimisation and efficiency programmes initiated in 2016 in combination with lower spend on freight and marketing.

The reported EBITDA margin was 16.9% (19.8%), a 2.9pp decline. Adjusted EBITDA was DKK 561 million (DKK 653 million), a 14.1% drop driven by the lower net sales and lower gross profit margin as well as negative currency impact of DKK 15 million. Organic EBITDA growth for the six months period was negative at 11.8%.

NET PROFIT

Net profit was DKK 241 million (DKK 346 million), a 30.3% drop driven by the lower net sales and gross profit and partly offset by the reduced OPEX spend and lower income taxes. In addition, net profit was impacted by non-recurring impairment costs of DKK 9 million related to the closure of factories announced in 2016.

EARNINGS PER SHARE

Earnings per share (EPS) for the six months period were DKK 2.4 (DKK 3.5). Fully diluted EPS were DKK 2.4 (DKK 3.5).

CASH FLOW

The free cash flow for the six months period was DKK 299 million corresponding to a cash conversion rate of 80.7% and a significant improvement from last years' free cash flow of DKK 165 million and cash conversion rate of 68.0%. The significant improvement in the free cash flow relative to last year was driven by less negative change in net working capital for the period, a tax refund related to prior years and a significantly lower and more normalised level of investments than last year, which included the TPD-related investments in new machinery etc.

CAPITAL STRUCTURE AND NET INTEREST-BEARING DEBT

At 30 June 2017, we had net interest-bearing debt of DKK 2,630 million (DKK 3,379 million). The net interest-bearing debt to adjusted EBITDA ratio declined to 2.0x (2.4x in H1 2016).

In July 2017 we have extended the maturity of our long-term bank debt by one year, so it now matures in 2021 (1/3 of total) and 2022 (2/3 of total) respectively.

BUSINESS HIGHLIGHTS

OPTIMISATION AND EFFICIENCY PROGRAMMES

Our optimisation and efficiency programmes announced in 2015 continued to deliver according to plan. The anticipated savings are being diluted by the drop in machine-made cigar volumes. However, the majority of the expected savings for 2017 will crystallise in the third and fourth quarters driven by the reduced number of production sites. We closed our factory in Nykøbing, Denmark at the end of the second quarter and production has now been relocated to our other factories. As previously announced, the factory in Wuustwezel, Belgium will be closed in the third quarter of 2017, after which we will have reduced our global factory footprint from 14 to 12 sites.

In the second quarter, we recognised DKK 17 million in non-recurring costs and DKK 1 million in impairment charges related to the optimisation programmes we announced last year, and in the first half of 2017 we recognised DKK 22 million in non-recurring costs and DKK 9 million in impairment charges related to the same programmes.

The working capital programme which aims to reduce inventories by DKK 500 million on a like-for-like basis versus 2014 remains on track. We expect to reach our DKK 500 million target by the end of 2017, one year ahead of the original plan.

FDA REGULATIONS

We continued our efforts to ensure compliance with the various requirements of FDA's deeming regulations as they take effect.

In May 2017, the FDA deferred its enforcement of all deadlines set for 10 May 2017 or later by three months. On 28 July 2017, the FDA announced its intention to extend the timeline to submit tobacco product review applications for cigars and pipe tobacco until 8 August 2021 (previously May 2018). This was formalised on 4 August 2017. The extension provides us with additional time to sell out products that may not qualify for the resource-intensive process of preparing a product review application, and it enhances our ability to prepare quality applications when due. The FDA now also allows products covered by a timely-filed product application to remain on the market during the agency's review. The FDA has announced its ambition to make the product review process more efficient, predictable and transparent for manufacturers, which is something which we welcome at Scandinavian Tobacco Group. The FDA has thousands of product applications under review and reviews currently take several years from the time an application is submitted.

On 28 July 2017, the FDA announced a plan to begin a public dialogue about lowering nicotine levels in combustible cigarettes to non-addictive levels. The agency also announced that it intends to seek input from the public on topics such as approaches to regulating certain flavours in e-cigarettes and cigars, and it will solicit additional comments and scientific data related to the patterns of use and resulting public health impacts from premium cigars.

The litigation initiated by several US cigar and pipe tobacco-related associations challenging the legality of the FDA's regulation of cigars and pipe tobacco is still pending.

