SMUCKER J M CO
Form 10-Q
December 09, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTIONS 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended October 31, 2008

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission file number 1-5111

THE J. M. SMUCKER COMPANY

(Exact name of registrant as specified in its charter)

Ohio	34-0538550
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
One Strawberry Lane Orrville, Ohio	44667-0280
(Address of principal executive offices)	(Zip code)

Registrant s telephone number, including area code: (330) 682-3000

N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for at least the past 90 days. Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller Reporting Company o

Indicate by check mark whether the registrant is a shell company as defined in Rule 12b-2 of the Exchange Act of 1934.

Yes o No þ

The Company had 118,432,164 common shares outstanding on November 30, 2008.

The Exhibit Index is located at Page No. 26.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

THE J. M. SMUCKER COMPANY
CONDENSED STATEMENTS OF CONSOLIDATED INCOME
(UNAUDITED)

	Three Months Ended October 31,		Six Months Ended October 31,	
	2008	2007	2008	2007
	(Dollars in thousands, except per share data)			
Net sales	$ 843,142	$ 707,890	$ 1,506,799	$ 1,269,403
Cost of products sold	599,723	489,402	1,055,601	864,931
Gross Profit	243,419	218,488	451,198	404,472
Selling, distribution, and administrative expenses	151,292	131,361	283,176	248,111
Merger and integration costs	6,210	2,552	9,610	2,984
Restructuring costs	127	588	646	901
Other operating (income) expense net	(507)	313	(359)	(1,373)
Operating Income	86,297	83,674	158,125	153,849
Interest income	1,901	3,826	3,239	7,321
Interest expense	(11,314)	(10,917)	(22,058)	(21,010)
Other income (expense) net	341	(707)	1,366	(461)
Income Before Income Taxes	77,225	75,876	140,672	139,699
Income taxes	25,772	25,710	46,928	48,772
Net Income	$ 51,453	$ 50,166	$ 93,744	$ 90,927
Earnings per common share:				
Net Income	$ 0.95	$ 0.88	$ 1.73	$ 1.60
Net Income Assuming Dilution	$ 0.94	$ 0.87	$ 1.71	$ 1.58
Dividends declared per common share	$ 5.32	$ 0.30	$ 5.64	$ 0.60

See notes to unaudited condensed consolidated financial statements.

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THE J. M. SMUCKER COMPANY
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	October 31, 2008	April 30, 2008
	(Dollars in thousands)	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 166,312	$ 171,541
Trade receivables, less allowances	267,498	162,426
Inventories:		
Finished products	335,647	280,568
Raw materials	164,961	99,040
	500,608	379,608
Other current assets	70,942	62,632
Total Current Assets	1,005,360	776,207
PROPERTY, PLANT, AND EQUIPMENT		
Land and land improvements	45,765	45,461
Buildings and fixtures	208,160	202,564
Machinery and equipment	614,117	586,502
Construction in progress	47,362	39,516
	915,404	874,043
Accumulated depreciation	(401,402)	(377,747)
Total Property, Plant, and Equipment	514,002	496,296
OTHER NONCURRENT ASSETS		
Goodwill	1,121,406	1,132,476
Other intangible assets, net	638,388	614,000
Other noncurrent assets	97,185	110,902
Total Other Noncurrent Assets	1,856,979	1,857,378
	$ 3,376,341	$ 3,129,881
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 146,799	$ 119,844
Current portion of long-term debt	75,000	
Other current liabilities	245,532	119,553
Total Current Liabilities	467,331	239,397
NONCURRENT LIABILITIES		
Long-term debt	1,113,205	789,684
Deferred income taxes	168,226	175,950

Other noncurrent liabilities	115,294	124,997
Total Noncurrent Liabilities	1,396,725	1,090,631
SHAREHOLDERS EQUITY		
Common shares	13,715	13,656
Additional capital	1,189,170	1,181,645
Retained income	331,634	567,419
Amount due from ESOP Trust	(4,830)	(5,479)
Accumulated other comprehensive (loss) income	(17,404)	42,612
Total Shareholders Equity	1,512,285	1,799,853
	$ 3,376,341	$ 3,129,881

See notes to unaudited condensed consolidated financial statements.

