

adidas Group First Half Year 2008 Results

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Q&A session

adidas Group participants:

Robin Stalker, CFO of adidas Group

Natalie Knight, Vice President Investor Relations

Uwe Weinreich – UniCredit

Congratulations and thanks very much for the positive surprise. Robin, the impact on the gross margin in the second quarter and in the first half coming from product mix, own retail and regional mix, could you please give us some more information about it?

And then, could you please give us some more guidance about the inflation of sourcing costs, in the year 2009, any additional information compared to the investor field trip?

Then a question about the currency impact on the net debt reduction in the first half: Will it be something in the area of € 100 million?

My next question is about Reebok order backlogs: Do you think that sales on a currency-neutral basis will be up in the current year if we adjust the consolidation of the Latin American operations? And the last question is: Are there any marketing expenses you have originally planned for the second quarter which are now transferred to the third quarter?

Robin Stalker – CFO

Well, thank you very much. Regarding your first question about gross margin development: Half of the improvement is due to the regional and product mix improvement. We are growing faster in countries such as China and Russia and have higher margins there. And for the other half: There are three key factors supporting our gross margin development. Firstly: The growth of own-retail activities. Secondly, there are benefits from the integration of our sourcing with Reebok. And thirdly, there are obviously some currency benefits through better hedging rates.

The second question relating to FOB and the visibility we have for 2009. Yes, we have definitely better visibility in terms of the first half of 2009 where most of our pricing has already been set. We don't see a significant or very material deterioration in the pricing. Unfortunately we don't know yet for the second half of the year. We are still in the process of negotiating second-half pricing, but we remain confident that the three key mitigating efforts that we have, that's the continuing lean manufacturing, improving our product design development and obviously looking at selective price increases, will help us to manage it.

Your third question was about the foreign exchange impact of borrowings. Yes, I think we did have a currency benefit here, which I estimate to be around a third of the reduction prior to the share buybacks.

And then your question related to Reebok and its sales for the full year, excluding the buyback of the business in Latin America: Here, we are targeting slight growth for the Reebok brand without the joint ventures. But as there are still tough challenges out there, we will need to see how the third quarter develops.

And for your fifth question about the marketing working budget spend and whether there was anything originally planned for the second quarter that might have been moved to the third

quarter. No, that is not the case. We obviously do have significant marketing spends coming at us in the third quarter because of the Olympics, but there was nothing in terms of a shift.

Allegra Perry – Lehman Brothers

I have three questions. Firstly, on Reebok: Could you give us a sense for what organic growth could be found in the second quarter, excluding the distribution buybacks effect? And also just staying on Reebok, if you could confirm that you're still expecting to see growth in the US and UK in full-year 2009?

The second question is on the Group's distribution mix. Could give us an update on the Group level of own retail plus controlled space, where we stand at the end of the first half?

And lastly, on the cost point, could you give us a little more information about what we might expect to see in terms of costs coming into the third quarter, and perhaps a reverse of the previous question, was some of the third-quarter cost actually slated into the second quarter? Thank you.

Robin Stalker – CFO

Firstly, the underlying Reebok development, excluding joint ventures in the second quarter, was negative 7%.

The second question related to the 2009 growth for Reebok in the UK and the US. Obviously we're not intending to give any specific guidance for 2009 today. But clearly the Reebok brand is improving from quarter to quarter. We remain confident that we will definitely be in a better position next year, and that means also growth in the US and the UK in 2009.

The third question related to controlled space. I guess at the end of the first half of 2008, we will probably be somewhere between the 25 to 30% for controlled space for the adidas brand.

And for your last question regarding any potential shift between the quarters. No, I don't think there has been any shift from our original planning for the development of the year.

Allegra Perry – Lehman Brothers

Thank you. Can you give us an idea of what the marketing expenses might look like in the third quarter with the Olympics?

Robin Stalker – CFO

We have given guidance for the full year, where obviously marketing budget for the adidas brand will be slightly up because of the two major events, the UEFA EURO 2008™ as well as the Olympics. We have seen a lot of our marketing activities come through already in the first half of 2008. As the Olympics are a major event for us, you will see significant expenditure in marketing working budget in that period. But I don't expect it to be as significant as it was in the second quarter.

Matthias Eifert – MainFirst Bank

I have a question regarding the divisional operating profit development you briefly mentioned in the call, Robin. The HQ operating profit was positive in the second quarter versus a negative one in the previous year quarter – we had a € 53 million swing. Could you give us an idea of where this swing is coming from?

