FINANCIAL RESULTS PRESENTATION

First Quarter 2012 Speech

May 3, 2012

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

John-Paul O'Meara
Good afternoon ladies and gentlemen and welcome to our first quarter 2012 financial results conference call. My name is JP O'Meara and I head the Group's investor relations activities.

Our presenters today are Herbert Hainer, adidas Group CEO, and Robin Stalker, Group CFO. They will give you more detail on the outstanding operational and financial results in Q1, which we already pre-announced on Monday. So let's get the ball rolling and over to you Herbert.

Herbert Hainer
Thanks JP and good afternoon ladies and gentlemen. We have started the second year of our Route 2015 strategic plan exactly like the first – setting a blistering pace, leaving the competition in our wake. With currency-neutral sales increasing 14% or 17% in euro terms to over 3.8 billion euro, we recorded our fifth straight quarter of double-digit revenue growth.

Group operating margin improved 1.1 percentage points to 10.7%, driving earnings per share up 38% to a new first quarter record of 1 euro 38, or 289 million euro in net income.

And our balance sheet continues to be in top shape with net debt down 30% year-over-year, and operating working capital as a percentage of sales remaining close to record lows at 20.7%.

So what's behind this period of unprecedented growth and success the Group is enjoying? Well, it's quite simple. It's the result of our focused and consistent investment into our brands, channels and markets. Plus, it's our disciplined approach to managing our market opportunities during this period of economic uncertainty.

In this respect, it is striking when looking at our results that, in several regions, we have been able to decouple from many of the macro issues and industry headwinds. It's been a lot of work. But our drive for excellence in execution in everything we do, and the attention we give to understanding local market dynamics is clearly evident in our performance around the world. So let me take you through three examples of this seen in our first quarter.

First let's look at Greater China. With growth of 26% currency-neutral, there is no doubt that we are gaining share in this key market. Why?

- Because we have rebuilt our business patiently and with discipline since 2009.
- We have kept a razor-sharp focus on the quality of distribution, optimising the number and type of stores as well as their locations.
- And we have refined our product offering, brand marketing and visual merchandising to match a more sophisticated and maturing Chinese consumer.

I can assure you, our strong trends in Greater China will continue. Feedback from our partners clearly shows that adidas is "THE" brand with the most momentum. This fact is also verified by our own-retail store development, where traffic is high and comparable store sales increased 10% in the first quarter.

Another example is Western Europe. Here, in our home market, our success is driven by our deep understanding of how to execute in a mature market by continuously leveraging our strengths. With revenue growth of 7%, we have not only secured, but built on the significant market share gains of the last year.

We are achieving this by paying close attention to where the consumer shops, putting the right product in the right channels, improving consumer interaction through high-quality in-store and shop-in-shop initiatives, as well as best-in-class customer replenishment programmes.

This is particularly the case in the UK and Poland, which, as you know, have the backdrop of the world's biggest sporting events this summer. Sales in these markets are up 19% and 35% currency-neutral respectively, putting us on a clear trajectory to achieve market leadership positions in these countries, using the event platform as a catapult for our strategic plans.

Finally, in North America, our business remains very strong. Sales at adidas and TaylorMade-adidas Golf increased 10% and 33% respectively. At Reebok, excluding the impacts from the various licence changes and toning, sales were up 5% currency-neutral. More importantly, you can see that our presence at retail, particularly in the mall improves with each and every quarter. This is visible in the market share gains of all our brands, and validates that our strategies to win over the next generation consumer are in full swing. adidas in particular has seen very strong growth in footwear market share, which now stands at a double-digit level. And sell-in momentum was strong in Q1 with footwear sales up 22%.

These three markets give you some great examples of just how well we are executing across the globe. But this of course would not be possible without being able to excite consumers and customers with the ultimate in product innovations and brand experiences. So let me spend a few minutes on the brands and categories.

At adidas, currency-neutral sales increased 16%, our eighth consecutive quarter of double-digit growth. Even more impressive is the fact that adidas sales are up at a double-digit rate in all regions.

All of our core categories continue to gain momentum. Those that are touched by the major sports events have definitely been a key highlight. Football is obviously at the top of the list, with sales increasing 23%. And looking forward, conditions are perfect for us to extend our market share lead with some very significant product introductions and brand activation events now hitting the market.

