

adidas Group First Half Year 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

Andreas Inderst – Exane BNP Paribas

Good afternoon, everyone. My first question would be on inventories, which were up 8% currency-neutral. If you strip out the impact from Latin America, what would the inventory position actually look like?

And maybe related to that question: You mentioned that you expect an improvement on inventories in China in the second half of the year. Can you give us an idea on how the overall market inventory positioning is right now in the industry in China, and what you expect for the market in the second half of the year?

My second question would be on the outdoor category. I remember you had a few initiatives in this category in the past, your biggest competitor as well, but so far you have not been very successful. What are the reasons for that? Why have the two top players not been successful in the outdoor category so far? And how do you think you will be able to change that in the years ahead? What are the key success factors from your point of view? And could you maybe also put some numbers behind your target for 2015?

My third question relates to the 2010 FIFA World Cup. You mentioned quite encouraging feedback for your collection. Could you provide us with a bit more detail, on what the feedback from your key customers actually looked like? Thank you.

Robin Stalker

Thank you, Andreas. Let me answer your first question on inventories, and Herbert will then talk about the markets, the outdoor category and the World Cup collection.

The development of our inventories: If I was to remove the deliberate Latin American build-up, it would probably be only 50% of what we are currently seeing.

Herbert Hainer

And regarding our inventories in China: We now definitely have a better position in China than we had at the beginning of the year. But there are still too many inventories out there. We are working in close cooperation with our customers in China to get them down. And I'm absolutely convinced that at the end of 2009, this issue will more or less disappear.

Question number two was on the outdoor category. As some of you might remember, I have always said that outdoor is an area where we see and have opportunities. adidas has always had an affinity to outdoor, because remember thirty years ago, we were the first to introduced the Trekking name and Trekking shoe at that time with Reinhold Messner. But over the last seven or eight years we haven't made outdoor a priority for us. Eighteen months ago we decided that we would make it a priority, as we do believe that this is a growing market going forward. Therefore we put together a complete new team twelve months ago which is led by Rolf Reinschmidt, our former Head of Footwear.

Rolf has built up a great team with new players. We have new product initiatives with TERREX and SUPERTREKKING. We have great ambassadors for our brand, going back to Reinhold Messner, because he founded Trekking, but also with the Huber Brothers or Angelica Lind, one of today's best-known outdoor athletes from Sweden.

We have already received very good first feedback for this initiative. One of the key outdoor retailers here in Germany saw us in Friedrichshafen. And he said that they are now really taking us seriously. And to answer the last part of this question, where we want to be in 2015: We definitely want to be the benchmark. And this would mean double-digit market share.

Question number three, regarding the FIFA World Cup: We have started with a road show in Europe, Asia and in America, showing our World Cup programme to all the key retailers around the world. The feedback has been very exciting.

We have great product concepts with completely new product categories. You will see a very colourful range, reflecting the colourful world of Africa. And we have marketing measures behind the initiatives, which really are spectacular. So far, the reactions are extremely good. And I do believe football is definitely an area where we have all the competencies we need. And this will definitely play into the World Cup in 2010. And I think I mentioned already a few weeks ago that we definitely do expect new record sales for football in 2010.

Erwan Rambourg – HSBC

Good afternoon. I have also three questions, if I may.

Firstly, on debt covenants and more generally on Reebok. I recently read a comment, saying that the efforts undertaken would make the brand profitable at some stage. Can you tell us what your profitability plan is for Reebok in terms of the year or just give us an idea in terms of when that can happen? And can you remind us what the debt covenants are, or give us at least an idea of how comfortable you feel with these debt covenants?

Secondly, I wanted to come back to adidas' Sport Style, because that division has done very well, I believe, following the introduction of Style Essentials. But overall is the growth coming from a specific region? Is it sustainable? Does it make you rethink the potential of the Sport Style segment for the brand in the future?

And then, my third question on timing of profits. My understanding is that you'll start to invest for the World Cup as of Q4 this year. So should we consider that Q4 will be very limited in terms of profits, and basically that Q3 will be the only really strong profitable quarter for the year 2009?

Robin Stalker

Okay, let me take the first one on the debt covenants and also the one on Reebok profitability. We feel pretty comfortable about the debt covenants we have. We have one relating to cumulative losses over a three year period. And one relating to net equity as a percentage of total assets. And I think that we are very comfortable with them.

