adidas GROUP

FINANCIAL RESULTS PRESENTATION

First Half 2009 Results Speech

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John Paul O'Meara, Head of Investor Relations

Good afternoon ladies and gentlemen and welcome to our first half 2009 financial results conference call. I'm JP O'Meara and I head up the IR activities here at the adidas Group.

Our presenters today are Herbert Hainer, adidas Group CEO and Chairman, and Robin Stalker, Group CFO. Today, they will be covering the Group's second quarter and first half financial performance. In addition, they will be updating you on our key initiatives as we set our organisation up for the coming years. Let me now turn the call over to Herbert to discuss the operational highlights of the year so far...

Herbert Hainer, CEO and Chairman

Thanks JP and good afternoon ladies and gentlemen.

The impacts of the economic downturn and the repercussions on consumer spending are well documented and certainly continued to influence our performance in the second quarter. However, I am pleased to report that we did not see any fundamental deterioration in our business since our last results presentation.

That means – our financials for the first half of 2009 are exactly in line with the guidance we gave back in May – if not a little better.

- Group sales for the first half came in at 5 billion euro – down 2% – or a 7% decline in currency-neutral terms.

- Gross margin decreased 460 basis points to 45.1%.

- And diluted earnings per share were 10 cents compared to 1.35 euro a year ago.

During the quarter, we have also been finalising our reorganisation plans. But before I come to that, let me briefly bring you up to speed on key developments at our brands during the quarter.

At adidas, currency-neutral revenues declined 9% in the second quarter, and 8% year-to-date. High prior year sales related to the UEFA EURO 2008™ and the Beijing Olympic Games played a large role in this development. While sales declined at double-digit rates in Europe and Asia mainly due to these factors, revenues grew 19% in Latin America and 1% in North America in Q2.

Below the top-line, our team at adidas did a great job during the quarter, offsetting the impacts of gross margin pressures by keeping a tight rein on costs. As a result, operating margin increased 1.1 percentage points to 10.7%. Although large portions of the year-on-year savings are due to the phasing of marketing spend in this non-event year, efforts to reduce complexity are already clearly delivering positive benefits.

While all of this was going on, the brand also continued to bring winning new concepts to market. In a few days time, on August 18, adidas will celebrate its 60th birthday, and leveraging this long brand heritage continues to be a visible driving force with the consumer. This is typified by the 15% growth we have seen in our Sport Style division in the second quarter, accelerating from 12% in Q1.

And we will continue to drive momentum in our lifestyle business in the second half, for example, by rolling out several hundred shop-in-shop systems in key European markets such as the UK and France.

Another area where we have excelled in the first half has been in the outdoor category where sales have increased at a high-single-digit rate. Outdoor is an attitude to life, and adidas is the athletic brand in the outdoor sector that provides every athlete with the best possible equipment for his or her individual challenge.

As part of a step-by-step plan, we intend to establish ourselves as the benchmark in the outdoor sector by 2015. Mountain sports, trekking and hiking are the main areas of focus in this plan. With regard to product development, the focus is on footwear, apparel and hardware. And we are well on our way. A few weeks ago, we returned to the largest outdoor fair in Europe in Friedrichshafen to great acclaim, showcasing our TERREX and SUPERTREKKING collections. Our TERREX shoe was already awarded the OutDoor industry award 2009. And like in all other categories, we have great partners in place, including Reinhold Messner, Angelica Lind and the Huber brothers, supporting our initiatives.

In other parts of the performance division we also continue to make noise with the athlete and the consumer.

- Our performance-enhancing apparel TECHFIT™ continues to grow strongly. In addition, we have been making the waves with our new HYDROFOIL swimsuits as adidas athlete Britta Steffen conquered Rome last week.
- In basketball, we are growing in Europe and Asia, while high-profile NBA star Dwight Howard capped an amazing season being named to the All-NBA first team.
- And in running, our marquee adiStar, SUPERNOVA and adiZero families are growing strongly, signalling that high-performance runners are choosing adidas. For example, in the London marathon, adidas

moved into the number two position in the shoe count, as we doubled our share of runners over the last two years.

And last but not least, football. We recently kicked off the one year countdown to the 2010 FIFA World Cup™, and retailer feedback to our plans is nothing short of overwhelming. And we are going to lead into it in a big way. We also just extended our long-term partnership with UEFA, where for the first time we will support all official UEFA club football competitions including the Champions League, the newly created Europa League and Super Cup. With all the initiatives we have in place, adidas has a great foundation to build momentum as we turn the year.

