

adidas Group First Half 2010 Results

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Q&A session

adidas Group participants:

Herbert Hainer, adidas Group CEO

Robin Stalker, adidas Group CFO

John-Paul O'Meara, Vice President Investor Relations

Andreas Inderst – Exane BNP Paribas

Good afternoon everyone and congratulations on a strong quarter. I have a few questions. My first question relates to the product costs, which are set to increase in 2011. Can you quantify the cost inflation on average and the impact on the gross margin in 2011? I understand you don't have full visibility, but maybe you can provide some information for the first half of the year. And related to that, on the price increases, what is your plan here? Have you seen any resistance or pushbacks from your retail partners on price increases? That's my first question.

The second question is on Reebok. Quite a strong and pleasing performance in the second quarter. You seem to be quite upbeat, heading into the second half of the year, for the toning and conditioning categories. Can you provide us with more information on the regional development? I understand North America was up 30%, but what about Europe? Can you also give us some information on the lifestyle business? When is that coming back? And my third question relates to the own-retail business. It's up nicely in terms of like-for-like growth – 10% in the second quarter. Still, you only guide for mid-single-digit growth for the full year, meaning you see a deceleration in the second half of the year. What is the reason for that, given that it seems Russia is accelerating, and you have also some own stores in China. Thank you.

Robin Stalker

Good afternoon, Andreas. I understand the question about the production costs. I can't give you a specific figure at the moment. If you look back at what we've experienced in the past, you know we have been successful in being able to mitigate a lot of these costs through improved operations, reengineering product and continuing to work with our suppliers in terms of early manufacturing.

It's clear that the second half of 2011 is likely to bring more pressures than the first half. You've seen, no doubt, the wage increases that some of the employees in China are getting at the moment. That will affect our industry at some stage. But, as Herbert said, we're very confident. We've got good opportunities to mitigate this. We're not too concerned at the moment. There may also be opportunities to do price increases next year, but it is too early to say that at the moment. I'm sure when we meet for our Investor Day, we'll be able to give you more colour on this.

Herbert Hainer

So, Andreas, concerning the first question on price increases: Of course when the economy is not booming, which is the case in several markets, then it is more difficult to achieve price increases. But as I said already over the past several years, I think the best approach is bringing innovative products to the market. Then you definitely can charge higher prices, and I think we prove this every day, be it with the F50 adiZero™ football boot, the JABULANI match ball, the EasyTone™ or the ZigTech™. In each case we can charge higher prices than any of our competitors. And this is what we continue to do.

The second question was on Reebok and that we are upbeat. Yes, this is definitely correct. You now see the concepts which we were working on 12 to 18 months ago. And I was bullish at that time already. Now they are in the market and are successfully helping us to reenergise the Reebok brand.

America will always be the spearhead of our Reebok campaigns and initiatives, as we have always said, Reebok is an American brand, and therefore we will start our victory in America. As you have seen, this is now accelerating from quarter to quarter, and this will continue in the second half. But also, now, the other regions are coming more into the game. Be it Asia, where, for example, we have an extremely good business in Korea. Japan is improving, and a lot of the other countries are also performing very well. And in the European Emerging Markets, we also see very good sales. There is still some work to do, especially in the Lifestyle or Classics category, which is what we call it at Reebok. EasyTone™ and ZigTech™ are helping us to get better shelf space for these other categories. Helping to get Reebok back into stores and also helping our other categories, where we are bringing in better products quarter by quarter.

Andreas Inders

My third question was on comparable store sales growth for the full year, which is guided at mid-single-digit. In the first half, you were up 7%, 8%, I believe, implying in the second half, you will have a slowdown. What is the reason behind that?

Herbert Hainer

No, we definitely do not have a slowdown in the second half, Andreas. We are running into tougher comparisons with the second half of last year. You might remember, a year ago, we brought in Michael Stanier, the new Head of Retail. I had a lot of hopes in him, which we are now seeing turning into positive results. The first thing he did was to help us to get more professional in our own stores, changing processes and the way we do business. And it is this growth you can already see in our comparable store sales. And we are quite confident that we will continue to further improve and professionalise the way we do retail, and therefore continue to get better results.

Juergen Kolb – CAI Cheuvreux

Thanks very much and good afternoon. Three questions.

First of all, on Reebok's EasyTone™ and toning apparel, can you give us more indications as to which distribution channels will get these products first? When are the launch dates exactly? And then, how are you planning to build from here to get Reebok back on the apparel front again?

Secondly, just housekeeping-wise, hedging. What's your hedging rate at this time? You indicated you're nicely hedged already for the full year 2011. Maybe, also, if you could put a number next to it?

And lastly, Mr. Hainer, on China. I think in the release, you talked about a new long-term strategy to increase the selling space in China. What exactly do you mean here in terms of new strategy? What have you or are you changing when it comes to China? Thank you.

