adidas GROUP

FINANCIAL RESULTS PRESENTATION

First Quarter 2013 Speech

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John-Paul O'Meara

Good afternoon ladies and gentlemen and welcome to our first quarter 2013 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 Robin Stalker, Group CFO.

To allow for ease of comparison, all sales and revenues related growth rates will be discussed on a currency-neutral basis, unless otherwise specified.

So, let's get started and over to you, Herbert.

Herbert Hainer

Thanks JP and good afternoon ladies and gentlemen.
As you will have seen in our release this morning, we are off to a good start in 2013.

Group sales remained on par with the prior year. Excluding the impacts from exiting the NFL contract, revenues increased 1%.

Put into context, this is a strong performance considering the robust event-related sales we enjoyed from the UEFA EURO 2012 and the London 2012 Olympic Games in the prior year, where first quarter sales grew 14%.

Even more importantly, and, as we have committed to for 2013, we visibly improved profitability with the Group operating margin increasing 1.1 percentage points to 11.8%. This, in turn, lifted earnings per share up 6%.

A cornerstone of our Route 2015 strategy is to ensure we drive quality growth for all of our brands. This is based on two principles: relentless innovation in our strategic growth categories and flawless execution at the point of sale in all of our markets. So let's take a look at how we delivered on these principles around the world in the first quarter.

Without doubt, the key highlight has to be the considerable success we continue to enjoy in the emerging markets. We pride ourselves on the attention to detail we put into being close to the consumer in every market we operate in. And this dedication is clearly visible with the 12% growth in Latin America and 6% growth in Greater China we generated in the quarter.

In Latin America, the adidas brand is firing on all cylinders ahead of this summer's football action in the region, with sales for the brand increasing 19%.

In Greater China, we continue to benefit from our healthy market position and in-depth consumer and customer knowledge, most notably in the lifestyle space, where sales increased at a strong double-digit rate.

In the European Emerging Markets, growth also continued with sales increasing 3%, driven by both the adidas and Reebok brands. This is also a solid performance given a challenging retail environment in Russia/CIS in the early months of the year.

In Western Europe, not surprisingly sales declined 6%. Growth in France, Poland and most of the Nordic countries was more than offset by declines related to the difficult consumer conditions in Southern Europe as well as the high comparisons from the prior year event-related sell-in, most notably in the UK. In Other Asian Markets, sales declined 4% as strong double-digit growth in South Korea and Pacific was more than offset by declines in Japan due also to the tough comparisons of the prior year.

And finally North America, where I am pleased to report that sales for the Group reaccelerated in the first quarter, rising 3%. Excluding the NFL impact, revenues in the region increased 7% driven by a 5% increase at adidas and a 19% jump at TaylorMade-adidas Golf.

Moving over to the brands, while we were definitely running up against some high numbers, the adidas brand again came out on top, highlighting the fantastic global appeal and the strong multi-category offering we have at our disposal.

Sales increased 1% for the quarter due to double-digit growth rates in all of our key strategic Route 2015 performance categories: running, basketball and outdoor. The strong consumer reaction to our latest innovations and fresh designs also meant that adidas was the most significant contributor to the Group's margin improvement in the quarter, as gross margin rose 1.8 percentage points.

In running, sales increased 12% driven by strong growth in footwear and apparel. There is absolutely no reason to doubt that Boost is the most significant innovation the market has seen in many years. Currently incorporated in three running models, the new technology has been a hit with industry experts, elite athletes and consumers alike.

The Energy Boost has already rapped up several coveted industry awards, including Runner's World "Best Debut", Running Network's "Best New Shoe" and Shape Magazine's "Best Cushioning" awards. Our elite athletes are already racking up medals wearing Boost products, with Dennis Kimetto winning the Tokyo Marathon in a course record in the adizero Boost.

From a commercial standpoint, Energy Boost has been our most successful running launch ever, with many markets almost completely sold through in the first four weeks. We also had record-breaking pre-sales on our own eCommerce platform, three times more than any footwear model before.

With more volume coming in the second half of the year, we are only getting started with our running revolution. Through further launches of Boost and several other new technologies we have in the pipeline, we are creating new territory and market share potential for the adidas brand, which I am convinced will lead to several years of double-digit growth in the footwear industry's most important category.

Not to be outdone, in basketball, we enjoyed another great quarter with sales increasing 18%. North America was again the standout market, with footwear sales increasing over 45% as our market share continues to edge higher.

And during the quarter we have been busy preparing to introduce our next basketball silo. On Wednesday we celebrated the retail introduction of the new Crazyquick franchise which will feature John Wall and 2012/2013 NBA Rookie of the Year Damian Lillard.

Another important category that saw momentum accelerate in the first quarter was Outdoor, where sales increased 21% on top of 45% in the prior year. Strong growth in the Terrex Fast R and Swift Solo product families spurred significant growth in fast-growing outdoor markets such as Greater China, Brazil and South Korea.