Moving over to Reebok. For the first half, Reebok segment sales decreased 2% in euros, and declined 6% on a currency-neutral basis. In comparison to what is going on in the market, I believe this is a reasonable result, and we have seen good progress in several areas.

- Although footwear volumes are down this year, our clean-up efforts have led to a double-digit increase in average footwear selling prices with the highest increase in North America.
- Our women's training business is up almost 50%, and our women's lifestyle sales have shown signs of stabilisation.
- In Asia, although our sales were heavily impacted by our store rationalisation initiatives in China, our mens and womens sport revenues are up 10%.

As a result, we are starting to feel a real difference when talking to retailers about Reebok's strategic direction, and feedback on our innovation pipeline for 2010 has been very encouraging.

We are leading the pack in the emerging toning category which some are tipping as the next billion dollar category. An industry expert recently commented in Advertising Age that people are starting to talk about toning the way they did about aerobics in the '80s. Reebok made a big statement then and is already doing so again now with the introduction of the EasyTone™ this year – which by the way has sold through at double-digit rates in all regions and key accounts since the launch.

Our other big initiative, the new workout concept JUKARI Fit to Fly™, is now up and running in all regions with recent launches in New York, London, Madrid, Hong Kong, Delhi, Buenos Aires and Santiago de Chile. The tremendous media coverage and consumer feedback to this concept shows we are really reigniting our connection to the female consumer. For example, Vogue.com recently named JUKARI Fit to Fly™ the "Best New Indoor Workout" – I can't imagine anything better for the brand's image. And look for the next installation of the JUKARI experience as we turn the year.

We have also been working hard with our new advertising agency, and our 2010 campaigns will make another step change in how the consumer perceives the brand. We will share information with you on all these new initiatives later this year as we approach market launch.

Before I move on, I want to acknowledge that we are still at the outset of turning Reebok around. While we are getting the traction we need for a turnaround, there is still a good portion of work ahead of us, particularly in terms of addressing profitability shortfalls and tying up loose ends in areas where the brand is still weak.

You will have seen today that we have adjusted our sales expectations down for the year, and now expect a low- to mid-single-digit sales decline compared to our previous stable forecast. This is mainly due to slower growth in emerging markets than we had originally planned, primarily impacted by the rationalisation of our business in China, and a lower than expected growth rate in Latin America.

Turning to TaylorMade-adidas Golf, I have highlighted before that even in a downturn there are opportunities. And despite what you hear from others, there is only one winner this year in the golf market – and that's TaylorMade-adidas Golf.

The golf market is estimated to be down in the high teens so far in 2009. TaylorMade-adidas Golf sales are up 3% currency-neutral in the second quarter, or down only 7% if you exclude our new Ashworth business. All regions grew in the quarter with the exception of Asia. That in itself testifies that we are taking significant market share, and certainly more than any of our major competitors.

We have record-high market shares in the US in both metalwoods and irons. In fact in irons, the Burner 09 was the top-selling model in June in the US, while the R9 continues its revolution as the leading metalwood and the most played on the PGA and European golf tours.

Our roster of leading professionals continues to grow, with Germany's highest-ranked player Martin Kaymer and Greg Norman joining our TaylorMade tour staff, while Sean O'Hair and Ryan Palmer join Fred Couples on Ashworth's.

But we're not just winning the top-line battles or those on the course. In terms of inventories, we have been very aggressive and fast to react to the current climate. Compared to the end of March, our inventories are down 26% as we successfully moved non-core product and identified and implemented a series of methods to reduce our lead times. This success and our innovation pipeline mean we continue to edge closer to the number one golf company in the market. With over € 800 million or US$ 1.2 billion in annual sales and our track record as the innovation leader, I am convinced TaylorMade-adidas Golf is on its way to achieving its mission – to be the leading golf company in the world.

So ladies and gentleman, those quick comments should give you a good overview of where we are with our brands. I'll be back in a moment to talk about our outlook and some recent developments in our organisational structure. But first, I'll hand off to Robin to go through the rest of our financials…

Robin Stalker, CFO

Thank you, Herbert, and good afternoon ladies and gentlemen.

I will now provide information on our regional development and update you on some significant progress we have made on our balance sheet during the quarter.

So let's begin with a brief recap of our top-line development. Currency-neutral sales declined 8% in the second quarter of 2009. Revenues decreased in all segments with the exception of TaylorMade-adidas Golf. Currency movements contributed positively to Group sales in euro terms, resulting in a 3% decline to 2.457 billion euro for the quarter.

