adidas Group Full Year 2010 Results
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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
I have a few questions. First question, can you give us a breakdown of the Reebok sales growth in the US? The 24% is very impressive. Can you give us an idea of how much is driven by toning, how much is driven by Techfit, how much is toning apparel? Is toning apparel already significant? What can we expect going forward to happen in other markets?
And for Reebok, what is your expectation in terms of volumes? Last year, you gave us a couple of number e.g. for toning to sell more than 10 million pairs in 2010, and Techfit also a few million units. How is this developing in 2011?
Third question, on the input cost issue, can you talk a bit about what happens along the supply chain? How much can you get from your manufacturers when it comes to sharing the high input costs? How much can you get from the retailers in terms of higher pricing? How much do you have to suffer on your own in terms of percentages?

Herbert Hainer
Okay, let me start with the first questions on Reebok in the US. Yes, this is definitely a remarkable development. This of course comes mainly from our new pillars toning and Zig. We have told you that we sold in around 10 million pairs of toning shoes in 2010, but we only delivered around 8 million into the market. When we saw in the second half that there was over-inventory and the price competition started, we were very disciplined in only bringing in volumes which we could sell through. Therefore, we were able to maintain our prices, which helped the retailer to get their full margin. This all has supported us in becoming the number one toning company at the end of the year. And this will also give us a lot of credibility with the retailers in 2011. So what do I expect in 2011? Around the same number in terms of volume of between 7.5 million and 8 million pairs of toning shoes in 2011.
Regarding ZigTech, we sold a bit more than 2 million pairs in 2010 and we believe this will increase further in 2011 as we are now expanding toning and ZigTech around the world. I guess you all have heard how well ZigTech was received in the US. So growth in 2011 will mainly be coming from our new concepts, toning and ZigTech.
Our Classics business decreased in 2010 as we tried to clean up our inventories in the market. We cleaned up our distribution channels and I think that we now have a very good platform on which to restart Classics, especially with new innovative products and with the new, before-mentioned collaborations.

Robin Stalker
Thanks Matthias for your question on input costs. These input pressures are affecting the whole industry, and everyone within the chain is going to have to share some of it. I don't believe anyone can tell you today a specific percentage of who shares what, but we're working on all fronts to ensure that there is a fair sharing here. Firstly, we're working with the factories to make sure that we are providing them with samples so that they can manufacture as efficiently as possible. We are at the same time making sure our product is engineered as attractively as possible. Secondly,

we have attractive brands with good product to ensure that we can also justify price increases. So, I think you'll have to wait and see at the end of the season who is hit the most, but it's a reality that obviously just reengineering our products alone is not going to be enough. We are going to also have to put up prices.

Michael Kuhn – Deutsche Bank
Maybe one more question also on the gross margin side. I think the adidas Wholesale gross margin was down something like 4 percentage points in the fourth quarter. Could you comment on what is product and regional mix and if you see some input factor pressures here already? A second question on operating working capital: We saw an inventory increase towards the end of the year and operating working capital as a percentage of sales, let's say, flattening out. Do you see further improvement potential here, or are we nearing a level at around 20% where further reductions are hardly achievable? Also in that context, what amount of earlier ordering did you do to benefit from lower procurement costs? Will we probably see some of the cost pressures phasing in with a time lag? Thank you.

Robin Stalker
When you look at the development of the margin, you need to bear in mind that you cannot, unfortunately, see the full development in the margin by just looking at our Wholesale and Retail segments, because there's clearly factors going through on a consolidation basis also, the hedging differences and other supply chain effects.
The decline, however, at the end of the year in the Wholesale segment was also due to the geographical mix and the fact that, in the fourth quarter, as I mentioned in my speech, we had less of that high-margin product for the World Cup that we launched in 2009. In terms of operating working capital and our development here, you may recall that over the last years I've been saying "I'm not sure if we are going to get much, much better in this", because we've had a significant improvement over the last several years. The 20.8%, our operating working capital as a percentages of sales in 2010, can it be better? I will certainly be challenging our team to make it better. However, I think we have to realise that we are a growing company, and we will have to recognise higher working capital costs. But it's our definite intention to try to improve this percentage further. And to your last point about the flattening out at the end of the year: I think you need to also bear in mind that part of the reason for the increase in the inventory, which was 34% year-over-year, was simply because the goods in transit in that period were up over € 300 million. So this speaks two things: Firstly, that we've had good timing of our production volume; secondly, that we are anticipating good growth in sales; and thirdly also that, at the end of the year, this product is very fresh. In fact, our current inventory as a percentage improved year-over-year.