To wrap up on adidas, growth in adidas Sport Style also continued, with sales increasing 4%. This was driven by a strong performance in Action Sports where sales increased over 50%, supported by new collections in Skate and the introduction of our new Snowboarding franchise.

Also the adidas NEO label continued to win with the young consumer around the world as sales grew 9%. With the high visibility we created at the Selena Gomez collection launch event in New York in spring, the global potential of adidas NEO is undeniable. Our test stores in Germany also underline the full potential of this sub-label as we have seen a steady improvement across all of our key KPIs as we implement the learnings we have acquired over the first full year of operation.

Turning now to Reebok, overall, the first quarter was in line with our expectations, as we built on the momentum we started to create last year with our House of Fitness category priorities.

With this quarter, we are also now fully through with the challenging comparisons resulting from the end of the NFL contract and the discovery of issues at Reebok India this time last year. Excluding these effects, sales were down modestly in the quarter, and more importantly profitability significantly improved, with gross margin increasing 1.5 percentage points driven by new product launches. For example, in fitness training, our Delta apparel and CrossFit ranges continue to do very well, growing 13% in the quarter. In Classics, we saw a big acceleration in momentum with particularly strong sell-throughs from new silhouettes in retro basketball driving sales up 33%.

During the quarter, we also evolved and improved our digital and e-commerce capabilities for Reebok, introducing a new fitness instructor platform, ReebokONE, and a highly intuitive fitness app which allows consumers to customise their own workouts. As we build on all of these initiatives throughout the year and introduce more volume in footwear by expanding new lines such as ATV, DMX Sky and ZigCarbon into the back-to-school season, I am confident you will see reported growth and margin improvements as promised in 2013.

Finally for my review today, let me spend a few minutes on TaylorMade-adidas Golf where we have had another outstanding quarter. Sales increased 13%, or 9% in euros, to 423 million euro. Excluding the acquisition of Adams Golf, sales increased 5%.

Key to our success this year has been our ability to exert the same kind of dominance we have shown for over a decade in metalwoods also in several of the industry's other key categories. For example in irons, we continue to drive market shares higher, thanks to the strong consumer reception to the RocketBladez family. In fact, in the US, our market share is now almost 31%, which is nearly double that of the number two brand.

In footwear and balls, we also saw market share improvements, driven by exceptional growth of over 20% in each category. The highly successful introduction of our lightweight technology adizero to the footwear category and the new family of Lethal golf balls were just some of the products that resonated with consumers during the quarter. Even our smallest brand, Ashworth, showed strong momentum, with sales increasing 32%, highlighting that our efforts to build consumer interest by expanding Ashworth's presence on golf's major tours is paying off.

Looking forward, I fully expect growth to continue in all facets of our golf business. In particular, with Adams Golf we have a third brand with great potential. And in categories such as balls, where we have significant market share potential, we are reinforcing our commitment to attack this opportunity. Our recent announcement that we will construct a new golf ball manufacturing plant in South Carolina is a great example of this.

So ladies and gentlemen, as you can see the adidas Group is fit and healthy and we are right on track to deliver on our three key goals for the year. As a reminder these are:

a) To deliver a step change in margin progression,

b) To seed game-changing product innovations to accelerate growth in key categories,

c) And to maintain a steady course for the Group against a mixed economic backdrop.

There is plenty to look forward to in the coming months and you will see a lot of activity from all of our brands throughout the second quarter to set us up for a strong second half. Some of these I have already mentioned in my speech today, but there is one other that I would like to leave you on today.

In just a few short days, we will introduce a revolutionary new fourth football silo – Nitrocharge, which is destined to become the next iconic football boot of our industry. You will hear a lot more about this in the build-up to the first all-German UEFA Champions League final featuring Bayern Munich and the all-adidas EUROPA League Final between Chelsea and Benfica.

With that, let me now hand you over to Robin to take you through the financials and outlook in more detail.

Robin J. Stalker

Thank you, Herbert, and good afternoon ladies and gentlemen. As you have just heard, our Group delivered a solid financial performance in the first quarter of 2013. For my comments today, I will focus on three topics:

a) The reasons for the strong development of our gross and operating margins,

b) A look at our performance by channel and segment,

c) And finally, our continued progress and discipline in balance sheet and cash management.

So let's start with the clear highlight of the quarter from a financial perspective – the gross margin development. The Group's gross margin increased an outstanding 2.4 percentage points to a new record level of

50.1%. This is only the second time in our history that we have generated a gross margin above 50%.

As opposed to the majority of the period since we began Route 2015, we were able to capture more visibly the positive impacts from pricing and product mix as well as regional and channel optimisation, due to fewer headwinds from sourcing costs. For the quarter, input costs were essentially flat and hedging was only slightly negative. However, the negative impacts of the latter will, I expect, become much more pronounced in the coming quarters.

Turning to operating expenses, we continue to tightly balance our investment needs while also ensuring we control growth in our overhead base. This can be seen in other operating expenses increasing only 1% in the quarter. That was mainly a result of higher marketing expenditure as well as the further expansion of the Group's own-retail activities. As a percentage of sales, other operating expenses were up 1.2 percentage points to 39.5%.