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THE J. M. SMUCKER COMPANY
CONDENSED STATEMENTS OF CONSOLIDATED CASH FLOWS
(Unaudited)

	Six Months Ended October 31,	
	2008	2007
	(Dollars in thousands)	
OPERATING ACTIVITIES		
Net income	$ 93,744	$ 90,927
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	30,043	28,651
Amortization	2,953	1,538
Share-based compensation expense	6,035	5,973
Changes in assets and liabilities, net of effect from businesses acquired:		
Trade receivables	(111,932)	(86,577)
Inventories	(123,134)	(61,975)
Accounts payable and accrued items	108,759	62,835
Other adjustments	2,254	(2,060)
Net cash provided by operating activities	8,722	39,312
INVESTING ACTIVITIES		
Businesses acquired, net of cash acquired	(56,076)	(163,494)
Additions to property, plant, and equipment	(55,770)	(36,319)
Proceeds from sale of business		3,407
Purchases of marketable securities		(179,505)
Sales and maturities of marketable securities	866	183,411
Disposals of property, plant, and equipment	2,009	590
Other net	6,258	(144)
Net cash used for investing activities	(102,713)	(192,054)
FINANCING ACTIVITIES		
Proceeds from long-term debt	400,000	400,000
Repayments of long-term debt		(148,000)
Dividends paid	(309,160)	(34,243)
Purchase of treasury shares	(3,356)	(3,627)
Proceeds from stock option exercises	1,850	16,655
Other net	335	2,758
Net cash provided by financing activities	89,669	233,543
Effect of exchange rate changes	(907)	5,090
Net (decrease) increase in cash and cash equivalents	(5,229)	85,891
Cash and cash equivalents at beginning of period	171,541	199,541
Cash and cash equivalents at end of period	$ 166,312	$ 285,432

( ) Denotes use of cash

See notes to unaudited condensed consolidated financial statements.

THE J. M. SMUCKER COMPANY
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)

Note A Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the U.S. for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles in the U.S. for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the six-month period ended October 31, 2008, are not necessarily indicative of the results that may be expected for the year ending April 30, 2009. For further information, reference is made to the consolidated financial statements and footnotes included in the Company s Annual Report on Form 10-K for the year ended April 30, 2008. References to the Company in the financial statements include the accounts of wholly-owned subsidiaries and any majority-owned investment. Intercompany transactions and accounts are eliminated in consolidation.

Effective May 1, 2008, the Company adopted the financial statement presentation requirements of Financial Accounting Standards Board Staff Position No. FIN 39-1, *An Amendment to FASB Interpretation No. 39*, (FSP FIN 39-1). Among other amendments, FSP FIN 39-1 requires the Company to make an accounting policy election to offset or not offset fair value amounts recognized for derivative instruments and fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral arising from derivative instruments recognized at fair value with the same counterparty under a master netting arrangement. The effects of FSP FIN 39-1 are to be applied retrospectively to all periods presented. The Company has elected to not offset fair value amounts recognized for derivative instruments and its cash margin accounts executed with the same counterparty. The Company has cash margin accounts of $26,193 and $12,634 at October 31, 2008 and April 30, 2008, respectively, that are included in other current assets in the Condensed Consolidated Balance Sheets. Prior to adoption, the Company s cash margin accounts were included in cash and cash equivalents in the Condensed Consolidated Balance Sheets as they were not considered material. The retrospective application of FSP FIN 39-1 had no impact on the Company s financial position or results of operations for all periods presented and resulted in a decrease of $1.1 million in cash provided by operating activities for the six months ended October 31, 2007.

Note B Subsequent Event

On November 6, 2008, the Company merged The Folgers Coffee Company (Folgers), a subsidiary of The Procter & Gamble Company (P&G), with and into the Company. Under the terms of the agreement, P&G distributed the Folgers common shares to P&G shareholders in a tax-free transaction, which was immediately followed by the conversion of the Folgers common stock into Company common shares. In the merger, P&G shareholders received approximately 63.2 million common shares of the Company valued at approximately $3.4 billion based on the average closing price of the Company s common shares for the period beginning two trading days before and concluding two trading days after the announcement of the transaction on June 4, 2008. Upon closing of the transaction on November 6, 2008, the Company had approximately 118 million common shares outstanding. As part of the transaction, the Company s debt obligations increased by $350 million as a result of its guarantee of Folgers LIBOR-based variable rate notes. In addition, on October 23, 2008, the Company issued $400 million in Senior Notes with a weighted-average interest rate of 6.6 percent. A portion of the proceeds was used to fund the payment of the $5 per share one-time special dividend on the Company s common shares, totaling approximately $274 million, on October 31, 2008.

