adidas GROUP

adidas Group Full Year 2011 Results
March 7, 2012
Q&A session
adidas Group participants:
Herbert Hainer, adidas Group CEO
Robin Stalker, adidas Group CFO
John-Paul O'Meara, Vice President Investor Relations

Matthias Eifert – MainFirst
My first question is about Reebok. How do you think to fix the issues in Latin America? Is it possible that you buy out your joint venture partner? And what, exactly, is going wrong there? And can you give us a bit more detail on the Finish Line store take-over deal with the 700 stores? What do you mean by taking over the stores exactly? And, then, my third question is about Route 2015. You have very impressive top-line momentum, but so far we haven't seen much of a margin uplift. So, in two years, you've gained less than 50 basis points, if I take year 2012 guidance. How are you going to manage the 300 basis points that are left to get to your operating margin target in the remaining three years?

Herbert Hainer
So, as you know, with regard to Latin America we have a joint venture for Reebok in Brazil and Argentina. We are not completely happy with the current set-up and the collaboration, and we are working on rectifying that. Please forgive me that I can't give you any details here, but we are definitely working on that. With regard to Finish Line, last year, at more or less the same time, Finish Line gave us over 700 stores that we were able to decorate with the Reebok brand in a way like we wanted to do it. We took over the whole store with Reebok decoration, from visual merchandising through to the product displayed, and in all of our categories. And, as it was very successful last year, Finish Line gave us the same opportunity again this year. We started in February and this time the results are even better than last year. This is really encouraging for us because this is a situation where we can showcase the concept and the product depth of Reebok in a way which we are not able to do otherwise. Therefore, with this type of experience, the consumer is definitely more attracted to the brand and this is really encouraging for us going forward.

Robin Stalker
Let me try and give you a bit more confidence about why we are so confident we're going to reach our profitability goals. Let's start with the 2011 leverage that you've seen in our operating expenses. That's a 70 basis points improvement, year-over-year. That is something you have not seen often in this Group. And I believe it speaks very clearly to the discipline we're instilling in the organisation at the moment, with the focus on the quality of our growth. We really do want to ensure that we have an over-proportional bottom-line development. So I believe it is perfectly logical that, with a lot of these programmes, you can expect the real benefits to come in the latter part of the period because, quite frankly, we have to do things differently and we are investing at the moment in doing some of these things differently. You've seen us significantly improve Retail, but that first had to be invested in. You can see us also improving things such as our consolidation of warehousing and supply chain and you see the investments we're doing in that at the moment. Probably the best example of that is the European distribution centre that we announced recently.

All these things are investments that have to happen at the beginning to be able to give us further leverage going forward. Come back and talk to us next year and I'm sure you'll be a bit more relaxed about it.

Jürgen Kolb – CA Cheuvreux
First, miCoach, and especially the Speed_Cell, has obviously been a bit of a topic in this whole presentation. Can you talk a little bit more about it? How has miCoach developed? How many members do you currently have? How many of these Speed_Cell f50 miCoach shoes have you sold? And is that already contributing meaningfully to your business and when you roll it out what impact might it have? Secondly, on the US, impressive growth rates, apparently, for adidas and also for Reebok. How has the profitability developed in that market and what do you think is still possible there? And lastly, on Reebok, the shift of the two licenses, can we talk about the impact that will have in terms of sales for this year and also, on the profit side, what that will do?

Robin Stalker
Yes, I can confirm that this growth in the American markets for both the adidas and Reebok brands definitely brings with it an improvement in the profitability. We've said in the past that America has been under-proportionally profitable for us in the Group, whereas Emerging Markets have been over-proportional. That is still the case, but we are definitely seeing an improvement in this and, obviously, some of that has also to do with our expectation in the future to further leverage our cost base in the States. But we're definitely on the right track with that.
In terms of the two license amounts, the first one, obviously, NFL disappears and that we've estimated in the past to be around about $ 200 million to $ 250 million. In terms of the shift of the NHL sales from Reebok to Reebok-CCM Hockey, that is, obviously, still within the family, so it's left pocket, right pocket. And we expect to have a double-digit top-line impact, but we make no comments about the profitability of that.

