adidas Group First Quarter 2009 Results
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Q&A session
adidas Group participants:
Herbert Hainer, CEO and Chairman of adidas Group
Robin Stalker, CFO of adidas Group
John-Paul O'Meara, Head of Investor Relations

Matthias Eifert – MainFirst Bank
Could you give us some more detail about the problems brand adidas faces in the US? The 25% sales decline is a bit shocking. What happened? What kind of changes will you do to improve the situation there?
Secondly, could you give us the organic sales development on a Group basis excluding the Reebok Latin American business and the consolidation of Ashworth and TaylorMade-adidas Golf? Also the organic sales number for these two divisions would be interesting.
Thirdly, could you give us some more information about the market development in China? What kind of growth rate did you see here in Q1? Thank you.

Herbert Hainer – CEO and Chairman
Let me start with the first and third question and Robin will take the second one. adidas in the US, yes, the figures are not pleasant. But the first quarter, especially at the beginning of the year, was characterised by an extremely high promotional environment, especially in January. And we therefore decided to take some products back from several of our retailers and channel them through our factory outlets. We focus on keeping the market clean. This is certainly the main factor in the sales reduction in North America. You might remember that we had slightly positive backlogs going into the year. So, we definitely do think that the development will get better during the course of the remainder of the year. But the US is definitely the most challenging market at the moment – consumers are extremely nervous in the US.
Your third question was concerning China, where we had a single-digit sales decline in the first quarter. The market and the stores are over-inventoried at the moment. And in addition to that, we have quite strong comparables with the first quarter 2008 where we were building up to the Olympic Games.
So, what are we doing going forward? We will focus on controlling our sales into our franchisee stores in China as we don't want to damage our brand. We have a huge business in China, which will go up to € 1 billion for the Group in 2010. And we don't want to disrupt our vision just for the sake of one or two quarters. Therefore, we are slowly bringing new products into the stores so that we can generate and guarantee a good sell-through. At the same time, we have supported our retailers by also taking some products back. All in all, China will be a more challenging this year than it was before. But there is no doubt that this will still be the growth engine in the years going forward – and the potential there is still huge.

Robin Stalker – CFO
So, Matthias, to answer your question about the organic sales growth: Our Group sales are down 6% on a currency-neutral basis. If we exclude the joint venture companies in Latin America and the acquisition of Ashworth, that figure would be minus 8%. For TaylorMade-adidas Golf currency-neutral sales also decreased by 6%. If we exclude Ashworth, sales are

down 13%. For Reebok currency-neutral sales declined by 4%. Excluding the joint ventures, we had a decrease of 12%.

Jürgen Kolb – CA Chevreux

My first question is on the working capital – which looks quite disappointing. From what I understood you still are quite confident to improve that figure. How are you planning to get rid of these excess inventory levels? Could you give us some indication on when we will see improvements here?

Further, I have a question on the initiatives Herbert mentioned and on the cost savings they implicate. Does that mean you will have all the costs behind you in 2009? And then, as of 2010, will we have a profit of € 100 million from these initiatives?

My last question is on the reduction of your net borrowings. What kind of assumptions do you have here? Will you be able to reduce your net borrowings given the disappointing performance in the first quarter?

Herbert Hainer

Jürgen, let me just answer your first question on our inventories. Please bear in mind that we have a lead time of six months at least. So, all these inventories comprise products which we bought in July, August and September last year. You can be sure that we have already taken measures this month concerning the second half of the year. We have considerably reduced our buys and included over-inventory, which we have at the moment, to get to our 2009 sales guidance. We also have initiated aggressive clearance sales activities, which started in mid-April as we didn't want to affect our third quarter sales.

And lastly, be assured that our current inventories are by nature clean. We hardly have any inventory from 2008 or before. And to give you a time frame: You will see significant reduction on this front from the third quarter onwards.

Robin Stalker

And then, Jürgen, just following on from the comment about inventories on your question about borrowings: The freeing up of cash that is tied up at the moment in inventories will be a major contributor to the cash that we expect to generate to pay down our borrowings. We're still very confident that our borrowings at the end of 2009 will be below what they were at the end of 2008. There are several factors that make us confident: It's the inventories, including the tight control of our inventory boot-up. It's extending supply of payment terms. It's also being very diligent in terms of our working capital expenditure, which we expect to come in at the lower end of the guidance that we gave you in March. And obviously this year, there's nothing planned in terms of share buybacks, no major acquisitions or anything like that. So, our priority really is on paying down borrowings. And I think we've got a good plan to achieve that.