The transaction with Folgers, the leading producer of retail packaged coffee products in the United States, is consistent with the Company s strategy to own and market number one brands in North

America. For accounting purposes, the Company is the acquiring enterprise. The merger was accounted for as a purchase business combination. Accordingly, the results of the Folgers business will be included in the Company s consolidated financial statements from the date of the merger.

The purchase price will be allocated to the underlying assets acquired and liabilities assumed based upon their estimated fair values at the date of acquisition. The Company will determine the estimated fair values with the assistance of independent appraisals, discounted cash flow analyses, quoted market prices, and estimates made by management. To the extent the purchase price exceeds the fair value of the net identifiable tangible and intangible assets acquired, such excess will be allocated to goodwill.

Had the acquisition occurred on May 1, 2007, unaudited, pro forma consolidated results would have been as follows:

	Three Months Ended October 31,		Six Months Ended October 31,	
	2008	2007	2008	2007
Net sales	$ 1,351,637	$ 1,166,823	$ 2,406,141	$ 2,110,436
Net income	$ 116,837	$ 108,629	$ 189,659	$ 200,458
Net income per common share assuming dilution	$ 0.99	$ 0.90	$ 1.61	$ 1.66

The unaudited, pro forma consolidated results are based on the Company s historical financial statements and those of the acquired businesses and do not necessarily indicate the results of operations that would have resulted had the acquisition been completed at the beginning of the applicable period presented, nor is it indicative of the results of operations in future periods.

Note C Fair Value Measurements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 and related interpretations provide guidance for using fair value to measure assets and liabilities and only applies when other standards require or permit the fair value measurement of assets and liabilities. It does not expand the use of fair value measurement. In February 2008, the FASB issued Staff Position No. 157-2, *Effective Date of FASB Statement No. 157* (FSP SFAS 157-2). FSP SFAS 157-2 amends SFAS 157 to delay the effective date of the standard, as it relates to nonfinancial assets and nonfinancial liabilities, to fiscal years beginning after November 15, 2008, (May 1, 2009, for the Company). SFAS 157 for financial assets and financial liabilities was effective for fiscal years beginning after November 15, 2007. Effective May 1, 2008, the Company adopted the provisions of SFAS 157. The adoption of SFAS 157 did not have a material impact on the Company s condensed consolidated financial statements.

SFAS 157 valuation techniques are based on observable and unobservable inputs. Observable inputs reflect readily obtainable data from independent sources, while unobservable inputs reflect the Company s market assumptions. SFAS 157 classifies these inputs into the following hierarchy:

Level 1 Inputs Quoted prices for identical instruments in active markets.

Level 2 Inputs Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 Inputs Instruments with primarily unobservable value drivers.

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The following table is a summary of the fair values of the Company s financial assets (liabilities).

	Level 1	Level 2	Level 3	Fair Value at October 31, 2008	Fair Value at April 30, 2008
Marketable securities [A]	$	$ 14,150	$	$ 14,150	$ 16,043
Other investments and securities [B]	10,003	15,510		25,513	25,563
Derivatives [C]	(22,731)			(22,731)	1,269
Total	$ (12,728)	$ 29,660	$	$ 16,932	$ 42,875

(A) The Company s marketable securities consist entirely of mortgage-backed securities. The securities are broker-priced, and valued by a third party using an evaluated pricing methodology. An evaluated pricing methodology is a valuation technique which uses inputs that are derived principally from or corroborated by observable market data.

(B) The Company maintains funds for the payment of benefits associated with nonqualified retirement plans. These funds consist of equity securities listed in active markets

and municipal bonds. The municipal bonds are valued by a third party using an evaluated pricing methodology.

(C) The Company s commodity derivatives are valued using quoted market prices.

Note D Share-Based Payments

The Company provides for equity-based incentives to be awarded to key employees and nonemployee directors. These incentives are administered through various plans, and currently consist of restricted shares, restricted stock units, deferred shares, deferred stock units, performance units, and stock options.