Herbert Hainer

Okay, Juergen, let me start with your first question on Reebok's EasyTone™ and toning apparel. And the same is true for ZigTech™, by the way. We will introduce EasyTone™ and ZigTech™ apparel in the last quarter of 2010, and then going into 2011, spring/summer. It will start first mainly in the US. And here again, we drive the strategy the same as we did

with footwear. We are starting with selective distribution of functional products, which have a higher price, to create excitement with the consumer and then we will broaden the offering in stages and expand it to Europe and Asia.

The third question, which I am happy you asked, because this gives me the opportunity to explain it a little bit deeper, was on China.

So, you have seen that all our countries and regions have grown, with the exception of China. So, what went wrong in China? As we have told you already in the last two quarters, we had too much product in the Chinese market. We started already dealing with this issue just after the Olympics in late 2008 and then the whole financial crisis came. And we were not willing during 2009 just to take back all the product, because this would have had a substantial financial implication. Therefore, we worked closely together with the retailers, and said, okay, let's work out a plan on how we propose to solve this problem. We told you that for spring/summer 2010, we would sell fewer products into the market, and we will take some product back during the course of the first half to lower the inventory levels. This is exactly what we did. We have even accelerated, a bit, the takeback in the second quarter of 2010. Therefore, the minus 18% on revenues is related to the fact that we now have a clean inventory level in the Chinese market which is very, very healthy and goes back to the good old times of 2007 and 2008.

But to show you how we are getting momentum back in the Chinese market, let me give you a few indicators. First and foremost, if you look at our own retail stores, where we don't have to carry old inventory and where we already have new product in place. Here we have already seen very positive comparable store sales from our stores in China.

Secondly, in the month of July, where we mainly have only new products in the Chinese market now, our sales with our franchisees are already positive.

And the third one is Taobao, which is the biggest online marketplace in China. We haven't worked directly with them until now. But from September onwards, we have a relationship with them and we will have our own website with Taobao. Taobao has sold some adidas products previously, which they got from wholesalers, but now we have an official license and have legitimised our relationship with them. And as I mentioned, from September on, they will have a complete adidas online store.

So these are just a few indicators of what we have already done and where the business will go. I am quite relaxed to tell you that we will grow our adidas business in the second half of 2010 in China, and this will accelerate in 2011. Also, because we have already shown the products for the first quarter in 2011 and the feedback from retailers is extremely positive.

Robin Stalker

And Juergen, for the housekeeping point about the hedging rates, you know we'll be tracking 2010 just under the 1.40 to the dollar. We are already over 75% hedged for 2011, and I would hope that we'd be able to maintain a rate slightly above 1.35 to the dollar.

Juergen Kolb

Maybe one quick follow-up on Reebok and the Classics business. Do you think you have the current inventory level of Reebok Classics clean at this point, so that you can start off with new products early from 2011 onwards?

Herbert Hainer

Yes, generally speaking, inventory for Classics is not a problem, Juergen. What we have to bring in now is new products and concepts, which really excite the consumer. You might know that the Classic consumer is a little bit different to the EasyTone™ or ZigTech™ consumer, but I can also tell you that the new product concepts have been very well received

and cater much better to the individual needs of this consumer type. And in general, what we have done with Originals in adidas is what we are doing now with Classics in Reebok.

Michael Kuhn – Deutsche Bank

Good afternoon, gentlemen. Also, a couple of questions from my side. We now have the information on your marketing working budget expenditures in the first half of the year. Could you maybe give us an indication for the second half of 2010. What's your plan in terms of marketing spending, in terms of growth year-over-year? Or maybe you could give us an absolute figure?

Secondly, you are talking about a year of investment this year, but I've seen that you've actually cut your guidance for capital expenditure. I would be interested in what has changed in your assessment since the first quarter.

And finally, we've spoken a lot about football today. Could you give us a concrete number on how many sales you have achieved in euro terms with football products in the first half of the year? Thank you.

Robin Stalker

Okay, Michael. Marketing, yes, you know we've significantly increased our marketing spend in the first half. We're up over € 125 million. And this trend, as you can hear from Herbert's comments about all of our campaigns and initiatives for the second half of the year, is definitely going to continue. We guided at the beginning of the year that marketing would be up at a percentage point or a bit more over the prior year level, and we're definitely going to be above that in the second half. I would say, just take the trend that you've seen in the first half and assume it will be similar in the second half.

In terms of capital expenditure, there's nothing special to say there. It's just the timing of some of our investments. We've not dropped or let's say deliberately slowed anything. Sometimes in retail, it takes a little bit longer to find the right retail locations. But we might also have been a bit generous in our first capital expenditure assessment. We're just not trending to the initial figure, and we've therefore amended it, but there's nothing special behind that.

Herbert Hainer

Concerning your third question on football, we don't split our sales by categories for the half year results. But, believe me, we are well on our way to achieving our overall football target for the year, which is to achieve sales of at least € 1.5 billion.

Michael Kuhn

Okay, thank you. One more question from my side, I just read yesterday some news saying that you have split up with one of your major Russian distributors. Could you provide us with some words on that topic?

Herbert Hainer

Yes, you're referring to Sportmaster in Russia, I guess. There are always ongoing discussions on how our relationship should move on going forward. But, as you know, our main business in Russia, is by far our own-retail business, so you shouldn't be concerned about that.