Herbert Hainer
So, to the first question, Jürgen, on miCoach. We have around 5 million applications now for the miCoach system. For the Speed_Cell, I can't give you any numbers because the speed cell concept is going through different categories. So, we have started with running, then going into other sports and team sports, particularly football, American football, tennis and so on. But I can double-check if you are interested in a more precise number of pairs that we have sold so far, but I don't have it with me. As I said, this goes through several categories, but we definitely can come back to you on this.

Michael Kuhn – Deutsche Bank
First question, I know impressions are still rather fresh, but what are the experiences so far with the NEO stores you just opened in Germany and do the developments so far fulfil your expectations? Then, secondly, and this is essentially two questions on the same topic, again, on operating leverage. We saw central administration costs rising by more than 15% last year. I think it was also around 10%. Is that one cost position that will grow under-proportionately going forward and that will result in operating leverage? And, just for clarification purposes, you said that you had 70 basis points from Opex last year. This year your margin implies an improvement of 40 basis points and that, with a roughly stable gross margin, would mean that operating leverage decelerated this year. Is this correct?

Robin Stalker
No, I think it's all good to try to put our various guidance figures and the averages that we're giving you together, but I believe that your calculation is incorrect. I expect to see a further improvement in our operating expense leverage for the year 2012. You are correct that in 2011 we saw already a 70 basis points improvement. Your point is valid, however, in terms of the CF&A. Here there was an increase in 2011. We saw savings in terms of sales and marketing overheads and logistics. And, exactly the same point I was mentioning to Matthias in his question, we have to invest in certain things first and some of that includes infrastructure, systems and processes. And we have to do things differently from the past and improve the way we run this organisation in terms of being able to leverage our cost base in the future and I'm very confident that you will see the CF&A part grow under-proportionally in the future.

Herbert Hainer
Michael, on your question to me about NEO – you are right, it is still a little bit too early. We opened the first store in Hamburg at the beginning of February, so just a few weeks ago, and, in the meantime, we have opened stores in Dusseldorf, Frankfurt and Berlin. So, overall, the reaction from the consumer is very, very exciting. And, if you do have the chance, please visit one of our stores, in Frankfurt, for example. The stores are really exciting, a very new experience for retailing, as I said before, with the Social Mirror and a lot of other things. But I think it's still too early after just four weeks for one store and the others sequentially coming in to give you, already, some sales numbers. And don't forget that we have over 1,000 NEO stores in China already running for quite some time and they are progressing nicely.

Antoine Belge – HSBC
First of all, could you comment a bit more on the performance of Reebok in China in the fourth quarter? Then, I think you mentioned price increases. Will you be able to give some idea of the timing of those price increases and on which category that would be implemented? And, finally, with adidas turning cash positive, apart from increasing the dividend ratio, which you have done, what are the possibilities of use of cash this year and the following two years?

Herbert Hainer
So, let me start with the first one, Reebok in China. You know that we have given the distribution rights and some license rights to our partner, YY, and they are progressing with Reebok according to plan. We still have to build up the right assortment and the right store locations, because we have closed several stores in the past for Reebok, and this is all going according to plan.
Secondly, price increases, as we have said, started already in 2011 and this is going by individual categories and individual products. As soon as we bring new products with more value for the consumer to the market, then we also try to raise our prices. And this differentiates from product to product, from category to category. Therefore, I can't give you an average number, but we definitely test the market when we bring new, innovative products to the market, to see what the consumer is ready to spend. And, given the examples in my speech, such as the adizero or Crazy Light, we are definitely able to achieve higher retail prices, which at the end of the day should mitigate the higher costs of FOBs and rising labour pressures.