CAFÉ CRÈME DISPUTE IN FRANCE

The French Ministry of Health and Ministry of Budget have on 17 July 2017 issued an official notice annulling the ban issued in February 2017 against several tobacco product brand names, including our brand names Café Crème and Paradise (see company announcements 3/2017, 4/2017 and 22/2017). The ban was supposed to take effect in February 2018.

The background for the annulment was a decision by the Conseil d'État (the French supreme administrative court) in a case not involving Scandinavian Tobacco Group. The French court set aside the provision in French law which let the authorities declare brands non-compliant with the law as part of a general process for the approval of product prices.

In the case at hand, the Conseil d'État also decided to refer the matter of the application of article 13 in the EU Tobacco Products Directive to established trademarks to the EU Court of Justice, and whether an application of the article to trademarks respects the property right, the freedom of expression, the freedom to conduct a business and the principles of proportionality and legal certainty. Article 13, as implemented in French law, is the provision which was used to ban Café Crème and Paradise.

The EU Court of Justice on average takes 15 months to answer questions referred to it by the national courts.

Scandinavian Tobacco Group expects the case, which it raised before the Conseil d'État in defense of its Café Crème brand name, to be closed by the court, as the brand is no longer banned.

Key Data Per Category

	Q2 17	Q2 16	Change	H1 17	H1 16	Change	2016
Net sales (DKKm)							
Handmade cigars	519	536	-3.1%	920	960	-4.2%	2,067
Machine-made cigars	635	647	-1.8%	1,158	1,246	-7.0%	2,593
Pipe tobacco	134	140	-3.8%	266	278	-4.3%	569
Fine-cut tobacco	148	148	-0.3%	274	300	-8.7%	652
Other	237	229	3.6%	434	416	4.5%	864
Group total	**1,673**	**1,699**	**-1.5%**	**3,052**	**3,199**	**-4.6%**	**6,746**
Gross profit (DKKm)							
Handmade cigars	216	241	-10.4%	387	424	-8.8%	903
Machine-made cigars	303	338	-10.2%	563	664	-15.2%	1,280
Pipe tobacco	84	87	-3.1%	163	170	-4.1%	346
Fine-cut tobacco	88	85	4.0%	161	172	-6.2%	378
Other	95	89	6.4%	160	149	7.8%	318
Group total	**786**	**840**	**-6.3%**	**1,434**	**1,579**	**-9.1%**	**3,225**
Organic net sales growth (%)							
Handmade cigars	-3.2%	6.5%		-5.6%	9.8%		7.2%
Machine-made cigars	-0.8%	-3.8%		-6.4%	-4.2%		-3.9%
Pipe tobacco	-3.4%	-14.8%		-4.9%	-9.1%		-8.9%
Fine-cut tobacco	0.2%	-5.6%		-9.2%	7.3%		13.3%
Other	3.5%	-0.1%		3.5%	-5.0%		-3.6%
Group total	**-1.1%**	**-1.5%**		**-5.0%**	**0.1%**		**0.4%**
Volume impact (%)							
Handmade cigars	-0.3%	9.3%		-3.0%	11.3%		7.4%
Machine-made cigars	-2.7%	-5.5%		-7.7%	-6.2%		-6.0%
Pipe tobacco	-4.6%	-15.1%		-5.7%	-10.2%		-10.6%
Fine-cut tobacco	-6.4%	-12.2%		-15.2%	0.9%		7.1%
Other	-	-		-	-		-
Group total	**-**	**-**		**-**	**-**		**-**
Price/Mix impact (%)							
Handmade cigars	-2.9%	-2.8%		-2.6%	-1.5%		-0.2%
Machine-made cigars	2.0%	1.7%		1.3%	1.9%		2.2%
Pipe tobacco	1.1%	0.3%		0.8%	1.1%		1.7%
Fine-cut tobacco	6.6%	6.5%		5.9%	6.4%		6.2%
Other	-	-		-	-		-
Group total	**-**	**-**		**-**	**-**		**-**
Gross margin (%)							
Handmade cigars	41.6%	45.0%	-3.4%	42.1%	44.2%	-2.1%	43.7%
Machine-made cigars	47.8%	52.2%	-4.5%	48.6%	53.3%	-4.7%	49.3%
Pipe tobacco	62.4%	62.0%	0.4%	61.4%	61.2%	0.1%	60.8%
Fine-cut tobacco	59.9%	57.4%	2.5%	58.7%	57.2%	1.6%	57.9%
Other	40.0%	39.0%	1.0%	36.9%	35.8%	1.1%	36.8%
Group total	**47.0%**	**49.4%**	**-2.4%**	**47.0%**	**49.4%**	**-2.4%**	**47.8%**
Adjusted Gross margin (%)*							
Machine-made cigars	51.6%	53.3%	-1.7%	51.2%	53.9%	-2.7%	52.6%
Pipe tobacco	63.0%	62.3%	0.8%	61.7%	61.4%	0.3%	61.2%
Fine-cut tobacco	60.3%	57.6%	2.7%	59.0%	57.3%	1.7%	58.3%
Group total	**48.5%**	**49.9%**	**-1.4%**	**48.0%**	**49.6%**	**-1.6%**	**49.1%**

