



**adidas Group Nine Months 2008 Results**

**November 6, 2008**

**Q&A session**

**adidas Group participants:**

**Herbert Hainer, CEO and Chairman of adidas Group**

**Robin Stalker, CFO of adidas Group**

**Natalie Knight, Vice President Investor Relations**

**Allegra Perry – Nomura**

**Yes, good afternoon. I have three questions, please. Firstly, on China, I was wondering if you could flesh out the situation a little bit more in terms of the inventory buildup post the Olympics. Has growth moderated since then? How does this match with your expectations and how does this affect your growth plans for '09 and beyond?**

**Secondly, on gross margin and more specifically currency, I was wondering if you could tell us about your current hedging position. When and how do you expect the stronger dollar to have an impact on your sourcing costs?**

**Lastly on brand adidas own retail: I wondered if I could get an update on the progress here and your plans for '09, especially in light of the current environment. Also an update on the total percentage of sales now coming from controlled space would be great. Thank you.**

**Herbert Hainer – CEO and Chairman**

Okay, let me take the first one on China. There was such a huge hype before and during the Olympics. So, yes, there is definitely a slowdown of sales in China after the Olympics. But this is exactly what we had foreseen and expected. Therefore we are monitoring the market quite carefully, which you can also see in our backlogs going forward. We are more careful in what we are selling into the markets to avoid excess inventory positions going forward.

And concerning own retail: We will continue to open new stores in China. We still see good sales in our existing stores. But of course, we are watching the market more carefully as we focus on the long-term health of our business in China.

**Robin Stalker - CFO**

Okay, Allegra, let me answer your next two questions: For your question on hedging: We are not changing the methodology or our approach to hedging. Obviously, we are trying to hedge 12 to 18 months in advance all of the purchase costs that are denominated in dollars. We already hedged for 2008 and are in a very good position for 2009. We have hedged over 80% already, at a rate of over \$1.40. So at the moment for 2009 no significant impact there. The effect of a strengthening of the dollar will obviously start to impact us now in our hedging contracts for the middle and later part of 2010. Let me just remind you that, obviously, when the euro is weaker against the dollar and some of the other currencies, that does give us a short-term advantage on the translation.

Your next question was about retail and our plans to continue rolling out retail. Yes, we are definitely continuing to roll out retail. But as we have already emphasized over the last year, our retail expansion plans are always in particular relevance to what we believe is happening in that marketplace. So we will be particularly vigilant at this particular time as to what extent it is appropriate to continue to roll out retail.

Own retail for brand adidas at the moment is around 18% of net sales; and controlled space is approaching the 30%.

**Aurelie Husson - Société Générale**

**I have three questions. The first one is on net borrowings and the amount of € 2.6 billion: Can you give us some details about the debt repayment schedule and the credit lines that are available for you?**

**My second question is on the cost synergies. Could you give us an update on where we stand now? As you mentioned that you were disappointed of Reebok's profitability, does it mean that the cost synergies you have benefited from were transferred completely to the adidas brand?**

**My last question is on Reebok. In the disappointment that you have, what part can be attributed to the inventories not being cleaned up enough? In other words, what would have been the growth today if you had done the cleanup earlier? Thank you.**

**Herbert Hainer**

Let me start with the third one, your Reebok question. I don't think it would be of great use to discuss what would have been if we had cleaned up inventories earlier. I think we should focus more on how we can go forward. So, more important for me is that we now clean up inventories rigorously. We had some negative surprises just in the last few months. One of these was Mexico, which I can mention.

As I said, we are getting very positive feedback from retailers on our products. But of course, getting positive feedback on the product does not mean that immediately the consumer is also seeing it and buying it. But if we clean the market, then the consumer in the future will only see the good and the new products of Reebok; and this will definitely help and enhance the image of the brand.

**Aurelie Husson**

**Ok, Herbert, just to follow up on what you said: When do you think the distribution network is going to be finally cleaned?**

**Herbert Hainer**

We do believe that by the end of the year we will be through the biggest part. When we talk to each other in March next year, I'm confident that we then can report major progress. As I said, we are quite consequent and rigorous now on clearing inventories up.

**Robin Stalker**

Aurelie, in terms of net borrowings, we are in a very good position with our financing. We don't have any particular large amount of refinancing due over the next 18 months. You may recall at the time we did the Reebok acquisition, we put a syndicated loan together of about 2 billion €. We have only drawn down 200 million € of that.

We have about 1.5 billion € in financial lines that are also at the moment totally free. So I think here in terms of our financing, we are in a very comfortable situation. All the details of this and the repayment terms are in the Annual Report 2007.

