

adidas Group Nine Months 2011 Results

November 3, 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

Louise Singlehurst – Morgan Stanley

Good afternoon. Three questions from my side. Firstly, just in terms of the guidance that you've given for 2012, the mid-single to high-single-digit top line, can you give us some colour by geography, what you're looking there for in the US, Europe and also touching on China as well? And then number two, just sticking with the theme of China, clearly it remains a very tough market for the local players. Can you just talk about the tone or the discussions that you are having with your partners in the region and your scope for expansion and taking market share as you push down into the lower-tier cities? And then finally, looking at the earnings guidance for next year, there's not a huge amount implied for operating margin next year - it looks pretty flat versus 2011. Can you also talk about the investment? Clearly, you've got a big event year, but what should we expect in terms of new product launches and what's going on at adidas and Reebok?

Herbert Hainer

Louise, let me start with question number one, our guidance for 2012. We will give you all the details when you are here in March next year when we do our full-year presentation for 2011 and then explain all the details of the P&L and the balance sheet for 2012. Your second question, on China, we definitely don't see any slowdown of our business in China. You have seen the results for the third quarter, which have been very encouraging and this will continue into the fourth quarter and, from what we know, this is set to continue in 2012, as well. We are in close contact with all our key retailers. One of them has just visited us here in Herzogenaurach a few days ago and they confirmed that all of our products are selling through very well, our inventory position is very healthy and the systems which we have put in place, to get the early warnings on sell-through on those inventories and then reacting to that, with replenishment, are all working very well. So, we are definitely very bullish on China, going forward.

Robin Stalker

To answer your third question and on the first question you'll obviously get more details in March on this, one thing is clear. We are leveraging our top-line growth. The quality growth we're going to have at the top is going to give us better profitability and it's all on track to bring us to the goal that we have a sustainable operating margin of at least 11% by 2015.

Louise Singlehurst

Thank you. Just as a follow-up, in terms of Q3 performance, has there been any change in terms of that European performance or any differences you'd call out by country? I know you gave the overall growth for the quarter, but anything month on month?

Herbert Hainer

No, we haven't seen any big changes in Europe month over month. It's just the other way around. Our business in Europe is still continuing very well and is broad-based. It's not just Russia and it's not just the emerging markets. It's all the countries, more or less, in Europe and also the so-called mature markets here in Europe, Germany or Spain and Italy. So overall, the 10%, as you have seen, is carrying on through the whole year and we are quite confident about our business in Europe.

Simon Bowler - Citi Bank

Just two questions from my side. First of all, on the gross margin, you mentioned you're not expecting to see any relief until the second half of 2012. I'm just wondering, given the modest declines we've seen in the third quarter and the flat performance year-to-date, how much can you do over the next nine months to offset those pressures or should we expect to see a slight acceleration in the gross margin declines? And then secondly, just a quick question on currency. You've mentioned the exposure to the Russian rouble. I was just wondering how much of a headwind, if any, the weakening that we've seen across the last quarter provided, whether that was something you could quantify? And also, in terms of your guidance, what future movements in that currency are assumed? Thanks.

Herbert Hainer

So, on your first point, on gross margin, we've been guiding throughout this year that, obviously, the second half of the year will suffer more from the FOB pressures than the first half. That's definitely the case. While we've acknowledged a continuation of FOB pressures, we have and will continue to have, underlying ways of being able to mitigate the largest part of this through the development of our retail and through further geographical and product mix. So there is nothing else to say about the margin development. And in terms of the rouble, there hasn't been movement in the last months. So this has been pretty immaterial and we have conservative, but consistent, expectations as we look forward to the future.

Matthias Eifert - MainFirst Bank AG

A few questions, mostly on Reebok. First of all, can you give us a bit more detail about the weakness you mentioned in Europe and Latin America, where exactly and in which countries? And how do you plan to fix this? Also on Reebok, was there already an NFL impact on the North American business for Reebok to phase out and to hand over to Nike in that category? And talking about this, can you give us an update on the Reebok-branded apparel business? How is that developing and also compared to overall sales and in regards to your expectations?