** Adjusted for non-recurring items*

CATEGORY UPDATE

HANDMADE CIGARS

Handmade cigars DKK MILLION	Q2 17	Q2 16	H1 17	H1 16	2016
Net sales	519	536	920	960	2,067
Reported growth	-3.1%	4.7%	-4.2%	8.6%	6.8%
Organic growth	-3.2%	6.5%	-5.6%	9.8%	7.2%
Gross profit	216	241	387	424	903
Gross margin, %	41.6%	45.0%	42.1%	44.2%	43.7%

Reported net sales for the second quarter fell to DKK 519 million (DKK 536 million). Organic growth was negative at 3.2%.

The price/mix impact was negative at 2.9% and the volume impact was negative at 0.3%.

Our branded cigars business continued to deliver positive growth in all channels during the quarter, driven by our focus on sales execution and keystone pricing. The sales outside the US continue to show double-digit growth rates however from a low base.

Cigars International's performance in the second quarter was still affected by the operational constraints resulting from the implementation of new IT infrastructure and ERP and warehouse management systems in the first quarter. Our focus in the second quarter was to resolve the issues related to the IT system and our customer service and inventory management in order to restore our ability to meet customer demand and run the necessary level of targeted campaigns and promotional activities to win back lost customers and recover net sales. We see steady but slow progress and recovery in this respect and we continue our efforts to remedy the situation.

The negative price/mix of 2.9% covers underlying opposing developments, as the branded business delivered a positive price/mix that was only able to partly offset the impact from special discount and promotional activities in Cigars International.

Gross profit was down by DKK 25 million to DKK 216 million in the second quarter, affected by the discounts and direct costs such as free shipping related to promotional activities in Cigars International. The gross margin was 41.6% (45.0%).

1 JANUARY-30 JUNE 2017

Reported net sales for the six months period declined to DKK 920 million (DKK 960 million). Organic net sales growth was negative at 5.6%. The price/mix impact was negative at 2.6% and the volume impact was negative at 3.0%.

Our branded cigars business continued to deliver positive growth in all channels in the six months reporting period, driven by our focus on sales execution and keystone pricing but not by enough to offset the negative performance of our online and catalogue business in Cigars International.

Our handmade cigars business was adversely affected in the reporting period by Cigars International's implementation of a new IT infrastructure and ERP and warehouse management systems. In the six months period, the negative price/mix was impacted by special offers and discounts in Cigars International's efforts to win back customers during the second quarter.

Gross profit fell by 8.8% to DKK 387 million (DKK 424 million) for a gross margin of 42.1% (44.2%). The decline was due to lower volumes and to the promotional activities in Cigars International.

MACHINE-MADE CIGARS

Machine-made cigars DKK MILLION	**Q2 17**	**Q2 16**	**H1 17**	**H1 16**	**2016**
Net sales	635	647	1,158	1,246	2,593
Reported growth	-1.8%	-5.3%	-7.0%	-5.1%	-4.0%
Organic growth *	-0.8%	-3.8%	-6.4%	-4.2%	-3.9%
Gross profit	303	338	563	664	1,280
Gross margin, %	47.8%	52.2%	48.6%	53.3%	49.3%
Gross margin, % adjusted *	51.6%	53.3%	51.2%	53.9%	52.6%

* Adjusted for non-recurring items

Reported net sales for the second quarter were DKK 635 million (DKK 647 million). Organic net sales growth was negative at 0.8%.

The price/mix impact was positive at 2.0%, while the volume impact was negative at 2.7%.

Total market developments remained unchanged, but we did see an improved trajectory in our European business as the TPD transition effects are beginning to fade. The improvements were mainly driven by stronger net sales in France, UK and Belgium as well as continuing sound price increases in most of our major markets. Mix changes have diluted the combined price/mix impact for the category.

