

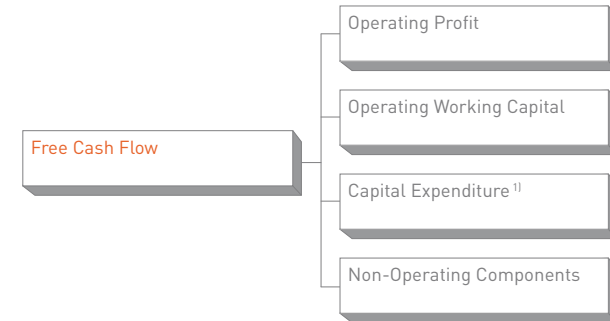
INTERNAL GROUP MANAGEMENT SYSTEM

The adidas Group's central planning and controlling system is designed to continually increase the value of our Group and brands to maximize shareholder value. By improving our top- and bottom-line performance and optimizing the use of capital employed, we aim to maximize free cash flow generation. This is our principal goal for increasing shareholder value. Management utilizes a variety of decision-making tools to assess our current performance and to align future strategic and investment decisions to best utilize commercial and organizational opportunities.

FREE CASH FLOW AS INTERNAL GROUP MANAGEMENT

FOCUS The cornerstone of our Group's Internal Management System is our focus on free cash flow generation, which we believe is the most important driver to sustain and increase shareholder value. Free cash flow is comprised of operating components (operating profit, change in operating working capital and capital expenditure) as well as non-operating components such as financial expenses and taxes. To maximize free cash flow generation across our multi-brand organization, brand management has direct responsibility for improving operating profit as well as optimizing operating working capital and capital expenditure. Non-operating items such as financial expenses and taxes are managed centrally by the Group Treasury and Tax departments. To keep Group and brand management focused on ongoing performance improvement, a portion of the responsible managers' total compensation is variable and linked to a combination of operating profit, operating working capital development, Group earnings before tax, or relative/absolute stock price performance.

FREE CASHFLOW COMPONENTS



1) Excluding goodwill and finance leases.

OPERATING MARGIN AS KEY PERFORMANCE INDICATOR OF OPERATIONAL PROGRESS Operating margin (defined as operating profit as a percentage of net sales) is our Group's most important measure of operational success. It highlights the quality of our top-line and operational efficiency. The primary drivers central to enhancing operating margin are:

⇒ *Sales and gross margin development:* Management focuses on identifying and exploiting opportunities that not only provide for future growth, but also have potential to increase gross margin (defined as gross profit as a percentage of net sales). Major levers for sustaining and enhancing our Group's sales and gross margin include optimizing our product mix, increasing the quality of distribution – with a particular focus on controlled space – as well as supply chain efficiency initiatives, and the minimization of clearance activities.

⇒ *Operating expense control:* Tight control of operating expenses is particularly important as we strive to leverage the Group's sales growth through to the bottom line. Marketing working budget is our largest operating expense. It is one of the most important mechanisms for driving top-line growth. Therefore, we are committed to improving the utilization of our marketing spend. This includes concentrating our communication efforts (including advertising, retail presentation and public relations) on key global brand initiatives and focusing our promotion spend on well-selected partnerships with top events, leagues, clubs and athletes. We also aim to increase operational efficiency and reduce operating overhead expenses as a percentage of sales. Refining business processes, eliminating redundancies and leveraging the scale of our organization are important drivers in this respect.

KEY FINANCIAL METRICS

$$\text{Gross margin} = \frac{\text{Gross profit}}{\text{Net sales}} \times 100$$

$$\text{Operating margin} = \frac{\text{Operating profit}}{\text{Net sales}} \times 100$$

$$\text{Average operating working capital} = \frac{\text{Sum of operating working capital at quarter-end}}{4}$$

$$\text{Operating working capital in \% of net sales} = \frac{\text{Average operating working capital}}{\text{Net sales}} \times 100$$

$$\text{Capital expenditure}^1 = \text{Additions of property, plant and equipment plus intangible assets}$$

1) Excluding goodwill and finance leases.