Robin Stalker
We are very happy with our cash position development, but obviously, we still have a gross debt in the organisation. There's a lot of seasonality in our cash flows. So, we remain, as I said in my prepared comments, very focused on a conservative use of our cash. Our first focus is to gain flexibility, so we will keep on paying down our gross debt. Our second focus is obviously to invest in

our existing business. You've seen our outlook for CapEx and our continued improvement and roll out of shops and investing in our business. And the third point is to share cash with our shareholders and the emphasis there is on our dividend payout. Improving this over the coming years is also going to be a focus. In terms of would we do anything else with the cash, I think we've been consistent over the last few years in making it clear that we see no need, nor do we have any great ambition, for any large acquisitions. We continue to feel it is our duty to look at little opportunities that may be relevant for the future development of the Group, in particular where technology may be available to us or certain positions in niche parts of a given category. And you've seen us do that over the last few years with Textronics, with Ashworth and, most recently, with the Five Ten acquisition. But they would be small items.

Andreas Inderst – Exane BNP Paribas
Good afternoon gentlemen. I have three questions. The first one is on Reebok in the fourth quarter and the disappointing sales, minus 3%. If I understood you correctly, because that's a bit different compared to the Annual Report, you guide a slight increase in sales and underlying basis for Reebok compared to the Annual Report, where you see stable growth. Maybe you can elaborate on that? And, related to that question, at the Investor Day one and a half years ago, you gave out a 2015 sales target of € 3 billion for Reebok. We are now at € 2 billion. Would you regard this target as still achievable or is now out of reach? And my next question is related to the start of the year. How did it go in January and February? Have you experienced a similar development compared to the Q4 sales performance? And my third question is on the input cost pressures. You nicely quantified the impact for 2011. Can you also quantify the negative input cost impact on the gross margin for 2012? Thank you.

Robin Stalker
That's a nice challenge for me, Andreas. I think one has to anticipate, when I get my little crystal ball out, I have no idea what the impact is going to be, quite honestly, of the FOB pressures in 2012. We do know, as Herbert also said in his prepared comments, that there will be continued pressure on FOBs, not just in the raw material prices - and we've seen some development in that recently, too - but also because of the continued wage pressures. Our belief is, however, that the most significant negative development on this is now behind us. We think that was in the fourth quarter of 2011. Therefore, we are confident that, as we go through 2012, we'll again be able to mitigate through the structure of our Group in terms of our Retail growth, in terms of our segment split, and so on, to be able to mitigate whatever those pressures may be. But I just don't know at the moment.
In terms of the first question, it was about Reebok's development in the fourth quarter, and this was the case despite a very positive growth in the North American market, I think Reebok actually grew 7% in North America, and that is also despite those continuing tough comps for toning. So, underlying this, you can see we have some good product initiatives in Reebok. In terms of the Western European development and the Latin American development, however, that brought us down in the fourth quarter and Herbert's already addressed the point earlier about Latin America and hopefully that will improve in the future.

Herbert Hainer
Regarding the second question, Andreas, about the February results, you know that we don't give out any numbers for the months. But let me say that we had a good start in 2012.

Andreas Inderst
Okay. Just on Reebok, your target, your 2015 target of € 3 billion sales?

Herbert Hainer
Of course, we are still sticking to our target, but I think it's fair to say that this target was included NFL, so we have to exclude the NFL from this target because these revenues we obviously don't have any more.

Volker Bosse – Baader Bank
Q4 sales growth dynamics slowed down in China and Other Asian Markets, so could you give a bit more detail on that background?

Herbert Hainer
Yes, I guess we have said from the very beginning that we cannot maintain the sales growth in China of more than 30% in the first quarters, but we are very confident in our China business, as I have said during my speech. I'm just back from China and I have spoken with our key retailers and with our employees. And I can tell you that, at the moment in China, we have the cleanest inventory of all suppliers. We have the best sell-through numbers and, according to the two biggest retailers, they are earning the most money with us and, therefore, they are willing to expand into further retail stores with us. And this you can see already in one number – in 2011, we had a net increase of stores of around 1,100. And they are only doing this because they believe in the business and they make profit from this. Most probably, we will not have that many stores opening in 2012, but we will definitely open a few hundred stores or more, particularly our partners will open these stores. And we are quite confident of our growth predictions in China in 2012.

