

adidas Group First Quarter 2010 Results

May 5, 2010

Q&A session

adidas Group participants:

Herbert Hainer, adidas Group CEO

Robin Stalker, adidas Group CFO

John-Paul O'Meara, Vice President Investor Relations

Uwe Weinreich – UniCredit

Good afternoon. Herbert, my first question goes to you.

Could you address some words on the adidas Sport Performance category in Wholesale, especially on Training, Running and Basketball? Is there something you could share with us, which is important to know?

Then, on the soccer sales, is it right to assume that soccer sales in the current year will be well above € 1.3 billion but below € 1.4 billion?

And then, on your Wholesale performance in China, do you still expect that the turnaround will take place in the second half of the current year, or is it expected to be a little bit earlier – maybe in the current quarter? Thank you.

Herbert Hainer – CEO

Good afternoon, Uwe. Let me start with your question on China. Yes, I am definitely convinced that we will see the turnaround in the second half of 2010. Obviously, I have seen the orders for the third quarter already, and know the outlook a little, so yes, I am convinced we will get to positive numbers in the second half.

Soccer, € 1.3 billion yes, this will be a number from the past at the end of 2010. How far we can go, we will let you know during the year. But we will definitely over-achieve the € 1.3 billion figure.

And the first question was on the individual categories. In Basketball, we are successful outside of the US and in the US we still have some work to do. But the decline in Running and in Basketball, this is nothing dramatic, this is just for the first quarter and you shouldn't worry too much about that.

Uwe Weinreich

Okay, but it's obvious that in your Retail business you have a very strong underlying performance, like for like, and in Wholesale you have quite a different performance.

Herbert Hainer

Yes, but when you look at the numbers, first and foremost, I can confirm that we have very strong performance in our Retail segment. But when you look at the Wholesale numbers, the main part is China's 5,000 stores, which are all reported under Wholesale. This is not our own-retail stores' performance. In fact our own retail stores in China are doing very well. They have a comp store growth of 11%, and this is what makes me confident of future growth in China.

So what influences our Wholesale performance is mainly China and Japan, which we have said are challenging markets.

Uwe Weinreich

Could you address also some words on your sourcing outlook for the second half of 2010 or even for 2011?

Herbert Hainer

We are confident on the guidance we have given for 2010 in terms of profit increase and sales increase, and this will not be hampered by any sourcing issues.

Jurgen Kolb - CAI Cheuvreux

Thank you very much. My first question is on the phasing of the earnings in 2010. Obviously, 2010 looks to be a little bit more tricky to estimate, from a quarterly perspective. Could you give us a little help here? Could we maybe take 2006 as the last World Cup year as an indication for how the phasing will develop throughout 2010?

Secondly, on China again, could you give us a little bit of an indication how the pricing in China is right now? Is there any breakdown you can provide us with in terms of volume and prices? And is that really all you need to do in order to clean inventories and then you'll return back to growth?

And help me on one issue. Herbert, you mentioned that you will sell more than 10 million pairs of shoes in the Toning category. Now, if we take away, say, 1 million pairs you sold last year already, and make some assumptions in terms of the wholesale price you achieve per pair, it looks as if there would be a quite substantial additional sales volume coming from the Toning category. So, which category is massively losing share here? Is there anything we should be looking at where Reebok is obviously not strong at all? Maybe some words on these other categories? Thank you.

Herbert Hainer

Okay, Jurgen, let me start with Reebok, because I think there are a few misunderstandings. The first one seems to be on Toning, I never said "more than 10 million pairs globally", but I said "up to 10 million pairs globally".

The second one, as you said, "we must lose massively somewhere else". I have never said this, in fact we will grow over 10%, or double-digit in North America. Reebok, with its Toning category as well, will definitely be seeing quite positive growth during the year.

Jurgen Kolb

Sorry, if I interrupt. Sorry, maybe I wasn't correct. I was referring more to the Classics category at Reebok. How is that specifically developing, when Toning is so strong?

Herbert Hainer

Yes, agreed, in Classics, we have lost some sales, but here we are doing what we have done in the Performance category, we are reshaping our Classics category. We do not believe that the old formula will attract the consumer enough anymore, we definitely have to reshape the category. We are progressing well in this area and as soon as we have more information on how the Classics category and its market positioning will look we will show you.

But coming back to Toning, this is definitely something which will help us, of course, but it is not the only factor. I told you already about ZigTech™ and now we see nice improvements in some parts of the Apparel business, especially here in Germany, which supports the Fitness category. So it's definitely not just the Toning category.

