

**adidas Group First Half 2010 Results**

**August 4, 2011**

**Q&A session**

**adidas Group participants:**

**Herbert Hainer, adidas Group CEO**

**Robin Stalker, adidas Group CFO**

**John-Paul O'Meara, Vice President Investor Relations**

**Andreas Inderst – Exane BNP Paribas**

**Great quarter, well done. My first question is on Reebok – we have seen a certain slowdown in sales growth in the second quarter. You expect an acceleration, as I understand, in the second half of the year. Could you provide us with some guidance on this, in terms of sales? And maybe elaborate on your comment that you see the toning segment as a sustainable growth category? What do you expect for the year? And also, for the conditioning segment and for the Flex shoe, what do you expect to be the growth potential of these two categories in 2011 and for the mid-term?**

**My second question is on the NBA lockout. Is there a plan B? How can you prepare for a potential lockout, how flexible is your marketing budget to react to a potential lockout?**

**My third question relates to inventories. You already mentioned that your inventory is quite clean, on a global basis. But are there any regions where you see a bit of an overhang? I would guess that Japan is maybe a candidate at this stage, but maybe you can give us some insight?**

**Herbert Hainer**

Let me start with your first question on Reebok and the Q2 sales being down. As I have already said in my speech, if we exclude toning, then Reebok sales would be up 24% in the quarter, compared to 23% growth in the first quarter. So the second quarter would be as strong as the first quarter. And you might remember that the second quarter 2010 was a big quarter, due to our toning introduction at that time. So therefore, this is not a concern. This development is what we announced already in May and it is exactly how it came in.

So, in terms of toning – when I say I think that revenues are stabilising, what I continue to see is that consumers want to have toning shoes and retailers want to have toning shoes. But you must inspire the consumer with new, innovative products and this is what we are doing. We are also getting a lot of positive feedback from our retailers on how we have handled the situation with EasyTone, in terms of pricing, inventory and how we have worked together with the retailers. And you can see that we haven't had the large inventories of EasyTone in the market over the last six months compared to some of our competitors.

On Flex – which we introduced in April – we once again started in the US, as we have done with our other key platforms – toning and Zig. And then in the second half, we will roll out Flex to the rest of the world. And the positive response that we have heard so far from the retailers in the US is very encouraging, with very good sales results. And what is really interesting and very pleasing for us, is that it is being accepted as a dual gender shoe. 60% of the sales for Flex are purchases by women. This is really encouraging as the EasyTone was more of a woman's shoe and the Zig was more a man's shoe. And now we have a shoe which appeals to both genders, and this definitely gives it more potential.

In terms of guidance, we don't give any outlook details for toning or for Flex for the second half.

On your NBA lockout question – first and foremost, we have had this situation previously with the NFL, and obviously with our SLD business and with our factory in Indianapolis, which provides the bulk of the merchandise for both leagues; in terms of the license business, we are very flexible. We have shown this with the NFL, and luckily, the NFL is now back in the game again. So with the NBA, we will be doing the same thing. We have already planned the raw materials and supply, but in a limited way, so if they don't start to play, we will be on the safe side, from an inventory perspective.

In terms of marketing working budget, obviously the NBA contract is locked. However, our activities around the NBA in terms of advertising, etc., are completely flexible. So if they don't play, then we don't have any of those advertising costs.

Last but not least, on your question regarding our inventory levels around the world – you are correct our inventories are definitely clean, especially in China, which I mentioned in my speech. The aging of our inventories is also very good. The only place where we have slightly higher inventory levels than we would like is Japan. As we have said, this is because of the earthquake disaster. However, this is not really worrying me, as I'm just back from Japan where I was speaking to 60 or 70 retailers and they are quite pleased with how we have reacted to the situation and how we have helped them. And you can see it in the results, minus 1% in the second quarter, which was also a positive surprise for us.

So overall, I am very happy where the business is at the moment. We are growing in all of our markets around the world, all of our brands are growing and I believe we haven't had a better platform in the last 10 years than what we have today.

### **Juergen Kolb – CAI Cheuvreux**

**Three quick questions. Firstly, in terms of Reebok's EasyTone and maybe Flex, can you provide us with any details in terms of unit sales? For EasyTone, where do you expect us to be in 2011 – maybe around 8 million pairs or below 6 million – would either be a fair assumption? Any kind of additional information on this would be helpful.**

**Secondly, you mentioned the currency movements' effect in the financial expense line for H1 over H1 in the prior year was about EUR 21 million. Assuming that the currencies stay where they are right now for the second half, would that be a number we should also be looking at for the second half?**

**And lastly, on the gross profit margin side, you've been mentioning for some quarters that lower closeout sales provided a nice support to the gross profit margin. Any indication as to how high, in terms of percentage, these closeout sales are? And do you approach some kind of an anniversary level where you cannot improve that level any further? And how do you expect this trend to develop in the second half?**

### **Herbert Hainer**

I understand that you are keen on getting some more numbers on toning, Flex or Zig, but we don't give out any unit numbers. You can be sure that they're all significant for us, as you can clearly see in the results, but we don't give out the number of pairs sold.