Year-to-date currency-neutral sales for the adidas Group decreased 7%, or 2% in euro terms. With the exception of Latin America, revenues declined in all regions. Excluding Russia and China, emerging market growth continued to offset declines in more mature economies. Sales in other emerging markets, excluding Russia and China, increased 11% year-to-date.

In Europe, revenues were down 8% as a result of the challenging market environment in Western Europe and the absence of prior year sales related to the European Championships. Significant currency effects from the devaluation of the Russian rouble also played a big role here.

North American revenues declined 10% due to our particularly weak first quarter. We saw a big improvement in our results in the second quarter with sales down only 3%, compared to 17% in the first quarter. A priority for all of our brands this year in North America is to ensure we keep our brand positioning in check. This has meant a high focus on managing excess inventories, particularly with factory outlets, while also reducing our exposure to lower price points such as 29.99 dollars at Reebok. While we are more satisfied with our performance in North America in the second quarter, I believe caution is warranted as we look to the remainder of the year. The jury is still out on how much appetite the consumer will have in the important back-to-school season this year. Therefore we are taking a prudent approach to the market.

Turning to Asia, sales declined 9% in the first half. There have been varying performances by market, with sales decreases in Japan and China, while India and other emerging Asian markets continue to show solid growth. In China, the market is still suffering the inventory hangover from last year's Olympic Games. However, we are through the worst now and we are confident that by the end of the year we will be in good shape to return to growth in 2010.

Finally, for Latin America, our most resilient market, revenues are up 24% on a currency-neutral basis for the first half. This is the reward for years of consistency in building brand image and we are very close to taking market leadership in the region. Although there are signs that the economic environment is weakening, which as Herbert mentioned, is having an effect on our expected growth rates for Reebok, we believe this market will continue to be our most robust market this year and we will continue to take share from our competitors.

Let's look now below the revenue line. The second quarter gross margin decreased 510 basis points to 45.0% (versus 50.1% in 2008), with declines in all of our brand segments.

For the six-month period, gross margin was down 460 basis points at 45.1%. Let me explain this performance in a bit more detail. We have identified the following three factors which are similar to those we outlined to you in the first quarter. Each of them contributed around a third to the overall decline year-to-date:

- First, higher sourcing costs stemming from record-high commodity prices in mid 2008 and overall growth of labour costs burdened our result. As a reminder, we start negotiating our pricing with suppliers around a year before the actual sale of the product. As already mentioned in May, we expect the pressure to lessen in the second half, however the easing of input prices will not play a positive role until 2010.

- Second, a further third of the overall decrease in gross margin was the result of currency devaluation effects – largely related to the Russian rouble which had depreciated significantly compared to the first half of 2008. Due to the fact that we cannot cost-effectively hedge the rouble, this squeezes gross margin as our cost base in Russia is largely US dollar denominated. While we have increased prices at a double-digit rate compared to the prior year, this has not been sufficient to offset the negative currency impact.

- And finally, our focus on clearing excess inventories accounted for the remaining third of the decline as we markedly stepped up our initiatives compared to the first quarter.

While these factors were relevant for all of our brands in the first half, their weighting by brand and in importance differed.

- At adidas, higher input costs and the Russian rouble accounted for the majority of the decrease.

- In the Reebok segment, around half of the decline was due to higher sourcing costs and the Russian rouble, with the remainder due to clearance activities primarily in China, Spain and the US.

- Finally, at TaylorMade-adidas Golf, two-thirds of the decrease was due to price repositioning as a result of the difficult golf market, with the remainder due to the first-time consolidation of Ashworth where we had a 4 million euro non-cash charge for purchase price allocation.

Moving below the gross profit line, other operating expenses as a percentage of sales increased by 270 basis points year-to-date, but by just a more moderate 60 basis points in the second quarter to 43.9%.

On the cost front, we have been diligently balancing our need to invest while continuing to work on initiatives to drive operational efficiency. On an absolute basis, second quarter operating expenses decreased despite our continued expansion of controlled space infrastructure. The phasing of marketing initiatives this year in the absence of major sporting events such as the UEFA EURO 2008™ and the Olympic Games played a large role in this development.