During the six months ended October 31, 2008, the Company granted 9,565 deferred stock units and 204,595 restricted shares to employees, with 65,830 of these representing the conversion of performance units into restricted shares, all with a grant date fair value of $51.37 per share and a total fair value of $11,001. Also during the six months ended October 31, 2008, the Company granted performance units to certain executives. The performance units granted correspond to approximately 65,182 common shares with a grant date fair value of $51.37 per share and a total fair value of $3,348. During the six months ended October 31, 2008, 11,011 deferred stock units were granted to nonemployee directors with a grant date fair value of $50.89 per share and a total fair value of $560. The grant date fair value of these awards was the average of the high and low stock price on the date of grant.

Compensation expense related to share-based awards was $3,236 and $3,147 for the three months ended October 31, 2008 and 2007, and $6,035 and $5,973 for the six months ended October 31, 2008 and 2007, respectively. The related tax benefit recognized was $1,080 and $1,065 for the three months ended October 31, 2008 and 2007, and $2,013 and $2,085 for the six months ended October 31, 2008 and 2007, respectively.

As of October 31, 2008, total compensation cost related to nonvested share-based awards not yet recognized was approximately $19,017. The weighted-average period over which this amount is expected to be recognized is approximately 3.1 years.

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Note E Restructuring

In 2003, the Company announced its plan to restructure certain operations as part of its ongoing efforts to refine its portfolio, optimize its production capacity, improve productivity and operating efficiencies, and improve the Company s overall cost base as well as service levels in support of its long-term strategy. To date, the Company has completed a number of transactions resulting in the rationalization or divestiture of manufacturing facilities and businesses in the United States, Europe, and Canada, including the September 2006 sale of the Canadian nonbranded businesses, which were acquired as part of International Multifoods Corporation, to Horizon Milling G.P., a subsidiary of Cargill and CHS Inc. The restructurings resulted in the reduction of approximately 410 full-time positions.

The Company expects to incur total restructuring costs of approximately $69 million related to these initiatives, of which $59.1 million has been incurred since the announcement of the initiatives in March 2003. The balance of the costs and remaining cash payments, estimated to be approximately $9.9 million and $1.9 million, respectively, are related to the Canadian restructuring and are anticipated to be incurred through 2009.

The following table summarizes the activity with respect to the restructuring and related asset impairment charges recorded and reserves established and the total amount expected to be incurred.

	Employee Separation	Long-Lived Asset Charges	Equipment Relocation	Other Costs	Total
Total expected restructuring charge	$ 16,900	$ 20,700	$ 6,900	$ 24,500	$ 69,000
Balance at May 1, 2007	$ 528	$	$	$	$ 528
First quarter charge to expense	53			260	313
Second quarter charge to expense				588	588
Third quarter charge to expense		262	64	641	967
Fourth quarter charge to expense		1,248	48	1,583	2,879
Cash payments	(176)		(112)	(3,072)	(3,360)
Noncash utilization		(1,510)			(1,510)
Balance at April 30, 2008	$ 405	$	$	$	$ 405
First quarter charge to expense				519	519
Second quarter charge to expense				127	127
Cash payments				(646)	(646)
Balance at October 31, 2008	$ 405	$	$	$	$ 405
Remaining expected restructuring charge	$ 400	$	$	$ 9,500	$ 9,900

Total restructuring charges were $127 and $588 for the three months ended October 31, 2008 and 2007, and $646 and $901 for the six months ended October 31, 2008 and 2007, respectively. Expected employee separation costs are being recognized over the estimated future service period of the related employees. The obligation related to employee separation costs is included in other current liabilities in the Condensed Consolidated Balance Sheets.

Long-lived asset charges include impairments and accelerated depreciation related to machinery and equipment that will be used at the affected production facilities until they close or are sold. Other costs include miscellaneous expenditures associated with the Company s restructuring initiative and are expensed as incurred. These costs include employee relocation, professional fees, and other closed facility costs.

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Note F Common Shares

At October 31, 2008, 150,000,000 common shares were authorized. There were 54,861,343 and 54,622,612 shares outstanding at October 31, 2008 and April 30, 2008, respectively. Shares outstanding are shown net of 10,574,237 and 10,807,615 treasury shares at October 31, 2008 and April 30, 2008, respectively.

