

HEAD NV

**TRANSCRIPT OF
FIRST QUARTER 2003
FINANCIAL RESULTS CALL**

THURSDAY MAY 15TH 2003

CHAIRMAN: CLARE VINCENT

INTERCALL UK

Clare Vincent

Good afternoon everyone and thank you very much for joining us for Head's first quarter conference call. By now, everyone should have received a copy of the press release that was sent out this morning and have access to the PowerPoint presentation that is posted to our web site. Joining us today from management are Johan Eliasch, Chairman and Chief Executive Officer and Ralf Bernhart, Chief Financial Officer. Before we get started, management would like me to inform you that the statements made in this conference call may be forward looking statements within the meaning of the US Private Securities Litigation Reform Act of 1995. In connection with such forward-looking statements, you should be aware that our actual results may vary materially from those projected in the forward looking statements. In addition, additional information concerning factors that could cause actual results to materially differ from those in the forward-looking statements is contained in our press release, dated May 15th 2003 as well as our prior filings on form 6K and our registration statements on the forms F1 and F4, all of which you are readily available.

If you would now like to turn to the PowerPoint presentation on our website, Johan and Ralph will present the quarterly results, discuss the performance of each of our divisions, comment on our capital and resources and give you their thoughts for the outlook for 2003. We will then take your questions. I would now like to turn it over to Johan.

Johan Eliasch

Thank you Clare. If you would like to move to the third slide entitled '**Summary of Quarter**'.

Market conditions have remained tough, and I will go into more detail on a divisional basis later. But against this backdrop reported sales dropped 2%. And in the last 12 months revenues are down only 1%. Our sales are of course affected by exchange rate with continued strengthening of the euro against the dollar helping our top line - on a constant currency basis the decline would have been much higher. The decline in local currency sales impacted our operating profit, and for the quarter it declined by \$7m from a \$2m loss in 2002 to \$9m in 2003.

On a divisional basis Winter Sports performed well in the quarter, with sales up 38% compared to last quarter, due to the late season snow conditions, strong product sell through, and of course strong euro.

In Racquet Sports Andre Agassi won his fourth Australian Open in an all Head final against Schuettler, so that was good news.

Product Split. If you would like to move to the fourth slide you will find a breakdown of our sales for the quarter by product business.

Normally we have only about 20% of our sales in the first quarter. Racquet Sales normally generate the majority of the income in this quarter, as Winter Sports sales only represent re-orders. Compared to the first quarter of 2002 the proportion of Racquet Sport sales has reduced from 63% to 58% due to current difficult trading conditions.

Geographic Split. The split by geography shows an increase in the proportion of European sales compared to US for first quarter 2003 compared to 2002. This increase in Europe is as result of the appreciation of the euro against the US dollar, and the relatively tougher market conditions, particularly in Tennis. And that is particularly prevalent in the US racquet market.

Market Dynamics. Without a doubt the market conditions have been tough in all our divisions. We believe that Winter Sports market has declined by 5% in 2002 due to two main reasons. The first reason is lack of snow at the beginning of the season in certain areas of Europe and east and North America. And the second is due to the difficult economic environment in the two important markets in Germany and Japan where we have seen significant market declines. Following several seasons of poor snow, the 02/03 snow arrived late in north Europe, but the season turned out to be one of the best we've ever had, which was good news, particularly in terms of sell-out of inventories. Whilst customers to the overall market has fallen by 5% we had much higher declines than some of our key competitors after experience some growth in 1999 and 2000.

The Racquet Sports market, is generally perceived to have declined in 2002 by approximately 5%, with racquet declining faster at 8% and balls at 2%. This we believe was due to the decline in the number of recreational tennis players, poor weather conditions, and in certain

key markets in the peak selling season on consumer reaction to a falling economy, where we experienced a strong deterioration in this market in the first three months of 2003.