I don't think that I made any particular comment about the specific timing of Reebok's return to profitability. But obviously we're not running this for charity reasons. Reebok will be making a profit as everything we're doing at the moment is improving the opportunity for the brand to return to profitability as quickly as possible.

Please bear in mind, however, that our attitude has always been: We've got to make the brand attractive. We have to see that the consumers are attracted back to the brand. We need to be doing the right things for the long-term sustainable profitability, not the short term. And I think that the efforts that Herbert was talking about earlier and the reception we're getting in the market at the moment encourages us that this turnaround is very close. But I think it would be unrealistic to expect any sort of return to profitability this year.

Herbert Hainer

Your second question was on Sport Style. Yes, you are right. Sport Style is doing very well after the 12% increase in Q1, we now have 15% in Q2. This is reflecting the strategy which we have put in

place: On the one hand, bringing interactive products segmented into different consumer groups into the market, and on the other hand, putting some marketing measures behind it.

As you said, Style Essentials is helping, but this is not the only reason. There is a lot of growth in Originals and we're also growing in the fashion part of our style business. This is mainly in Europe and in Asia, supported by marketing initiatives. The "House Party"-campaign was one of the most successful campaigns we have ever done. We do believe we can continue this success. As I said in my speech: On August 18, we celebrate sixty years of adidas. This is definitely something where Originals plays a huge role. We have a cooperation with Vespa and we will continue to work together. And I think that in this part of the business, we are definitely at the forefront.

Erwan Rambourg

And then looking at your business in the long term – the balance, 20% lifestyle, 80% performance, can that shift a bit towards more lifestyle? Obviously not in 2010 because of the World Cup. But in a longer term, do you see that balance shifting?

Herbert Hainer

Previously, we have said 25% and 75%. But you can be sure that I will push the Performance Division for next year's World Cup and for the year's to come as well. But overall I think 25% to 75% is a good ratio.

Robin Stalker

And your last question was about profitability in the next two quarters. As you know, we don't give specifics on a quarterly basis, but we've given guidance for the second half. It's obviously going to be profitable. You're correct to observe, however, timing of marketing as we move into the World Cup. There will be more marketing in the fourth quarter than there was in the previous year.

Michael Kuhn – Deutsche Bank

Yes, good afternoon. Three questions from my side, if I may.

First of all, operating costs came down more than most people expected in the second quarter. I think this was heavily driven by lower marketing expenses. And, even if you don't give us the complete number on how much you spent on marketing, could you however give us an indication of the balance Q2 '09 versus Q2 '08?

Second question, I know it's always very difficult to make any predictions on the tax rate. You mentioned that you expect it to increase from last year's 29%. Could you maybe give us a rough indication? Are we talking about a one or two percentage points increase? Or could it also be bigger?

And finally, on the consolidation effects, you showed the precise effect for the Ashworth consolidation in the quarterly report. Could you also give us the numbers for the Reebok joint ventures in South America, and also what you expect for possibly '09 in terms of total consolidation effects on the top line? Thank you.

Robin Stalker

In terms of operational expenses, you correctly guessed that we don't give specifics on the marketing data. And you are correct with the assumption that obviously timing, as I mentioned in the last question, does play a role this year. But don't underestimate other factors impacting our operating expenses: We've had a hiring freeze in place since the end of last year. We've taken specific initiatives on various costs such as travel, consultancy and that sort of thing that have really started to bear fruit in the second quarter.

So there are positives also in underlying operational expenses. And if you're looking at the full six months, don't forget there is also a considerable number of so called one-offs that we explained to you in the first quarter.

In terms of the tax rate, I'm really just guiding that the spread of our earnings by country in this year is obviously going to be very different than it has been in the past. And therefore the tax rate will be higher. But this should not give you any indication that it's of great significance. We've been pretty good over the last few years at bringing the tax rate down to around the 30% and as you saw last year even under the 30%. And I have no intention of seeing a significant deterioration in that. And finally to your point about the consolidation effect on the top line: Reebok sales are down 9% for the quarter. If I exclude the impact of the joint ventures, it would have been down 11%. And that's the same figure effectively for the full year year-to-date. If I take the 6% that we have and exclude the full effect of the joint ventures it would be down 11%.