The second question was on China. I can't give you any precise information on pricing in China. We haven't changed our pricing in China. But what we definitely are doing is bringing

a lot of new products into the Chinese market, as we are doing around the whole world. This will help us increase sales in the second half of the year. For the first half of the year we have reduced sales to our Chinese franchise partners. We don't have full visibility on sell-through numbers and whether they are making a profit and whether, at the end of the first half, they have cleaned their inventories. However, from what I've seen so far it makes me believe that this is exactly what is happening.

And the first question regarding earnings, I'll give it to Robin to answer.

Robin Stalker - CFO

Jurgen, you asked about phasing, and I think it would be inappropriate to go back and take 2006 as a guide. We have different dynamics this year. Also, as you've heard from Herbert, the dynamics in China, which are coming back in the second half of the year and the growth of the Reebok business, which is improving throughout the year. I think you can assume, as you normally can for our industry, that the third quarter is the best quarter, but otherwise, don't make any assumptions based on 2006.

Jurgen Kolb

Okay, and maybe one quick follow-up on the US. Obviously, a great performance there. Adjusted for the merchandise take-back you had at adidas in Q1 '09, do you think you have gained market share with brand adidas in the US again in the first quarter?

Herbert Hainer

As far as the numbers are concerned, we still have a double-digit increase in the US, even excluding the take-back, and I don't think that the market is growing double-digit at the moment. So yes, I do believe that we are gaining market share.

Andreas Inderst - Exane BNP Paribas

Good afternoon everyone. Well done in the first quarter. My first question is on Retail. Can you provide an update on your strategy? I mean, the gross margin increased significantly, your like-for-likes are up. I assume this is a good lead indicator for the pre-order business and for Wholesale as well? But can you provide a strategic update here? What are your current measures to improve efficiency further and to improve your like-for-likes further? That is my first question.

My second question is on the Wholesale business. At brand adidas, gross margins were down 0.6 percentage point in the first quarter. Can you elaborate on that? And maybe here, related to that, can you provide some information on the overall pre-order orders for the third quarter, for the Group? I assume it is positive, but maybe you can provide more insight?

And my third question is on Russia. We have seen some positive impacts from currency effects. Can you quantify how much that is and what's the underlying improvement on own retail in the first quarter? Thank you.

Herbert Hainer

Yes, hello Andreas. Let me take question number one and number three. Number one was on our strategies for our own-retail activities and efficiency in this area. This has definitely moved on. I told you six months ago that we have hired Michael Stanier, a real professional in the retail world to help us get stronger and more efficient in this area. We do believe we have a strong brand and we believe we have a good formula to develop our retail business. Our

stores are highly attractive to the consumers, but we haven't been real in-store retailers for very long. So we have to become more professional and efficient as retailers. Michael is driving this and building the organisation to really bring this to the stores. And of course, he is considering all the parameters, be it sales per square metre, be it headcounts per store, etc., etc. And this is what we are working on and you can see already the first results from this in Q1. Then before Robin answers question number two and number four, your question on pre-orders. No, we don't give any pre-order numbers anymore because we believe they are not indicative for the business going forward, because of the bigger share of own retail in our business.

Andreas Inderst

You have upgraded your guidance for Wholesale from low-single-digits to low- to-mid-single-digits. I assume this is based on good pre-order business or is that related only to the current trends? Can you elaborate on that?

Herbert Hainer

What you are saying is definitely correct. Of course we have visibility for the next three to six months and remember that Wholesale is a large part of our business in China. We are expecting positive sales for China in the second half of 2010 and this will definitely have an influence on our Wholesale business as well. So all that we have seen so far and the acceptance from the consumer for our retail programmes makes us optimistic.

Robin Stalker

In terms of the Wholesale adidas gross margin being slightly down, this is really only related to the regional mix. You would have seen that we are down in terms of sales in China, but up in North America. And the margins that we get in both of those regions are obviously significantly different.

In terms of your fourth question, regarding the Russian rouble impact for the quarter, we believe it to be around €15 million, positive, net, for the operating result. The underlying retail business, however, in Russia is showing strong double-digit comparable store sales growth.

Matthias Eifert - MainFirst Bank

Another question on China. Can you also give us an idea how the sellout of your retail is going, in terms of your product? Are you able to maintain market share in China, or are you losing, a bit, to local brands?

And second question I have is also on the retail strategy. Where do we stand in terms of the development on Reebok concept stores? A large part of Reebok own-retail sales has been in your outlet stores. How far along are you in developing more Reebok concept stores?

And my third question. Are you able to quantify the effect you had in the first quarter from your € 100 million cost savings programme?