Peter Steiner - BHF Bank
Yes, I have two questions. First, on marketing, what is your assumption for the next one or two years for your marketing working budget? And you have been talking last year about shifting more of your budget to the new channels, social media, and so on and that could also be a factor in lowering marketing expenses. What are you seeing here for the next couple of years? And the second question relates to FX. You said that FX volatility is still a factor for you. What is the working assumption for this year and what is your hedging rate?

Herbert Hainer
In terms of marketing, there is no change in our strategy. As we said already some time ago, we will spend between 12.5% to 13% and this is what we're leveraging out during the years, be it a so-called non-event year or an event year, this will not change. It's definitely correct that we are putting more and more money into social media. You see it on our digital approach. We spoke about 32 million fans on Facebook, etc., in our presentation and this will continue. We still will do TV advertising and other advertising, the usual merchandising in our store, but we definitely see a huge crowd and a huge fan base for us in digital media and this is what we are building on for the future.

Robin Stalker
So, Peter, we have, obviously, a tremendous number of currency pairs and we're doing our business in various countries around the world, so currency is always going to be a factor. There are three key points, however. What I was mentioning in my prepared comments was about the swing in the financial costs, which was € 9 million over the year and that basically is a translation

of foreign-currency-denominated balance sheet items at the end of the year, and we have no idea what that is from quarter to quarter. But the largest part of the influence is either through translation of the top line or through our hedging. And I think here we do the very best we can and are continuing to pursue a rolling 6- to 18-month hedging period. For 2012, we are, obviously, already 100% hedged and we're probably on a good way, around 30% hedged for 2013. It is true, however, that the 2012 hedge rate will be slightly worse than that which we enjoyed in the 2011 period. We had about 1.38 €/$ in 2011 and we are probably around 1.36 €/$ for 2012.

Mark Josefson – Silvia Quandt Research
Three follow-up questions from previous questions, really. Starting with the gross margin, you've made it clear that you believe that the headwinds or the peak in the headwinds are behind us now, probably in the Q3 – Q4 number. There was quite a deterioration in Q4, so are we presuming in our guidance, going forward, that the price increases are going to stick? Have you got any evidence that this is the case? Secondly, with respect to the inventories, I think they were up 16% or 17% at year-end. Presumably, that is mainly for delivery in the next six months or so. Therefore, in your sales guidance for the full year, is there a sort of significant bias to the first half vis-à-vis the second half in terms of rate of growth for the top line? And, thirdly, with respect to NEO, with the earlier Chinese stores or, indeed, the earliest shops that you opened in Russia, can you give us some idea on the sales density of these stores compared to other stores under the adidas label, non-NEO stores? How does the sales density compare?

Robin Stalker
So, let me attempt to answer your question about pricing. We have already started increasing our pricing, as we said last year, and that was in fall/winter 2011 for spring/summer 2012. I can't quote any particular evidence that it's holding, but I believe that we're being successful and I've given you some examples of where we've actually been able, through innovation and with new product launches, to significantly increase those price points. So, I think we're very confident that that's going to help us mitigate these FOB pressures. The second question was about inventories and I made the comment that really our inventories are extremely clean. I believe if I go through all of the geographies, we can be very happy with that and I also said that it includes some of the FOB increases. So, we have a fairly good increase in our inventories, very much in line with what we would be expecting in sales, and I would say that the six-month period is probably too long, that we would hope to be selling them quicker and, therefore, we actually anticipate good sales development throughout the whole of the year. But, through my comment with the FOBs, I think you can see that we're expecting the FOBs to be even better in the second half of the year than in the first half of the year.

