adidas GROUP

FINANCIAL RESULTS PRESENTATION

First Quarter 2010 Speech

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Herbert Hainer, Robin Stalker, John-Paul O'Meara

John-Paul O'Meara

Good afternoon ladies and gentlemen and welcome to our first quarter 2010 financial results conference call. I'm JP O'Meara and I head up the IR activities here at the adidas Group.

Our presenters are Herbert Hainer, adidas Group CEO, and Robin Stalker, Group CFO. Today, they will be covering the Group's first quarter financial performance, and updating you on our outlook for the remainder of the year. So, let's get started and over to you, Herbert.

Herbert Hainer

Good afternoon ladies and gentlemen.

After the hard work of last year to reshape our organisation, we began 2010 with confidence and the full belief that our product and marketing strategies could make a real difference in an improving economic environment. And without doubt, the strength and power of our brands was visible on every playing field in the first quarter.

- We generated record first quarter sales of 2.7 billion euro, an increase of 4% currency-neutral, driven by growth in all segments.
- Our profitability improved substantially, with gross margin up 3.5 percentage points to 48.6%.
- And through operating expense leverage and benefits from the cost-saving initiatives we put in place last year, first quarter net income jumped to € 168 million from € 5 million 12 months ago.

By segment, Wholesale revenues increased 1% currency-neutral with growth being dampened by difficult retail conditions in several markets. However, there were some bright spots with sales growth of 16% in both North and Latin America and 4% in Western Europe offsetting declines in Greater China, European Emerging Markets and Other Asian Markets. Gross margin in the Wholesale segment improved 50 basis points in the first quarter to 43.1%.

The recovery in consumer spending that gained traction in many regions as the quarter progressed into late February and throughout March was definitely encouraging. And this is really visible in our Retail segment's performance. Sales were up 16% currency-neutral, with comparative store sales increasing 7%, which is certainly much better than we had anticipated. On a brand basis, adidas and Reebok comp store sales increased 5% and 15% respectively.

North America and European Emerging Markets grew 15% and 26% respectively and were particularly strong as the consumer recovery in the USA and Russia gathered pace. On a store format basis, we saw big improvements in our concept stores and other retail formats. Comparable concept store sales increased 12% and other retail formats, which include e-commerce, grew 43%, with online sales almost doubling.

This translated into a significant profitability increase as the Retail segment's gross margin grew 3.7 percentage points and operating margin expanded 7.6 percentage points over the prior year. This demonstrates the leverage we have in our Retail operations. And taking this together with the work we are doing in 2010 to create greater efficiency and improve our retail competency, I am convinced we will be able to continue to drive higher returns on our retail investments over the medium term.

For those of you not yet familiar with our new reporting structure, the Wholesale and Retail segments comprise the business of the adidas and Reebok brands. So let's take a few minutes to talk about the key highlights of each brand for the quarter.

First adidas. Revenues grew 4% currency-neutral in the quarter and gross margin expanded 70 basis points to 47.7%. In the football category, we picked up just where we left off in 2009, leveraging our involvement with the FIFA World Cup 2010™, and utilising our convincing portfolio of products to incredible success.

So much so, we generated record first quarter sales in the category with growth of 26% currency-neutral. And let me assure you, we still have plenty more to come ahead of the kick-off to the event with the new F50 football boot coming to market next week.

While adidas is passionate about football and no event is bigger and more anticipated than the FIFA World Cup™, there was still a lot more to the brand's performance in the first quarter.

- In running, our Supernova and Response families grew at strong double-digit rates, with the Supernova Adapt and Response Trail 16 receiving Runner's World Editor's choice awards. In addition, strong marketing initiatives made the new adidas miCoach platform a big draw to our retail stores.
- In outdoor, sales grew 4% currency-neutral with sales in one of our most important target categories, Mountain Sports, up over 60%.
- Finally, in basketball, our international business and our high performance TechFit offering both grew at double-digit rates. And in March, we extended our global partnership with the NBA giving adidas exclusive rights to all NBA apparel in Europe beginning with the 2010/11 NBA season.