Robin Stalker – CFO

Thanks very much for that question, I'm sure there will be other people interested in this. The HQ/Consolidation segment includes various operating costs and results that are not brand specific. It also includes sourcing, logistics and various treasury items.

It is difficult for you to forecast the HQ/Consolidation segment. If you look at it on a year-to-date basis, you will see that the net difference year-over-year is about € 33 million, and of that € 20 million relates to hedging gains that are booked at Central Treasury. So I think year-over-year it is not a significant amount, but obviously yes, it is difficult for you to forecast on a quarter-to-quarter basis.

Matthias Eifert – MainFirst Bank

So the biggest part comes from hedging gains?

Robin Stalker – CFO

That is correct. Year-to-date it is that part of the hedging that is not on the brands. And you will recall we have said at various times that obviously when we set our billing rates we are trying to reflect our hedge position at that stage, and that goes into the brands. But, as we finalized our hedging, about the last 20%, which is often done after the billing rates are set, that then goes into the central headquarter function. It could be a positive or a negative, depending on how the currency has developed.

Matthias Eifert – MainFirst Bank

I would like to ask another question on the reduced Reebok guidance. Now you expect that operating margin is going to decline for the full year versus the previous year. Is that mostly due to the difficult main markets you operate in, or do you see some of your campaigns not working as you expected?

Robin Stalker – CFO

No, Matthias, we are generally very satisfied with how the campaigns are going. But bear in mind, these campaigns are only part of our whole repositioning activities. What we have to recognize is that we are operating in particularly challenging markets. Therefore, our update on our expectations in terms of operating margin here relates to the sales expectations that we have now for this brand, particularly in the US and the UK.

Matthias Eifert – MainFirst Bank

Regarding Reebok in the US: How is the rollout going with the shop in shops at Dick's Sporting Goods and in how many stores are you now represented? Is there any initial feedback on that?

Robin Stalker – CFO

Yes, we're definitely on plan with our rollout there, and we will definitely be in the 300 shops by the end of this year. This is giving us a tremendous presence that we have not had previously. But it is a bit early to give you specific details on sell-throughs as we have only really just started.

Antoine Belge – HSBC

Good afternoon, I have three questions. First of all, could you comment a bit on the environment in the US not only for the adidas brand but also for Reebok? So what are the latest developments with Foot Locker now in the upcoming months?

Second question: You just mentioned that you had hedging gains. I think overall the currency impact was very favorable this year, and it might be different going into 2009. At the same time you earlier were experiencing some higher costs of doing business in some of your cost of goods in China. How are you addressing these trends?

And finally, you mentioned a very good performance in football this year. Can you perhaps tell us what will be the impact on the gross margin of the sale of these very profitable products?

Robin Stalker – CFO

Concerning the US, if we look at the market generally, I think we would have to remain very cautious about the situation. It is a difficult consumer environment there, and I think we are well advised to remain fairly careful about expectations for that market. We are obviously less exposed to the American market than many other competitors, and we're much more exposed to the emerging markets, which are growing a lot faster.

Regarding your question about the specific situation with Foot Locker: As you know, Foot Locker is a very important player in the market and it is a very important customer for our Group. We had to reposition the Reebok brand presentation, and chose not to supply them for some months. But we are going to be supplying them by the end of this year again. Both of us, of course, want to make money from the business that we do with each other. So we will monitor it very carefully and make sure that it is a satisfactory business development for us. We do not expect too much from Foot Locker for Reebok in this year, but it's a growth opportunity for us in 2009.

And the second point was about currencies. Yes, definitely we have had some currency benefit in terms of hedging this year. Don't forget, however, that we suffer negative currency impacts through the translation impacts. A lot of the currencies in which we do business such as the Chinese Renminbi, the Russian Ruble, the UK Pound, have all depreciated against the Euro. However, we are not giving guidance for 2009 specifically, but the hedging benefits are likely to continue. Our hedging rates will be better in 2009 than they have been in 2008, as they have been better in 2008 than in 2007.

And FOB, as I mentioned earlier, this is still a risk for us and for everybody in the industry. There are FOB pressures there, but this is not something particularly unique. Every year we have had price pressures here. They are a lot higher this time because of the compound effects of commodity price increases and wage increases, but we expect to be able to manage them.

We may also in the mitigation have to do some strategic price increases that some of our competitors have already also announced.

