

**FINANCIAL RESULTS PRESENTATION**

**First Nine Months 2010 Speech**

**November 4, 2010**

**Herbert Hainer, Robin Stalker, John-Paul O'Meara**

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**John-Paul O'Meara**

Good afternoon ladies and gentlemen and welcome to our nine months 2010 financial results conference call. Our presenters today are Herbert Hainer, adidas Group CEO, and Robin Stalker, Group CFO. With our Investor Day coming up on Monday of next week, we intend to keep proceedings fairly brief today and focus on the key operational achievements and developments for the quarter as well as on our near-term outlook. So let's get started and over to Herbert...

**Herbert Hainer**

At the beginning of this year, I outlined a clear agenda of what we needed to do to propel our Group back to profitable growth:

- Drive new record sales in the football category;
- Continue the strong momentum of our Sport Style business;
- Complete Reebok's transformation;
- And actively address our weakest markets of 2009 – North America and Greater China.

I am pleased to report to you today that the adidas Group has not only met, but in many cases already after nine months exceeded the high expectations we set for the year. I'll come to these points in more detail over the next few minutes, but first let me run you through the key financial highlights of the third quarter.

- Currency-neutral sales grew an impressive 10% in Q3 and 8% year-to-date, to new record levels of 3.5 and 9.1 billion euro, respectively.

- We delivered substantial year-over-year improvements in profitability, as gross margins expanded 2.1 and 3.1 percentage points for the quarter and year-to-date.
- This in turn sent net income up 25% for Q3, and more than doubling in the first nine months to 560 million compared to 226 million euro in 2009.

From a geographical basis, third quarter currency-neutral sales increased in all geographies. And yes, before you ask, we are back to winning ways in Greater China.

Sales increased 9% currency-neutral in the third quarter, with Wholesale revenues turning positive for the first time since 2008. We have worked closely with our key partners throughout the year such that we see a much cleaner and healthier level of inventory in the market today.

This has been our Achilles heel over the past few quarters, and as the Chinese consumer rapidly becomes more affluent and fashion-conscious, it is imperative that we get back to the top of our game at point-of-sale in all channels. We are now in a position to do just that, through the improvements we have implemented in our merchandising, product offering and operational processes.

Here we definitely took inspiration from our best-in-class own-retail activities where comparable store sales growth continues to be up strongly this year, with the third quarter up almost 20%. As the gap in performance between our Wholesale and Retail segments narrows in the coming quarters, Greater China will once again become a growth engine for our business.

But that is not all the positive news I have to share with you today on the Group's regional performance. Another development of note is the upward sales trend in North America. Third quarter sales are up 14% on a currency-neutral basis. Both adidas and Reebok have really hit the accelerator in this market with adidas revenues up 15% and Reebok sustaining its strong momentum increasing 25%.

For adidas, we have now had three consecutive quarters of growth in the US driven by double-digit increases in Training, Originals and Soccer. Our efforts to segment

and range our customers more appropriately, matching their strengths with the right product, as well as increasing the share of controlled space, have been key components of this success.

It is a similar story for Reebok. Q3 marks the fourth quarter of consecutive growth for the brand, and I will tell you more about the key drivers of that performance a little later.

But it wasn't just in these markets that adidas and Reebok continued to resonate strongly with consumers. Both brands recorded healthy double-digit sales increases and gross margin improvements for the quarter as a whole.

At adidas, third quarter sales increased 10% currency-neutral and gross margin expanded 60 basis points to 47.4%. While at Reebok, currency-neutral sales were up 14% in Q3 and gross margin jumped 310 basis points to 36.8%, as average selling prices in footwear increased almost 30%.

So let's look at each brand division in a bit more detail. Starting with adidas Sport Performance, where sales increased 6% currency-neutral in the third quarter to 1.9 billion euro. Here we continued to do what we do best – inspiring athletes and consumers with market-leading innovation. Particularly pleasing in this period's result is the composition of the growth. While Football and Outdoor continued to lead the way in terms of growth rates, all of our other key performance categories – Running, Training and Basketball – also grew.