Herbert Hainer
Just in addition to that, I think is also fair to say on inventories that we took inventory earlier this year because the Chinese New Year is much earlier this year and considering the effect of factories being closed. As a result, we could have a good start in 2012. So, you will see this easing down. In terms of NEO, in general, the indications which we have got from the Russian market where we have, I think, 29 stores now, are very encouraging. Germany, as I said before, is too early to tell just yet. The stores are smaller, they are around 200 square metres, but in terms of density of product per square metre, this is comparable and density is even a little bit higher because it's more T-shirts, it's more tops, it's more shorts, etc. Because of the smaller ticket items, we put more products onto a table or onto a square metre than we can get onto the same square metre sales in the bigger adidas stores. But you cannot compare it on a total size because the normal adidas stores are bigger than the NEO stores. But density is relatively high there as well.

Julian Easthope – Barclays Capital
I've got two questions. First, in terms of interest rate, you've basically got € 1.2 billion of debt and € 1.3 billion of cash. You paid down some of your private placements early during 2011. I was just wondering if there is any more that you could do to sort of narrow the gap between the 4.9% interest payment and the 1% you'll get cash on deposit? And the second question comes back to Reebok. You had fantastic sell-in and stocking of Zig and the RealFlex products last year, with obviously quite decent volumes at high margins. I was just wondering if the Reebok margin would also come under a bit of pressure this year, following the loss of the two contracts, as well as what we saw in the selling part of last year?

Robin Stalker
On the first point Julian – thanks for the tip on the interest. Yes, that's exactly what we will obviously be trying to do, to manage that as best as we can. Some of our debt, however, is fixed-term and in the 2011 results, we also had certain debt in countries where the interest rate was particularly unfavourable and we have taken steps to correct that also. So, I think you can look to us improving this in 2012.

Herbert Hainer
In terms of Reebok, I think when you talk about the two lost contracts you mean the NFL and the shift from Reebok to the Reebok-CCM Hockey brand, which is not a lost contract, it's just a shift from the left to the right pocket. But in terms of NFL, it should be the other way around, that the margin should get better, because the NFL contract product had a lower margin than our ordinary Reebok business.

Andrew Mobbs – Redburn Partners
Yes, two questions from me, please. The first one is quite a detailed one on Q4 operating costs. When I look at the central non-segmental operating costs, excluding the marketing working budget, this cost line seems to have increased pretty significantly year-over-year in Q4. Can you tell us what's behind that, please? And then the second question is a more general one. You've been consolidating your number of manufacturing partners over the last few years, but this number looks to have increased more than 10% in 2011. How should we think about that development?

Robin Stalker
Okay, well, I can't give you an easy answer to that one, I'm afraid. If you're looking at the non-allocated or non-segmental specific costs, they should also be improving, but obviously what we have here and similar to the question earlier from Michael, was about the development in the CF&A. That's obviously not allocated and you'll also find in here certain marketing and some logistics costs. I'm not aware of any particular extraordinary developments in our costs in the fourth quarter. I think this can only be a timing issue. Look for improvement in that in the 2012 period.

Herbert Hainer
On your second question relating to our suppliers, there are three reasons for this development. One is that, obviously, we had much bigger volumes, a 10% increase, on average, in every year or 13% in the last year. These bigger volumes mean more capacity is required. Secondly, the fact is that we want to have more diversification when our partners go out into some other countries, be it

Vietnam, Cambodia, Laos, etc. And the third point is that, with NEO, we have also started with some new suppliers who are specialised in fashion production capabilities. And these are the reasons for this increase.

Ingbert Faust – Equinet Bank
I have two questions I would like to ask. The first one is on what you said on the Olympic Games. You mentioned that you are planning to open 100 multi-sport facilities. Can you explain a bit what that means? Are you also selling products there or is that just a marketing thing? And the second question, again on Reebok, would it be possible, as over the last two years you gave us some indication on the volumes you sold in toning, for example, could you give us an example where you are there? Do you expect this to have bottomed out or is it that this type of product is very difficult to pick up again? And related to that, if you could give us some indication on ZigTech and Flex as well, in terms of units, that would be great.