We strive to maximize revenues and minimize costs by detailed target setting, and we constantly monitor deviations in rolling forecasts on a monthly basis. If necessary, action plans are implemented to optimize the development of the Group's operating performance.

OPTIMIZATION OF NON-OPERATING COMPONENTS Our Group also puts a high priority on the optimization of non-operating components such as financial expenses and taxes, as these items strongly impact the Group's cash outflows and therefore the Group's free cash flow. Financial expenses are managed centrally by our Group Treasury department. [▶ see Treasury, p. 091](#) The Group's current and future tax expenditures are optimized globally by our Group Taxes department.

TIGHT OPERATING WORKING CAPITAL MANAGEMENT Due to a comparatively low level of fixed assets required in our business, operating working capital management is a major focus of our efforts to improve the efficiency of the Group's balance sheet. We have made major strides in this area through tight working capital management focused on continuously improving our Group's inventories, accounts receivable and accounts payable.

Our key metric is operating working capital as a percentage of net sales. Monitoring the development of this key metric facilitates the measurement of our progress in improving the efficiency of our business cycle. We strive to manage our inventory levels to meet market demand and ensure fast replenishment. Inventory ageing is controlled to reduce inventory obsolescence and to optimize clearance activities. As a result, stock turn development is the key performance indicator as it measures the number of times the average inventory is sold during a year, highlighting the amount of capital locked in products in relation to our Group's business. To minimize capital tied up in accounts receivable, we strive to continuously improve collection efforts in order to reduce the Days of Sales Outstanding (DSO) and improve the ageing of accounts receivable. Likewise, we strive to continuously optimize payment terms with our suppliers to best manage our accounts payable.

CAPITAL EXPENDITURE TARGETED TO MAXIMIZE FUTURE RETURNS Improving the effectiveness of the Group's capital expenditure is another lever to maximize the Group's free cash flow. Our capital expenditure is controlled with a top-down, bottom-up approach: In a first step, Group Management defines focus areas and an overall investment budget based on investment requests by brand management. Our operating units then align their initiatives within the scope of assigned priorities and available budget. We evaluate potential return on planned investments utilizing the net present value or internal rate of return method, in relation to the cost of capital. Specific investments are assessed according to the principles of risk-weighted returns. For large investment projects, timelines and deviations versus budget are monitored on a monthly basis throughout the course of the project.

M & A ACTIVITIES FOCUS ON LONG-TERM VALUE CREATION POTENTIAL We expect the majority of our Group's growth to come from organic business. However, as part of our commitment to ensuring sustainable profitable development, we regularly review merger and acquisition options that may provide additional commercial and operational opportunities. Acquisitive growth focus is primarily related to a potential for increasing market penetration, strengthening our Group's positioning within a sports category or addressing new consumer segments. The strategies of any potential acquisition candidate must correspond with the Group's long-term direction. Maximizing return on invested capital above the cost of capital is a core consideration in our decision-making process. Of particular importance is evaluating the potential impact on our Group's free cash flow. We assess current and future projected key financial metrics to evaluate a target's contribution potential. In addition, careful consideration is given to any potential financing implications which may be required to complete a prospective acquisition.

COST OF CAPITAL METRIC USED TO MEASURE INVESTMENT POTENTIAL Creating value for our shareholders by earning a return on invested capital above the cost of that capital is a guiding principle of our Group strategy. We source capital from equity and debt markets. Therefore, we have a responsibility that our return on capital meets the expectations of both equity shareholders and creditors. Our Group calculates the cost of capital utilizing the weighted average cost of capital (WACC) formula. This metric allows us to calculate the minimum required financial returns of planned capital investments. The cost of equity is computed utilizing the risk-free rate, market risk premium and beta. Cost of debt is calculated using the risk-free rate, credit spread and average tax rate.