For example, the best-selling boot in the market, the adizero f50, will be joined on field this Saturday by the new and highly anticipated Predator Lethal Zones which launched on Tuesday.

On May 19, we will witness an all adidas UEFA Champions League final between two of Europe's football heavyweights, Bayern Munich and Chelsea.

We also have just started introducing the new jerseys and match balls for the 2012/13 club season. Today, for example, we are presenting the third generation of the Bundesliga match ball, the "Torfabrik", of which we have sold more than one million balls in Germany since its introduction in 2010. And all of this is even before the main event, the European football championships, kicks off in Warsaw on June 8.

Our Olympic related product is also doing very well, with the Team GB offering designed together with Stella McCartney exceeding all of our expectations.

Another important category for us, especially in an Olympic year, is running. Sales are up 16%, driven by the continued success of our lightweight adizero offerings where sales are up over 40%, and the introduction of our most breathable running shoe to date, the new ClimaCool Seduction, which has seen sales in our Clima franchise jump over 80%. Given the close relation between running and the Olympics, we are also very visible in the market with our marketing instalments – "Are You Ready To Run?" and "We All Run".

In basketball, we also continue to see robust sales growth, with footwear in particular up a very strong 23%. The adizero Crazy Light 2, weighing just 9.5 ounces and nearly 10% lighter than the nearest competitor's basketball shoe, was launched at a 140 dollar price point just over a week ago, as our brand momentum enables us to move up the pricing ladder.

And to wrap up on adidas, in outdoor and Sport Style, growth rates show no sign of slowing versus the prior year, increasing 45% and 24%, respectively.

In particular, we are very satisfied with our NEO development, where sales were up almost 30% in the quarter. I am also pleased to report, even though it is early days yet, our 8 test stores in Germany are showing very encouraging signs, with traffic exceeding expectations, and the stores achieving our goals in terms of selling to a higher number of girls.

Moving over to Reebok, sales declined 7% currency-neutral, in line with our expectations. However, excluding the impact from shifting the reporting of

US-related NHL sales to the Reebok-CCM Hockey segment, the end of the NFL licence and excluding toning, Reebok brand sales increased 10% currency-neutral. The NFL impact, however, was rather small in the quarter as the contract just ended in March.

Although Reebok has some challenges to overcome in Western Europe this year, due to the weak economic environment, and as retailers currently focus on the major sporting events, we nevertheless continue to see good progress in most other regions.

In North America, sales were up 5% on a like-for-like basis and excluding toning, and profitability improved markedly due to a better price mix and an overall stronger product offering. In all other regions, sales were up for the quarter, as we expanded performance-related offerings like Zig and RealFlex, and introduced some new Classics product. On the latter, we are now starting to see some decent traction, with global Classics sales up 7% currency-neutral.

Taking all these factors together, this is having a positive impact on margins, with an improvement of 60 basis points in the brand's gross margin. Therefore, while I would have liked to have been able to show more top-line growth, our progress with the brand continues. Looking forward, our plans for 2013 will include some major product and technology launches. And we will be sharing more on this with you on our Investor Trip in September.

To finish on Reebok and as you will have seen in Monday's announcements, unfortunately, we discovered commercial irregularities at our Reebok business in India.

As there has been some misinterpretation, to be clear, this issue only relates to Reebok and its legal entity in India, and has nothing to do with the adidas brand or the adidas legal entity in that market.

Due to the sensitivity of the ongoing investigation, we cannot comment further than we already did on Monday. However, let me assure you that we have, and will continue to, vigorously pursue a course of action to protect our Group's interests.

The situation in India, although unfortunate, will allow us to now accelerate plans to improve a specific underperforming part of our business, which was already in the scope of our Route 2015 profit-enhancing initiatives. Under the new leadership team which was announced at the end of March, we will now accelerate and more aggressively restructure our business activities in India, including significant changes to our commercial business practices. The implementation of new commercial initiatives and terms could result in a reduction of our Reebok franchise store base with partners by about one-third, as we focus on maximising our future profitability in the market. These along with other planned actions could lead to additional one-time charges in the remaining quarters of 2012 in an estimated amount of up to 70 million euro. Rest assured, our goal is to begin 2013 with a clean sheet in this market.