### **Robin Stalker**

So in terms of currencies and the swing in financial expenses, this is because of the spot rate translation of balance sheet items that are denominated in non-euro currencies. So we had a positive effect there in the first six months of last year and now we've got a negative effect. If the currencies stay where they are at the moment, there shouldn't be any further positive or negative effects over the next couple of quarters. As far as the gross margin is concerned, clearance was particularly important last year, because we deliberately tried to reduce our exposure in terms of inventories due to the uncertainties in the market at that time. Clearance is always a part of our normal business. We do not however ever break out the particular percentage. Obviously, we try to keep it as low as possible. I think the key point that you should be thinking about for the future is the translation impact of currencies, because that obviously has the largest impact.

### **Michael Kuhn – Deutsche Bank**

**Also three questions from my side – First of all, a follow-up question on currencies. Obviously, these created a negative top-line effect in this quarter, but with a positive implication in the mid-term for your growth margins. I would be interested in the hedge rate that you've currently locked in for next year, and to what amount, in terms of overall sourcing volume, have you locked in at that hedge rate?**

**Second question, on market share gains – you've mentioned market share gains in essentially all major markets where you're present. Could you give some indication as to what those market share gains were in percentage points, and where you took market share from?**

**And thirdly, we see an on-going strong momentum in Sport Style, both in Retail and in Wholesale. Could you give us an indication what NEO contributed, what Originals contributed and what dynamics we should expect for the remainder of the year?**

**Robin Stalker**

In terms of our hedging, you're absolutely right. The strength of the euro would help us in the future, unfortunately, it's not that much. We are tracking this year at probably around the 1.36 hedge rate. And for 2012, we're over 70% to 75% hedged there already, and we would expect the rate to be better than that, at around 1.38, at least.

**Herbert Hainer**

On your second question, on the market share gains – this is simply because we are growing faster than most of our competitors in most regions and most countries around the world. In the US, where we do have market share data, you can see in terms of footwear that Reebok is close to 7% of the market. So our combined market share is now a little bit over 13%, and growing.

Regarding your last question, where is the Style growth coming from – NEO sales grew by over 50% and Originals by over 20%, so this is driving the expansion of the Style business.

**Christopher Svezia – Susquehanna Financial Group**

**I have a couple of questions. Firstly, I want to circle back to Reebok and North America. When I think about what's been going on there in the second quarter for the Reebok business and looking at point of sale data, etc. A lot of your stronger selling products have been Zig, RealFlex, etc. And if you take out Toning, you're still up over 20%. But I am trying to calculate a little bit here – and given the fact that it was down 15% for the business, but you had so many other new products quarter over quarter, year over year – that are top sellers that are very strong – I just wouldn't expect it to be down that much. So I'm trying to understand that and maybe what were some of the puts and takes.**

**Secondly, on the Reebok business – we've reached out to some retailers, in terms of our checks, and seen some additional promotional cadence on some of the Zig products. This was given as somewhere between 20% to 30%. I'm not sure if that's just inventory management or just making room for some of the new products that are coming in. So I wonder if you could also address that point?**

**And thirdly, a lot of brands are starting to work closely with retailers, in terms of shop-in-shop concepts – whether it's within the malls or within the sporting goods channels – be it refreshing, updating or expanding their offering. So, I was wondering if you could maybe talk about some of the things that you may or may not be doing there as well.**

**Herbert Hainer**

Let me start with the first question on Reebok. What you have said is correct – that Zig and Flex were the drivers. And with toning, please bear in mind that in the second quarter of 2010, we were up 31% because of the big toning introduction. So, as you can imagine, a high volume of product was brought into the market at that time, because it was more or less pipeline filling for the whole US toning market. And this is what we are now comparing against. Therefore, as I have said, if you exclude toning, then our business would have been up 24% in North America. And also Reebok is expanding in terms of creating more technology pillars. In 2010, we only had EasyTone. Now we have ZigTech and most recently RealFlex. And, as I said, toning, in my opinion, will definitely remain as a sustainable business. As I outlined in my speech, this is especially the case in Asia, where we have a very good toning business, particularly in Japan and in South Korea. We're also seeing good demand for toning in Russia. And in the US, there is a very good response from the consumer to our new toning products which we are bringing into the market.