Your second question was about the cost savings and when we expect to see the full benefits of that. In 2010 we should definitely see the effects. All the initiatives that Herbert was talking about, we expect to execute upon those throughout 2009. Some of our steps have already been taken in the first quarter. And more will be coming, obviously. But we should be able to get an annualised benefit of the whole programme starting in 2010.

Andreas Inderst – Exane BNP Paribas

Good afternoon, everyone. My first question is on the second quarter guidance. You indicated EPS at breakeven. Can you maybe elaborate on this a little bit more? How much

will this be impacted by one-offs? You indicated some € 25 million related to TaylorMade-adidas Golf as I understood. Can you maybe give us a little bit more insight into on the second quarter development – what is really underlying, how much are one-off effects.
Then, my second question is regarding the € 100 million one-off costs. How much did occur already in the first quarter and how much is still to come?
My third question is on Reebok. You already indicated some improvements in certain countries such as Germany, Italy and India. Can you give us a little bit more insight how the new products are perceived? And how is the inventory situation at Reebok? You mentioned the US market. But how is it for example in the UK and in the rest of Europe? Thank you.

Robin Stalker
Okay, Andreas, I'll talk about the cost side. Regarding guidance for the second quarter – I don't feel in a position to give you too detailed guidance. What we can give you is a sort of indication, a breakeven for earnings per share for the second quarter.
What we said in terms of Ashworth is that we're expecting additional integration costs throughout the rest of the year of € 25 million. And about half of that will be in the second quarter, so we expect that to be around € 12 million.
And then, to answer your second question about the € 100 million restructuring costs, how much we've already covered in the first quarter and what's still coming. That's also obviously relevant for the second quarter. We've identified € 26 million for the restructuring we announced in February this year – which is obviously in the first quarter. So, that means there are another € 74 million to come in the remainder of this year. And I'd say your best bet is to look at that being equally spread out over the remaining three quarters.

Herbert Hainer
Okay, let me answer your question on Reebok. As you have indicated, Andreas, we have several countries where we are really doing well – be it Germany, India or the Nordics. We also had a very good first quarter for example in the UK. We have cleaned up the distribution channels in the last 18 months and are now coming in with new products – and this is working very well.
Overall, I think we have made a lot of noise with JUKARI Fit to Fly™. This is definitely seen as something like Aerobic Step 20 years ago when Reebok changed the fitness world. You might remember one of our last conference calls, when I told you that we are working on really changing the fitness world again. And with JUKARI Fit to Fly™, we have definitely the right concept in place to do so. When you go to L.A., for example, this is the talk of the town there. We now have to capitalise on it and build on the reputation of the Reebok brand.
With the EasyTone™ shoe, we are already doing so. The EasyTone™ is one of the best-selling shoes, if not the best-selling shoe in Lady FootLocker in the US, with sell-through rates of up to 20% per week. We will introduce a family of EasyTone™ products in the second half. And we're already looking further into 2010, building a kind of a "Tone category" to really commercialise and capitalise on that.
I definitely think that the hard work which we have put into the Reebok business in the last three years is slowly but surely coming into place. And as I already saw Reebok's spring/summer 2010 collection, I can tell you that it is again a big step in getting better products to the market.

Andreas Inderst – Exane BNP Paribas
Thank you. Maybe a follow-up question on the inventory position of Reebok: If you cross out the joint ventures in Latin America, is it fair to assume that the Reebok inventory would be down or would have been down in constant currency? Or would it still be up?

Robin Stalker
No, Andreas. It would not have been down. It would be still up. But there's nothing in here that would indicate Reebok's inventories any sort of worse position than what we said about the total inventory position. We have a little bit much at the moment but Reebok's fine. But it would have been up, even if you took out the joint venture.

Michael Kuhn – Deutsche Bank
Good afternoon. I have also three questions. My first question would be on the € 34 million allowances on doubtful accounts. I would be interested if this number was actually zero in Q1 '08, so if the delta was indeed € 34 million. And adding to that, could you give us some more details on your general credit and merchandise insurance policy? And is there a danger of further allowances?
The second question: We saw SGI numbers recently coming out suggesting that you have lost market share in the US athletic footwear market last year. Q1 numbers for sales also look not that great. Do you expect to continue to lose market share?
And the third question also relating to the first half year and the second quarter guidance: You obviously assume that you will have recurring restructuring costs in a similar amount or even more in Q2 than in Q1. Does this mean that you don't expect any improvement in your operating performance in the second quarter? Thank you.