Juergen Kolb – Cheuvreux
Just a quick one on Reebok, first of all. Flex, maybe a quick word on that, when you're planning to launch it, what sales you expect in terms of million pairs? Could it be as big as ZigTech in the first year? And the same question also on the EasyTone apparel collection and when will the full roll-out of that collection happen? Will it only be in the US or also in Europe? And on the Classics line: When do you start to sell it and in which regions? I would appreciate an indication on how much you expect from that angle.
Secondly, on a broader scale, maybe for you Robin, since 2002 the oil price through to today, or in the last couple of weeks, has more than quadrupled. How has the margin or the profitability in the footwear category developed in this period? Also, what have you done to keep the profitability at this level? Do you see, going forward, any opportunity to make sure that you can

keep that profitability or even bring it forward? Or what are the levers you can really drive here so that we are not seeing a deterioration on that side?

Herbert Hainer
Let me start with Reebok. Flex we will launch mid April in the US. We will do it the same way as we have done it with toning and Zig. We started in the US because as we've always said: We want to position Reebok as an American-inspired brand, so we start again in the US, and then roll it out internationally in the 6 to 12 months afterwards. We believe, without giving any specific numbers on Flex, that it has huge potential and will therefore be our third big concept pillar. The trade sell-ins, which we had done four or five months ago, have been very encouraging. With EasyTone apparel we started in smaller quantities with some selected retailers in the fourth quarter of 2010. At some retailers, it sold out within a few weeks. We have now launched a big campaign with Eva Mendes in Los Angeles last week and will roll it out internationally in the second half of 2011. We are absolutely convinced that all of our three pillars – toning, Zig, and Flex – will further elaborate on the roll-out into the international businesses and into the regions outside of the US.

Robin Stalker
So gross margin development; particularly with respect to the development of oil price and the impact on footwear. First, we should acknowledge that clearly, in our development of the gross margin over the last several years, currency has played a role. We are sourcing and purchasing in dollars and we are hedging that obviously. That's one figure, one fact that we need to bear in mind. The second factor is that together with our factories we have invested considerably in lean manufacturing techniques over the last several years and becoming better at manufacturing. That means obviously being as efficient as possible in the use of materials, in many cases also changing materials, and through our growth and the scale that we get, that's obviously been an advantage as well. So lean manufacturing, and then in addition to that, innovation have been the key drivers of this improvement. I would expect those to continue to play a positive role in the future.

Jürgen Kolb
Maybe one quick question for housekeeping purposes: Hedging for 2012, how far are you or what is the level?

Robin Stalker
For 2012, we are probably already over 50% hedged. But I need to put this into context. If we look at 2010, we were probably around 1.38. For this year 2011, we are talking about probably 1.35 and we are over 90% hedged. For 2012, it will probably look a little bit better, at around 1.36 or so, at the moment, but as I said, we are at the moment just over 50% hedged.

Ralf Stromeyer – RCM Capital Management
Your provisions have increased a lot. On my calculation, that has cost you 70 basis points of your margin. So are you trying to hide an even stronger underlying profitability, or do you really need all of those provisions?

Robin Stalker
We definitely aren't trying to hide anything. We have a very transparent presentation to you today and for all of our quarters. But it is a fact that, at the end of the year, the balance sheet accruals figures or the provisions have increased. That is correct. A lot of that has to do with risks in various areas. Firstly, it has to do with non-invoiced expenses. Secondly, it has to do with risks and customs. Thirdly, it has to do with certain product allowances that are coming in the market.