In Football, we saw another quarter of strong double-digit growth as we translated the positive energy of the World Cup into the back-to-school period, and the kick-off to the new football season. In particular, the F50 adiZero™ has clearly set the new industry benchmark not just in terms of design and performance, but also through its commercial success. Being the most successful and top scoring boot at the World Cup is an obvious driver. But furthermore, the quick acceptance of such a new football boot by professionals was never higher. If you look around, there are even plenty of high-profile competitor athletes switching to this ultra-lightweight boot.

In Outdoor, through a steady stream of new innovations, we have been able to increase momentum in the category in the third quarter, with sales up 15% currency-neutral. With each season, we are gaining more and more credibility and recognition in the market for our products, and, for the first time, we have a complete TERREX range from top to toe on the shelves this season.

In Running, our lightweight adiZero footwear and apparel collections continue to excite the market. Growth in the category was driven by strong double-digit increases in North America, and Japan. And our credibility in running was further enhanced by another successful period of athlete performances. At the Berlin Marathon, two of our athletes, Patrick Makau and Aberu Kebede, stormed home to win the men's and women's races, adding further credibility to our position in the sport. So far this year, the adiZero adios has clocked over 65 race wins with significant recent successes at the Commonwealth Games and the World Half Marathon Championships.

In Training, which has been one of our weaker categories earlier in the year, we launched the Fluid Trainer, offering full foot flexibility and freedom of motion. In addition, we introduced the latest updates to our TechFit and Clima apparel collections, which are now driving market share gains in the active sports segment.

Finally in Basketball, sales also increased for the quarter as we initiated the roll-out of the strongest product offering we have had in recent years. This includes signature shoes such as the adiZero Rose and Beast for iconic athletes Derrick Rose and Dwight Howard. And, at the end of September, adidas unveiled the NBA Revolution 30, the lightest and most technologically advanced NBA uniforms. Made from 60% recycled materials, they are 30% lighter and dry twice as fast as previous NBA uniforms, helping enhance player performance by keeping athletes cooler, drier and more comfortable on the court.

Turning to adidas Sport Style, the division has once again surpassed all expectations with sales growing 21% in the third quarter and 20% year-to-date. Geographically, the performance has been strong in most major markets, particularly in Greater

China and Western Europe. Collections such as Originals by Originals, Originals Blue and adidas NEO (which you may have heard us previously refer to as Style Essentials), as well as our various controlled space initiatives with key accounts in Europe have again been key top-line drivers. Today, we are without doubt the leader in the sports lifestyle market, and I am confident that we can continue to expand on this in the coming years with the depth of product offering we have at our disposal.

Switching over to Reebok, I believe the sales growth of 14% currency-neutral in the third quarter speaks volumes about where the brand is in its revival. With every quarter, the top-line drivers are becoming more broad-based and more international. Looking deeper into our third quarter results, while North America, given its size, is still the driver of sales with a 25% increase, important markets for the brand's future growth including Russia, Germany, Japan and Korea are also all up at 25% and higher in the quarter.

This is down to Reebok's strategy to innovate globally relevant, credible and scalable product platforms true to the DNA and positioning of the brand.

Our multi-category toning technology has been the first of those platforms. And it has successfully ignited new brand conversations among customers and consumers alike. Our second major platform, ZigTech, which was launched earlier this year in training and running, is also proving to be another game changer. For instance, it was the number one shoe at several major US retailers in the important back-to-school season.

Like toning, ZigTech is also a scalable multi-category platform. The ZigTech basketball shoe which we launched last Monday was top of the charts on several pre-order websites ahead of its release. And let me assure you, we will not fall short of new product stories to keep Reebok's upswing going in 2011. Next year, we will add a third technology platform, in addition to beginning the rebuild of our classics business. Therefore, I can confirm Reebok has only just started to bloom.

Before I move off Reebok, I want to talk about two other important developments since the last time we spoke. One is the concern about the sustainability of the toning category, and the other is the non-renewal of the NFL contract.

So first on toning. Like others, we did see a slowdown in sales during the summer months. However, as the category evolves we have seen, just like in other categories, there is a seasonal aspect to it. This stems from the fact that in warmer weather the female consumer places a higher priority on open toe footwear such as sandals and slides.

But I also think the slowdown needs to be put into perspective. Compared to this time last year when the category first burst on the scene, our retail partners now are selling five times more product. And at least for Reebok, they are still doing it at a great margin and a solid price point.