Gross profit was DKK 303 million (DKK 338 million). Our cost optimisation and efficiency programme continues to deliver the expected cost reductions. In the second quarter, the programme was unable to offset the impact from low production volumes and the activities related to the ongoing closure of the factories in Nykøbing, Denmark and Wuustwezel, Belgium, which impacted our efficiency and triggered non-recurring restructuring costs. The gross margin was 47.8% (52.2%). The adjusted gross margin was 51.6% (53.3%).

1 JANUARY-30 JUNE 2017

Reported net sales for the six months period declined to DKK 1,158 million (DKK 1,246 million). Organic net sales growth was negative at 6.4%. The price/mix impact was 1.3% and the volume impact was negative at 7.7%. The price/mix was adversely affected by price competition in Canada at the beginning of the year and volumes were negatively impacted by inventory reductions by our distributor in France in the first quarter of 2017 in addition to the impact from overall market developments.

Gross profit declined by 15.2% to DKK 563 million (DKK 664 million) for a gross margin at 48.6% (53.3%). The adjusted gross margin was 51.2% (53.9%). Developments were driven by the lower volumes as well as the activities in especially the second quarter related to the closure of the cigar factories in Nykøbing, Denmark and Wuustwezel, Belgium.

PIPE TOBACCO

Pipe tobacco DKK MILLION	**Q2 17**	**Q2 16**	**H1 17**	**H1 16**	**2016**
Net sales	134	140	266	278	569
Reported growth	-3.8%	-16.2%	-4.3%	-10.2%	-9.5%
Organic growth	-3.4%	-14.8%	-4.9%	-9.1%	-8.9%
Gross profit	84	87	163	170	346
Gross margin, %	62.4%	62.0%	61.4%	61.2%	60.8%
Gross margin, % adjusted *	63.0%	62.3%	61.7%	61.4%	61.2%

* Adjusted for non-recurring items

Reported net sales for the second quarter were down by DKK 6 million to DKK 134 million (DKK 140 million). Organic growth was negative at 3.4%.

The price/mix impact was positive at 1.1%, while the volume impact was negative at 4.6%. Both the price/mix and the volume impact improved compared to the first quarter of 2017.

Deliveries to Middle East/Africa have started to recover and will continue to pick up in the second half of the year, although at somewhat reduced prices due to the macro-economic developments affecting the Nigerian market. In the second quarter, we once again successfully offset the effect of the structural volume decline for traditional pipe tobacco by applying effective pricing across most markets.

Gross profit was DKK 84 million (DKK 87 million). Gross margin was 62.4% (62.0%) and adjusted gross margin was 63.0% (62.3%).

1 JANUARY-30 JUNE 2017

Reported net sales for the six months period declined to DKK 266 million (DKK 278 million). Organic net sales growth was negative at 4.9%. The price/mix impact was positive at 0.8% and the volume impact was negative at 5.7%.

At the beginning of the reporting period, volumes were impacted by the disruption of deliveries to Middle East/Africa, which started in the first half of 2016. Net sales for the second quarter of this year improved as sales to the region resumed and comparisons were favourable.

Gross profit declined by 4.1% to DKK 163 million (DKK 170 million) for a gross margin of 61.4% (61.2%). Adjusted gross margin was 61.7% (61.4%).

FINE-CUT TOBACCO

Fine-cut tobacco

DKK MILLION	Q2 17	Q2 16	H1 17	H1 16	2016
Net sales	148	148	274	300	652
Reported growth	-0.3%	-7.6%	-8.7%	4.5%	11.8%
Organic growth	0.2%	-5.6%	-9.2%	7.3%	13.3%
Gross profit	88	85	161	172	378
Gross margin, %	59.9%	57.4%	58.7%	57.2%	57.9%
Gross margin, % adjusted *	60.3%	57.6%	59.0%	57.3%	58.3%

* Adjusted for non-recurring items

Reported net sales for the second quarter were DKK 148 million (DKK 148 million), for 0.2% organic growth.

The price/mix impact was positive at 6.6%, while the volume impact was negative at 6.4%. Both the price/mix and volume impact improved compared to the first quarter of 2017. We continued to gain market share in Germany but had lower volumes in most other major markets due to timing. Pricing remains a key priority.

Gross profit increased by 4.0% to DKK 88 million (DKK 85 million). Reported gross margin was 59.9% (57.4%) and adjusted gross margin was 60.3% (57.6%). Profitability improved as the effect of stronger pricing and cost savings more than offset the lower volumes.