Note G Operating Segments

The Company operates in one industry: the manufacturing and marketing of food products. The Company has two reportable segments: U.S. retail market and special markets. The U.S. retail market segment includes the consumer and consumer oils and baking strategic business areas. This segment primarily represents the domestic sales of *Smucker s®, Jif®, Crisco®, Pillsbury®, Eagle Brand®, Hungry Jack®, White Lily®*, and *Martha White®* branded products to retail customers. The special markets segment is comprised of the international, foodservice, beverage, and Canada strategic business areas. Special markets segment products are distributed domestically and in foreign countries through retail channels, foodservice distributors and operators (i.e., restaurants, schools and universities, health care operations), and health and natural foods stores and distributors.

The following table sets forth reportable segment information.

	Three Months Ended October 31,		Six Months Ended October 31,	
	2008	2007	2008	2007
Net sales:				
U.S. retail market	$ 634,988	$ 535,224	$ 1,107,129	$ 953,379
Special markets	208,154	172,666	399,670	316,024
Total net sales	$ 843,142	$ 707,890	$ 1,506,799	$ 1,269,403
Segment profit:				
U.S. retail market	$ 98,960	$ 98,407	$ 186,821	$ 177,165
Special markets	26,451	20,788	47,189	42,424
Total segment profit	$ 125,411	$ 119,195	$ 234,010	$ 219,589
Interest income	1,901	3,826	3,239	7,321
Interest expense	(11,314)	(10,917)	(22,058)	(21,010)
Amortization	(1,482)	(1,417)	(2,953)	(1,538)
Share-based compensation expense	(3,236)	(3,147)	(6,035)	(5,973)
Restructuring costs	(127)	(588)	(646)	(901)
Merger and integration costs	(6,210)	(2,552)	(9,610)	(2,984)
Corporate administrative expenses	(27,736)	(27,249)	(56,628)	(55,380)
Other unallocated income (expense)	18	(1,275)	1,353	575
Income before income taxes	$ 77,225	$ 75,876	$ 140,672	$ 139,699

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Note H Long-Term Debt and Financing Arrangements

Long-term debt consists of the following:

	October 31, 2008		April 30, 2008	
6.77% Senior Notes due June 1, 2009	$	75,000	$	75,000
6.60% Senior Notes due November 13, 2009		203,205		204,684
7.94% Series C Senior Notes due September 1, 2010		10,000		10,000
4.78% Senior Notes due June 1, 2014		100,000		100,000
6.12% Senior Notes due November 1, 2015		24,000		
6.63% Senior Notes due November 1, 2018		376,000		
5.55% Senior Notes due April 1, 2022		400,000		400,000
Total long-term debt	$	1,188,205	$	789,684
Current portion of long-term debt		75,000		
Total long-term debt less current portion	$	1,113,205	$	789,684

On October 23, 2008, the Company issued $400 million in Senior Notes in two series with maturity dates of November 1, 2015 and November 1, 2018. A portion of the proceeds from the Notes was used to fund costs related to the Folgers merger and the payment of the $5 per share one-time special dividend, totaling approximately $274 million, on October 31, 2008. Additional proceeds will be used to finance other strategic and long-term initiatives as determined by the Company.

All of the Company s Senior Notes are unsecured and interest is paid annually on the 6.60 percent Senior Notes and semiannually on the other notes. The 6.60 percent Senior Notes are guaranteed by Diageo plc. The guarantee may terminate, in limited circumstances, prior to the maturity of the notes. Among other restrictions, the note purchase agreements contain certain covenants relating to liens, consolidated net worth, and sale of assets as defined in the agreements. The Company is in compliance with all covenants.

In addition, as part of the Folgers merger on November 6, 2008, the Company s debt obligations increased by $350 million as a result of its guarantee of Folgers LIBOR-based variable rate debt due November 7, 2009.

Note I Earnings per Share

The following table sets forth the computation of earnings per common share and earnings per common share assuming dilution.