What you read and see about our competitors vis-à-vis toning only reinforces my belief in Reebok's discipline and skill, at introducing and building a new category for long-term enduring success. We have built our presence in the right way, taking our time, choosing selectively how we distribute, and matching supply carefully with demand.

Others have not. And it is no surprise they are struggling. Let me assure you, we will use this to our advantage. Retailers believe in the longevity of toning and so do we. And Reebok is committed to stepping forward and taking leadership of the category for the mutual success of our Group and our customers.

Now on the NFL. First of all I would like to say that Reebok can be very proud of its collaboration with the NFL over the last decade. In particular, this partnership showcased a true talent of Reebok – being responsive, flexible and fast to market. The infrastructure, supplier relationships and knowledge to execute against rapid turnaround products is a competitive advantage the entire adidas Group in North America enjoys and exploits today.

From a business perspective, although we will lose a specific revenue generator, there is still plenty of opportunity to expand our licensed apparel and team sports activities in North America over time. Don't forget we have other significant long-term assets such as the NBA, the NHL and the MLS. The latter we actually extended during the summer until 2018.

From a branding and sponsorship perspective, you all know the competition for top assets is high and provokes in some cases excessive bids. It is therefore very important to evaluate whether a sponsorship deal makes sense from a business point of view, and if it matches our strategic and financial objectives.

This time it didn't. First, in relation to Reebok, the brand is a very different proposition today from what it was back in 2000, with its focus and energy now squarely on fitness and training. Second, in terms of our Group's ambition, we remain unwavering in our commitment to be a force in American football, and to serve the football athlete. However, we will not do so under an uneconomic structure, which we would have faced from 2012 onwards under a new contract.

In the future we will use other means to tell our football stories which first and foremost will start with product. And here we are in a position of strength, already possessing some of the most innovative and advanced products in the game, whether it is the adiZero Scorch, the lightest boot, or the Reebok U-Form cleat providing the best in comfort and fit. In addition, we will also use the period ahead to have a much more grass roots approach to the sport, building a deeper connection through individual athletes, colleges and high schools.

Finally, let me spend a moment on Other Businesses. Sales increased 4% currency-neutral in the third quarter, and are up 3% year-to-date. By segment, in Q3 sales at TaylorMade-adidas Golf and Rockport increased 4% and 3% respectively, while sales at Reebok-CCM Hockey remained stable. A key highlight of the quarter was the strong improvement in gross margin which expanded 7.5 percentage points driven by strong increases at TaylorMade-adidas Golf and Rockport.

It was a highly successful third quarter for TaylorMade-adidas Golf, as the segment secured its position as the largest golf company in the world. While the golf market tracked negatively again in the third quarter, our strong pipeline of innovative product ensured we continued to take market share. Some of the key product highlights of the quarter were the introduction of Burner® 2.0 irons, which we launched for the first time via the web, as well as the adiPURE Z and TRAXION LITE in footwear. In addition, during the quarter, we set

- A new record for metalwoods, where our market share in the U.S. was at almost 36% in August, more than twice the share of the No. 2 brand.
- A new record for market share in putters thanks to double-digit growth and the continued popularity of the Corza Ghost.
- And our balls business also kept rolling with over 30% growth year-to-date as the Penta TP continues to win over tour players and consumers alike. None more so than Martin Kaymer, who won his first Major at this year's PGA Championship at Whistling Straits in August.

So ladies and gentlemen, it is clear we have made an explosive comeback in 2010, and I fully expect us to round off the year on a high. Although the last quarter of the year is seasonally a small one, it is nonetheless an important period for seeding some of the initiatives that will inspire and excite consumers in the year ahead.

Therefore, we will continue our marketing offensive in the fourth quarter, particularly in areas such as basketball where adidas and Reebok have significant product launches, as we already discussed.

As a result, I expect our full year Group sales to increase around 8% on a currency-neutral basis. While we continue to expect Wholesale sales to increase at a mid-single-digit rate, the Retail business is now forecasted to be up at a mid-teens rate, which is primarily due to the acceleration of our comparable store sales throughout the first nine months.

Group gross margin is likely to come in at a level around 47.5% with visible improvements in all our segments, and together with the increase in our operating

margin to around 7.5%, this will result in earnings per share in the range of € 2.68 to € 2.70. This development represents an increase of around 5% versus the previous expectation of € 2.50 to € 2.62.