Restructuring expenses amounted to around 5 million euro in the quarter. In the first six months, we have hence spent around 30 million euro under the restructuring programme we announced in May. As I mentioned at that time, the phasing of our expenses is dependent on the timing of our reorganisation initiatives. However, due to factors such as the success of the hiring freeze we implemented at the end of last year, we now believe the costs to generate our planned annual savings of 100 million euro will be modestly lower than the 100 million euro we originally expected.

Finally, the integration of Ashworth into the TaylorMade-adidas Golf segment resulted in 6 million euro of expenses in the second quarter. To complete the integration, which largely involves winding down non-core operations, we will incur further charges of around 12 million euro through the remainder of the year, and 4 million in the first quarter of 2010 due to planned retail disposals.

To wrap up my discussion on operating profit, Group royalty and commission income increased 19% in the quarter and 7% in the first half year. The negative effect from the replacement of distributor agreements in Latin America with new Reebok companies was more than offset by growth in the adidas segment and positive currency effects.

As a result, first half Group operating profit declined 74% to 129 million euro from 490 million euro in the prior year. This translates into an operating margin of 2.6% – down 700 basis points versus the prior year.

Turning now to the non-operating items of the P&L, net financial expenses increased 10% in the second quarter, which is a significant improvement compared to the first quarter. For the first six months of 2009, net financial expenses increased 31%.

Due to lower average interest rates on gross borrowings, interest expenses declined compared to the prior year period, despite the higher level of net borrowings. However, similar to prior quarters, we again took a hit from the revaluation of subsidiary balance sheet positions denominated in foreign currencies that have weakened against the respective functional currencies. This quarter, the effect amounted to 12 million euro, bringing the year-to-date effect from exchange rate volatility to 31 million euro.

This unfavourable development, coupled with the decline of operating profit, led to a 91% decrease of IBT and a 95% decline of net income attributable to shareholders in the first six months. A strong increase of the Group's tax rate negatively impacted the latter. While we should not overemphasise the tax rate development due to the low absolute level of IBT, the Group's tax rate will most likely increase versus the prior year level of 28.8% as a result of a less favourable regional earnings mix and the non-recurrence of prior year one-time tax benefits.

Finally, first half basic and diluted earnings per share decreased 95% and 93%, respectively, to 7 and 10 cents – well in line with our May guidance of a first half EPS around break-even.

Let's move over to the balance sheet, where we have made significant progress compared to the first quarter.

First of all let me comment on inventories. In Q2, inventories grew 8% in currency-neutral terms or 13% in euros to slightly above 2 billion euro, more than halving the growth rate we saw in the first quarter. Although the current status still warrants some improvement, we have clearly demonstrated that inventory management was front and centre of our management efforts at all of our brands and in all regions during the three-month period.

At Reebok and at TaylorMade-adidas Golf excluding Ashworth, inventories have actually declined year-on-year. For adidas in Europe and in North America, our inventories were almost at prior year levels as we made very effective use of our factory outlet network during the three-month period.

There are two main reasons for the increase:

- The first relates to adidas Latin America, where due to the threat of higher import tariffs in Brazil and Argentina we have taken a deliberate decision to accelerate product shipments over the course of the last six months.
- Secondly, although inventories in Japan are down, we still have some overhang in Asia including in the Chinese market.

Looking out to the rest of the year, we have markedly reduced sourcing volumes. Therefore, we expect to further improve our inventory situation over the next couple of quarters – despite a moderate negative impact from World Cup products shipped over the next months.

We are also keeping a close eye on the other important areas of working capital. Accounts receivable were up 4% on a currency-neutral basis and 6% in euro terms, to 1.7 billion euro. The increase continues to be broad-based across all brands and regions. We had already taken a higher allowance for doubtful accounts at the end of the first quarter, which we believe offers sufficient protection against potential payment defaults going forward.

As a result, average operating working capital came in at 26.2% – an increase of 200 basis points from 24.2% in the prior year.

Let me briefly comment on the effects these developments had on our debt situation. In the second quarter, strong progress in managing down working capital contributed to the generation of 380 million euro in cash from operations – despite a 66% drop in operating profit. This is the highest amount of cash we have ever generated in a quarter outside of our seasonally strong fourth quarter.

As a result, borrowings declined quarter-over-quarter, but nevertheless remained above prior year levels. At the end of June, net borrowings amounted to 2.7 billion euro, an increase of 21% (or 472 million euro) versus 2.3 billion euro last year. Last year's share buyback distorts comparisons of the underlying development by 136 million euro. In addition, currency movements had a negative impact of 110 million euro. In summary, the

Group's financial leverage at the end of the second quarter was 85.7% versus 82.3% in the prior year.