On your second question – on Zig – as far as I know, and I have spoken to my guys just a few days ago in the US, it's only the old styles of Zig which are being discounted. The new styles of Zig, for example, the new designs which we have launched with Finish Line, are retailing for USD10 above the previous retail prices of the original Zig.

### **Christopher Svezia**

What would you think in terms of growth for the Reebok brand as we go forward? Will it stabilise? Will it turn into growth in the back half of the year for the North American business, relative to Q2?

### **Herbert Hainer**

Yes. This is definitely our plan, no doubt.

### **Christopher Svezia**

Okay, and then I was wondering what you are thinking about in terms of the opportunities, such as shop-in-shops, etc., whether it's with Dick's or within the malls, etc.?

### **Herbert Hainer**

Yes, definitely. When we take the two key channels for us, which are on the one hand the mall and the other hand, the sporting goods store, I think we have more shop-in-shops than ever. Be it the special corners we have with Footlocker, Finish Line, Dick's, the Sports Authority and a lot of others. And as an example, just think about what we did with Reebok and Finish Line, when we changed the whole store into a Reebok store for several weeks. And this will happen again in the second half. We have special white walls within the Footlocker stores where we are showcasing Originals. We have special shop-in-shops with Dick's Sporting Goods for both brands – adidas and Reebok. And we are also working with the Sports Authority and their presentation of the adidas brand. Yes, this is definitely where we see part of our growth coming from, with better presentation of our products to the consumer, a wider offering, and therefore we are seeing better sales.

### **Matthias Eifert – MainFirst Bank**

**I also have a question about Reebok. You have had a lot of success with Zig, and also now with Flex. How should we think about Reebok on more of a two-, three- or four-year time scale? Is there another technology platform on the horizon, or is the next big focus the relaunch of Classics? My second question is about NEO. You are saying that you plan to open NEO stores outside of India and China. Have you done this already, and if so, how is the feedback on that? And do you plan a further roll-out of these stores?**

**And a third question is on your use of cash. If you keep this run rate in terms of declining net debt, you're going to be net cash positive by the end of the year. Any thoughts on share buybacks, or will you focus more on increasing the dividends?**

### **Herbert Hainer**

Let me start with your question on the three- to four-year view on Reebok. First and foremost, let me tell you that we are quite happy that we have these three key platforms on the footwear side now, and we will of course further build on these. We want to develop them for the long term and make them into real franchises, and not just for the short term. And we see a lot of potential there. Furthermore, we are now building the Reebok business on a much broader basis. The next development, as you already mentioned, is the revitalisation of Reebok Classics, where we had a big launch two weeks ago in NY with Swizz Beatz. And all the feedback that I have heard regarding these platforms is very promising. So this will be the next focus category, which at the moment is below 20% of our total Reebok sales. Historically, Classics was 30% to 35% of the Reebok business. So this gives us a big opportunity and significant potential.

And the other part to consider with Reebok is the apparel business. Here, we are building up the apparel business above the existing license business, which we have today, into a real apparel business, which Reebok is still somewhat lacking. This will be on a next three- to four-years outlook, and this is where we see the growth potential from a product perspective. Besides this, we still have

a lot of markets where we are not as good as we can be. Therefore, the growth potential is coming from both of these factors – on the one hand, product developments, as I just pointed out, and on the other hand, the brand's international expansion.

Your second question, on NEO – the biggest part of our NEO store base is in China, where we started it two years ago, when we called it Essentials. We now have around 900 NEO stores in China and the new NEO collection is selling very well. In fact, NEO sales increased by over 50% in the second quarter. And, as I have said, the biggest part is coming out of China. We are now starting with the test stores in Germany, where we will test around 10 stores in a much more mature market. Depending on how these tests go, within the next 12 to 24 months, we will then decide on any further roll-out, how fast we go, where we go, etc.

### **Robin Stalker**

And in terms of use of cash, there is nothing new there. You know our first priority is obviously to continue to pay down debt. We want that flexibility. You have seen that we have increased our dividend payout ratio policy, and have every expectation that we would continue to move in the right direction with that. We have no plans whatsoever at the moment for any sort of share buyback.