We followed a bold strategy this year, which I believe will pay dividends for the future and definitely for next year. Innovation, creativity and an appetite for success are running as high as ever and the success of 2010 will spur us on to new heights in 2011. Although it is early days yet, we felt it appropriate to give you some initial indications of what we can potentially achieve next year. Barring any economic upsets, and assuming the continuation of a gradual improvement in the consumer environment, we believe we will grow our top line at a mid-single-digit currency-neutral rate, which in light of a record year in the football category in 2010, is no small achievement.

While rising input and labour costs as well as currency volatility will be headwinds for the development of our profitability, earnings per share are nonetheless forecasted to increase at a rate between 10% and 15%.

For the longer term, I believe that the last two years have highlighted that if you lack commitment to your brands, you will not create sustainable success. And we are certainly not lacking in commitment. Next Monday at our Investor Day, we will for the first time present to you some of the exciting highlights of our strategic plan for the next five years. With our powerful brands, extensive global presence and our commitment to innovation, we will deliver enduring success for the adidas Group and its stakeholders.

Now, I'll hand you over to Robin to give you some further details on the financials...

### **Robin Stalker**

Thank you, Herbert, and good afternoon ladies and gentlemen. You have just heard from Herbert about the strong improvements in our key markets and, of course, the

excellent performance of our brands. Therefore, I will focus today on our regional performance as well as walk you through the developments of our other key operating metrics.

As you already heard, currency-neutral sales increased 10% in the third quarter of 2010. The year-over-year appreciation of various currencies against the euro contributed significantly to sales in reported terms. As a result, Group revenues were up 20% to almost 3.5 billion euro. Year-to-date currency-neutral sales for the adidas Group increased 8%, or 14% in euro terms to 9.1 billion euro. For the fourth quarter, I do not expect such a strong tailwind, as currencies such as the US dollar and the Russian rouble have depreciated rapidly over the last few months. In fact if the trends persist, currency translation will become a slight headwind in 2011.

By segment, Wholesale revenues increased 10% in the third quarter as sales grew in all geographies and in all brand divisions. Gross margins for the segment decreased 30 basis points in the quarter, largely due to regional mix effects. For the first nine months, Wholesale segment sales were up 8% currency-neutral while gross margin expanded 40 basis points. This was mainly due to higher Reebok gross margins, lower input costs and lower clearance sales, partly offset by less favourable regional mix effects.

In the Retail segment, sales increased 15% currency-neutral in Q3, with comparable store sales up an impressive 10%.

For the first nine months, Retail segment sales grew 16% currency-neutral and comparable store sales were up 9%. By brand, adidas and Reebok comp store sales increased 8% and 12% respectively. By region, North America and European Emerging Markets grew 13% and 26% during the period, with Greater China and Latin America performing even stronger, with sales increases of 51% and 34%. Comparable store sales in North America, Russia and China again all grew at double-digit rates for the period.

At the end of September, the adidas Group Retail segment operated 2,257 stores, a net increase of 45 compared to December 2009. During the first nine months, we opened 143 stores, closed 98 and remodelled 24.

As Herbert already mentioned, revenues grew in all geographical areas during the third quarter, with solid improvement in Greater China and North America. Elsewhere, in Western Europe, revenues increased 8% on a currency-neutral basis. This development was mainly driven by the UK, Germany and France. Strong football sales again played an important role for the entire region during the quarter.

Group sales in European Emerging Markets increased 16% on a currency-neutral basis due to growth in most of the region's major markets, in particular Russia.

Currency-neutral revenues in Other Asian Markets increased 7% in the quarter. This is mainly a result of the continued double-digit growth in India and Korea as well as a slight improvement in Japan. The improvement in Japan was mainly driven by strong growth at Reebok.

Finally, in Latin America, sales were up 7% on a currency-neutral basis. The slowdown in Latin America relative to earlier quarters must be seen in light of the increasingly tough comparisons to the prior year following a period of significant double-digit growth.

Moving below the top line, third quarter gross margin increased 210 basis points to 47.3% versus 45.3% in 2009. In line with our expectations, the improvement decelerated versus the first half. In fact, in the third quarter, we suffered a 50 basis point negative impact from less favourable hedging rates compared to a year ago, mainly related to the US dollar and the British pound. In the first nine months of 2010, Group gross margin was up 310 basis points, reaching 48.2%.