Robin Stalker
Okay, Michael. Let me take your first question. I'll also touch briefly on your third question and Herbert will talk about market share. Regarding provision for doubtful accounts: We're not reflecting any particular default of customers. This is a pure provision. There's maybe even the opportunity that, if things improve over the next few months, we don't need as much as what has already been provided for. But we're definitely talking about a delta. Obviously, each month-end we have some sort of provision for doubtful debts. Quarter-over-quarter, there's an increase in that provision to € 34 million. It reflects the fact that the aging structure of our receivables has got older, and it's reflecting that the risk of customers defaulting is higher than it was in the first quarter of last year.
Credit insurance is not really a subject for us. There may be a little bit of credit insurance in some of the smaller markets. But it's basically not a subject we have. The biggest part of the risk is covered by us. And that's why we do this provisioning. I don't think at the moment, from what we see about debt, that there is any other risk than what we've already reflected in the first quarter.
And the third question was about guidance for the second quarter. Sorry, but we're not giving any specific guidance on the operating performance. I think we've given you a good indication here. We're not being too optimistic on the operating performance, because as we said already: We don't see any significant change in the market trends we've indicated in the first quarter.

Herbert Hainer
So, let me come to the North American market. There was definitively a shift to lower price points – especially in January when there was a highly promotional environment – and these

are not the price levels we want to be in. Therefore we have taken out products from the stores to keep our brands healthy, which might have an impact on market shares.
We will definitely do whatever is right for the brand. And you also have to see that in the US, the profitability of our brand is much lower than in all the other regions around the world. And therefore, we do not want to get into any price competition in the US because this would further hurt our margin.

Peter Testa – One Investments
I have two questions, please. Firstly, on the gross margin: If one was to take the assumption that the rouble stays where it is – could you give us a feeling for the gross margin development? To which degree could the first quarter gross margin decline be recovered through the remainder of the year? And then my second question is: Could you give us some qualitative comments on how retailers' order patterns have changed in markets where that's relevant. Thank you.

Robin Stalker
We'd be quite happy if the rouble stays where it is. And we have seen that over the last few weeks the rouble has been fairly stable. But year-over-year, obviously, it has significantly depreciated against what we had in 2008. And therefore, that will continue to have a negative influence as we go through this year. If it improves, then yes, that's an opportunity for our margin also to improve.
In terms of the mitigation that we're doing, obviously, we are increasing prices. But there's a limit to how much that price increases can recover in counting your overall impact. We will continue to exploit that market opportunity there. But I don't think we should be too optimistic until we see a real improvement of the rouble over the euro.

Peter Testa
I would like to understand the broader picture. How much of the gross margin decline in the first quarter do you think will be recovered through the year?

Robin Stalker
I think that's a different situation. I thought you were just talking about the rouble impact. Definitely, we can be generally optimistic about improvements in the gross margin, particularly through the FOBs. We already know that the FOBs that we have been able to negotiate for the 2010 seasons, which start at the end of 2009, are significantly better than the FOBs that we're suffering at the moment.
We also continue to improve and extend our own retail. Once the growth comes back in the emerging markets we will see the benefits. So, I think we will continue with our retail strategy. We are also expecting further improvements at Reebok. Considering that, and the quality of our business, we will definitely see an improvement in the gross margin as we go through the end of this year and definitely in 2010.

Herbert Hainer
So coming to the question of the order pattern, yes, it is definitely correct that the order pattern, especially in this difficult environment, is changing. The retailers want to advance business. This is exactly what we had already foreseen since quite some time. Therefore, you might remember that in March we told you that we won't give any backlog figures anymore because they are not indicative of the business going forward. Take the example of Reebok.

We had backlogs at the end of the year of close to minus 20%, and now we are at plus 1% or minus 4% currency-neutral in terms of sales.
On the other hand, this is exactly why we are changing parts of our organisation. The new organisational structure will help us to be closer to the consumer. By shortening lead times and streamlining the product creation process, we will be able to bring products faster to the consumer while our retailers will be prepared for faster changing trends. This also means higher replenishment activities for the retailers. And this is exactly one of the key reasons why we are changing our organisation.