And the last question in terms of football: Football, particularly for such an event as the UEFA EURO 2008™, is a very profitable business. And I think that, as I mentioned in an earlier question, the product and regional mix is a factor in our gross profit. I said about 50% of the improvement is coming from that. But I would not give you any other particular details about football because we don't want to break down individual profitability in the categories. But it was a positive, yes.

Antoine Belge – HSBC

Maybe a follow-up on what you said on Foot Locker. What has actually changed in your relationship with them? Is it the kind of product that you are going to be selling there or different attitudes from them towards your product? What can you share with us?

Robin Stalker – CFO

I think all retailers obviously need products they are confident will sell through. As we have seen with the development of the adidas brand with our key retailers over the last few years, including Foot Locker, we have been very specific and clear on what sort of products we put into those channels. We also managed the volumes, so that we're very confident that they sell through well at the right sort of prices. And we wanted and still want to make good margins on this. I think that it has been appropriate in the Reebok brand to readdress some of the product offerings, to make sure that we have the right sort of products for the consumers at that sort of retailer – so that we can also enjoy better margins. And that is what you will see coming into Foot Locker at the end of this year.

Michael Kuhn – Deutsche Bank

Basically I have three short questions. The first one, we have seen quite a significant increase in the cash tax rate. I would be interested in what are the factors behind that development?

The second question is: In the US market, we have seen an improvement of the adidas order books in the second quarter versus the first one and in obviously a very difficult market environment. I was interested in what were the factors behind that development.

And the third question: You have now increased your gross margin target to above 48%, so it is now clearly ahead of your 2009 target. I was wondering if we have to expect any update on the 2009 targets soon? Thank you.

Robin Stalker – CFO

Michael, you are presumably referring to the actual cash payments that you have seen in the cash flow. This is pure timing. I would always guide you to look at the income statement and the tax rate there. It will obviously flow through the cash tax payment. There may be some lags depending on the certain situation in some of the tax regimes, but I don't think it's a significant difference. The difference may be from quarter-over-quarter.

In terms of the improvement of US backlogs in the adidas brand, yes, this is a footwear situation where we are very well-positioned, particularly with our performance products. We're seeing great improvements driven by running but also through some of the other performance categories there.

And your third question about gross margin in 2009: We're not going to give 2009 guidance at the moment. I'm sure you will understand we want a bit more visibility before we do that. But I'm sure you can see that having increased our gross margin expectations for 2008 this is a positive indicator for the strength of our business at the moment.

John Shanley – Susquehanna Financial

Robin, can you give us an idea of what percentage of the Reebok brand business is partly being done in both the US and the UK core markets, as opposed to some of the developing markets that you spoke of earlier? And the core markets, what percentage of the business is done there?

Robin Stalker – CFO

Yes, John, we are still around the 50%. It has obviously come down as we have been growing faster in the other markets, but it would still be around about 50%.

John Shanley – Susquehanna Financial

Can you give us an idea of the plan that you have to turn around the business, with forward orders in North America for the Reebok brand down 21%? You mentioned in your prepared remarks a weakness in the UK business. Do you see that business turning around anytime soon? Is it going to happen in 2008, or is this going to be a 2009 story in terms of turning around that brand?

Robin Stalker – CFO

So here it is important to remember that our strategy is the same as we announced a couple of years ago – and we're working on the strategy for the long-term improvement of this brand. We want to build a basis upon which this brand is going to grow profitably over a long period. We're not interested in just the short-term quarterly improvements, as you know. So a key to this is our positioning in the major markets or those core markets that you've mentioned, the US and the UK. But it is a difficult task there. It is difficult because we have to change the perception of some of the consumers. We need to improve the market and the distribution. All these things have to happen and be supported by the right products – and that does take some time.

We believe we're making good progress on that. Don't forget the cleanout of these markets. It relates also to moving us out of the lower price point, high-volume areas, into distribution that includes more of the sporting goods and more of the better department stores. 2009, as I said, for the US, seems to be the right sort of period where you would expect growth.

In the UK, I believe we are progressing quite well this year on the cleanup of inventories at retail. The UK market is, however, tough also, and we have to recognize that Reebok is still a weak brand also in that market. But yes, I think, we can look positively towards 2009 in regards of opportunities for growth also for the Reebok brand.

John Shanley – Susquehanna Financial

Based on the orders that you have received so far for the spring 2009 selling season in both the UK and the US, does it look like this is going to be a front-end loaded turnaround, or do you think you're going to have to wait until the back half of 2009 before you see real material progress in the brand?