Erwan Rambourg – HSBC
I have three quick questions. Firstly, on the inventory build-up at the end of the year, can you point to any specific region or any specific brand? The plus 34% is quite impressive. I was just wondering if there's anything specific going on either by region or by brand. Secondly, looking at pricing, I think most of the sporting goods market is looking to increase prices this year, or maybe early next year, to try to mitigate some of the input pressures. I was wondering when and what magnitude of price increases you could put through. How do you view this as a risk to volumes generally in the sector? Thirdly, on China, I think you had a good second half, 11% double-digit growth in Q4. However, it seems that competition these days and essentially your main competitor is more in the mid-to-high teens level in terms of sales growth. I know your goal is to gain share market by market. So, I'm just wondering what's holding you back at this stage to reach that mid-to-high teen level. What could we expect for China this year?

Herbert Hainer
Let me start with the third question on China. We want to get back to sustainable growth in China, as I've always said. We've cleaned up the market now, and I also said, for 2011 and the years to come, we definitely want to grow at double-digit rates in China. We believe that we can do this in a sustainable way. As I told you during my speech, I have just come back from China, where I had the opportunity to speak to two big retailers, Belle International and Yue Yuen. They all confirm good sell-throughs of our product and the very healthy inventory level. Therefore, we are not shy to tell you that we want to grow double-digit in the upcoming years. You might have heard that some of the competitors in China have problems with their growth numbers.
In terms of pricing, we are always looking into that and checking to see what kind of price elasticity we have, although this is not at a special point in time, e.g. that we say on July 1 or on January 1, 2012 we will increase prices. We also try to put more value into our products and this also enables us to raise prices. This is an ongoing process; it's not on a particular day. And last but not least, on our inventory levels: This is not focused on one brand or on one country. When you say the impressive 34%, honestly, to us, it's not impressive at all because this is just normalising now after the sharp inventory reduction which we have done over the last 18 months. As we are growing, we need these inventories.

Erwan Rambourg
When I was saying impressive, I meant you could be looking to anticipate very strong growth in a specific brand or a specific region in the few months to come, basically.

Herbert Hainer
As I said, this is spread through all of the brands, obviously adidas and Reebok and also in all regions. Once again, this is very healthy, very young inventory. We definitely have got rid of all the old inventory in the last 12 or 18 months.

Louise Singlehurst – Morgan Stanley
Just a couple of quick questions please. Firstly, on the high revenue guidance for 2011, what regions are really driving this increase? What's doing better from when we spoke to you last in November? Within that, can you give us any colour on Europe specifically as well please? Then secondly, just in terms of the operations gearing and the margin implied for 2011, with the flat gross margin expectations, it looks as though we are obviously seeing a ramp-up in the operational expenses. Can you just give us some colour on the moving parts there, particularly with regard to the marketing budget? Then finally, Herbert, you mentioned about the difference

in gross margin from the regional mix and how emerging markets will help offset some of the pricing pressures in 2011. Can you give us any idea of the difference by region? Thank you.

Herbert Hainer
So let me take the first one on revenues. We plan to grow everywhere in the world in 2011 and with all our brands. The biggest growth will come from the emerging markets like Russia and China, but we will also further grow in the US and in Europe. You have seen that we have some quite impressive numbers in a few European countries like the UK, Spain, or Germany. We believe there is a platform for further growth in all of the regions and definitely in China. As I've told you, we are back on track, also in America where we see a very, very healthy business for us and further growth prospects for the future.

Robin Stalker
We are definitely not expecting an increase in the operating expenses as a percentage of sales. In fact, we are expecting some leverage there, and specifically in terms of marketing spend, Herbert has always guided to around 13% being an appropriate figure. We were a little bit higher than that in 2010. But if we are to get to our target of increasing our operating margin to between 7.5% and 8.0% there needs to be some leverage there.

Tony Shiret – Credit Suisse
Can you give us some sort of idea regarding any "Olympics effect" that we can expect in terms of past effects and what you're expecting in terms of sales and margin?
My second question is about manufacturing optimisation. Can you give us some sort of metrics, cost per unit or any numbers, etc. that we might be able to judge you by in the future on this growth and also an overall comment on this subject?

Herbert Hainer
I don't think that we can give any details on the second question. Regarding the first question on the Olympics, you will see the first impact in Q4 2011, with the biggest impact in terms of sales coming in 2012, as we get closer to the event. However, we have already started selling merchandise and we will be starting our related communications in the fourth quarter of 2011. But obviously the biggest effects will be in 2012.