Herbert Hainer
So, let me start with the adiZones. This is in cooperation with the communities and with LOCOG in England. These are areas which we build in the individual villages and communities, where people, especially kids, have free access. Here they can do outdoor, they can go climbing, they can play basketball, they can play football. So, we want the kids in the UK to get more accessibility to doing sports and this is what we're doing. We have already built 50 of this adiZones and we still have 50 to come during the course of the year. We don't sell any products there. This is really just providing the playgrounds for kids so that they can play there. And the second question was on toning. We said in 2010, in our best year, that we are close to selling 10 million pairs of toning shoes. Obviously, this number went down because of the reasons which we mentioned. We're still selling toning in some countries very well, so we're also still talking a few million pairs, but we want to bring it back to the level which we had before. Therefore, we are introducing a new series of new toning products in the second half of 2012. We definitely believe in this category because our market research clearly shows us that there is a lot of consumer demand out for this kind of product. And we definitely have been the most innovative in terms of bringing toning products to the market. So, we definitely believe we can rebuild the category. Zig and Flex, here we're also talking about millions of pairs for both franchises. But I don't think we have given out any numbers and, therefore, we won't give any numbers today, either.

Jorg Philipp Frey – Warburg Research
One last question on retail. You had very strong comparative store sales, but I'm a bit surprised that you are so cautious in the expansion speed. What would give you the confidence to be a bit more aggressive in terms of retail expansion and how do you currently see the return on invested capital in your retail operations, particularly in new openings? And a bit of a related question, how can you split your CapEx last year into maintenance CapEx and expansion CapEx and particularly the expansion, in the expansion CapEx, how much was the CapEx related to Retail?

Herbert Hainer
Okay. Let me start with retail. So, we mentioned that we wanted to open around 100 to 150 own retail stores. We will still open a lot of franchise stores with our partners in China, etc. However, first and foremost, Philipp, you should know that we are not retailers. We were born in the wholesale business over 60 years ago and this is what we really know. We are getting better and better every day as retailers, as you can see from our comp store sales. But we still want to be

sure what we are doing is going in the right direction and helping us to support our 11% operating margin target. Secondly, you know that, in retail, if you make a mistake, you have to carry the consequences of such a mistake, because normally you have to sign contracts with several years' commitment for retail locations, so we are very careful that we get the locations which we really want to have and are very selective in how we choose our locations. Nonetheless, I think 100 to 150 stores, which are mainly in emerging markets, because in the European markets we have a good retail network with our wholesale partners, is still fine to support our retail growth initiative.

Robin Stalker

So, retail in terms of profitability and our CapEx. I think I've committed in the past that gradually as we boot up that experience that Herbert has just mentioned that we share with you more and more information about how we look at the investment and the return on investment internally and then, hopefully, get a system where we can share that information with you. At the moment, we are still developing all of the historic numbers and getting the comparisons right. I think the best thing for you is to see the following. We're starting to share additional KPIs with you, such as what we just mentioned with the increase in the sales per square metre by concept shop and we're also seeing in the general improvement in the profitability of retail that our focus on this is clearly moving us in the right direction here.

In terms of CapEx, it's fair to say that over 60% of the CapEx investment is definitely in new CapEx, with less than 40%, obviously, in the refurbishments or store renewals. And, of all our CapEx, just over a third of that is being spent at the moment on retail.

John Paul O'Meara

So, ladies and gentlemen, that concludes our 2011 annual results presentation. Our next event will be the release of our first quarter results on 3rd of May.

And, just a final note to those of you here in the room, thank you very much for making the effort to come here today and we also are very proud to present you with our adidas brand book, which tells the story of adidas over the past 40 years and into the future through pictures and interviews with many of the people who have contributed to the success of our great company.

And, with that, thank you very much for your attention and have a good day.