But please bear in mind here that we've been expecting Latin America and generally the emerging markets to generate more for us in the Reebok line.

Michael Kuhn

Okay, maybe one short follow-up. The one-off expenses you mentioned. You now say that they are expected to be modestly lower than € 100 million. Any rough indication on what "modestly lower" means? Are we talking about € 80 million or so?

Robin Stalker

You're referring specifically to restructuring. And yes, of course what I was referring to included obviously debt provisioning and other effects. In terms of restructuring, you should not take the second quarter as guidance for the full year, because obviously that's very dependent on specific initiatives throughout the year. The success of natural attrition through our hiring freeze means that we will probably incur less personnel restructuring costs. So it should be below € 100 million. But I can't give you any better guidance than that. You should not be expecting it to be a lot below € 100 million.

Uwe Weinreich – UniCredit

I have three questions on your fundamental performance. Robin, I assume you have already fixed the input costs for the first half next year, and probably for some months for the second half next year. Maybe you can share some realised improvements within this area?

Then on your performance in Japan, we already know you don't talk about single countries, but in challenging times like this, you could maybe comment on the Group's performance in Japan? Is it still challenging?

And then last question is on your own retail activities excluding Russia. When do you believe they will be on the same EBIT margin than in the year '07? Maybe in '09?

Robin Stalker

Regarding your question on input costs: Yes, you are right, we've already entered into negotiations. And it definitely gives us confidence that we will see benefit again in 2010. We're expecting at this stage that we will probably be getting to prices approaching the level that we had in 2008.

Herbert Hainer

And your second question was on Japan. You are right, we don't give any numbers for individual markets. But nevertheless, I can tell you that with Reebok we are up in Japan. At adidas, it's a

little bit more challenging. We have done some distribution channel reorganising in the past twelve months. Nonetheless, we will probably be slightly down in 2009. But looking forward I definitely do believe that Japan can be a growth market for both of our brands.

Uwe Weinreich

And how about TaylorMade-adidas Golf?

Herbert Hainer

TaylorMade-adidas Golf is down. It was up in all the regions except Asia. And this is of course mainly Japan.

Uwe Weinreich

How about profitability in own-retail ex Russia?

Herbert Hainer

We haven't reported anything about profitability in own retail yet. But obviously it is our intention to share this with you as soon as possible.

Uwe Weinreich

How about soccer sales in 2010? You said you will probably generate sales of more than € 1.3 billion in 2010. Is that right?

Herbert Hainer

I said we will have a new record. And you are right in putting numbers into it. It will be more than € 1.3 billion because this was our highest number so far.

Tim Burkhardt – LBBW

Yes, hello, everybody. Tim Burkhardt from LBBW. Three questions from my side.

The first is on the gross margin development. Can we expect also this 500 basis points decline year-on-year for the remainder of the year, especially in Q3 and Q4?

My second question is on the operating expenses. Will operating expenses increase in Q3, and especially in Q4 in absolute terms compared to the second quarter?

And my third question is on the overall development in the headquarter segment. Could you give us at least an indication on how especially gross profit and operating expenses will develop in this segment, because it's really significant for the overall results in the full year 2009.

Robin Stalker

So firstly, I don't believe that the trend you've seen for the gross margin development for the first six months will continue at that rate. It is still going to be down obviously year-over-year, but we have the confidence that the very big pressure on the FOBs that we had in the first half of the year, the input costs, will be less influential, although still negative, in the second half of the year.

In terms of operating expenditures, obviously operating expenditures are going to be up on the previous year. I'm not going to give you any specific guidance on that. But the comments I just made will suggest to you that it depends a little bit on the timing of certain restructuring costs.

And the third one was on headquarters. I do appreciate that it is very difficult for you to estimate this for the future. But the major reason that we have swings from one year to the other in our so

called headquarter and consolidation line has to do with the non-allocable costs that include treasury profits or losses. This year's swing has a lot to do with the fact that last year we had hedging benefits that were at a headquarter level, but this year in the operating units. In terms of all the restructuring that Herbert also mentioned, we are not seeing any major impact on costs in the HQ/consolidation from that.

Tim Burkhardt

The follow-up on gross margins: so it seems that you still expect price pressure on retail to continue also in the second half, at least at a lower level or to a lower extent than in the first half.