Another stand-out performance for the adidas brand in the first quarter was the Sport Style division. Sales increased 22% currency-neutral (to over half a billion euro), representing our highest growth rate in nearly three years. And this comes on top of 12% currency-neutral growth in the same period last year.

To be successful in sports lifestyle, it is critical to continuously engage the consumer with unique and creative concepts that keep them coming back to the brand day after day, year after year. And collections such as Star Wars™ and Originals by Originals are just some examples of how we achieved this during the quarter.

With many more unique collections in the pipeline and of course the marketing investments we are carrying out by way of our “Street Where Originality Lives” campaign, we can safely tick the box that 2010 will be yet another record year for our lifestyle business.

Moving over to Reebok, where I can confirm the Reebok turnaround is gathering pace, we saw positive global sales growth of 1% currency-neutral already in the first quarter. Momentum continues to build in North America as sales increased 6% currency-neutral driven by the toning category. The explosion of growth in this space in such a short period of time eclipses nearly everything I have witnessed in the industry over the past 25 years. And we are well on track to selling at least five million pairs of toning footwear in the US alone this year.

Now also we are gaining traction in international markets following recent advertising campaign launches in Germany, Russia and the UK. As well as the TV campaign, since last Saturday, we have started an incredible PR collaboration in Europe with supermodel Helena Christensen showcasing creative images of a futuristic fashion/workout routine, wearing EasyTone™ and key pieces from On The Move as well as trying out Jukari Fit To Flex™.

But we are not stopping there. Our second major product innovation ZigTech™ is already proving to be another winner for the brand. On March 11, we launched the ZigTech™ training shoe at retail in the US, supported by an aggressive marketing campaign including TV, print and digital communication. Sell-through rates have been so strong that I believe we will easily sell over one million pairs of this shoe in the US in 2010.

These great products give a clear demonstration of our intention with Reebok to secure our territory, and lead in fitness and training. It is with confidence that I can say today that Reebok will grow at a double-digit rate in North America this year. Also I believe we could now sell up to 10 million pairs of toning footwear globally this year.

With such premium products becoming a bigger piece of our sales, this is starting to have a major impact on brand profitability. In the first quarter, Reebok gross margin increased almost 900 basis points to 36.3%. As growth rates accelerate in North America and as we also start intensifying our efforts internationally, I am particularly excited about the prospects for the brand and its impact on our Group going forward.

Finally, let me spend a moment on Other Businesses which comprises the activities of TaylorMade-adidas Golf, Rockport and Reebok-CCM Hockey. Sales grew 8% currency-neutral in the first quarter, driven by an industry-leading 16% currency-neutral sales growth at TaylorMade-adidas Golf. Sales at Rockport and Reebok-CCM Hockey declined 5% and 17% currency-neutral respectively. Profitability in the Other Businesses also improved considerably with gross margin expanding 5.7 percentage points and segmental operating profit increasing 112% to 92 million euro.

Looking in a little more detail at the TaylorMade-adidas Golf performance, this was driven by strong double-digit increases in metalwoods, footwear and irons. And in golf balls we are really starting to challenge at the premium end of the market with growth of over 50% in the first quarter, and a doubling of market share to just under 10%. Of note, our Penta TP ball ranked number three in tour ball sales in the USA during the month of March.

Visibility for TaylorMade also remains very high across the important tour events where TaylorMade was the No. 1 driver brand at every event on the US and European PGA tours during the first quarter, driven by the popularity of the R9™ SuperTri and Burner® SuperFast drivers.

Although the golf market at retail is off to a weak start, with most major markets around the world contracting at a high-single-digit rate, I am confident we will again achieve important market share wins in several categories this year as we continue to dominate the premium end of the sport, and cement our position as the largest golf company in the world.

So ladies and gentlemen, let me wrap up by saying that this quarter's accomplishments are a real testament to the strength of our brands and clearly demonstrate that our product and marketing strategies are really making a difference.

Given our Q1 performance and the good visibility we now have into the important third quarter, we have adjusted our guidance accordingly for the full year. We now forecast that full year sales will increase at a mid-single-digit rate currency-neutral due to a stronger than expected performance from the Wholesale and Retail segments, which we now project to grow at a low- to mid-single-digit rate and a low-double-digit rate respectively.