For the third quarter and the 9-month period, the weighting of key positive margin drivers was similar:

- First, about a third of the increase relates to lower sourcing costs compared to the prior year. We expect this factor to start playing less of a role in the fourth quarter.
- Second, another third of the increase was due to the overproportionate growth of higher-margin own-retail sales.
- And, finally, the remainder of the increase was mainly due to clean inventory levels which meant we had to do less clearance sales compared to the prior year. This factor will also play less of a role in Q4 as most of our major inventory clearance initiatives were completed in Q3 last year.

Moving below the gross profit line, other operating expenses grew by more than 250 million euro in the third quarter. This is in line with our strategy to sustain brand momentum throughout the back-to-school and holiday periods for both adidas and Reebok.

Higher sales and marketing working budget expenditures accounted for around 100 million euro of the overall increase. Aside from marketing investments, we continued to strictly manage operating overheads during the quarter, helping us leverage our top-line momentum. The further expansion of controlled space, investments into retail talent and systems, as well as negative currency translation effects contributed to higher total operating expenses.

As a result, Group operating expenses as a percentage of sales increased 1.7 percentage points in the third quarter, but were down 0.5 percentage points to 40.5% of sales in the first nine months. Therefore, I feel confident to confirm our outlook for the full year, that operating expenses as a percentage of sales will decrease.

To wrap up my discussion on operating profit, other operating income decreased in the quarter, but was up year-to-date, the latter primarily reflecting the two positive one-time effects we recorded in the first quarter, each accounting for a low double-digit million euro figure. Finally, Group royalty and commission income increased 41% in the quarter and 14% in the first nine months. As a result of all the above factors, nine months Group operating profit almost doubled to 865 million euro from

465 million euro in the prior year. This translates into an operating margin of 9.6% – which is up 370 basis points.

Turning now to the non-operating items of the P&L. For the first nine months, net financial expenses decreased 46% compared to the prior year. A positive swing in exchange rate effects of 26 million euro as well as lower interest expenses drove this development. In the third quarter of 2010, however, a negative swing of 15 million euro in exchange rate effects more than offset interest expense declines, leading to a slight increase in net financial expenses of 1 million to 31 million euro.

The Group's tax rate for the nine months came down 4.5 percentage points to 29.7%, mainly due to a more favourable regional earnings mix.

Therefore, net income attributable to shareholders for the first nine months significantly increased to 560 million euro from 226 million euro in 2009. On a per share basis, this translates into basic and diluted earnings per share of two euro sixty eight cents.

Let's move over now to the balance sheet. At the end of September, Group inventories were up 9% currency-neutral, representing 1.9 billion euro. The increase in inventories compared to the prior year reflects a normalisation of levels compared to 12 months ago as well as our expectations for further growth in the coming quarters.

Accounts receivable increased 8% on a currency-neutral basis to almost 2.2 billion euro, with the growth however below the sales increase for the third quarter. Accounts payable increased 40% currency-neutral to 1.3 billion euro due to higher production volumes and the extension of supplier payment terms last year.

In summary, and as a consequence of our continued top-line momentum, this means we were able to further decrease operating working capital as a percentage of sales. The current level of 20.9% marks a new record for our Group, decreasing 4.7 percentage points compared to the prior year.

Finally ladies and gentlemen let me make a brief comment on the financing structure of our company. Compared to the end of September 2009, net borrowings have declined by almost 1.4 billion euro to 903 million euro. This is due to the improvements in Group profitability, the full conversion of our convertible bond last year and a moderation in investment activity. With a ratio of net borrowings over 12-month rolling EBITDA of 0.7 times at quarter-end, we are comfortably within our target corridor of a ratio below two times. Looking at our equity development, our equity ratio now stands at 44.5%, improving almost 9 percentage points in the last 12 months. Therefore, we are well on track to end the year with net debt below the prior year level.

To wrap up for today, our financial performance in the first nine months is a clear endorsement of the strategic goals we set ourselves for 2010, and as Herbert already told you we have every intention of keeping this momentum going as we start turning our attention to the year ahead.

We look forward to welcoming you to Herzogenaurach on Monday for our Investor Day, and with that let's take your questions...