Peter Testa
Okay, I understand that you don't want to give backlog numbers anymore. According to your experience, how do you enter the order season for the second half based upon the new product portfolio? Can you give us a sense about how retailers are behaving in comparison to a normal order pattern? Do they reflect the fact that there is a more promotional environment or more inventory around from other competitors? And are they accordingly behaving more cautiously? Or what do you see in terms of behaviour in this environment?

Herbert Hainer
This is quite an easy question which has a complex answer because you see differences from market to market. We still have markets which are doing quite well. Germany, for example, is one of these markets. Then, you have to decide or differentiate between products which are carryovers and new products. For example, our R9™ product at TaylorMade is pre-ordered by 100%, because everybody wants to have it. It is selling like hot cakes.
When you have carryovers, the retailers are expecting you to have the products on stock and to replenish them permanently. Overall, I can tell you that the business which we can foresee for the next three to six months is definitely going into the direction of what we have indicated in March, which is a low- to mid-single-digit decline for the whole year.

Christoph Dolleschal – Commerzbank
Hi, ladies and gentlemen. I've got two questions if I may. The first one is on Reebok and its restructuring. Actually, the question is simple: When do you actually think it will bear fruits? We have already asked about the restructuring efforts in the first quarter. Still the underlying result was significantly negative at about minus € 75 million. And the gross margin is below 30%. So, what will be the underlying gross and operating margins once restructuring is done? And when is the restructuring done?
The second question is a bit more detailed on the sourcing cost side. Can you actually break down the sourcing costs into volume and a price effect? How much were prices up, starting for example in China, and how much was your volume supposed to be down going into the 2009 season? Thank you.

Robin Stalker
Okay, Christoph. Let me just take the second one first. No, we can't give you any more specific information on the FOBs. I think we've given you a good flavour about this. I think we've put in a lot of efforts to try to mitigate these FOB increases. And we continue to work on these. We're going to get some benefit through the general reduction of input costs. But at the moment, it's a negative factor for us. I'd expect in 2010, however, that our FOBs should get back to the 2008 sourcing levels.

With regard to the question about Reebok and when we expect a decent profitability for Reebok, we've got a two-tier approach. Firstly, we have to establish the brand and make sure that there's some traction with the consumers. This is definitely starting to be the case. Herbert has given you some comments about that, particularly in terms of the women's initiatives and what we'll see going through the next quarters.
The profitability comes out of that. Profitability is obviously a major focus for us. And we do expect that when we go into the year 2010, there will be a significant improvement over what we have in 2009. But at the moment, we're doing, I think, everything that's right for the long-term reestablishment of that brand. And that includes, obviously, significant improvements of Reebok's profitability. But it's not about a particular quarter, not about a particular half year, it's about long-term sustainable profitability of that brand. And I'm sure we'll be able to talk in more detail about that as we go to the end of this year and give an outlook for 2010.

Aurelie Husson-Dumoutier – Société Generale
I have three questions. The first one is regarding your long-term target of 11% for the group's EBIT margin. How should we consider that? Is it still in your plan to achieve this level of 11%, and could you give us some guidance as of when this target will be realised? I also have a question about the tax rate. Robin, could you guide us a little bit further in the direction of the level that we should take into account for the full year '09?
And finally, a question about the US. Apparently, you continue to operate in separate headquarters. Could you explain why you've decided not to merge the headquarters in the US? And should we expect that to happen in the years to come? Thank you.

Robin Stalker
I'll do the first two questions. Very definitely yes, we still very much believe in the 11% as a medium- to long-term guidance. We're not putting a particular date on that, but obviously management is highly focused on trying to achieve this target as soon as possible. And I think the tonality throughout all the things that we've been discussing with you today and over the last few months should show you that we're doing the right things to secure the medium-term success the company. And that means we definitely need to get to this 11%. We're just seeing that this year has obviously a few factors which impede us in reaching this target this year. But it's definitely still very much a focus.
In terms of the tax rate, the tax rate over the last few years, I think, has been very good. There's no indication that we shouldn't be in the sort of range that we've been over the last few years. I'm just saying that you should not expect, however, the 28% or 29% that we saw in 2008 to be achievable again this year. We have a change in the mixture of our earnings in the various countries. And it would definitely be higher. But you should not be expecting any particular extraordinary major impact in the tax rate. It's just going to be higher than it was in 2008.