And my last question would be, could you explain what the driver for the 120% increase of the gross profit from HQ/Consolidation was? I know it's always a bit of a black box, but could you help us to understand what was the driver here in the quarter?

Herbert Hainer

Well, let me start with the first part of the question, the sellout in China. We have seen improvements for the sellout within our franchisee stores, starting mid February and going into March. It is not skyrocketing, but it's still improving on a week-by-week basis. Once again, this makes us confident that we will clean our inventories and then, in the second half of the year, come in with fresh new products and grow our business.

On market shares, when we talk about market share we mainly talk about market share vis-à-vis our main competitor Nike, and Nike is, in the first half, growing faster than us, because they started to clean their inventories earlier, which as I explained last time, was not our strategy. But we will come back to growth in the second half.

On the Reebok concept stores, you are right that the biggest part of our own retail for Reebok is factory outlets. We have, so far, concept stores for Reebok mainly in Russia and in India. We are further developing this, but we are not yet at a stage that we can put in concept stores for Reebok in mature markets, like, for example, in Western Europe or in America. We still have to build more on the brand depth and breath, and on more concept pillars like EasyTone™, Toning and ZigTech™.

Matthias Eifert

Could you give us an idea when you could start that? Is that more for 2011, 2012, or even further beyond?

Herbert Hainer

As soon as the brand is strong enough that we believe we can carry own stores we will tell you.

Robin Stalker

Matthias, you also asked about whether we are seeing savings from the reorganisation efforts that we took last year, yes, we definitely are. We'd estimate them to be around € 20 million for the first quarter. In terms of the so-called "HQ/Consolidation segment", you are seeing some increase there because of the increased sourcing costs. We have a mark-up internally through our sourcing organisation, and that has been the major factor in that segment for this quarter.

Michael Kuhn - Deutsche Bank

Good afternoon Gentlemen. Also a couple of questions from my side. First of all, on your underlying cost base, if I exclude the one-off expenses from last year, and also exclude the marketing costs, then I arrive at an increase in the operating cost base of around 3%. I would be interested if this is a number that we can project towards the remaining quarters, or if there will be any change in the cost development?

A second question. Reebok was still down 3% in the Wholesale operations in the first quarter. I would be very much interested when you expect the turnaround, and what, at least approximately, you expect for Reebok Wholesale for the whole year.

And thirdly, on marketing expenses that were still slightly down as a percent of sales in the first quarter. Do we need to expect a big over-proportionate increase for the rest of the year to get back to 13%, or will we probably end up a bit lower?

And finally, from today's point of view, and the currency developments that we've seen year-to-date, what do you expect in terms of currency impacts on your sales development?

Herbert Hainer

Michael, let me take question number two and number three, and Robin will take number one and number four.

Reebok Wholesale: As I said already before, we are expecting to see growth in all parts of our Reebok business during the year. We are expecting growth of at least 10% in the US, and also in some other regions and you can also expect growth in our Wholesale segment going into the second and third quarter.

Marketing expenditure: Overall you won't see extreme increases in marketing expenditures for the rest of the year. Obviously, they will be bigger with the World Cup and, as I have always said, we will invest and support Reebok's growth. We have the concepts and campaigns which we have already started, as you know in the middle of March with the ZigTech™ in the US and initiatives in Europe that started in April. But we still will have a close eye on our cost base.

Robin Stalker

And that, Michael, is a nice introduction into the first question you asked about the costs generally. As Herbert already said, we are keeping a very close eye on all of our costs and we definitely expect nothing significant in the trends to change from the calculation you've just made for the first quarter. I would point out, however, that most of that is coming from the expansion of retail and obviously those costs would depend on the speed of rollout in our Retail segment, and I think we've given you guidance on that already.

In terms of the currency impacts for this year, I can tell you in terms of all the costs, and obviously in terms of all of our sourcing costs, that we are fully hedged for 2010. I don't think we have any exposure there. In terms of the translation of revenues in non-euro denominated currencies, it looks at the moment that the trend will be slightly positive for reporting back into euro, because some of these currencies have obviously appreciated against the euro. But it's a bit of a guess for us also, in that category.

Michael Kuhn

Okay, and maybe one short follow-up. Could you be a bit more specific in terms of marketing costs as a percent of sales, or is it too early to say?

Herbert Hainer

As we have always said, we will increase our marketing spending slightly during a World Cup year, but don't expect that this will grow above what you are generally used to from us.

Antoine Belge - HSBC

Good afternoon. Three questions.

First of all, you gave the sales evolution of Reebok in the US at plus 6%. Given that the overall number is plus 1%, would it be possible to get the same Reebok sales evolution in both Europe and Asia?