In terms of cost synergies, we're definitely on track for all of the cost and indeed also the revenue synergies that we'd identified.

Cost synergies for 2008 through to the end of September now total about 80 million €. That is from the net expected 105 million € for 2008. There is obviously an over-proportional benefit in the adidas brand for that because, as we mentioned some time ago, a lot of this cost saving is also coming through the improvements in our sourcing, which is volume related - and obviously adidas has higher volumes.

**Michael Kuhn - Deutsche Bank AG**

**Good afternoon. I have one question, focused on the improvement of working capital development. I think compared with the second quarter the situation did really change to the negative. At Q3 we saw plus 14% operating capital. Working capital at half year was minus 4%. We saw plus 10% at the end of Q3. I wondered what the main sources for this quite significant deterioration are, and when you think you can turn the situation.**

**Maybe one more question regarding your other emerging growth markets, Russia and India. What is the current situation over there?**

**Robin Stalker**

Okay, Michael, for your first question on working capital: Don't forget you have to look at this year-over-year not quarter-over-quarter. Obviously, we have a very cyclical business, and we have tremendous cash generation particularly in the fourth quarter.

So I think looking at the working capital development at the end of the third quarter, we are very happy with that. The use of funds here has a lot to do with the timing of payables. So I think if you look at this at the end of this year, we will be perfectly in line with our guidance.

Certainly we have differences between the inventories and payables at each quarter end because of the cycle of our business, as I said. That is why we have such a good cash generation in the fourth quarter, because we have lower inventories and lower receivables at the time.

**Herbert Hainer**

So let me answer your second question about Russia and India. We still have very healthy and good business in both countries. In Russia, we are continuing to open stores. The sell-throughs are still very good in our stores. Of course, we are watching the situation quite carefully, but I can't tell you what influence the economic situation will have in neither Russia nor India in the future.

As for now, we are still enjoying good business over there. We will continue to invest in these two markets because we do believe they will grow - especially in India with Reebok, where we have a 50% market share. Our business is doing very well, and we will further invest there as well.

**Michael Kuhn**

**Okay, thanks. Maybe coming back to the working capital one more time. Comparing last June with this June, inventories were up 100 million €. Comparing last September with this September we are up 200 million €.**

**So isn't there an inventory buildup that you should be worried about?**

**Robin Stalker**

No Michael, inventories are up 15% year over year. As we said in the prepared comments, the reason for that is twofold.

One, it's the first-time inclusion of the inventories in the joint ventures in Latin America that Reebok has entered into. Secondly, it is the buildup of inventories in emerging markets; and the expectations of sales in the future warrant that inventory.

Due to the gradual increases in the FOBs, we've also done some level loading in the factories and received some of the inventory perhaps a little bit quicker than we did in previous years, particularly at brand adidas.

#### **Erwan Rambourg - HSBC**

**Firstly, going back to the comments of Herbert on China and on the slowdown there. I remember when we did the trip to China, you were mentioning that you had focused on the Tier 1 to Tier 3 or 4 cities; and you would be looking to move to lower tier cities in terms of expanding the networks. Should we consider that, given the slowdown, this plan of expansion is partly jeopardized or at least delayed now? And given that you've retracted guidance for '09, should we also consider that the indication you gave of double-digit growth in Asia going forward is obsolete as well?**

**Second question is on inventory growth. I think it was up 15%, currency neutral. Could you give us an idea of what it would have been without the impact of integrating the joint ventures?**

**Then finally, on cash, should we understand that you will stop buying back shares? Would the focus be more on paying down debt, or on maybe benefiting from the markets right now, to go after bolt-on acquisitions like you did recently with Ashworth? Thank you.**

#### **Herbert Hainer**

Let me start with the first one on China. No, we are not postponing the openings of our own stores, because we had already foreseen a slowdown of sales in China after the Olympics. We're very familiar with situations like this. We had other big events, be it the Olympics in Athens or the World Cup here in Germany etc. You always have a slowdown after these events; and this is what we have already incorporated in our plans going forward.

We will open stores in China, be it in Tier 1 or Tier 2 cities where we still have white spots, and going further in Tier 5 or Tier 6 cities.

In terms of 2009 we are not giving any guidance so far and we will be more specific in March 2009.

#### **Robin Stalker**

In terms of inventories, if we were to take out the impact of the joint ventures, you would still have high-single-digit growth in the inventories. But the business in the emerging markets is obviously having a high weighting in that.

And for your question about the share buyback or acquisitions: As Herbert said in his comments, I think we just need to be vigilant about what the opportunities out there are at the moment.