Robin Stalker

I think, as Herbert mentioned in his comments, we still see a very challenging environment out there. But that is obviously only one factor within our gross margin development. There is still the Russian rouble and other currency effects that we are seeing here. The rouble seems to have stabilised, which is good. But it is still stabilised at a worse figure than last year. And as I said, there is some improvement over the first half in the input prices, but definitely still negative compared to the prior year.

Jürgen Kolb – Cheuvreux

The first question is on Reebok again. Could you please share a little bit your ideas about Reebok's men's strategy for next year, maybe some more colour on what you are planning for 2010, and also if we should expect a substantial increase in marketing for Reebok next year. The idea is if you will see growth here already substantially and will that also be visible on the profitability side, or will most of that be the idea to really push the brand into the market also on the demand side.

And secondly, a very easy question on the hedge rates at the end of the second quarter. And maybe also a quick word on the current trends among retailers, what you are seeing in terms of cancellation rates or if you expect an even higher share of at-once business or reorders in the second half and whether this is going to continue - or how long that is going to continue. What are your thoughts on that subject?

Herbert Hainer

Let me start with Reebok. Overall, as we always have said, we have three key pillars to this, owning the women's business, being more creative on the Classics side, and then attacking the men's category.

I think on the women's, we have done a very nice job. And as we have said, our sales were up 50% in the first half. And we will continue to do so.

There is similar development in Classics. Coming to the men's training area we definitely have to come from two sides. One is the innovation side, and the other is the apparel side.

In those areas we definitely have potential to grow. But you will already see in 2010, especially in the second half, that we will come out with new innovations on the men's training side - mainly on the footwear side but also on the apparel side. I am sure we will make an interaction to the consumer as well.

You also asked about marketing. I think in the meantime we have restructured the company. We have set up a complete new distribution channel strategy. We have new innovative products in place and we have eliminated the entry price level of \$29.99 in our Classics business.

So now I think everything is together that we really are able to put money behind and get the best out of the money we spend. So therefore you are right, we will increase our spending for Reebok in 2010.

The last question on the retail side especially concerning at-once business and cancellations. We do not expect major cancellations in the second half, because as we have already said, we have reduced our purchases for this period. So therefore we are bringing less products to market, because we want to further reduce our inventories in the second half and adapt ourselves to the market conditions out there.

I don't know how long this will go on. But what we definitely will do, already have done, and will continue to do even further is to reduce the time to market and increase the speed to market. This means that we have to react to market needs.

We have a programme which is called "Lean and Fast" where I don't want to go into details because it would take too long. But this is a complete reorganisation of our product development cycle to get faster to the market, because I do believe the uncertainty in the market will still be there for quite some time. We do not want to lose any sales and therefore we have to react to market changes, market needs and opportunities faster.

As you can see even in tough times there are always opportunities in the market. Look at the EasyTone sales figures, look at the R9. Therefore when you bring new innovative products to the market, even in tough times you can achieve good sales figures.

Robin Stalker

Your other question was about hedge rates and as you know, we are a beneficiary of a weaker dollar against the euro. So at the moment, we are enjoying favourable hedging rates.

For the 2010 period, however, we have largely finished our hedging now and that rate will be a little bit worse than what the 2009 rate was. So we are looking at something just under the \$1.40, but still better than it was a few months ago. And now obviously we are taking advantage of the rates in the market at the moment for the 2011 hedging.

Christopher Svezia – Susquehanna

I have three questions, the first one concerning North America. If you look at some of the market statistics that are out there, whether from NPD and SportsScan, both the adidas brand and Reebok continue to lose some incremental share. And I recall during the first quarter you decided not to bring a lot of product into the market because of the promotional environment. And it seems like in the first quarter the North American market actually saw very robust growth in athletic footwear overall, and very strong average selling price growth. Maybe you can talk about your plan in terms of addressing the North American market, both for Reebok and the adidas brand. It seems like you're getting success in some categories on the fitness side at Reebok and some success in your Sport Style division at adidas. Could you talk a little bit more about how you view the North American market, and when you can start to see some market share improvements? Will this be in 2010?

The second question I have is on China. You continue to see the weakness in terms of the sell-through and you are still working through the inventory. Can you talk about the overall store growth, when do you anticipate the reduction of the inventory, or again, will we see the stabilisation more in 2010?