Robin Stalker – CFO

I think here it is quite clear that with Reebok, as you saw with the turnaround of the adidas brand some years ago, this is an ongoing development. You should see from quarter to quarter improvements in some way. Those improvements will either be in terms of sales, or they will be in the profitability, in terms of the uptick through our marketing campaigns from the reception that the consumer has to the brand. So, as we go through any particular periods and definitely as we go through 2009, I'm sure we will be improving throughout that period.

John Shanley – Susquehanna Financial

Brand adidas has done extremely well in both Europe and Asia, and you certainly should be complimented on that. But the brand continues to have a more difficult time in North America, specifically in the US. Both of our research databases are telling us that the brand is losing

market share at a fairly rapid clip. Can you give us an idea of what the game plan is to reverse this trend in the United States specifically in terms of rebuilding market share position for the brand? How long do you think this is basically going to take? Is this something that is going to happen in 2008, or are we going to have to wait for 2009 for the adidas brand to show recovery in North America?

Robin Stalker – CFO

You are definitely going to see an improvement in the adidas performance in the American market in the second half of 2008. We expect that due to our product offering. Also, the third quarter is a very important one in that market. But I think you are touching on a general issue with adidas in the American market. We still have a very low market share in that important market. But I believe that the brand perception there is probably the best it has been for quite some time, and that speaks to the improving marketing position that we have and also the quality of the products. We have good response to the technical product in the States. But we still need to improve the distribution of our products. We need to put our product in front of the consumer, which is an ongoing development. You cannot expect us to have that problem solved alone in 2008, but I'm sure we're getting better quarter to quarter with the adidas brand in this important market.

John Shanley – Susquehanna Financial

Fair enough. The last question I have is on the golf market. Golf sales in the United States have gotten very difficult. A lot of the retailers that we follow are reporting pretty weak sales. Do you think there's a possibility or a probability that TaylorMade-adidas Golf is going to have to be more aggressive in terms of addressing the golf market, or are their inventories in pretty decent shape, where they will not revert back to what they did last year in terms of being much more promotional?

Robin Stalker – CFO

Actually I think there is some good news here. Part of the gross margin improvement is also due to less clearance, and TaylorMade has actually been enjoying growth in the US market. I know some of the competitors have not, but I think the second quarter figure was a 5% growth in that market.

The market is tough, that is correct, and I think as we go into the second half we need to remain cautious. But no, I don't believe that they have any issue with inventories. Our goal is obviously to match the sell-in into the retail areas so that the retailer also manages his inventories to match the sell-through or sell-out. At the moment we are not aware of any issues here, although we do appreciate that the market is very tough, and a lot of their growth obviously is definitely coming from outside the States.

Tim Burkhardt – LBBW

I have got two follow-up questions on Reebok. The first is on Reebok own-retail sales. In the report, it says that first half year own-retail sales of Reebok grew 19% on a currency-neutral basis, mainly driven by new store openings. So can you tell us how much the like-for-like growth was in the own-retail business?

And the second question: The like-for-like sales in the second quarter, excluding the joint venture in South America, were minus 7% on a currency-neutral basis. So which triggers do

you expect now during the second half of 2008 that could finally lead to this mid-to-high-single-digit growth that you're guiding for the full year?

Robin Stalker – CFO

Yes, own retail is an important growth driver for the Reebok segment. In terms of comparable sales, we cannot give you the specifics as we can with adidas simply because a lot of these retail shops have not been open for more than 12 months. Don't forget this is regarding a lot of the concept shops at Reebok in countries such as Russia. But as a generalization, I can definitely say that there is a positive influence coming from own retail.

And in terms of the like-for-like underlying business without joint ventures for Reebok, there Reebok was down 7% in the second quarter. Year-to-date we're down 6%. Nevertheless we are confident about currency-neutral mid- to high-single digit growth for the full year - but obviously this includes more months of these joint venture businesses and an improving underlying Reebok business in the emerging markets.

Michael Geiger – Credit Suisse

Robin, also congratulations from my side. The stock market shows you have published a good set of numbers. The questions I have remaining here are, first of all, coming back to the HQ/consolidation EBIT. If you increase the overall margin for the full year, you must have an assumption in the second half whether there will also be extraordinary – or not extraordinary – but positive hedging gains or whether this comes just from the operation of the individual brands. That would be my first question – what is the assumption on the increase in the EBIT margin with reference to the two issues?