Continuing on this slide, the overall market for Diving Equipment. Generally this has declined by 10% in 02 from 01, with the important US and Japanese markets showing, according to some estimates, a downturn in demand of up to 20%. This overall decline was essentially due to the general worldwide economic slowdown, and a consequent decrease in the number of end users of diving products travelling on holiday to diving and other resorts. Only certain markets such as South America and Eastern Europe showed some improvement across the industry in 2002. Since the beginning of 03 the diving market has been further impacted by the Iraq war and the SARS epidemic.

Next slide, **Winter Sports** sales have grown substantially during the first three months of 2003 compared with the first three months of 2002. It should, however, be borne in mind that this is not the critical quarter for Winter Sports, with majority of the sales being re-orders. Sales in this quarter normally represent less than 10% of the total year's sales. Even though it is not the most important quarter, the growth was a result of good sell-through of our products including the Intelligence and EDGE ski boots, both of which were launched for the 02/03 season. All products reported double-digit growth in overall sales in the division growing by 38%.

Whilst good visibility of our full year Winter Sports Sales is not available until later in the summer when the pre-season order books have been finalised. So far 2003 has started well for the Winter Sports division. Bookings are ahead of those achieved at the same time in 2002, and the reaction to the 03/04 season products presented at ISPO was very positive.

Racquet Sports. We have been experiencing very tough market conditions, particularly in the US. Both the tennis racquet and tennis ball markets were down by 14% for the first three months, largely as a result of this and also due to large one-off OEM business shipment in the first quarter of 2002, but was not repeated in 2003. Racquet Sports sales declined by 10.1% for the three months ended 31 March 03.

We believe that the decline in the market is short term with customer distractions such as the Iraq war and economic uncertainties. The unprecedented decline in tennis is as result mainly of lack of participation. However, we are confident that the consumers will return to the sport

once these distractions are eliminated. By geography, in our reporting currency, our sales have increased in Europe, but this was offset by double-digit decline in North America.

As market conditions remained tough, Head continues to make advances. Head market share in the US was up nearly one percentage point in the first quarter 2003 compared to the first quarter of 2002, and held its racquets global market share despite tough competition. The gross margin for the Racquet Sports division declined by 200 bps as a result of the strengthening of the euro and a reflection of the tough market conditions which have resulted in increased competition and lower average prices.

Next slide, **Diving**. Our Diving division sales for the first three months of 03 compared to 02 were down 11.7%. This is a reflection of current market conditions and the timing of shipments. The overall market for diving equipment in general we see has declined by 10%. With some important markets such as US and Japan showing, according to some estimates, the downturn in demand of up to 20%. This overall decline was we believe principally due to the general worldwide economic slowdown, and the consequent decrease in the number of end users in diving products, travelling on holiday to diving and other resorts. In the first quarter of 03 the Iraq war and the SARS epidemic exacerbated this effect. In addition to the poor market conditions our diving division result was also affected by the timing of shipments, but we expect to catch up.

Gross margins have declined due to higher sales of close-out products at lower margins, particularly in the US, and the strengthening of the euro against the dollar compared to the first quarter 02. Sales are expected to recover in the second quarter when a number of recently launched products reach the market. The momentum should extend into the second half of the year, with the launch of our new dive computer line and a special trade campaign planned for the fall.

Next slide, **Licensing**. Here revenues grew by 35.8% in the three months to 31 March 03 compared to the first three months of 02. This increase was predominantly due to timing of licensing receipts, and also in part due to the income from the new licensees taken on in 2002.

I will now hand over to Ralf Bernhart, our Chief Financial Officer who will comment on the financial results.

Ralf Bernhart

Thank you Johan. The seasonality of our business means historically we have always had a loss in the first quarter. For the first quarter of 2003 compared to 2002 this loss has grown by \$7m. Whilst it appears from our reported numbers that this is due to cost increases and margin erosions, this is not the case. The driver of the decline in profitability is mainly lower sales in local currencies, as Johan has just explained, due to the tough market shares and due to the tough development. We have on our side tried as much as possible to reduce the costs as well the variable costs in the local currencies, as also in the fixed costs. But the driver in specific is the exchange rate, where the fixed costs which are in local currencies the same way lower than last year, are now shown by close to 20% higher because most of the fixed costs are euro costs and we are reporting in US dollar. And it is similar for the variable costs, even if we have clearly to say that as an exporter we are influenced by the strong euro and our margins in percentage are going down.