Right now, we have no plans to do another share buyback, nor indeed any sort of acquisitions. Our focus is on repaying our debt. You may recall that we've set our target for debt to equity to around 50%. At the moment, we are running about 78%, and it's our focus to get back down again.

**Erwan Rambourg**

**Right, thank you. Just one last quick question: What is the number of stores right now in Russia? Can you confirm that these are all controlled stores and not via third-party retail?**

**Herbert Hainer**

We have around 400 stores in Russia at the moment, and they are controlled by ourselves. They are own stores, and therefore we know exactly what is going on day in and day out. We see what products are selling through and not selling through; and as I said before, we are seeing a very good business in Russia and the sell-throughs are still very good for us.

**Luca Cipiccia - Goldman Sachs**

**Could you quantify your sales performance in China, just to clarify, to what level does it moderate?**

**Also if I look at the Asian backlogs, I don't know if you can give us an idea on how Japan would be impacting or diluting the number that was reported.**

**Second question is on your targets for 2009. I think you are very sensibly removing some of those targets. You're still, however, assuming growth. How much of a downside risk do you see for your growth projection?**

**Also, how should we read your comment about still growing on the operating margin level? How much room do you think there will be in any case, even if the top-line visibility is low, that the operating margin will be up compared to 2008?**

**Lastly on Reebok: Could you maybe comment on those markets where you don't have any more inventory issues? How you are seeing the performance of the brand tracking? Are you satisfied with the work that you've already been doing over the last few years for the brand? Thanks.**

**Herbert Hainer**

Okay, so let me start with the Reebok one. We have cleaned up our inventories in the last 18 months in the UK and in the US. We definitely see better sell-throughs here at, to a certain extent, higher prices. We have raised our prices, for example, for classics by £ 5 in the UK just to give you an indication, or at directional accounts in the US.

So we can definitely see the success, wherever we have a clean and new product offering and no bargaining. This is what really encourages us to go and continue this way.

Your other question was on 2009 and on our order growth, or respectively on our growth perspective. As we said, yes, it is our plan to grow in 2009. Looking at our order books and listening to retailer feedback, we are quite encouraged.

Of course, we don't know what will happen with the economic environment in the next six to 12 months. But right now, we're pretty confident that we can grow in 2009. We want to grow our bottom line faster than our top line. And by the way, on your second question, we have not given any guidance on operating margin.

**Luca Cipiccia**

**Provided that the top-line visibility is very low, how comfortable are you still in your capability to increase your operating margin? Can you make any comment on that? Or can you tell us something about the actions that you will take when it comes to cost control? And can you share any view on the operating margin already?**

**Herbert Hainer**

I understand that you want to get a more concrete idea of our 2009 targets. But as we have said already, we are not giving any guidance yet.

So let me answer your first question, China and Japan. We are not disclosing any figures for individual countries, only for the region. And for Asia, our backlogs are up 8%.

**Michael Geiger - Credit Suisse**

**Good afternoon. Two questions, if I may. First of all, for Herbert maybe, now do you see the share price reaction? Obviously your results were good and better than expected; so that can't be the issue – I guess it's the forward-looking stuff.**

**Herbert, maybe you can share with us a little bit the latest trading experience in your own retail in various regions. Is there a real decline in floor productivity? Or is it more like you report in China or in Russia, where you still see very satisfactory business as you just told us? So, has the world changed just in the last four to six weeks?**

**And then, Robin, we now know about your nine months results and we know your guidance. You stick to it - congratulations. Plus more than 15% will be a fantastic achievement. Certainly, it requires a real boost in Q4 results. Maybe Robin, you can share the rationale for that expectation with us. You also refer to very strong free cash flow in the fourth quarter. We know last year's fourth quarter was down and it was a small number. That explains some of that. But the drivers for this fantastic growth to be expected in the fourth quarter – can you please give us your rationale for that?**

**Herbert Hainer**

Okay, Michael, let me answer your first question. Of course the last four weeks have not been better than the weeks before, and the times are getting more challenging. But on the other hand, the world is not stopping. People are still buying, going out and shopping, although they don't do it to the same extent as they did six months ago.

Although we are on the one hand disappointed about our Reebok business, we are very satisfied with our business at brand adidas. We have never been in a stronger position than today. You can also see this in the retail stores and in our own retail stores.

I think we have very compelling products. We have a great marketing story to tell. We have divided our brand into two divisions to be able to appeal to more consumers, and this really works. We are not just a football brand. We are not just a tennis or basketball brand. We are also appealing to young consumers who are buying our style products.