	Three Months Ended October 31,		Six Months Ended October 31,	
	2008	2007	2008	2007
Numerator:				

plus a return equal to the Contingent Return of 10.00%,
resulting in a Payment at Maturity of $11.00 per $10.00 Face
Amount of Securities, calculated as follows:

$10.00 + ($10.00 x the *greater of* (i) Contingent Return and (ii) Index Return)

$10.00 + ($10.00 × 10.00%) = $10.00 + $1.00 = $11.00

Example 4 — The Final Index Level of 2,700.00 is less than the Initial Index Level of 3,000.00, resulting in an Index Return of -10.00%. Because the Final Index Level of 2,700.00 is greater than the Trigger Level of 2,100.00 and the Index Return of -10.00% is less than the Contingent Rate of 10.00%, Deutsche Bank AG will pay you Face Amount *plus* a return equal to the Contingent Return of 10.00%, resulting in a Payment at Maturity of $11.00 per $10.00 Face Amount of Securities, calculated as follows:

$10.00 + ($10.00 x the *greater of* (i) Contingent Return and (ii) Index Return)

$10.00 + ($10.00 × 10.00%) = $10.00 + $1.00 = $11.00

Example 5 — The Final Index Level of 1,500.00 is less than the Initial Index Level of 3,000.00, resulting in an Index Return of -50.00%. Because the Final Index Level of 1,500.00 is less than the Trigger Level of 2,100.00, Deutsche Bank AG will pay you less than your initial investment, resulting in a loss that is proportionate to the percentage decline in the level of the Index, and a Payment at Maturity of $5.00 per $10.00 Face Amount of Securities, calculated as follows:

$10.00 + ($10.00 x Index Return)

$10.00 + ($10.00 × -50.00%) = $5.00

If the Final Index Level is less than the Trigger Level on the Final Valuation Date, you will be fully exposed to any negative Index Return and, for each $10.00 Face Amount of Securities, the Issuer will pay you less than the Face Amount, resulting in a loss on the Face Amount that is proportionate to the percentage decline in the level of the Index. In this circumstance, you will lose a significant portion or all of your initial investment at maturity. Any payment on the Securities, including any repayment of the Face Amount at maturity, is subject to the creditworthiness of the Issuer and, if the Issuer were to default on its payment obligations or become subject to a Resolution Measure, you could lose your entire investment.

EURO STOXX 50® Index

The EURO STOXX 50® Index is composed of 50 component stocks of market sector leaders from within the 19 EURO STOXX® Supersector indices, which represent the Eurozone portion of the STOXX Europe 600® Supersector indices. The STOXX Europe 600® Supersector indices contain the 600 largest stocks traded on the major exchanges of 18 European countries. The component stocks have a high degree of liquidity and represent the largest companies across all market sectors. This is only a summary of the EURO STOXX 50® Index. For more information on the EURO STOXX 50® Index, including information concerning its composition, calculation methodology and adjustment policy, please see the section entitled "Indices — EURO STOXX 50® Index" in the accompanying underlying supplement No. 1 dated August 17, 2015.

The graph below illustrates the performance of the EURO STOXX 50® Index from January 2, 2008 to December 29, 2015. The closing level of the EURO STOXX 50® Index on December 29, 2015 was 3,314.28. We obtained the historical closing levels of the EURO STOXX 50® Index from Bloomberg L.P. and we have not participated in the preparation of, or verified, such information. The historical closing levels of the Index should not be taken as an indication of future performance and no assurance can be given as to the Final Index Level or any future closing level of the Index. We cannot give you assurance that the performance of the Index will result in a positive return on your initial investment and you could lose a significant portion or all of your initial investment at maturity.

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What Are the Tax Consequences of an Investment in the Securities?
In the opinion of our special tax counsel, Davis Polk & Wardwell LLP, which is based on prevailing market conditions, the Securities should be treated for U.S. federal income tax purposes as prepaid financial contracts that are not debt. Generally, if this treatment is respected, (i) you should not recognize taxable income or loss prior to maturity or other taxable disposition of your Securities and (ii) the gain or loss on your Securities should be capital gain or loss and should be long-term capital gain or loss if you have held the Securities for more than one year. The IRS or a court might not agree with this treatment, however, in which case the timing and character of income or loss on your Securities could be materially and adversely affected.

In 2007, the U.S. Treasury Department and the IRS released a notice requesting comments on various issues regarding the U.S. federal income tax treatment of "prepaid forward contracts" and similar instruments. The notice focuses in particular on whether beneficial owners of these instruments should be required to accrue income over the term of their investment. It also asks for comments on a number of related topics, including the character of income or loss with respect to these instruments; the relevance of factors such as the nature of the underlying property to which the instruments are linked; the degree, if any, to which income (including any mandated accruals) realized by non-U.S. persons should be subject to withholding tax; and whether these instruments are or should be subject to the "constructive ownership" regime, which very generally can operate to recharacterize certain long-term capital gain as ordinary income and impose a notional interest charge. While the notice requests comments on appropriate transition rules and effective dates, any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the Securities, possibly with retroactive effect.