The second question relates to the gross margin at the adidas brand. I think in the quarterly report you say gross margin is down 60 basis points in Wholesale, but up 280 basis points in Retail. Will it be possible to get the Retail percentage share for the adidas brand, or to help us with the Retail versus Wholesale mix within the brand?

And finally, in terms of the foreign exchange evolution, I understand that there would be no meaningful impact, but I think you said that your current hedging was around 1.40 for 2010/2011, and that the euro-dollar would be moving close to 1.30. When and how are you approaching this for maybe the end of 2011 or the beginning of 2012?

Herbert Hainer

On Reebok, yes, you are right. If we are up 6% in the US and in total up 1%, then there must definitely be some areas where we don't perform that well. This is correct. This is mainly China and Latin America.

Robin Stalker

I'll talk to you about the gross margin development for our brands. The gross margin for adidas has improved 70 basis points to 47.7%. And the Reebok brand gross margin has improved 870 basis points, to 36.3%.

And for your question on the Wholesale/Retail split: Basically you can assume that around about 19%, say approximately 20%, of the brands' business is own retail.

And then your last question was on hedging. What I said was that for 2010, we're fully hedged. For 2011, we're probably over 50% hedged already. Our rates for 2010 are just under 1.40, around 1.38. And for 2011, for that part we're probably hedged around the same sort of level. Obviously, you're right, that the trend, in terms of what's available now in the market, is more negative, but we haven't completed all our hedging for 2011.

Antoine Belge

Just one follow-up on Reebok in China and Latin America, if I may. Do you think that there are things in the development there that are rather cyclical and that you could also have an improvement soon? I think you already commented for China, but could you maybe say something more specifically on Latin America?

And finally, as you've been kind enough to provide the own-retail share for adidas, can you give it for Reebok as well?

Herbert Hainer

To answer your question on China and Latin America. First and foremost, in China: We told you a few months ago that we will change our business approach there and will cooperate with the Pou Sheng Group. They will distribute our Reebok products and we will work closer with them going forward. There was a period of time we didn't bring products into the market and it did take some time to build the business up. But please bear in mind that our China business was never big for Reebok.

On Latin America, you know that we have a joint venture partner in Argentina and Brazil, which has always had a very strong market share, also due to their own production. And here, we are also improving the product offering, which means we are cutting down on lower entry price levels and are bringing more innovative product into the market. It is with a time lag compared to the rest of the world, but overall the same approach: We will be cutting entry price levels, cutting low price products, and will bring in, step-by-step, more of the higher price products, innovative products like the Toning products, etc.

And therefore, I am convinced that from 2011 on, we will have a positive development there as well.

Robin Stalker

And in terms of the own-retail share for Reebok: Reebok is close to 19% in the first quarter.

Christopher Svezia – Susquehanna International Group

Good afternoon, everyone. I have four, maybe five questions. I'll go through them very, very quickly: I guess first, just on the SG&A, I was wondering if you could maybe clarify, is there a particular quarter on which you might see deleverage, and where might that be? Is it Q2 and Q3, given the World Cup expenditures?

The second question is on the gross margin. Great improvement in the first quarter, and based on where your inventories are, product pricing, which still seems to be pretty favourable, growth in your own retail. It's just that I'm curious why maybe your gross margin trend line shouldn't be stronger than what you're indicating. I know there's some headwinds, but I'm just curious if there's anything else that we're missing.

The other question I had here is on Reebok. You saw a great gross margin improvement, getting back to a more normalised level. I'm curious, on the operating margin line, given the investments. How should we be looking at the Reebok business as this pertains to the operating margin as the year unfolds.

The fourth question, just on Toning: 5 million pairs in the US, now looking at potentially 10 million pairs globally, does that include ZigTech™? And have you ramped up production to meet demand, particularly here in the US?

And my very last question is, just for clarification purposes, on the adidas wholesale business in North America. I'm curious what the growth rate was, and what specifically drove that. Based on some of the research data I was seeing, NPD and SportScan, it seems to me that you guys were still losing some share for the adidas brand at wholesale in North America. I'm curious to hear your comments on that. Thank you.

Robin Stalker

Okay, I'll start, Christopher, with your question on the SG&A spendings. Deleveraging - Q2 is obviously a small quarter for us, and we also have increased marketing in the second quarter to support the FIFA World Cup™. But as I said in an answer to one of my previous questions, tight controls of SG&A and the successful reorganisation of the previous year will bring these down generally. And we're choosing to invest more on the marketing side.

Gross margin, I think we've been very fair in increasing our guidance on the gross margin. We've got, obviously, a good tailwind from the first quarter, but the market is still extremely challenging and very price competitive. And I think we should not underestimate that.