Finally for today, I want to finish on a part of our business that often gets overlooked by the media and the financial community – TaylorMade-adidas Golf.

Our performance at TaylorMade-adidas Golf in the first quarter was simply breathtaking. With 32% currency-neutral growth, the segment achieved its highest growth rate in almost nine years.

This is even more significant as it comes on top of 20% growth last year. What’s behind the success? Well, it’s the innovative product line-up we have for today’s golfer across all categories.

Sales grew at double-digit rates in all club categories, apparel and footwear, with metalwoods up 28% and irons growing an amazing 64%. Our US market share in metalwoods was a staggering 50% in the first quarter at retail, and the gap to our closest competitors in irons has also expanded to now 8 points, with a share of almost 26%. Even more importantly, the strong increase in sales allowed TaylorMade-adidas Golf to double its operating profit compared to a year ago.

After achieving our goal to become the largest and the best performance golf company, we now are ready to pursue an even greater ambition - to be the best golf company in the world across all geographies, products and customer demographics.

In line with this goal, we have found a perfect fit with our planned acquisition of Adams Golf. The proposed combination of TaylorMade-adidas Golf and Adams Golf brings together two highly complementary sets of brands, combining TaylorMade-adidas Golf's focus on the younger and the low-to-mid handicap golfer, with Adams Golf's focus on game improvement as well as senior and women golfers. The total transaction cost is around 53 million euro, and we expect the deal to close later this quarter.

So ladies and gentlemen, looking at the big picture, we are right where we want to be. We are manoeuvring through the still challenging economic environment in a diligent way, while at the same time ensuring we capture the opportunities that will deliver on our promise – to secure long-term quality growth and enduring success for our Group.

All in all, there is no doubt that these results confirm the outstanding momentum and global power of the adidas Group. Let me now hand you over to Robin to take you through the financials and updated outlook in more detail.

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

As Herbert outlined, we enjoyed an exceptional start to 2012, with strong growth throughout the Group. As you have already been able to digest our headline figures over the past few days, I am only going to focus on a few topics today, which from my perspective include three important takeaways:

- First, our strong margin development despite significant gross margin pressures,
- Second, the power of this Group and our potential to leverage,
- And thirdly, the competitive advantage we are gaining from our balanced approach towards inventory management.

Starting with margins: Just as in other quarters, higher sourcing costs caused us quite a challenge, alone eating up 4.7 percentage points of Group gross margin in the first quarter. However, through focus and execution throughout the value chain we were able to lessen the impact to only 70 basis points. The biggest offsetting factors were:

- Firstly, the over-proportionate growth of sales in our Retail segment, which carries higher margins.
- Secondly, we had a more favourable product and regional sales mix. The latter mainly related to strong growth in higher-margin markets such as Greater China.
- And, finally, our hedging also provided some tailwind. However, I do not foresee this continuing throughout the year. In fact, it will be a slight negative in the coming quarters.

Despite the Group gross margin decrease, our operating margin improved a considerable 1.1 percentage points versus the prior year, coming in at 10.7%. This resulted in Group operating profit increasing 30% to 409 million euro.

While higher other operating income and royalty and commission income contributed to this development, more importantly, we were again able to leverage our strong top-line growth to bring down other operating expenses as a percentage of sales by 1.6 percentage points to 38.4%.

This was the fifth consecutive quarter our operating expenses increased at a lower rate compared to sales, a testament to our efforts to improve and leverage our investments. Looking at our segments, Retail again was a star performer, with segmental operating margin increasing by 1.1 percentage points to 16.6%. This confirms that the strategies and initiatives we are putting in place to drive retail excellence continue to bear fruit.

For the quarter, sales and marketing working budget expenditures increased 2%, amounting to 426 million euro. As a percentage of sales, the ratio came down 1.6 percentage points to 11.1%. For the full year, I expect this metric to be at a similar level versus 2011, at around 12.7%. As in most event years, our marketing spending this year will be focused on the event quarters, which are Q2 and Q3.

To complete the P&L picture, net financial expenses decreased 32%, which is mainly a reflection of an 84% increase in interest income as well as a 70% decrease in negative exchange rate effects. The first quarter tax rate came down 1 percentage point to 25.5%, which was predominantly due to a more favourable regional earnings mix. Please note that for the full year, I continue to expect our tax rate to be slightly above the 2011 level of around 28.5%.