So the only thing I can tell you going forward, in terms of our brand perspective, is that we have never been as strong as today and we are convinced that we have a winning formula.

Whatever the market conditions will be for Reebok, I think I have said enough on what we are doing. We know that we still have to work very hard and have a long way in front of us.

But for adidas and TaylorMade-adidas Golf - this is how I see things at the moment and this is what makes us confident that we can grow further.

**Robin Stalker**

Michael, in terms of the fourth quarter, you hit the nail on the head in saying this is a small quarter. That means the result there can fluctuate quite considerably year-over-year. We are very confident that the trading trend that we've seen in adidas and TaylorMade will continue strongly in the fourth quarter.

There are some of last year's expenses that we will not have this year as we launched a marketing campaign for example, to support the launch of the European Championship product. And also we did a big Olympic campaign which was launched in Q4 2007. We don't have those campaigns this year. And that is where you should get some confidence on the improvement in the operating result in the fourth quarter this year.

**Michael Geiger**

**One additional question if I may, concerning the two small acquisitions on golf and technical products you mentioned. By when would you expect those to contribute positively to the Group?**

**Herbert Hainer**

Michael, this is a little bit more complicated to say, as the first one, Textronics, is not a company we are buying in the original meaning. Textronics is focused on the development of technology. We are now using their patents and will bring it into the adidas products going forward. You will see the first products in this magnitude for fall/winter '09. And then you will see the results in the adidas segment.

The second one is a different one. We definitely do believe that the Ashworth acquisition will go through. It's not finalized yet, as you know. We definitely do believe it will already contribute in the near future. Of course, we will do some structural changes. So therefore, we will have to do some work in the first step, but we do believe that the acquisition gives us a lot of opportunities going forward.

**Christopher Svezia - Susquehanna Financial Group**

**Good afternoon. I have four questions: My first question is on Reebok. You have lowered your growth targets in this segment. Does your 21% decline in North American backlogs include the realignment of Footlocker on a future contract basis?**

**Secondly, can you give us an idea of what you believe might be done to the Reebok brand to improve sales and margins? It seems that your position has been cut in half in terms of your market share position in the US. And your backlogs have not improved on a constant currency basis. So I'm just trying to get an assessment of where you believe the bottom in this division is? And what might be needed from an investment perspective? Will you need marketing or product developments and distribution improvements to reestablish the brand?**

**Thirdly, in Europe, specifically in southern Europe, Spain, France, and Italy, what might be going on there relative to your performance in the UK and Germany?**

**And my final question: Could you give us an update on sourcing costs coming out of southern China and whether or not the reduction in oil could potentially offset some of the higher labor costs and distribution costs you are seeing out of southern China? Thank you.**

**Robin Stalker**

Okay, Christopher, let me take the questions on FOB. As you know, there have been pressures on FOB from the wages and also from the raw materials side. We are seeing that for 2009 in both seasons, spring/summer '09, although it's fairly minimal, and also in fall/winter '09. We've been very pleased, however, that through the mitigation activities that we've followed, the net impact of this will be quite small.

In terms of whether the reduction in the oil price can actually help us already in fall/winter '09, I would be a little bit skeptical. That will obviously be an important factor in future negotiations. It's not playing that much of a factor at the moment but we will be finalizing our fall/winter '09 pricing by the end of this month. And it's obviously positive to see that oil is coming down in price.

### **Herbert Hainer**

Okay, let me take the question on Reebok and especially on Reebok in the US. We are not making any comments on individual accounts and their impact on backlogs. But as I have said several times in the past, we are cleaning the markets in a first step – and especially in cooperation with Footlocker, their own inventory – and then we will start to rebuild the business.

In the US, when do we see the bottom? Have we reached it already? As I said before, I do believe that by the end of the year, we will have cleaned the majority of all of our inventories around the US. We have more or less gotten rid of all the entry price level products. This was a close to 200 million € business before.

So therefore - yes, I would say we see the bottom. I don't know what the economic situation going forward will be, in the US. Therefore, I cannot tell you: "Yes, we will grow in the next year in the US." But we have cleaned the market and we are bringing better products into the market now. This is what I can tell you today.

### **Christopher Svezia**

**And can you give us an update on Europe?**

### **Herbert Hainer**

Yes, this was your third question, correct? Southern Europe especially. Yes, southern Europe has modestly underperformed the rest of Europe in Q3, especially Spain. We saw some challenges there in the last six months.