Herbert Hainer

Question number one, on Reebok in Europe and Latin America. First and foremost, in Latin America, it was only because of timing of deliveries into the markets, mainly into the big ones, be it Mexico, Argentina or Brazil. In Europe we have different developments. Russia and the emerging markets are still doing extremely well. In some other countries, ZigTech was not as successful as it has been in the US. This has brought a slowdown, whereas we have seen fair successes on Flex, so we definitely believe when we roll out Flex next year on a broader scale in Europe that we will catch up. The NFL hasn't had any influence at all, so far. And my third point, on the apparel business, as we have told you several times, we started on the footwear side with individual concepts, Toning, ZigTech and Flex and the next one is Classics, where we are building a big programme and then will push it out. Obviously, we'll be further developing apparel, and apparel will definitely be one of the next waves where we will invest and then push it forward.

Matthias Eifert

So, then, more like 2013, if I understand you correctly?

Herbert Hainer

Of course, as you might know, we have a new head of apparel for Reebok who just joined us six months ago and whom we know from previous adidas times and he will be further developing the programmes. But the big push behind Reebok is definitely seen later in 2012 and then in 2013.

Michael Kuhn - Deutsche Bank

Also three questions from my side. First of all, back to Reebok, according to my calculation it was down roughly 5%, currency-neutral, in the third quarter and the gross margin was down by about 1.5 percentage points. You said that timing issues played a role in the third quarter, so I would be interested if we might see a turnaround into positive growth territory again in the fourth quarter and what you foresee in terms of margin development at Reebok in the upcoming quarters? Then secondly, on inventories, you said that you feel good with your inventory situation, nevertheless I would like to get some more details on the regional situation, if there's any region with higher growth compared with others, and maybe some more details on both the price and the volume effects that drove up your inventories in the third quarter? And finally, not so much about details on your 2012 guidance, but more on the macroeconomic scenario that you had in mind when you gave the guidance. What is your expectation for GDP growth next year so that you're able to deliver on that guidance?

Robin Stalker

Michael, I'll take the first two. So, you're wrong. Your calculation is false. The third quarter Reebok sales development, currency-neutral, had growth of 2%.

Michael Kuhn

I'm sorry, I am thinking about wholesale only - Reebok in wholesale.

Robin Stalker

We're looking at this, too. Let me finish my answer first. And in terms of the gross margin, there's a positive development of 70 basis points for the Reebok brand. I'll see if while I'm answering the second question we can get to the Reebok wholesale figure for you. Inventory is not an issue, and it's not a regional issue. We've seen growth that's fairly broad there. It is not any particular region or country that stands out in terms of that growth and you're right, however, to identify that there is a percentage that's coming from the increase in prices, as I said in my comments. And if the growth is at 20% and if we take out the currency effect, it would be high teens, so I suppose there's almost a 10% impact through prices there.

Herbert Hainer

So, let me answer the third question in terms of how our guidance for 2012 is based in terms of macroeconomic factors. First and foremost, we are looking to ourselves, what kind of product innovations we are bringing to the market, what the events are and how our brands are positioned. And I think we have never been in a better position. When you look at 2011, for example, as a testament to this, the economies around the world are definitely not all in the best state and we are still growing 12%. So, when I look to the macroeconomic figures, you have different pictures in China and Russia and Brazil and then in some other countries, obviously, such as Greece, and some others, where the economy isn't that good. But I definitely believe that our industry has proven to be much more resilient to this development and especially our Group has shown that we can grow much faster. So, all together, our assumptions for 2012 are based on the strong concepts and the strong brand positions which we are offering in the market today and which we know we will roll out in 2012.

Robin Stalker

Michael, I can complete the answer to your first question where you are looking at Reebok in the third quarter for just wholesale. The answer is, it's down about 2%, currency-neutral, and that's purely due to the Toning timing effect year-over-year and also the effect of Latin America, that Herbert spoke about earlier.

Michael Kuhn

So, we might see a return to growth in the fourth quarter?

Robin Stalker

We're not giving specific guidance on the individual parts of the fourth quarter, but, yes, you might see a return to growth in the fourth quarter.