We also have, obviously, the redevelopment of the Reebok business, and there's still work to do in that area. And, please bear in mind that in the first quarter we had fairly easy comparisons to the previous year, at least in terms of some of the margin pressure.

In terms of the operating margin, you should be aware that we don't give any profitability figures below the gross margin by brand. That's because we have reorganised our Group and now split our business by Wholesale and Retail, where we do give you these figures.

In terms of Reebok, however, the point is that sales are increasing, that gross margin is significantly increasing and that through our joint operating model operating costs are under control. So I think you can make a good assumption on what you should be expecting as the trend for Reebok's operating margin throughout this year.

Herbert Hainer

So your next question was on Toning, whether ZigTech™ is included. No, this is not included in this "up to 10 million pairs". For ZigTech™, we don't have any issues on the sourcing or production side. For Toning, yes, the demand is big, for a certain period, and we cannot always cope immediately with the demand in the retail stores. But overall, I think we have it now under control and we are quite happy with the demand and the response which we are getting from the consumers and from the retail side.

The last question was on adidas wholesale in the US. This is up by 22%, and the main drivers are football, adidas Sport Style, including Originals, and apparel.

Christopher Svezia

Okay, and the trend line, just on the Wholesale segment for the adidas brand in North America, is that sustainable at that level? And just maybe some colour on where that growth is coming from. Is that coming from the sporting goods channels?

Herbert Hainer

First and foremost it is the sporting goods channel: It is Dick's Sporting Goods and the TSA, The Sports Authority. This is definitely the channel which caters and fits very well to our brand offering within adidas. But we also plan to increase our revenues with, for example, the malls and with Footlocker and Finish Line. We are bringing more and more new products to the markets and new concepts. And I am absolutely convinced that you will see that our growth for brand adidas in the US market will continue.

Cedric Lecasble – Kepler Capital Markets

Yes, good afternoon, gentlemen. I have two questions.

The first one is on the sourcing costs. You still are enjoying tailwinds. Could you tell us a little bit about the results of your negotiations with the manufacturers? Do current conditions and the more difficult markets worldwide help you to better negotiate, or maybe ease some rising commodity costs, for instance? When should we expect a headwind from that side again? Could you help us a little bit with that?

And the second question is on Reebok. Could you give us an idea of the evolution of the average selling price in the US? When do you intend to massively promote Toning shoes in Europe? Do you think it would be more challenging to be successful in Europe than in the US, given some image problems in some European markets? Could we have your view on this? Thank you.

Herbert Hainer

Okay, no problem. So let me start with the first question, on the sourcing side.

Please bear in mind that we have very long-lasting relationships with our key suppliers worldwide. We don't squeeze every last drop of blood out of them when times are tough for them – and we expect the same from them when it turns around the other way, that they are good and reliable partners with us. This does not mean that we have tremendous tailwinds now and that we expect tremendous headwinds in the future. What we definitely will see going forward is rising raw material costs, but this is a different issue, and we have to tackle that. But overall, I am quite pleased with the pace of our suppliers. Let's take for example the Toning category for Reebok and this tremendous amount of product we are selling and delivering into the market in 2010. Nobody had expected this six or nine months ago and we're still able to deliver.

The second point, the evolution of the Reebok average prices. Of course, they are going up at the moment, there is no doubt. We have successfully cut the \$29.99 entry price level and are selling our Toning products, the EasyTone™ and the ZigTech™ for \$99. This is a quite big improvement which helped us to get to the 870 basis points improvement in gross margin.

We have also started an advertising campaign in Europe, mainly in Germany, the UK and in Russia, and here we are seeing more or less the same effect as in the US. As soon as we kick in advertising, our revenues start to increase between eight and ten times compared to

before the advertising started. And we will further roll out our campaign in the second half of the year in the rest of Europe.

Cedric Lecasble

Will you be able to find Toning shoes in the other European markets maybe in the second half? Or, what's your plan here? Is your focus first and foremost Germany and the UK? Or do you intend to spread through the European markets?

Herbert Hainer

As we have always said, we want to start our Reebok business in the US and then roll it out to other countries. We have done it now in the key major markets outside of the US, be it Japan, be it Germany, be it the UK, be it Russia. And then the next wave will be the rest of the world, so you will see an advertising campaign for Toning in the second half in France, in Italy, and in some of the other markets as well.

I have forgotten to mention one market that is doing extremely well, which is Korea. We have great success with Toning there as well. So, to summarise this, we will be covering more or less the whole world in the second half of 2010 with our Toning offerings.