Withholding under legislation commonly referred to as "FATCA" might (if the Securities were recharacterized as debt instruments) apply to amounts treated as interest paid with respect to the Securities. Notwithstanding anything to the contrary in the section of the accompanying product supplement entitled "U.S. Federal Income Tax Consequences," under a recent IRS notice, withholding under FATCA will not apply to payments of gross proceeds (other than any amount treated as interest) of a taxable disposition, including redemption at maturity, of the Securities. You should consult your tax adviser regarding the potential application of FATCA to the Securities.

You should review carefully the section of the accompanying product supplement entitled "U.S. Federal Income Tax Consequences." The preceding discussion, when read in combination with that section, constitutes the full opinion of our special tax counsel regarding the material U.S. federal income tax consequences of owning and disposing of the Securities.

Under current law, the United Kingdom will not impose withholding tax on payments made with respect to the Securities.

For a discussion of certain German tax considerations relating to the Securities, you should refer to the section in the accompanying prospectus supplement entitled "Taxation by Germany of Non-Resident Holders."

You should consult your tax adviser regarding the U.S. federal tax consequences of an investment in the Securities (including possible alternative treatments and the issues presented by the 2007 notice), as well as tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.

Supplemental Plan of Distribution (Conflicts of Interest)

UBS Financial Services Inc. and its affiliates, and Deutsche Bank Securities Inc., acting as agents for Deutsche Bank AG, will receive or allow as a concession or reallowance to other dealers discounts and commissions of $0.25 per $10.00 Face Amount of Securities. We have agreed that UBS Financial Services Inc. may sell all or part of the Securities that it purchases from us to investors at the price to public indicated on the cover of this pricing supplement or to its affiliates at the price to public indicated on the cover of this pricing supplement *minus* a concession not to exceed the discounts and commissions indicated on the cover. DBSI, one of the agents for this offering, is our affiliate. Because DBSI is both our affiliate and a member of the Financial Industry Regulatory Authority, Inc. ("**FINRA**"), the underwriting arrangement for this offering must comply with the requirements of FINRA Rule 5121 regarding a FINRA member firm's distribution of the securities of an affiliate and related conflicts of interest. In accordance with FINRA Rule 5121, DBSI may not make sales in this offering of the Securities to any of its discretionary accounts without the prior written approval of the customer. See "Plan of Distribution (Conflicts of Interest)" in the accompanying product supplement.

Validity of the Securities

In the opinion of Davis Polk & Wardwell LLP, as special United States products counsel to the Issuer, when the Securities offered by this pricing supplement have been executed and issued by the Issuer and authenticated by the authenticating agent, acting on behalf of the trustee, pursuant to the senior indenture, and delivered against payment as contemplated herein, such Securities will be valid and binding obligations of the Issuer, enforceable in accordance with their terms, subject to applicable bankruptcy, insolvency and similar laws affecting creditors' rights generally, concepts of reasonableness and equitable principles of general applicability (including, without limitation, concepts of good faith, fair dealing and the lack of bad faith) and possible judicial applications giving effect to governmental actions or foreign laws affecting creditors' rights, provided that such counsel expresses no opinion as to the effect of fraudulent conveyance, fraudulent transfer or similar provision of applicable law on the conclusions expressed above. This opinion is given as of the date hereof and is limited to the laws of the State of New York. Insofar as this opinion involves matters governed by German law, Davis Polk & Wardwell LLP has relied, without independent investigation, on the opinion of Group Legal Services of Deutsche Bank AG, dated July 31, 2015, filed as an exhibit to the opinion of Davis Polk & Wardwell LLP, and this opinion is subject to the same assumptions, qualifications and limitations with respect to such matters as are contained in such opinion of Group Legal Services of Deutsche Bank AG. In addition, this opinion is subject to customary assumptions about the trustee's authorization, execution and delivery of the senior indenture and the authentication of the Securities by the authenticating agent and the validity, binding nature and enforceability of the senior indenture with respect to the trustee, all as stated in the opinion of Davis Polk & Wardwell LLP dated July 31, 2015, which has been filed as an exhibit to the registration statement referred to above.