Ingbert Faust – Equinet Bank

I have one further question, which is on the seasonality or the impact of the Olympic Games and the UEFA EURO 2012, in particular. Could you remind us when you expect to see the impacts of these events on your sales volumes? I assume that this will already start in Q4, but could you give us a bit of an indication where you expect the impacts in Q4, Q1 and Q2?

Herbert Hainer

With these two events you have two different scenarios. As the UEFA EURO 2012 is a much more commercial event, we start by introducing the jerseys for all the participating adidas teams, then we launch the official match ball and we also are continuously bringing new football boot concepts to the market, such as the F50, Predator or the adiPure. With the Olympics it is much more of a platform to showcase our brands and our new innovative performance products, but it is a less commercial event. So, in football, we will already start next week to launch the jerseys of the individual teams, be it Germany, Spain, Russia, Greece, Ukraine, et cetera. Then we follow this up with the introduction of the new Predator football boot. And on December 2nd, we launch the new official match ball. And then we go into 2012. In January, we launch the F50 and then we continue every month until the European Championship starts, introducing new product concepts.

Ingbert Faust

And a bit more detail, in terms of volumes, how it could be split? I know it's very difficult, but that would mean that in Q4 we could already see quite a reasonable impact, I assume?

Herbert Hainer

Yes, obviously, Q4 will have an impact on sales, but will also have an impact on investments, because we start to invest with all of the activities I just mentioned. And the big push, then, also in terms of volumes, you will see in 2012.

Allegra Perry – Nomura

I have three questions. Firstly, on China, I was wondering if you could give us an indication of like-for-like trends from your retail partners and perhaps any colour on October? Secondly, in terms of Reebok, within the retail division, I was wondering how much of the gross margin improvement was stemming from lower markdowns and if there was the potential for further reductions, going forward? And then lastly, within the Group figure, perhaps, can you give us some indication of the composition of like-for-like between price mix and volumes?

Herbert Hainer

In China we definitely see like-for-like growth with all our key partners, as I have indicated before. We also see a like-for-like decline for some of the local players with the key retailers. As you are aware, we don't give any results for October at this time.

Robin Stalker

And then to the question on Reebok, in terms of the margin development, everything is playing a role in the positive development of margins. So, yes, that's correct, there will be less markdowns. But it's also because the product that Reebok is bringing to market now is more attractive and can also justify a higher price point. Don't forget we've still got a major differential between the Reebok margins and the adidas margins, so that's the potential I was talking about earlier, but, you're right, that all has a positive impact. Your third question was about whether we could break down the price and volume of the increase in sales. We can't do that in a very sophisticated way. My estimate is that pricing definitely had a role, but it would be at a low-single-digit percentage.

Antoine Belge – HSBC

Three questions. First of all, I would like to come back on the evolution of SG&A in the third quarter. I think this morning you beat expectations for sales, but, actually EBIT was in line because the SG&A ratio, even though declining, was still more than what we expected. Can you come back to that and explain what has been the impact of, first of all, the expansion into retail and is there some initiative to support Reebok? And my second question is on Reebok marketing. I think you mentioned some initiatives for Q4. Were those initiatives for Reebok in North America part of the marketing plan or is it something that you have decided more recently, in light of more recent developments at Reebok? And finally, regarding spring and summer, what is the reaction of your retailers on products excluding everything which is related to the events, more on the non-event products? Can you maybe comment on how your retailers are feeling for 2012?

Robin Stalker

To the first point, you're right, we still have, obviously, a potential to further improve our leverage and definitely work on our SG&A and that is part of our goals in terms of delivering that improvement in profitability through to 2015. There's nothing particularly special about the third quarter and maybe we have not been able to reduce the cost as much as you anticipated, but there's been no major increase in the costs. I would say, however, that you're right to identify retail as an area where we've probably invested a little bit more, and faster, than was originally planned in those first nine months and you'll see part of that in the third quarter.