1 JANUARY-30 JUNE 2017

Reported net sales for the six months period declined by DKK 26 million to DKK 274 million (DKK 300 million). Organic net sales growth was negative at 9.2%. The price/mix impact was positive at 5.9% and volume impact was negative at 15.2%.

The first six months were adversely affected by the timing of shipments in the first quarter to Norway and a tough comparison to the first quarter of 2016 when the timing of shipments to the Danish-German cross-border trade worked in our favour.

Gross profit declined by 6.2% to DKK 161 million (DKK 172 million) for a gross margin of 58.7% (57.2%). Adjusted gross margin was 59.0% (57.3%).

OTHER

Other

DKK MILLION	Q2 17	Q2 16	H1 17	H1 16	2016
Net sales	237	229	434	416	864
Reported growth	3.6%	1.2%	4.5%	-3.9%	-2.0%
Organic growth	3.5%	-0.1%	3.5%	-5.0%	-3.6%
Gross profit	95	89	160	149	318
Gross margin, %	40.0%	39.0%	36.9%	35.8%	36.8%

Reported net sales for the second quarter were up by DKK 8 million to DKK 237 million (DKK 229 million), equal to 3.5% organic growth. The growth was primarily driven by accessories, fire products and distribution of snuff in Canada.

Gross profit increased by 6.4% to DKK 95 million (DKK 89 million) and the gross margin increased to 40.0% (39.0%).

1 JANUARY-30 JUNE 2017

Reported net sales for six months period were up by DKK 18 million to DKK 434 million (DKK 416 million). Organic net sales growth was positive at 3.5%.

Gross profit increased by 7.8% to DKK 160 million (DKK 149 million), while the gross margin increased to 36.9% (35.8%).

EVENTS AFTER THE REPORTING PERIOD

No events have occurred since 30 June 2017 which are expected to have any material impact on the financial position of the Group.

FINANCIAL GUIDANCE 2017

We maintain our FY 2017 guidance ofslightly negative organic net sales growth and negative organic growth of 4-8% in adjusted EBITDA.

Our other financial expectations are:

- Financial expenses, excluding currency gains/losses, are expected to be in the range of DKK 80-90 million (previously DKK 70-80 million)
- The effective tax rate is expected to be in the range of 23-24% (previously 24-25%)
- Maintenance CAPEX is expected to be approx. DKK 150 million
- We expect remaining non-recurring costs of approx. DKK 50 million from our ongoing cost optimisation and efficiency programmes

The Board of Directors will continue to evaluate the distribution of excess cash to shareholders in connection with the third-quarter earnings release scheduled for November 2017.

ADDITIONAL INFORMATION

FINANCE CALENDAR FOR 2017

Interim report Q3 2017: 8 November 2017

FORWARD-LOOKING STATEMENTS

This 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 developments and results to differ materially from the expectations set out in this report.

MANAGEMENT STATEMENT

The Board of Directors and the Executive Management have today considered and approved the interim report of Scandinavian Tobacco Group A/S for the period 1 January – 30 June 2017.

The interim consolidated financial statements have been prepared in accordance with IAS 34 “Interim Financial Reporting” as adopted by the EU and additional Danish disclosure requirements for listed companies. The interim report has not been reviewed or audited.

In our opinion, the interim consolidated financial statements give a true and fair view of the Group's assets, liabilities and financial position at 30 June 2017 and of the results of the Group's operations and consolidated cash flows for the financial period 1 January – 30 June 2017.

Furthermore, in our opinion the Management Review gives a fair review of the development and performance of the Group's activities and of the Group's results for the period and financial position taken as a whole, together with a description of the most significant risks and uncertainties that the Group may face.