Gross margin will improve to a range of between 46.5% and 47.5%, and operating margin will be around 7.0%. This translates into earnings per share of 2.05 to 2.30 euro compared to our original expectations of 1.90 to 2.15 euro.

This still gives us the flexibility we need to carry out the brand investments I outlined in detail earlier this year geared to accelerate our momentum if opportunities arise. Let me now hand over to Robin who will walk you through further specifics on the quarter and additional comments on our outlook.

Robin Stalker

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

As we already released preliminary results almost two weeks ago, our headline figures should have come as no surprise to you this morning. Let me now give you some additional details on how we achieved this strong performance.

In the first quarter of 2010, as Herbert outlined, we saw a broad-based improvement in sales. Momentum accelerated particularly in March for an overall Group sales increase of 4% on a currency-neutral basis.

From a regional perspective, first quarter currency-neutral sales increased in nearly all regions. In Western Europe, revenues grew 4% primarily as a result of higher sales in the UK and Germany. Strong sales growth in our football category in the run-up to the FIFA World Cup™ played an important role here.

Group sales in European Emerging Markets increased 1% on a currency-neutral basis due to growth in most of the region's markets. While the appreciation of the rouble positively impacted sales, this effect was dampened in euro terms by negative translation effects from the US dollar, which is our functional currency in Russia.

North America sales for the 3-month period grew 14% on a currency-neutral basis. adidas sales even increased by 21%, with

Reebok sales up 6% currency-neutral. While the adidas performance will be more moderate in coming quarters as the first quarter was in part supported by favourable comparisons relating to product takebacks last year, we expect Reebok to gain in momentum as the year progresses.

First quarter sales in Greater China declined 15% on a currency-neutral basis. This was a result of lower sell-ins as a result of continued clearance activities at retail. However, own retail sales in the region were again up over 50% following the expansion of our store network in 2009, and comp store sales were also strongly up 11% for the quarter.

Currency-neutral revenues in Other Asian Markets declined 3% primarily as a result of decreases in Japan, where the challenging macroeconomic environment is still weighing heavily on consumer spending and buying behaviour. This development more than offset our solid performance in the region’s emerging markets.

And finally, in Latin America, sales were up 18% on a currency-neutral basis, with increases in all of the region’s major markets, at all our brands, and in all segments.

Moving below the top line, I am pleased to report we were able to almost fully reverse last year’s declines. The Group’s first quarter gross margin increased 350 basis points to reach 48.6% versus 45.2% in the prior year quarter.

This development reflects four major factors:

- First, almost half of the Group gross margin increase relates to lower sourcing costs compared to the prior year period. For the rest of 2010, we expect this effect to continue supporting gross margin development, albeit at more moderate levels in the second half of the year.
- Second, the overproportionate growth of higher-margin own-retail sales had a positive impact on Group gross margin.
- Third, clean inventory levels meant we had to do less clearance sales.
- And finally, due to the appreciation of the Russian rouble we regained some of last year's currency losses.

While these factors were relevant for all of our segments and brands in the quarter, their weighting in importance differed.

- At Wholesale, lower input costs, less clearance sales and positive product mix effects at Reebok were the main drivers for the segmental gross margin improvement.
- Gross margin performance in the Retail segment was supported by the same factors. However, on top, the appreciation of the Russian Rouble had an overproportionate effect due to own retail being the primary distribution channel for our Group in Russia.

- And finally, Other Businesses were positively impacted by favourable product mix effects and less clearance sales in the TaylorMade-adidas Golf segment. In addition, the Rockport gross margin increased significantly versus the prior year due to a lower portion of clearance sales.

As a result of these developments, gross profit was up 12% and reached the highest first quarter level in the Group's history at 1.3 billion euro.

Moving below the gross profit line, other operating expenses as a percentage of sales decreased 330 basis points to 41.5%, and declined 4% in absolute terms to 1.1 billion euro. Here, there were two positive and negative factors at work.