Tony Shiret
Regarding the sales related to the Olympics, will they be materially different in terms of the margin you expect to achieve on them, bearing in mind that some of the products presumably won't be mass-market in nature?

Herbert Hainer
We will definitely bring products and concepts into the markets which are supporting the overall positioning of our brands. So, we will not go in with mass-market products just to maximise our revenues for that period of time. Obviously, we want to cater for as many consumers as possible, both in the UK and around the world, but nevertheless we will always make sure that our brands are protected.

Bernd Müll – Landesbank Baden-Württemberg (LBBW)
Could you shed some light on the magnitude of the impact the higher input costs will have on the gross margin for 2011? And would you share the view these higher input costs could in fact even grow in 2012?
The second question concerns selective price increases and I know you see some opportunities here. But, do you have any specific product categories in mind where you see particular chances of increasing prices or do you see any regions that could take price increases easier than others?

Robin Stalker
I'll take the first part. This is very important and it's in our interest to make sure everybody has as much of an understanding of it as they can, because it is indeed, as Herbert said in his speech, the big challenge for everyone at the moment. But let's not just dwell on input prices; let's look at the whole subject of gross margin. There are a lot of moving parts in gross margin. Certainly, we do have a negative impact on the industry at the moment because of these input prices, but we have a lot of other things happening as well. I remind you of the positives, such as the growth of retail as a percentage of our business, which brings in higher gross margins and our faster growth in the emerging markets, which also brings us higher gross margins. And the significant improvement in Reebok, where you've already started to see the effects in terms of the gross margins, which will also be a positive. So I don't think I can put a specific figure on any particular element. All of these things play a role, and we're giving you the best guidance we can at the moment. If the pressures continue, I'm sure that we have enough people looking at what we need to do to adjust our products and our pricing to ensure that we can maintain good margins in the future.

Herbert Hainer
To the second question, in terms of selective price increases, the best argument to increase prices is when you have desirable brands. This is what we have and what we build on daily. We obviously are looking carefully into the individual categories, to see what kind of price elasticity we have, what kind of positions we have for each brand and product, and where are the key price levels, which you shouldn't move, etc. Therefore, I can't give you any specifics. It's not a certain category and it is not a certain region. And we will be managing this very carefully because we definitely do not want to lose volume, because we want to further grow our business.

Andreas Inderst – BNP Paribas
First of all, congratulations for the extremely strong free cash flow development and net debt reduction. Robin, can you quantify the working capital as a percentage of sales, what is a normalised rate here?
My second question is on Reebok. Herbert, you mentioned strong exposure at Finish Line in February with the additional merchandise walls. How was the reception by the consumer to that initiative and what is the plan, particularly for the North American market to gain more exposure at the point of sale for the Reebok brand and also for the adidas brand in 2011?
And then my third question is on own retail. Here, you talked about 100 store closures. Can you repeat how many stores you closed in 2010? And what are the costs related to the store closures in 2011?

Robin Stalker
Thanks for the recognition in relation to the cash flow. I don't think I can give you a final figure of what the right operating working capital as a percentage of net sales is. We'd like it to be as low as possible. 20.8% seems to me to be a very good figure, bearing in mind that I think it was only about eight years ago we were over 30%. But clearly we would like to further improve. However, I would

ask you to recognise that this company is growing and in growing, there's likely to also be further pressures on our working capital. But if we can be around the 20%, I think that's a good figure.

Herbert Hainer
Question number two on Reebok and Finish Line. Obviously, as you've seen from the pictures, this was great exposure for our brand because it was not just a few walls, it was the whole store which was Reezigged and completely redesigned. This was 680 stores for the entire month of February, and it gave us huge exposure. Also, the sales numbers which we have achieved are very encouraging. Without giving away too many secrets, we are working closely with some key retailers in the US on how we can bring more initiatives like this to life in the second half. And believe me, there is enough interest from the different key retailers. And for adidas, further to what we told you in our US generation plan, where we are focusing on the high school kid, we are definitely getting better and improving our exposure. Obviously one of the pillars is basketball, because it is a very attractive category to this consumer group, and you've seen what we have done with Dwight Howard and Derrick Rose. Starting in October, the Derrick Rose shoe was for weeks the best-selling shoe at key retailers in the US, better than anybody else. But also the Dwight Howard shoe and the ZigTech shoe with John Wall within the Reebok brand have performed quite well. So I'm absolutely satisfied with the progress we have made with both brands in the US. You've seen the growth numbers for 2010, which I think clearly shows you that we have outpaced the market and that we are definitely heading in a good direction.
So the last question on own retail. Closing and opening stores is a normal process in our own-retail business and the 100 store closures is not that many for us. In 2010 we closed 127, and I believe, going forward, we will have a similar number which we are closing, but always opening more so that we have a net gain overall in terms of store size.