### **Uwe Weinreich - UniCredit**

**One question to Herbert on Reebok. I would assume it will get a little bit worse in the fourth quarter before it gets better at the beginning of '09. How much of Reebok's total sales are affected by the clearance in Q4? And which categories, especially? Are these clearance activities also effective in the UK and Japan or is it only in the US?**

**Even if the demand is not coming in next year, have you already discussed any results-saving issues for brand Reebok? And what is more important for you, top-line sales or keeping the margin? Because, if I assume correctly, next year you will have more or less zero integration costs. I think that would have a positive impact on the operating result by roughly 70 million €. That should have, assuming stable sales, a positive impact on the margin. Is that right, or am I missing something?**

**And my last question: You said that you are not giving any indications by countries, but given that order backlogs of brand adidas are up in China and having in mind that you were optimistic about Japan for the next year: Are you still optimistic or is there anything you have changed in your assumptions? Thank you.**

### **Herbert Hainer**

Okay, Uwe. This was one question with a lot of different issues, so let me talk about Reebok in the fourth quarter. We definitely do believe that the fourth quarter for Reebok will be profitable. And of course, as you know, profitability is our most important metric and this is what we focus on going forward.

Of course, we want to increase our revenues and we definitely believe we are doing the right things, but profitability is our most important metric. This is why we are cutting entry price levels. This is why we are rigorously going after old inventories which are counterproductive to our margin and to our brand image. And this is also why we are building the business outside of the US: Because we will get better margins when we build the business outside of the US, in Asia or in Europe.

Unfortunately, as I have already said before, it is taking longer than we thought. We still have some old packages to carry. Of course, the economic environment at the moment doesn't help and makes retailers concentrate: They are focusing on brands where they expect to have a safe haven, which is mainly adidas and Nike at the moment.

Nevertheless, our products and our concepts for Reebok going into 2009 are much better and much more accepted. We would be happy to give you one or the other retailer name where you can go and countercheck that.

**Uwe Weinreich**

**And which categories are affected at the Reebok brand?**

**Herbert Hainer**

We focus on three categories that will define the new Reebok. This is first and foremost women's fitness, this is men's training, and this is the whole classics business. This is what we are pushing through because we do believe this is the heritage of Reebok. This is where Reebok has the best reputation and the most acceptance by consumers.

**Uwe Weinreich**

**And next year, do you expect less integration costs?**

**Herbert Hainer**

This is correct, yes. We will definitely have less integration costs next year. But I think it would be honestly too simple to say, yes, you have less integration costs so your profit is going up by 70 million € because we have lost business in some regions and categories. As I said, we will definitely give you more guidance in March 2009.

**Uwe Weinreich**

**Would you repeat your statement with regard to Japan that you are still optimistic for brand adidas in terms of sales?**

**Herbert Hainer**

We do believe we have a very healthy position for brand adidas in Japan. You know that we are number one, and I think we are doing a lot of good things in Japan. Once again, I don't know exactly how the economic crisis will affect Asia and especially into Japan, but our position there is very good and very healthy.

**Jürgen Kolb - CA Cheuvreux**

Thanks very much. Most of my questions have been answered. Two are actually left:

First, on 2009 – where and how, Robin, can you cut costs if things move even more into the negative than you may think right now? Herbert, you stated that obviously profitability and earnings are the main focus. But how much are you really prepared to take to preserve margins?

Secondly, on the opening of new stores in China. We had about 470 new stores, I think, per annum. Is that a run rate you also are looking at going forward, or are you prepared to take down that number in light of a potential crisis also in the Asian market?

**Robin Stalker**

Jürgen, I think Herbert mentioned in his prepared comments that we have already started initiatives to really address our flexibility on the cost base and that also includes marketing working budget. We have a considerable amount of marketing working budget spend per year, not all of that is committed. The important thing here will be to make sure that we do so in light of what the business development is. I think that with the initiatives in terms of the cost base, and in terms of marketing working budget we have flexibility, but I don't think it's appropriate to try and put a figure on it.

**Herbert Hainer**

The second part of the question was on China. Yes, we plan to open several hundred stores in China going forward. Of course, we are watching the situation very carefully. We definitely will make sure that we don't run into excess inventory positions and that we open stores only wherever we think there is a real good opportunity to get them profitable very quickly. But once again, China is still a very good and a very healthy business. We have a clear plan. We want to achieve over 1 billion € in sales by 2010 for brand adidas, and all our plans and indications are going in this direction.

**Natalie Knight – Vice President Investor Relations**

Okay. Well, thank you everybody for participating today. I want to give you just a small reminder in terms of the next reporting date which is going to be March 4, 2009. That will be our full-year results and we will be having an analyst conference here in Herzogenaurach where management will be excited to see you and give you more details on 2009. So thanks again, and have a great day.