- On the positive side, we benefited from the non-recurrence of various one-time expenses in the prior year quarter. As a reminder, these related to higher allowances for doubtful debts, the Gekko divestiture, the integration of Ashworth into the TaylorMade-adidas Golf segment, as well as costs associated with the Group's reorganisation programme. From the latter, we are realising more and more savings, primarily from headcount reductions in Wholesale and central Group functions.

- However, as we outlined in March, we did also invest in our business in the first quarter. Higher sales and marketing working budget expenditures, which accounted for 12.4% of sales during the quarter, were primarily related to the Reebok brand. Here we supported in particular the brand's launch of ZigTech™ in the USA and initiatives in toning internationally. Also, we continued our activities to harmonise and improve our Retail systems and processes. Spending in both of these areas will continue throughout the year, with a significant pick-up in marketing coming in the second and third quarters.

To wrap up my discussion on operating profit, first quarter other operating income amounted to 47 million euros, which represents a 75% increase compared to 2009. This development was mainly due to the settlement of a lawsuit and the divestiture of a trademark, each of which had a positive low-double-digit million euro impact on the Group's financial results. And finally, Group royalty and commission income in the first quarter grew 7% to 22 million euro or 10% currency-neutral.

In sum, these factors led to a significant operating profit improvement of 349% to 260 million euro from 58 million euro in the prior year and a 7.5 percentage point operating margin uplift to 9.7%.

Let us now move over to the non-operating items of the P&L. Financial income and expenses both improved strongly, increasing 91% and decreasing 48% respectively. A positive swing in exchange rate variances from negative 19 million euro to positive 6 million euro as well as lower interest expenses due to the strong reduction of gross borrowings contributed to this development.

Taken together with the increase of operating profit, this resulted in income before taxes rising to 243 million euro from 9 million euro in the first quarter of 2009. The Group's tax rate came down 21.2 percentage points to 30.5%, due to a more favourable earnings mix.

As a result, first quarter income attributable to shareholders increased to 168 million euro from 5 million euro in 2009. This translates into basic and diluted earnings per share of 80 cents each. In the prior year period, basic earnings per share amounted to 2 cents and diluted earnings per share to 4 cents. Remember that following the full conversion of our convertible bond, we have no potential dilutive shares outstanding anymore.

Let's turn to the balance sheet, where we maintained the discipline we demonstrated last year.

At the end of March, Group inventories were down 20% currency-neutral or 17% in euro terms to 1.7 billion euro. This improvement relates to the significant reduction of sourcing volumes and clearance initiatives we executed in the second half of 2009. Expect inventory growth rates to return to normalised levels over the next one or two quarters as our organisation maintains its growth trajectory.

Accounts receivable were flat on a currency-neutral basis or increased 5% in euro terms to almost 2 billion euro. In light of our positive sales development, this reflects continued strict discipline in implementing the Group's trade terms.

Accounts payable increased 25% currency-neutral or 29% in euro terms to 1.1 billion euro due to higher production volumes and improved trade terms with our suppliers.

Therefore in summary, we were able to further decrease operating working capital as a percentage of sales, this time by 2.7 percentage points versus the prior year. The current level of 22.9% reflects a new record level for our Group.

Obviously, ladies and gentlemen, our success in managing operating working capital positively impacted net debt development. The improvements in Group profitability, the full conversion of our convertible bond and disciplined investment activity meant we were able to reduce net borrowings by more than 1.5 billion euro compared to the end of March 2009 to slightly below 1.4 billion euro.

With a ratio of net borrowings over 12-month rolling EBITDA of 1.4 times at quarter-end, we are comfortably within our target corridor of a ratio below two times. We are also on track to achieve absolute net borrowings below the prior year level at year-end.

So, ladies and gentlemen, I hope we were able to convey the improvements we have seen in our operating development and financial metrics this quarter.

Looking out on the rest of the year, we have good reasons to be optimistic: The Reebok turnaround is gathering pace and the FIFA World Cup™ is kicking off in just a few weeks. Of course, there is more work to do. But we have clearly seen that our organisation is able to turn challenges into success. We don’t expect this to change anytime soon. Therefore we have raised the bar and increased our full-year guidance.

And now, ladies and gentlemen, Herbert and I will be happy to take your questions.