### **Bernd Muell – Landesbank Baden-Württemberg**

**Three quick questions also from my side. Mr. Hainer, you commented on Japan, saying that you were seeing lower profitability probably in the second half of this year, due to margin pressure. Just as a clarification, does that refer to your previous statement of overall higher input costs or is that due to a special situation in Japan?**

**The second question, perhaps you can comment on the back to school business in the US. Do you see any special trends and what product in particular do you see very well positioned in the market?**

**And lastly, after your first quarter results call, you were commenting on the new adidas football boot that you have for the UEFA Euro Championships. Perhaps any update with regard to the product?**

### **Herbert Hainer**

Let me start with the third question, on the adidas football boot. Yes, we have just launched the new Predator, but this is for the season starting right now. Our product offering for the European Championship will be launched in December when we will introduce the new official ball, and from there on, on a monthly basis, we will be new products, such as jerseys, football boots, etc., into the market. At the moment, it is too early for us to talk about the European Championship.

So on your second question – our back to school plans in the US. Yes, we have a lot of products going into that season. We have great confidence because of products such as Zig and Flex, coming from Reebok, which I spoke about already. And the same confidence is coming from our retailers, because of the huge volume of products that they have ordered and with which they will be quite successful. But also on the adidas side, we have, for the first time, launched a basketball shoe in June, which is after the basketball season. This is the adiZero Crazy Light, the lightest basketball shoe in the industry. And the sell-through rates have been phenomenal, we are seeing a 75% sell-through after 45 days, which we have never seen before with a basketball shoe. This will continue and then our latest Originals offering is starting to come into play in the US. So, given the circumstances that we have seen in the last few days in the US, we are fairly optimistic for the back to school business in the US for our brands.

And your first question on Japan and lower profitability, etc. – yes, this is because of the situation in Japan. Bear in mind that a lot of retailers had problems directly after the disaster. About 300 stores have been destroyed and affected by power outages, etc. Obviously, we are working closely with the retailers, as I have said before, to help them. But we also want to continue to gain market share in the Japanese market, and we have every confidence that we can do this. The information I'm getting is that there is a little bit of over-inventory, as I said before, and this is putting pressure on our margins in Japan. But I would like to clearly point out that we will still be very profitable in Japan. Japan has always been a very profitable market for us.

**Louise Singlehurst – Morgan Stanley**

Three questions from me as well – Firstly, just in terms of the US, obviously great momentum, which we can see on the weekly data. Can you talk about how the competitors are reacting? Are they also putting through new lightweight products and is there any challenges with new products coming in at lower price points?

And secondly, I remember at the end of last year, you were talking about targeting the high school age group. What things are you doing differently, and how do you feel about that going into the all-important back to school season for Q3, also in terms of product launches?

And then my final question, Robin, you kindly reminded us of those losses at Reebok in 2009. Can you give us any update in terms of benchmarking where we are today versus 2009 and are we back to some kind of breakeven point in terms for this year?

**Herbert Hainer**

Coming to your first question regarding the competitors' reactions – definitely, I think you could find out more about this by talking to our competitors, to hear what they are doing, because honestly, in terms of the lightweight product, I don't see any reaction so far. I think we are the clear leader. You might remember that we started this with the introduction of the F50, the lightest football boot. We are following this with the adiZero Crazy Light, the lightest Basketball shoe in the market. And we are continuing now with running, with the adiZero Feather. We are introducing this shoe at the IAAF World Championships in Athletics in South Korea. And I think this is part of our success, which we are celebrating, results from the fact that we are more innovative than some our competitors at the moment.

Regarding your second question on the high school kids and what we are doing there – I have already spoken about the product introductions. Our focus and activities in terms of advertising, product offering or which distribution channels we use are all targeted at the high school kid. And this you have seen already in some of our advertising which we have tweaked a little bit because of this focus. All of the responses so far have been very favourable.

**Robin Stalker**

And Louise, I'm really happy to report that obviously, there's a significant improvement in the profitability of Reebok. Unfortunately, I can't specify on a bottom line, because as you know, we do not run our business any longer on that basis, and therefore we do not allocate the joint operating model costs between the two brands.

But what I can say, as is evident in the gross margin development over the last few years, which has been a significant improvement for Reebok – and again, over the first six months of this year, you can see Reebok's gross margin improving another 160 basis points – that this should give you good confidence about the right trajectory and the improving profitability of Reebok.

**John-Paul O'Meara**

So, ladies and gentlemen, that concludes our call for today. Just before we finish, I'd like to remind you that we are hosting an investor trip to Russia in October, on the 10<sup>th</sup> and 11<sup>th</sup>, with Herbert Hainer. For those who would like to join us, and it's filling up pretty fast, please make sure you register by August 15<sup>th</sup>, so we can make sure you can get a visa to us in time to join. With that, thank you very much, and enjoy the rest of the day.