Soeborg, 24 August 2017

EXECUTIVE MANAGEMENT

Niels Frederiksen
CEO

Sisse Fjelsted Rasmussen
CFO

Christian Hother Sørensen
EXECUTIVE VICE PRESIDENT,
SALES & MARKETING

Vincent Crepy
EXECUTIVE VICE PRESIDENT,
SUPPLY CHAIN

BOARD OF DIRECTORS

Nigel Northridge
CHAIRMAN

Henrik Brandt
VICE-CHAIRMAN

Søren Bjerre-Nielsen

Dianne Neal Blixt

Conny Karlsson

Luc Missorten

Henning Kruse Petersen

Kurt Asmussen

Lindy Larsen

Hanne Malling

Mogens Olsen

CONSOLIDATED INCOME STATEMENT AND STATEMENT OF COMPREHENSIVE INCOME

1 JANUARY - 30 JUNE

CONSOLIDATED INCOME STATEMENT

DKK million	Note	Q2 2017	Q2 2016	H1 2017	H1 2016
Net sales	2	**1,673.2**	**1,699.3**	**3,052.1**	**3,198.7**
Cost of goods sold	2	-886.9	-859.8	-1,617.8	-1,620.0
Gross profit	2	**786.3**	**839.5**	**1,434.3**	**1,578.7**
Other external costs		-292.1	-304.6	-540.9	-569.0
Staff costs		-179.6	-171.8	-378.2	-380.9
Other income		0.0	3.0	0.0	3.2
Earnings before interest, tax, depreciation and amortisation (EBITDA)		**314.6**	**366.1**	**515.2**	**632.0**
Depreciation and impairment		-35.5	-28.4	-76.9	-55.6
Earnings before interest, tax and amortisation (EBITA)		**279.1**	**337.7**	**438.3**	**576.4**
Amortisation		-43.1	-41.9	-85.0	-83.6
Earnings before interest and tax (EBIT)		**236.0**	**295.8**	**353.3**	**492.8**
Share of profit of associated companies, net of tax		3.1	3.0	5.7	5.3
Financial income		1.6	5.3	7.1	17.7
Financial costs		-24.8	-28.8	-51.8	-57.2
Profit before tax		**215.9**	**275.4**	**314.3**	**458.6**
Income taxes		-49.4	-67.5	-73.2	-112.7
Net profit for the period		**166.5**	**207.9**	**241.1**	**345.9**
Earnings per share					
Basic earnings per share (DKK)		1.7	2.1	2.4	3.5
Diluted earnings per share (DKK)		1.7	2.1	2.4	3.5
OTHER COMPREHENSIVE INCOME					
Items that will not be recycled subsequently to the Consolidated Income Statement:					
Actuarial gains and losses on pension obligations		0.0	0.0	-1.6	0.0
Tax of actuarial gains and losses on pension obligations		0.0	0.0	0.5	0.0
Items that will be recycled subsequently to the Consolidated Income Statement, when specific conditions are met:					
Cash flow hedges, deferred gains/(losses) incurred during the period		2.2	-12.0	17.1	-52.7
Tax of hedging instruments		1.2	2.6	-3.4	11.6
Foreign exchange rate adjustments		-366.7	102.0	-429.4	-120.7
Other comprehensive income for the period, net of tax		**-363.3**	**92.6**	**-416.8**	**-161.8**
Total comprehensive income for the period		**-196.8**	**300.5**	**-175.7**	**184.1**

CONSOLIDATED BALANCE SHEET

ASSETS

DKK million	30 Jun 2017	30 Jun 2016	31 Dec 2016
NON-CURRENT ASSETS			
INTANGIBLE ASSETS			
Goodwill	4,374.8	4,449.9	4,592.0
Trademarks	3,118.6	3,261.5	3,259.6
IT software	94.8	68.3	85.5
Other intangible assets	191.4	217.1	204.5
Total intangible assets	**7,779.6**	**7,996.8**	**8,141.6**
PROPERTY, PLANT AND EQUIPMENT			
Land and buildings	598.7	661.4	622.1
Plant and machinery	516.6	374.9	555.6
Equipment, tools and fixtures	82.3	87.4	83.5
Leasehold improvements	42.2	43.2	46.7
Construction in progress	31.3	219.1	48.5
Total property, plant and equipment	**1,271.1**	**1,386.0**	**1,356.4**
OTHER NON-CURRENT ASSETS			
Investments in associated companies	133.0	126.0	134.6
Deferred income tax assets	128.3	130.6	137.2
Other financial fixed assets	9.1	0.6	0.0
Total other non-current assets	**270.4**	**257.2**	**271.8**
Total non-current assets	**9,321.1**	**9,640.0**	**9,769.8**
CURRENT ASSETS			
Inventories	**2,740.5**	**3,034.4**	**2,824.1**
RECEIVABLES			
Trade receivables	684.5	798.9	700.4
Other receivables	49.2	98.0	116.9
Corporate tax	158.1	161.2	210.4
Prepayments	84.1	65.8	71.8
Total receivables	**975.9**	**1,123.9**	**1,099.5**
Cash and cash equivalents	**542.0**	**363.7**	**570.3**
Total current assets	**4,258.4**	**4,522.0**	**4,493.9**
Total assets	**13,579.5**	**14,162.0**	**14,263.7**