As a result, net income attributable to shareholders increased 38% to 289 million euro. This translates into basic and diluted EPS of 1 euro 38, up from 1 euro a year ago. Although we issued a convertible bond in mid-March for an aggregate nominal amount of 500 million euro, there was no dilutive effect in the first quarter.

While I am on the subject of this extremely successful bond placement, let me help you with your future calculations, and how to calculate the dilutive effect. While it is clear you will need to adjust the number of shares by 5.99 million, don't forget you will also have to add back an after-tax amount of around 9 million euro to net income attributable to shareholders. This means that the convertible should only be about 1% dilutive.

By segment, currency-neutral Wholesale revenues increased 10%, driven by growth in all regions except North America. Other Asian Markets and Greater China performed exceptionally well, growing at 29% and 27% on a currency-neutral basis, respectively.

In the Retail segment, sales grew 16% on currency-neutral basis or 20% in euro terms to 693 million euro. Our comparable store sales continued to drive our Retail performance, posting a 9% currency-neutral increase, with North America and Latin America being the outstanding highlights, as comp store sales increased 17% and 14%, respectively.

At the end of the first quarter, we operated 2,422 stores, a net increase of 21 stores or 1% versus December last year. During the period, we opened 110 new stores and closed 89 stores, while 30 stores were remodelled. In addition, 58 concept stores were reclassified as stores in other retail formats and one concept store was reclassified as a factory outlet.

Finally, the pinnacle of our Q1 performance by segment was that of our Other Businesses, where sales rocketed 32% currency-neutral. This outstanding performance was mainly a result of the phenomenal 32% sales increase at TaylorMade-adidas Golf as Herbert already described. Sales at Reebok-CCM Hockey also increased strongly at 69% currency-neutral, supported by the NHL licence shift from Reebok. But even excluding this effect, Reebok-CCM Hockey sales soared at a strong double-digit rate. Rockport sales also improved versus Q1 2011, with growth of 7% currency-neutral.

Looking now to the balance sheet, ladies and gentlemen, we also have some really positive news to share with you today. The hard work and extra discipline we have instilled throughout the organisation on working capital management since the economic crisis began is now turning into what I consider a real competitive advantage.

At the end of March, our Group inventory growth rate again slowed to 13% currency-neutral, from 16% in the prior quarter. In addition, the inventory ageing profile has also improved. Considering our consistent efforts to balance inventory management between planning for growth and keeping markets and channels clean and fresh, I believe we are in the industry's best and healthiest inventory position. This will ensure we can capitalise on our tremendous product pipeline, which will allow our brands continue to excite consumers and customers around the world.

Finally on our results, ladies and gentlemen, the strong operating cash flow generation over the last twelve months contributed to a meaningful reduction of net borrowings. At the end of March, our net debt stood at 640 million euro, equating to a decrease of 274 million euro or 30% versus the prior year.

In addition, our equity ratio has also improved considerably, increasing 2.9 percentage points to 48.1% at the end of the first quarter.

Taking into account this exceptionally strong first quarter financial performance, which was better than we had initially expected, the continuing strong momentum of our brands in key markets, as well as the negative impacts from potential one-time charges related to our planned restructuring of activities at Reebok India, we are in a position to increase our outlook for 2012.

Full year sales are now expected to grow at a rate approaching 10% on a currency-neutral basis, compared to our original projection of a mid- to high-single-digit increase. This is as a result of an increase in sales expectations in Wholesale and Other Businesses.

Despite first half input cost pressures, we continue to forecast a stable gross margin compared to the prior year. In addition, operating margin is expected to increase to a level approaching 8%, despite the negative one-time charges of up to 70 million euro.

Putting it all together, net income attributable to shareholders is expected to increase at a rate of between 12% and 17% to a new record level of between 750 million euro and 785 million euro, translating into basic earnings per share of 3 euro 58 and 3 euro 75. This is also above our initial guidance, in which we projected an increase of between 10% and 15%.

In summary, our strong start to the year is a testament to the consistent investments we have made in building brand equity. This is clear across our brands and channels, in our industry leading growth rates, and in the direction of our margins. And with our strong balance sheet and clean inventories, we have all the resources we need to continue driving forward with our Route 2015 ambitions.

Now, Herbert and I will be happy to take your questions.