Matthias Eifert – MainFirst Bank

I have a question about Reebok. The Q2 wholesale gross margin was at 26.6%. So there was an increase of only 120 basis points. I was actually expecting a bit more here. What is still dragging on the gross margin? I believe that it's going to increase going forward, but given all these increases in toning and ZigTech™ sales in the US, I would have expected a bit more here. So, what is underperforming?

Secondly, a question on Retail in Western Europe in the second quarter, you just had an increase of 0.4% in sales. What was the reason here? Did you have a lot of store closings, or why did this region not grow as much as other regions?

And then, lastly, on China. Are you still confident to end the year more or less flat in this region, as you previously indicated, or is this goal now out of reach as you had this strong decline in the second quarter?

Robin Stalker

Hello, Matthias. I'll take the margin question, and hand over to Herbert afterwards. The trends of Reebok are very positive, the gross margin is improving almost everywhere. What you're seeing in the Wholesale numbers for the second quarter is the influence of a geographical component: There is a Latin American component in there. The joint venture arrangement we have in Latin America comes along with lower gross margins. So, it all has to do with the weighting of sales geographically.

However, look at the total increase and the gross margin for Reebok, and as you said yourself, there's a very positive development there and that trend will definitely continue.

Herbert Hainer

So, Matthias, let me answer your second question on Retail in Western Europe: Yes, this is correct, sales are more or less flat. But as you indicated already, the reason here is that we had to remodel a few stores – and for that reason needed to close them for a few weeks, as you know. So therefore, there is no underlying negative trend, it's actually the opposite. There were a few remodels and we had two closures.

And for your third question, on China: We will be slightly down in China for the full year. This is our projection now, because of the bigger than expected product takebacks in the second quarter. The growth which we will see in the second half will not completely balance it out. But there will only be a slight decrease.

Antoine Belge – HSBC

Just one question, please. I saw you took a restructuring charge which was quite significant. Do you consider that you already have all the benefits in the 2010 base, or that 2011 should see some additional benefits in terms of the restructuring you have done last year?

Robin Stalker

Thanks, Antoine. The restructuring we did last year was quite significant. We are seeing the effects coming through as planned this year. So you should see a continuation of the same, but no additional benefit in 2011.

Tony Shiret – Credit Suisse

I have three questions, please. First of all, one question on production and product. You kindly provide the information on this in the annual accounts. And I just wondered, last

year, you had a decrease in footwear production to 171 million pairs in 2009. I just wondered what you're projecting for this year, in terms of millions in pairs.

And then, in apparel, you had cut your production by 16% to 239 million units in 2009. I wondered what you're predicting here for 2010. That's my first question.

In terms of eCommerce, I don't know if you do disclose it somewhere, but I wonder what the percent of sales in the first half was for you. And how did your eCommerce activities move year over year?

And then my last question, probably the most important one, I guess, is on pricing and your power in the market to increase prices in 2011. Could give us some indication on how your average selling prices have developed in terms of full price sales in Wholesale and Retail so far in 2010?

Herbert Hainer

Okay, let me start with the first one. In terms of production, I only know that we are selling more than 200 million pairs of shoes per year. Honestly, I don't know the exact amount we are producing, as we decreased our inventories significantly last year. The same is true for apparel. We are selling around 400 million pieces of apparel every year. So, for now, I can't give you the exact numbers for the current year.

Your second question on eCommerce, please understand that we don't give any details on that. As we said, our eCommerce business is still in the build-up phase, so at the moment it's definitely not significant.

And for the average selling prices, yes, we permanently try to increase our average selling prices by bringing in new innovative products, be it for example the F50 adiZero™ football boot, the JABULANI match ball or the ZigTech™ and EasyTone™ for Reebok. These products definitely have higher average selling prices than other products. But we don't disclose any numbers for the exact average selling prices of our products.

Tony Shiret

I don't need an exact number, but some sort of indication would be great.

Herbert Hainer

Well, our indication is to raise prices wherever we can, and this will definitely mean that we will see higher average selling prices in the end. But we still have to figure out what we can do in 2011.

Tony Shiret

Have you seen higher average selling prices in the first half of 2010 versus the first half of last year on full price?

Herbert Hainer

Yes, we have seen this, because we have better and higher-priced products in the market. And obviously, we have seen it as well because we had a lot of clearance sales in 2009.

Tony Shiret

Sorry, I was talking about full price.

Herbert Hainer

I just wanted to be clear about that and also remind you that we had a lot of clearance sales last year. But also, if we just compared the non-clearance sales products of 2009 to 2010, we would have increased our average selling prices.

John-Paul O'Meara

Thank you very much, that actually completes our conference call for today. I just have two more points to add. The first one is, our Q3 results will be reported on November 4, 2010. And finally, I would like to announce a date change. We will now host our Investor Day on Monday November 8, 2010 here in Herzogenaurach. We will be sending out the invitation by the end of this week and we look forward to welcoming you here this year.