The second question I have is the integration synergies. I think for 2008 you targeted € 105 million. How much of this have you achieved in the first half, and how are you progressing in reaching next year's € 175 million net synergies penciled into this schedule?

Robin Stalker – CFO

Thanks very much, Michael. It is very difficult to forecast actual timing of some of these operating results at a headquarter level. But I see no fundamental reason why there would be any material difference this year to what we had last year in this particular segment.

As I said earlier, we have seen some hedging gains in the first six months in the central area, but I don't expect this to necessarily be repeated in the second six months. So I think really you can get comments that our increase in what we are seeing in the operating margin is purely operational.

Your second question about synergies: We have good news for the synergies, as we really are delivering on our plan. We're not only on time with the planning, but also in the amount that we originally estimated. From a cost synergy point of view, we have year-to-date already got the € 50 million net, and on a revenue basis, we are around the € 120 million for this year. And we're definitely on target for next year as well.

Juergen Kolb – Cheuvreux

I have three questions. First of all, on the inventory side. Currency adjusted 16% increase. Robin, could you help us breaking down this growth rate, how big is the impact from the joint ventures at Reebok? Secondly, I would be interested in getting some comments on some regions, specifically Japan and also Eastern Europe. Do you see any changes in the trends

there? And how is retail developing there? And lastly, also the reorder business, how is that developing on a global basis?

Robin Stalker – CFO

Regarding your questions about inventories, yes, they are up 16%. I cannot give you a specific figure for the joint venture from that, but it was definitely a good double-digit million figure here. This is the first-time inclusion of the inventories on those joint ventures in Brazil and Argentina. But there is a large driver in the inventory growth that can be found in other emerging markets, particularly Russia and Turkey, where we have high own-retail activities.

In terms of the retailer response or the market response in some of the Eastern European and Japanese markets: Eastern Europe just continues to be moving. We have not seen any indication of slowdowns here. The demographics are good, the infrastructure is improving. We continue to be very optimistic about growth through the Eastern European markets.

Japan is also looking a little bit better now – we think this may have bottomed out. We and various other suppliers in the market have taken the last year to clean out a lot of issues there, and we're growing again. However, Japan is still a fairly promotional market.

And regarding your question about the reorder business: Reorders continue to be an important factor. We have opportunities to improve sales here, particularly because of the improvements in our supply chain. We are able to supply when things are going well. People maybe don't want to carry too much inventory, and they are able to reorder. And the negative obviously is that because of the tougher macroeconomic environment, we don't necessarily have as much visibility because we are also at risk of people just not reordering. But at the moment, sales are going well, and we think this is also a positive for us.

Ide Kearney – King Street

I would like to go back to a question somebody asked about the US market: You do appear to be losing a fairly substantial amount of market share there. Can you share with us how much you are losing and if there is actually a decline in underlying trends in the market as well? But just sort of the health and robustness of that market by footwear and apparel if you could?

Robin Stalker – CFO

adidas sales are down about 7% in the US, in the first half year. That is obviously weaker than we would like. But, as I just said in an earlier question, you are definitely going to see growth or a much improved situation in the second half of this year, and our aim is still to grow for the full year. It is a difficult market, but I cannot give you any specific on the total market share. We have been improving the situation at the adidas brand in that market for several years. We have grown in the last five years, and we would expect to grow continuously also this year and then grow further. It is still an important market, but our focus is and remains on those very important emerging markets for us where we have much more "bang for our buck" as the Eastern European and also the emerging markets in Asia are giving even more profitability to the Group.

Ide Kearney – King Street

I totally agree that you have done a very good job in Asia. I think that is pretty obvious. But your main competitor in the US has had increasing sales, and yours are down by mid-single-

digit amounts. So it's a huge discrepancy in performance. Can you give us a more concrete idea of the exact reason for the decline? Why have these performances been so different?

Robin Stalker – CFO

Talking about the US, you're looking at a totally different market dynamic there. In the North American market, we have a competitor who has a significant market share of about 40%. And that gives a particular presence in distribution that we do not yet enjoy. Part of the rationale behind the Reebok acquisition is also to improve our positioning with retailers in this important market.

Now we have backlogs that are the same as the competitor. We see opportunities in the second half of this year, and, as I've just said, we still believe that there is an opportunity to grow here, particularly on the performance side. I think in terms of lifestyle and apparel, that is a more difficult market. But we are positioning the adidas brand as a performance brand, and here we see good opportunities also in the American market going forward.