Herbert Hainer

Coming to the second question, Reebok advertising, you are correct, this is mainly in North America, for example, in basketball with John Wall and we have the holiday season coming up. But we will also have a further push in Russia, especially with the whole winter programme, which we have in our stores in Russia, which is a very important quarter for Reebok there. Those are the two key markets. Coming to question number three - all of our retailers, who I have seen and spoken to over the past two weeks are all quite happy with what we have shown them. You can imagine that we have sold in already for the first quarter. This was done in the past weeks, and we would not be here giving you guidance already for 2012 if we were not very optimistic about what we have so far on our books and what we have heard. And with all that I have heard relating to the upcoming European 2012 football championship and in terms of our broader concepts, which we have shown to our retailers, you can be sure that they are more than excited and if you have the chance please do talk to some of the retailers. I am absolutely convinced they will confirm what I just said.

Cedric Lecasble – Raymond James Euro Equities

I would like two follow-up questions on Reebok and the marketing expenditure. First, on Reebok, you mentioned some very different trends in the US, obviously on Toning and the new ramp-up in new products where you were quite optimistic on Zig and Flex. Can you help us understand how fast the new products might take off? And what can you reasonably expect for Reebok going forward, maybe not next quarter, but in the next two, three quarters? And also a little on your new product plans, especially in the US? And my second question is about marketing expenditure. Is there any reason to expect something different from what we've seen in the past in terms of a percentage of sales for marketing expenditures? You have two big events at the same time. What should we think about this? Is there any reason to believe that it will be more expensive this time than it was in the past? Do you have some inflation on some costs relating to the events?

Herbert Hainer

Let me take the first one, the question concerning Reebok, the new products, how they resonate and how we are going forward into 2012. We are extremely happy with Toning and Flex in the US, as I have already mentioned. Zig has not been as successful in some of the European countries, whereas in some others, such as Russia and the emerging markets, it was quite successful. The

first results we are getting for Flex in the US are that we are seeing products selling through very well and we have already started to tease some of the European markets and the first results we have been getting have also been very encouraging. So, going forward, we will have a big rollout of Flex in Europe. We will bring new Toning products into the US market, with new technologies. And we will further develop, though without giving any detailed guidance for 2012, and we will definitely continue our growth path with Reebok. Not only in the US, but you will see this all over the world.

Robin Stalker

In terms of the marketing working budget, no, there's nothing that you should expect that would significantly increase the percentage that we spend on MWB. As you know, over the last few years, whether it's been an event year or non-event year, there have only been minor changes in the percentage that we're spending on MWB. When there's a big event year, that tends to be what we spend our marketing on, and in the non-event years we spend it on other things, whether it's brand building or technologies or things of that nature. So don't expect any change in the percentage of MWB.

Cedric Lecasble

Just to be sure, on Reebok, we've seen some negative trends in wholesale for a couple of quarters. What are your reasonable visions and assumptions in relation to Reebok, are you expecting to go back to growth in the wholesale segment?

Herbert Hainer

Yes, when you talk about wholesale, then you also have to see that we're dropping out of some of the retail channels. We are introducing products in a much more sophisticated way with retailers who are picking up on our positioning and treating and representing the brand really well. Therefore, I don't think it gives you a complete picture when you just look to the Reebok wholesale business, because, on the other hand, we are pushing our Reebok business further, for example, in Russia, in Japan and in emerging markets, such as in India. So don't look just at the wholesale business, because this was the part which was, more or less, the big majority in the past, which we had to clean up.

Thomas Effler – WestLB

Just two follow-up questions. First, on average selling prices, you were mentioning that this was quite positive for you so far. Especially considering the new product introductions you expect, how do you see that average selling pricing developing? And my second question is just a technical question, relating to the acquisition of Five Ten, can we assume the cash out, the \$25 million, is in the fourth quarter?

Robin Stalker

So for the clear answer on average selling prices, we expect them to continue to increase and we have been doing that and supporting that, obviously. And with the quality of our products and the attractiveness of those products, we expect that to continue. And in terms of the cash out for Five Ten - yes, Herbert mentioned that we expect this to close within a couple of weeks and so the cash will be out at that time, so that is within the fourth quarter.

John-Paul O'Meara

So, ladies and gentlemen, that completes our conference call for today. Our next communication will be on the 7th of March when we report our full-year results for 2011, here in Herzogenaurach. We wish you all the best for the remainder of the year. Thank you and goodbye.