If we look at the next page, **Balance Sheet Highlights**. Our balance sheet has also been impacted by exchange rate movement with European assets, working capital and the euro dominated high yield bonds increasing in dollar terms as a result of the strengthening of the euro. Working capital has in effect been managed down over the last 12 months, and in local currency terms working capital and net debt lower at 31 March 2003 than it was at the 31 March 2002.

When we look at the next slide, the impact of exchange rates is clearly also to be seen by looking at the movement in US dollar terms of our high yield bonds. You can see that in dollar it looks like from \$60.3m last year via \$68.9m end of December 2002, it was now calculated at \$71.5m end of March. In euro denominated the high yield bonds which is euro denominated, it was €69m for the end of March last year, and it was €65.6m end of December, and the same €65.6m for the end of March this year.

So I think now I will hand over again to Johan for the current outlook for our year 2003. Please, Johan.

Johan Eliasch

Thank you. So on the next slide here, Current Outlook for 2003. The outlook is tough especially in our Racquet Sports market. We are proactively managing the business through

these difficult conditions, but based on current market conditions we believe that our results will be below those achieved in 2002.

That's the end of the presentation, so I would now like to answer any questions that you may have.

Q&A Session

Dan Carroll

Hello, gentlemen. I'd just like to ask you a question around your dividend policy and share repurchase activities that have been announced, how you expect those to go for the rest of this year.

Johan Eliasch

Well we have no intention of paying a dividend for this year. And with regards to share repurchases we will ask at the AGM for authority to buy back up to 30% of outstanding shares. However, our intention here is not any other than have the maximum approval to have the maximum flexibility. I hope that answers your question.

Dan Carroll

It does, if I could just follow up with one other quick question around working capital? How much room do you think you have to get further improvements there?

Johan Eliasch

Ralf?

Ralf Bernhart

Yes we are working on inventories clearly to adjust to the business as we have to, and this is our main target and such that we bring this down. This will of course follow in relation to the sales clearly, but here we think that we have good terms.

Dan Carroll

Okay, and one very last question. Around Tennis, in the US are you holding market share?

Johan Eliasch

Yes, indeed we are. Based on the latest PIA numbers we are.

Dan Carroll

Great, thank you very much.

Gabor Bognor

Hi, I have three questions. The first related to working capital. You said if we measure it in local currency terms it was actually managed down on a year-on-year basis. Could you just give those figures and maybe compare that to the sales change in local currency terms in the same period?

Ralf Bernhart

The working capital went down by about 12% and in the last 12 months at constant currency the revenue went down by 4.3%. So we have reduced it relatively more.

Gabor Bognor

The second is in Japanese sales, the document you released showed Japanese revenue down 72.6% year-on-year, and I'm wondering what happened in that market? Are you withdrawing, or is there a distribution change? What has changed that the revenue has declined so catastrophically?

Johan Eliasch

It is winter sport in Japan and the first quarter that is not the most important. And the reality is that there are also some timing difference in it. But the market is not stable in Japan.

Gabor Bognor

But do you think you have underperformed the market?

Johan Eliasch

We feel that in the full year it shall be a better picture. And we don't think that we have underperformed, we are in the same as the total market. Definitely we don't feel that we are behind the market.

Gabor Bognor

My last question relates to your dividend and repurchase policy. Maybe I would take it in two parts. The first is, why are you eliminating the dividend given that your cash position has actually improved? And the second part is, historically you have told us that part of the reason you are not more active in repurchasing shares is relating to the constraint of only being able to trade up to a certain proportion of the flow in the market. Considering that this is the case, are you considering tender for shares to repurchases, ie non-market purchases but a capital market transaction to repurchase shares?