CONSOLIDATED BALANCE SHEET

EQUITY AND LIABILITIES

DKK million	**30 Jun 2017**	**30 Jun 2016**	**31 Dec 2016**
Share capital	100.0	100.0	100.0
Reserve for hedging	-13.8	-71.4	-27.5
Reserve for currency translation	731.3	890.7	1,160.7
Treasury shares	-40.5	-22.1	-45.5
Retained earnings	7,776.7	7,762.8	8,085.2
Total equity	**8,553.7**	**8,660.0**	**9,272.9**
Bank loans	2,873.8	3,422.9	2,730.7
Deferred income tax liabilities	666.1	619.3	637.1
Pension obligations	260.2	225.8	263.8
Other provisions	50.2	43.5	36.3
Other liabilities	24.1	98.0	64.8
Total non-current liabilities	**3,874.4**	**4,409.5**	**3,732.7**
Trade payables	324.9	338.2	385.5
Corporate tax	176.2	171.6	183.0
Other provisions	67.2	19.8	113.9
Other liabilities	583.1	562.9	575.7
Total current liabilities	**1,151.4**	**1,092.5**	**1,258.1**
Total liabilities	**5,025.8**	**5,502.0**	**4,990.8**
Total equity and liabilities	**13,579.5**	**14,162.0**	**14,263.7**

CONSOLIDATED CASH FLOW STATEMENT

1 JANUARY - 30 JUNE

DKK million	Q2 2017	Q2 2016	H1 2017	H1 2016
Net profit for the period	166.5	207.8	241.1	345.9
Adjustments	116.4	159.2	245.4	277.3
Changes in working capital	85.9	149.5	-40.1	-144.5
Non-recurring costs, paid	-41.2	-24.7	-59.0	-79.6
Cash flow from operating activities before financial items	**327.6**	**491.8**	**387.4**	**399.1**
Financial income received	1.6	5.3	7.1	17.7
Financial costs paid	-24.8	-28.8	-51.8	-57.2
Cash flow from operating activities before tax	**304.4**	**468.3**	**342.7**	**359.6**
Tax payments	-34.1	-16.5	0.3	-55.5
Cash flow from operating activities	**270.3**	**451.8**	**343.0**	**304.1**
Investment in intangible assets	-11.2	-7.0	-21.7	-14.1
Investment in property, plant and equipment	-9.7	-80.3	-26.3	-133.5
Sale of property, plant and equipment	0.0	3.2	0.0	5.3
Dividend from associated companies	1.5	1.3	3.5	3.1
Cash flow from investing activities	**-19.4**	**-82.8**	**-44.5**	**-139.2**
Free cash flow	**250.9**	**369.0**	**298.5**	**164.9**
Revolving credit facility	223.2	112.0	223.2	112.0
Dividend payment	-550.0	-500.0	-550.0	-500.0
Purchase of treasury shares	0.0	-22.0	0.0	-22.0
Cash flow from financing activities	**-326.8**	**-410.0**	**-326.8**	**-410.0**
Net cash flow for the period	**-75.9**	**-41.0**	**-28.3**	**-245.1**
Cash and cash equivalents, net at 1 April / 1 January	617.9	404.7	570.3	608.8
Net cash flow for the period	-75.9	-41.0	-28.3	-245.1
Cash and cash equivalents, net at 30 June	**542.0**	**363.7**	**542.0**	**363.7**

STATEMENT OF CHANGES IN GROUP EQUITY

1 JANUARY - 30 JUNE 2017

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 period						
Net profit for the period	**0.0**	**0.0**	**0.0**	**0.0**	**241.1**	**241.1**
Other comprehensive income						
Cash flow hedges		17.1				**17.1**
Tax of cash flow hedges		-3.4				**-3.4**
Foreign exchange adjustments on net investments in foreign operations			-429.4			**-429.4**
Actuarial gains and losses on pension obligations					-1.6	**-1.6**
Tax of actuarial gains and losses on pension obligations					0.5	**0.5**
Total other comprehensive income	**0.0**	**13.7**	**-429.4**	**0.0**	**-1.1**	**-416.8**
Total comprehensive income for the period	**0.0**	**13.7**	**-429.4**	**0.0**	**240.0**	**-175.7**
Transactions with shareholders						
Share-based payments					6.5	**6.5**
Settlement of vested PSUs				5.0	-5.0	**0.0**
Dividend paid					-550.0	**-550.0**
Total transactions with shareholders	**0.0**	**0.0**	**0.0**	**5.0**	**-548.5**	**-543.5**
Equity at 30 June 2017	**100.0**	**-13.8**	**731.3**	**-40.5**	**7,776.7**	**8,553.7**