STRUCTURED PERFORMANCE MEASUREMENT SYSTEM Our Group has developed an extensive performance measurement system, which utilizes a variety of tools to measure the performance of the adidas Group and our brand segments. To evaluate the Group's current sales and profitability development, we monitor our annual budget on a monthly basis, addressing shortfalls and identifying additional opportunities. Further, we monitor operating margin developments at all brands on a monthly basis. To optimize the Group's balance sheet, we control operating working capital movement via a monthly monitoring system. When negative deviations exist between actual and target numbers, we perform a detailed analysis to identify and address the cause. In addition, we benchmark the Group and brand results with those of our major competitors on a quarterly basis. We measure the Group's future top-line development on the basis of our order backlog development. Order backlogs comprise orders received within a period of up to nine months in advance of the actual sale. Our order book represents approximately 70 % of future anticipated revenues. Also increasingly important are other indicators such as our own-retail activities and at-once business, which are not represented in the order book. We provide updates on these developments as part of our quarterly reports.

➤ see Outlook, p. 118

MANAGEMENT APPRAISAL OF 2007 PERFORMANCE AND TARGETS FOR 2008 AND 2009

We communicate our Group's financial targets on an annual basis. We also provide updates throughout the year as appropriate. In 2007, we achieved all key financial targets within the focus of our Internal Management System. We outperformed global industry and macroeconomic growth, increased our earnings at a double-digit rate, and made strong debt reduction progress during the year. [▷ see Economic and Sector Development, p. 078](#)

By segment, development at adidas and TaylorMade-adidas Golf exceeded our initial sales expectations while the Reebok segment performed marginally below initial expectations. At Reebok, strong sales increases in the emerging markets, particularly in Asia and in Eastern Europe, could not fully compensate lower than anticipated revenues in North America and the UK. The deliberate limitation of sales to mall-based customers in North America contributed to this development. Management took this decision to reduce product discounting at retail and protect brand image.

For 2008 and 2009, we have again committed to ambitious targets which will help us optimize our Group's free cash flow development going forward. Despite lower expected global economic growth in 2008, we believe the current trading environment will not negatively impact these expectations given the high percentage of growth we expect to come from emerging markets and the positive impetus of the major sporting events during the year. We believe our targets are realistic within the scope of the current trading environment, and no material event between the end of 2007 and the publication of this report has altered our view. [▷ see Subsequent Events, p. 117](#)

TARGETS VERSUS ACTUAL KEY METRICS

	2006 Actual	2007 Initial Target	2007 Actual	2008 Target	2009 Target
Group sales growth (currency-neutral)	53%	mid-single-digit	7%	high-single-digit	high-single-digit
adidas segment sales growth (currency-neutral)	14%	mid-single-digit	12%	high-single-digit	
Reebok segment sales growth (currency-neutral)	(6%) ¹⁾	low-single-digit	0%	low- to mid-single-digit	
TaylorMade-adidas Golf segment sales growth (currency-neutral)	13% ¹⁾	mid-single-digit ¹⁾	9% ¹⁾	mid-single-digit	
Group gross margin	44.6%	45 – 47%	47.4%	47.5 – 48%	46 – 48%
adidas segment gross margin	46.2%	increase	47.4%	increase	
Reebok segment gross margin	35.0%	increase	38.7%	increase	
TaylorMade-adidas Golf segment gross margin	43.9%	increase	44.7%	increase	
Group operating expenses (in % of sales)	36.7%	increase	39.2%	increase	
adidas segment operating expenses (in % of sales)	35.4%	stable	35.6%	increase	
Reebok segment operating expenses (in % of sales)	32.8%	increase	35.8%	increase	
TaylorMade-adidas Golf segment operating expenses (in % of sales)	33.5%	increase	34.4%	increase	
Group operating margin	8.7%	approx. 9%	9.2%	at least 9.5%	approx. 11%
adidas segment operating margin	11.9%	increase	12.9%	increase	
Reebok segment operating margin	3.5%	increase	4.7%	increase	
TaylorMade-adidas Golf segment operating margin	8.5%	decrease	8.1%	increase	
Net income growth (attributable to shareholders)	26%	≤ 15%	14%	at least 15%	double-digit
Operating working capital (in % of net sales)	25.8%	< 25%	25.2%	further reduce	further reduce
Capital expenditure (€ in millions)²⁾	277	300 – 400	289	300 – 400	300 – 400
Net debt (€ in millions)	2,231	< 2,000	1,766	maintain or reduce	

1) On a like-for-like basis.

2) Excluding goodwill and finance leases.