Andreas Inderst
Can you also provide some feedback on adidas NEO and the ZigTech NEO and the SLVR line?

Herbert Hainer
ZigTech NEO we don't have. However, for NEO in general, we will further expand this label and, as you know, we have quite ambitious plans. We will further extend NEO in China where we already have around 700 stores. We will also extend NEO into Russia and we start it here in Germany. Then SLVR - SLVR is still a small part of our business as it is a takedown of Y-3, for a specific target group. It will not get that big, but it will give us enormous exposure to a target group which so far hasn't seen adidas as their preferred brand. So we believe we can explore this new consumer group and then obviously when they buy SLVR products, they will also buy other adidas products like Originals, etc. This is the strategy behind SLVR.

Christopher Svezia – Susquehanna
I have a number of questions. My first question is on the gross margin. As we think about 2011, I was wondering about your guidance in terms of a flat gross margin rate. Is there any way you can give any colour on the first-half/second-half timing of pricing, mix of business, where more of the pressure could be on a year-over-year comparison, etc? Any colour around that would be helpful.
Secondly, also on the gross margin; some clarification on the gross margin during the quarter, and maybe for the full year for both the Reebok and the adidas brands?
Third, on toning; here in the States, there has been some ASP pressure related to your toning products, at least since the beginning of the year. We're seeing it down roughly 25% or so. I'm curious about how you foresee that developing, going forward, given the fact that you're thinking

about 8 million pairs of toning products in 2011. So what are you doing with the balance of the inventory that you didn't ship? When do you expect pricing will stabilise?
Then the last question I have is just in terms of the Classics business for Reebok. I guess, we're starting to see improvements there. Should we expect to see growth in that business in 2011 for the Reebok brand or is it more to do with repositioning the brand? And what do the pre-books look like for that brand?

Robin Stalker
The only additional flavour I can give you on gross margin development in 2011 is that clearly the second half of 2011 is more challenging than the first half. That's basically all I can say because, as you've heard from all the explanations given on this so far, the input prices are across the board and not in any particular product or in any particular brand.

Herbert Hainer
In terms of pricing for toning, I guess it's fair to say, and as you are in the US you have seen it, the pricing pressure is mainly coming to our main toning competitor. And as you know they have stated that they have an enormous over-inventory issue and that it will take them several months until they have cleared their inventory. I think we have been very disciplined on this and when you look into the stores in terms of our toning product you will see this. I saw this myself four weeks ago when I was over in the US. The toning products from the last season have been down 20% to 25%. However, for all of our new toning products which we have introduced into the market, they have all been at their recommended retail price. This will definitely be maintained going forward because retailers want to keep their margins high and the product is still selling through very well. As I said before, we will definitely show great price discipline and we don't want to oversell into the market. Therefore, we haven't shipped all the products which we sold in 2010 and we will be disciplined in how we work together with the retailers in 2011. And if you ask our key retailers, they're quite happy with our strategy regarding toning.
The last part on Classics, yes, we definitely will grow the Classics business in 2011. As I said before, we've cleaned up Classics in the last 18 months, taking out products which aren't selling well. We've also refreshed the collection, starting with new collaborations such as with Swizz Beatz and we also have clean inventories. So we definitely will see growth in 2011. As far as I recall, we already grew Classics in the fourth quarter in 2010.

Christopher Svezia
Just on the gross margin rate, can you give that by brand as you've done in prior quarters?

Robin Stalker
We have published these numbers. For the full year, the Reebok brand gross margin is up 400 basis points to 35.9%. The adidas brand is up 40 basis points at 47.2%. For the fourth quarter, the Reebok brand was up 180 basis points to 35.9%, and the adidas brand was down 140 basis points to 45.8%.