And the last question is on the World Cup in terms of your expectations: I think you made a comment that you will start to ship products in the next month. Is it really more in 2010 when we will see the revenues coming in from this, or will we see some of the impact in the fourth quarter? I'm just trying to anticipate the timing of the costs and the potential revenue benefit from the World Cup.

Robin Stalker

On the US, I think we have seen from the adidas side that we had already success in the second quarter and don't count the first quarter too much with the minus 25% if I have it right in my mind, because we took a lot of products back in that quarter. So therefore the first quarter was not as bad as it looked.

I do believe that the American market will still be challenging for the next six months. I don't know how back to school will be. It is a little bit too early. But we do see successes within the adidas product range on the one hand in the Sport Style division, but also we are seeing successes in football and in some Performance parts. Still the American market is challenging, no doubt, but I do believe we are doing the right thing.

On the Reebok side, we mentioned it already, especially on the women's side, with the EasyTone we have great successes. And we were able to increase our average selling price by 14% and this is exactly according to our strategy. We are eliminating low price levels like \$29.99. This might mean we lose quantity, but in the mid-term we will win or gain value and better sales. And this should lead into higher margins at the end of the day.

Second question concerning China: In China our sales are a little bit under pressure in the market. This is because after the Olympics the demand definitely fell. I cannot yet say that the market in itself is through. But everybody is facing the same situation there and we are definitely developing better than most of the other brands in the market.

In terms of inventory, as I have said, there is still a little bit too much from our side, but much better than six months ago. But in my opinion, still a little bit too much. And we will be careful in the second six months. And as I said, we have worked out cooperation programmes with our key retailers that by the end of the year we are definitely through. We want to have a clean start going into 2010.

And last question on the World Cup, both of your assumptions are correct. On the one hand, we are starting shipping products in the fourth quarter, mainly then in December. But the main bulk of the revenues you will see then in 2010 in the first and second quarter. And this is also true for marketing expenses.

Matthias Eifert – MainFirst Bank

First question on Reebok, you were saying the average selling prices are up double-digit. How does that work in connection with the substantial gross margin decline?

Second point on China, also regarding Reebok, you said you closed stores and it developed a bit worse than you previously expected. How can it be that you are closing stores in such a growth market with potential also in the future? Did you open stores in the wrong locations, or what exactly went wrong here?

And can you give us an idea regarding the cut in orders for the second half? How exactly does that work? And do you start the year with a certain commitment to the suppliers and then come back on a quarterly, monthly basis and talk about all this again? And can you also try to quantify a little bit more, please?

Robin Stalker

In terms of the last point, you're asking about our efforts to manage the inventory purchases for the second season. Our lead time is about six months, so we are ordering six months in advance. Therefore it's not a question of ordering and then going back to the manufacturer and renegotiating. That's not the case.

We have already, as we saw in the development at the end of last year and beginning of this year, started to reduce what we allowed to our countries to purchase for the second half of this year. And I think it's fair to share with you that the decrease over the initial expectations of orders is a double-digit figure. And this will help us do two things: One, it means that the existing season will effectively stretch out longer because we have less product in the second season. And secondly, it also keeps us disciplined in terms of our inventory levels going into the end of this year. Your first question was about the Reebok average net selling prices. And you were trying to relate it to the negative margin development. I think what Herbert was saying was he was highlighting the development on the footwear side of Reebok's business. This is the positive development that we are seeing at the moment and we are able to command increased average net selling prices in the women's categories, in the Fitness categories and some of our new initiatives in Classics. And we will obviously come out with more of those – also on the apparel side – as we develop in the men's category in 2010.

Herbert Hainer

So on the China store closures, I think the answer is a little of both, so it's a little bit of everything what you assumed already. On the one hand, the locations which seemed to be the right ones two years ago are not the right ones anymore because of consumer traffic and the shift or slow-down of trends. On the other hand, there is less consumption in some parts of the cities and this we have to reflect as well.

We don't want to continue with stores which are not profitable. Maybe there is an effect that we opened stores a little bit too fast in 2007 and 2008 and this is what we are correcting now. But once again in China it is the same as with all the other markets. We do what we believe is right for the brand in the mid and long term. And this is what we are just doing in China.

But without this China effect, we were up in Asia overall at Reebok. And of course we see also China as a growth market for Reebok going forward. There is no doubt that we have to do it right.