Johan Eliasch

The answer to that is negative.

Gabor Bognor

And on the dividend issue?

Johan Eliasch

On the dividend, as I said we have no intention to pay dividend this year?

Gabor Bognor

My question is why is that considering that your cash position has actually improved?

Johan Eliasch

Because looking at the results of last year, and also the outlook for this year, we think that dividend paying is not prudent.

Gabor Bognor

Can we expect this to be a long-term change in your dividend policy, ie are you communicating to the market that your ability to pay dividends is impaired for the indefinite future?

Johan Eliasch

No, we are not. We are saying whether we pay dividends on a year-by-year basis, and we feel that it is not prudent to do so this year given the results and the market outlook.

Gabor Bognor

Thank you.

Eugene Demario

I just would like to have the variation in sales on a constant currency basis for the different product categories in the quarter? Thanks.

Johan Eliasch

Eugene, if I may suggest that to an extent whatever numbers we can give you here we will fax to you.

Eugene Demario

Okay, thanks.

Johan Eliasch

Or call Clare direct.

Clare Vincent

Could I clarify that. We do have an issue where we cannot actually give you now constant currency sales numbers because we have to reconcile them to US GAAP under the new disclosure requirements in the US.

Eugene Demario

I see, okay.

Clare Vincent

So unfortunately that will cause us a problem. We can however provide you with unit numbers.

Eugene Demario

Yes, that would be very helpful

Clare Vincent

Would you like those faxed or should we do it over the phone?

Eugene Demario

Over the phone.

Clare Vincent

Okay, quarter one 2003, tennis racquets including contract manufacturing, 480,000. Tennis balls, again including contract manufacturing, 1.9m dozen.

Eugene Demario

I'm sorry, maybe with the variation against the year before?

Johan Eliasch

May I suggest, Clare, if you call Eugene after the conference call and give those figures.

Eugene Demario

Oh right, let's do that. Thanks.

Kia Agemalo.

Yes, hello. I would also be interested in the unit numbers of sales per division. And then also relating to Racquet Sports, what kind of development have you seen in April and May? And also do you expect the whole year market in Racquet Sports to grow or decline? And then lastly have you seen any change in competitive dynamics following the previous NBO? Thanks.

Johan Eliasch

We have not seen any change in the competitive dynamics among the three top players. The trends here are quite clear. If you look at what's happening to Wilson and also Prince if there is a change in market dynamics it's coming from predominantly Babolat at the expense of Wilson and Prince. Whereas our market share is actually going up a little bit.

Kia Agemalo.

Sorry I also asked before that, do you expect Racquet Sports market to grow or decline in this year.

Johan Eliasch

We would think that there is downside risk for the market, not significant given what it is today, but there is further downside risk.

Kia Agemalo.

And then lastly what kind of development in Racquet Sports have you seen in April and May?

Johan Eliasch

It's really too early to tell, to give a picture for the rest of the year.

Kia Agemalo.

Okay, thanks.

Gabor Bognor

Hi, I forgot to ask you about capital expenditure, which was relatively low this quarter.

Could you explain whether you have changed your expectation for a \$20m or so of annual Capex? And if you have, why?

Clare Vincent

I'm happy to take that. Capital expenditure is obviously very lumpy, it depends on projects. So one quarter will not give you a good indication of the full year. However, we do want to reduce capital expenditure this year slightly below the 20m of last year, and that's purely just due to a review of current requirements by the divisions.

Gabor Bognor

To what level approximately?

Clare Vincent

Probably reduce it by 2m.

Gabor Bognor

Okay, thank you.

Johan Eliasch

Thank you very much.

Clare Vincent

If there are no further questions I'd like to thank you all for your time and we will be ending the conference call now.

Operator

Thank you, that does conclude our conference for today. I would like to remind all parties, today's conference has been recorded and you will find all replay facility details on the Head NV website. You may all disconnect and thank you for participating.