Let me finish my discussion of the balance sheet with a quick update on our financing structure. As you know, credit markets currently have a healthy appetite for new issuances from reputable companies with strong brand names. We took this opportunity to further improve the term structure of our existing debt instruments in favour of longer maturities.

At the end of June, we completed the placement of a 200 million euro German Schuldscheindarlehen with maturities until 2012 and 2014, respectively, at favourable terms. At the beginning of July, we also issued a 5-year Eurobond with a total volume of 500 million euro. The transaction was multiple times oversubscribed, which allowed us to price the bond with a spread of just 200 basis points above the respective Euro mid-swap. These successful transactions reflect our Group's high credit quality and our excellent access to the capital markets.

Ladies and Gentlemen, it remains our goal to return to a financial leverage of below 50% in the medium term. The reduction of net borrowings continues to be at the forefront of our activities in 2009, in line with our target to achieve year-end net borrowings below the 2008 level. I'm confident we will be able to build on the progress we have made during the quarter with a relentless focus on tight operating working capital management and disciplined investment activity.

Now back to Herbert who will give you more detail on our outlook for the rest of 2009 and some further details on our Group's reorganisation initiatives...

Herbert Hainer, CEO and Chairman

Thanks Robin.

Looking forward, the environment is still challenging and there are undoubtedly still some unknowns for the second half. But I am confident we are through the worst of the hurdles the environment has thrown our way. This means I believe we have seen the bottom in our performance in the first half. Therefore our guidance for the Group remains unchanged, with the exception of the top-line guidance for Reebok which I already spoke about.

We continue to forecast that full year sales will decline at a low- to mid-single-digit rate currency-neutral. We expect to generate significantly positive earnings per share in the second half of the year, all-be-it below the record levels of the prior year. This will be a consequence of a moderation of input cost increases and positive impetus ahead of the 2010 FIFA World Cup™. We will make further progress on reducing inventories as Robin has outlined, which will set our Group up for a clean start to what will be an eventful 2010.

To conclude today, I would like to spend a few minutes on the Group reorganisation. Since 2000, our success has been a result of our dedication to common Group pillars and strategies.

- Lead our industry through innovation and design,
- Expand our distribution in existing and new markets, partnering with best-in-class retailers, and more recently with strong and unique controlled space activities,
- And leveraging the scale of our global organisation to drive efficiencies.

After years of expansion and our Group's transformation into a true multi-branded company, we are now at a point where we need to change our internal organisation. This will ensure we foster future growth and engage the consumer and our customers in an even more profound and relevant way. To reach this objective, we must build an organisation that

- Firstly, brings us even closer to the consumer, by accelerating speed to market, and being more responsive to market needs.
- Second, to increase our effectiveness by strengthening the consistency of our brand messages globally, ensuring the right growth for our brands, and driving a higher return on investment on the commercial opportunities we choose to follow.
- And finally, we need to focus our sales organisation to cater to the two key distribution models we are pursuing – wholesale and retail.

This new structure follows two important principles:

- First, to foster further alignment and strengthen brand management to support our long-term growth strategies. This will be achieved through the creation of a new global brands structure driven top-down, with each brand division led globally to ensure a strong profile and vertical brand integrity.
- Second, under the new global sales structure already announced in May, we will drive a well-coordinated and best practice execution in the marketplace.

At the same time, we will also ensure we leverage the scale of our organisation and the depth of talent and skills we have built up over the years.

All facets of our organisation are currently undergoing change, as we move our business towards the new operating structure we announced in May. This includes the implementation of joint operating models in Europe and Latin America, elimination of regional offices in favour of direct interaction with our key markets and the formation of new wholesale and retail structures to drive our global sales organisation.

As we get closer to completing these structural changes which we are making on a brand, regional and market level, we will now separate the responsibility between global brand and global sales management also on the Board level. I will in addition assume direct responsibility for global sales while my Board colleague Erich Stamminger will take responsibility for global brands, comprising adidas and Reebok. Due to the different business model of TaylorMade-adidas Golf and Rockport, these brands will continue to report directly to me.

So ladies and gentlemen, let me assure you everyone at the adidas Group is highly motivated to deal with this challenging environment proactively and to continue building brand equity for long-term sustainable growth. To achieve this, we will drive our standards to new heights while remaining true to the principles that have brought our organisation to the forefront of the sporting goods industry.

Thank you for your attention. Now let’s take your questions.