STATEMENT OF CHANGES IN GROUP EQUITY

1 JANUARY - 30 JUNE 2016

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 period						
Net profit for the period	**0.0**	**0.0**	**0.0**	**0.0**	**345.9**	**345.9**
Other comprehensive income						
Cash flow hedges		-52.7				**-52.7**
Tax of cash flow hedges		11.6				**11.6**
Foreign exchange adjustments on net investments in foreign operations			-120.7			**-120.7**
Total other comprehensive income	**0.0**	**-41.1**	**-120.7**	**0.0**	**0.0**	**-161.8**
Total comprehensive income for the period	**0.0**	**-41.1**	**-120.7**	**0.0**	**345.9**	**184.1**
Transactions with shareholders						
Purchase of treasury shares				-22.1		**-22.1**
Share-based payments					0.1	**0.1**
Dividend paid					-500.0	**-500.0**
Total transactions with shareholders	**0.0**	**0.0**	**0.0**	**-22.1**	**-499.9**	**-522.0**
Equity at 30 June 2016	**100.0**	**-71.4**	**890.7**	**-22.1**	**7,762.8**	**8,660.0**

NOTES

NOTE 1
BASIS OF PREPARATION

The unaudited interim report has been prepared in accordance with IAS 34 and additional Danish disclosure requirements for listed companies.

Significant accounting estimates

The estimates made by STG in the determination of the carrying amounts of assets and liabilities are based on assumptions that are subject to future events. For a description of risks and accounting estimates, see the Annual Report for 2016.

Accounting policies

The interim report has been prepared in accordance with the accounting policies set out in the Annual Report for 2016, with the additions described in the Q1 2017 report concerning the implementation of IFRS 9 ‘Financial Instruments’.

NOTE 2
SEGMENT INFORMATION

H1 2017 DKK million	**Hand-made cigars**	**Machine-made cigars**	**Pipe tobacco**	**Fine-cut tobacco**	**Other**	**Not allocated**	**Total**
Net sales	919.8	1,158.3	265.7	274.1	434.2	0.0	3,052.1
Cost of goods sold	-532.8	-595.3	-102.6	-113.1	-274.0	0.0	-1,617.8
Gross profit	**387.0**	**563.0**	**163.1**	**161.0**	**160.2**	**0.0**	**1,434.3**
Other external costs						-540.9	-540.9
Staff costs						-378.2	-378.2
Other income						0.0	0.0
EBITDA						**-919.1**	**515.2**
Depreciation and impairment						-76.9	-76.9
Amortisation						-85.0	-85.0
EBIT						**-1,081.0**	**353.3**
Share of profit of associated companies, net of tax						5.7	5.7
Financial income						7.1	7.1
Financial costs						-51.8	-51.8
Profit before tax						**-1,120.0**	**314.3**

NOTE 2
SEGMENT INFORMATION (continued)

H1 2016 DKK million	**Hand-made cigars**	**Machine-made cigars**	**Pipe tobacco**	**Fine-cut tobacco**	**Other**	**Not allocated**	**Total**
Net sales	959.7	1,245.6	277.7	300.1	415.6	0.0	3,198.7
Cost of goods sold	-535.3	-581.7	-107.7	-128.6	-266.7	0.0	-1,620.0
Gross profit	**424.4**	**663.9**	**170.0**	**171.5**	**148.9**	**0.0**	**1,578.7**
Other external costs						-569.0	-569.0
Staff costs						-380.9	-380.9
Other income						3.2	3.2
EBITDA						**-946.7**	**632.0**
Depreciation						-55.6	-55.6
Amortisation						-83.6	-83.6
EBIT						**-1,085.9**	**492.8**
Share of profit of associated companies, net of tax						5.3	5.3
Financial income						17.7	17.7
Financial costs						-57.2	-57.2
Profit before tax						**-1,120.1**	**458.6**

NOTE 3
FINANCIAL INSTRUMENTS

The fair value of financial instruments included in the balance sheet as per 30 June 2017 amounts to a net liability of DKK 38.0 million (DKK 45.0 million on 31 December 2016).