Herbert Hainer
With regard to the last question, yes you are right, there are several headquarters in the US. We have a headquarter in Carlsbad for TaylorMade-adidas Golf, in Portland and in Canton. Carlsbad is like a Silicon Valley for the golf industry. You definitely don't want to move the headquarters from there because you would lose all your good people. So, then we are left with Portland and Canton. And of course, as professionals, we are looking into it and analysing and examining it. We still have a few hundred people in each location. And this should be carefully reviewed and analysed. And this is what we are doing.

Jörg Philipp Frey – Sal. Oppenheim
Hello, it's Philipp Frey of Sal. Oppenheim. Just quickly again on the gross margin, could you just shed a bit more light on to what extent incentivising retailers in China or basically China's inventory situation burdened gross margin in the first quarter? And also, to what extent are price increases in Russia already implemented? And, could you please give us an absolute number of price increases that you are targeting there? And thirdly, if you look more into the medium term, how do you see trading down impacting your gross margin and your performance overall?

Robin Stalker
Okay, Philipp. In China about a third or under a third of the decline in Reebok's gross margin in the first quarter was due to the promotional environment and the various other activities that had to suffer in this trading environment. And I would anticipate that if you looked at something around the half of that, for China, that would be a fair estimate.

Herbert Hainer
Coming to the second question, price increases in Russia, yes, we have implemented price increases in Russia. But you have to be careful there as well, as you have a downturning economy. And you have to make sure that you don't lose your consumer.
Nevertheless, we try to get whatever we can get to mitigate this rouble devaluation. On the other hand, we are also aggressively renegotiating our rents for all the stores which we have in China, to get some benefits out of that.
And the third question was on trading down. We have the best pipeline of innovative products. This is what we have done the last eight years and this is what we continue to do. We will bring highly innovative products to the market, and for these products, we definitely can charge higher prices, which gives us a better margin. This was a success formula for us in the last eight years and it will still continue in the future.
And as we have said before, even when the golf market is extremely tough, and especially in the US, the R9™ is selling extremely well because it is a new, innovative product. And hence, you can charge higher prices. The same goes for the EasyTone™ product. A woman's shoe for over $100. For Reebok, this hasn't been possible before. But it's completely new, innovative, and it caters to the taste of the consumer. So, this is how we're going forward.

Rodolphe Ozun – Merrill Lynch / Bank of America
Yes, good afternoon. I have a question on Reebok. Could you give us an indication of how much the women's business represents as a portion of the total? And also, second question, maybe give us a bit more details on what you expect from the Chief Sales Officer and the impact it could have on your wholesale operations. How do you look at the function basically? Thank you.

Herbert Hainer
Okay, first question, I can't give you an exact number for the women's business because it is spread through a lot of categories. For example, when we go to Classics, we have the Freestyle, which is a women's product, but which is classified into the Classics segment. So therefore, I cannot give you any precise figure for the women's business. If we just talk about what we see at the moment with our JUKARI Fit to Fly™ and On the Move collections, we are talking about a small business, but with quite some potential, as we do believe.

So then, when it comes to the new organisation, the Chief Sales Officer and the Chief Retail Officer are of crucial importance as we are becoming one of the largest retailers in the world going forward. And we have to be even more professional in using all the opportunities and chances, which this organisational move will give us. To do the right thing, we have to bring in more professionals into our retail business. And this is what we have already done in course of the last 12 months. We have brought in retailers, who are really successful around the world.

So, the retail business will be a separate part. It will be organised worldwide. So wherever consumers go into the store, it won't matter whether they're in Tokyo, San Francisco or in Hamburg, they will see the same brands, the same message, and the same values for our brands and companies. And this is why we are doing the reorganisation. The Chief Sales Officer will ensure the connection between the product guys from Headquarters and the marketing guys of the countries. This connection represents a direct interlink. The Chief Retail Officer will also ensure that the product concept is executed in the right way in all key countries around the world.

The changes are necessary. We have realised that having a harmonised range for a region won't work anymore in the future. Let me just give you an example: Russia and Germany, two completely different markets which at the moment are under the umbrella of Region Europe. In Russia we have 90% of our business with our own-retail stores. In Germany, we have only a few percentage points because it is a wholesale market.

In Russia, to fill the 700-and-something stores twelve months a year, we need a strong winter assortment, which we don't need in a normal wholesale market. So, these things are completely different. And to utilise all the potential that we have in the market, we have to get closer to the key markets. And this is what the new organisation will ensure. And in addition to that, it will be much faster and more efficient.