Thereof, sales and marketing working budget expenditure increased 3%, due to an 8% increase for the adidas brand to support our key innovation launch Energy Boost, as well as campaigns such as myGirls and Unite all Originals which have all been key traffic drivers in recent weeks. As a percentage of sales, sales and marketing working budget increased 50 basis points to 11.6%.

As a result of the modest growth of expenses and the strong gross margin improvement, Group operating profit increased 8% to a new record level of 442 million euro. This translates into an operating margin of 11.8%, up 1.1 percentage points compared to a year ago.

Turning briefly to the non-operating items of the P&L: Net financial expenses decreased 23%. This mainly reflects a 31% decrease in interest expenses due to lower gross borrowings.

The first quarter tax rate increased 200 basis points to 27.5%, which is in line with our guidance for a full year tax rate at a level between 28.0% and 28.5%. As a result of the higher tax rate, net income attributable to shareholders increased 6% to 308 million euro.

Let me now spend a few minutes on our segments. Wholesale revenues decreased 3% in the first quarter, as sales growth at adidas Sport Style was more than offset by double-digit revenue declines at Reebok which were mainly due to the NFL, the JV in Latin America and lapping the issues in India that affected our results this time last year.

Gross margin for the segment was up 2.6 percentage points to 44.3%, driven by pricing as well as a more favourable product and regional sales mix.

Segmental operating margin for Wholesale rose 3.4 percentage points to 36.0%, as a result of the gross margin increase as well as the positive effect of lower segmental operating expenses as a percentage of sales.

Looking at Retail, revenues increased 6% as a result of growth at both adidas and Reebok. Comparable store sales were slightly down 1% versus the prior year, as double-digit sales growth in concession corners was more than offset by decreases in concept stores and factory outlets. By brand, Reebok comp store sales remained stable in Q1 while adidas comp store sales decreased 1%. Our eCommerce business continued to go from strength to strength, with sales up 68%.

Retail gross margin decreased 80 basis points to 60.7%. Increased promotional activities in certain markets, particularly those still affected by weak economic conditions, led to this development.

Segmental operating margin for Retail was down 2.6 percentage points to 14.0%, resulting from the gross margin decrease as well as higher segmental operating expenses as a percentage of sales. The latter is due to the higher store base compared to a year ago.

Looking at the 1% comparable store sales decline, it should be no surprise that the majority of this decrease is due to the difficult trading environment in Western Europe and Russia/CIS at the beginning of the year given the overall weakness in traffic and consumer sentiment. Beyond these regions, Retail trading actually was quite robust.

Comparable store sales were up 8% in Greater China and even 13% in Latin America. And, the adidas brand in North America showed very good comparable store sales growth of 6% on top of the very strong 20% comp growth in the prior year.

As the first quarter is the smallest in our Retail calendar and normally an off-season period in our stores, I would not draw too many negative conclusions from this performance. In fact, looking at the gradual improvements in recent weeks, I can fully reiterate our Retail guidance, where we expect to see comparable store sales growth of low- to mid-single-digit for the year.

In terms of our store development, at the end of the first quarter, we operated 2,458 stores, a net increase of 12 stores versus end of December. Of the total number of stores, 1,372 were adidas and 349 were Reebok branded. In addition, the adidas Group Retail segment operated 737 factory outlets. During the first quarter, we opened 92 new stores and closed 80 stores, while 37 stores were remodelled.

To wrap up on our operating segments, let me spend a minute on Other Businesses. Revenues grew 9%, driven by 13% growth at TaylorMade-adidas Golf. While revenues at Rockport increased 2%, sales at Reebok-CCM Hockey were down 18%. This was due to the NHL lockout, which unfortunately continued into the start of the year. As a result of the slow rebound in the hockey market, we are now slightly reducing our sales outlook for Reebok-CCM Hockey to mid- to high-single-digit currency-neutral growth for the year.

The segmental gross margin increased 90 basis points to 44.6%, mainly as a result of the higher weighting of TaylorMade-adidas Golf.

Segmental operating margin was up 2.6 percentage points to 31.3%. This was due to the positive effects from a higher gross margin as well as lower segmental operating expenses as a percentage of sales, due in particular to the strong growth at TaylorMade-adidas Golf.

Finally, looking at the balance sheet, we continue to manage our capital prudently and diligently. Compared to the prior year, we have maintained our discipline on inventories, which declined 2% currency-neutral. As a result, our operating working capital as a percentage of sales remains at a very low level of 20.3%.

This, combined with our strong operating performance, led to a decline in cash used in operations, allowing us to reduce net debt by 72% or 460 million euro to 180 million euro. Taking all of our capital management measures together, we have seen another strong increase in our equity ratio, which is up 2.7 percentage points to 49.7%.

In conclusion, the solid first quarter results reinforce our confidence in the aspirations we set for the year in March. Given the strong reception to our latest product innovations and our full pipeline for the second half of 2013, our earnings momentum is set to accelerate as we move through the year.

We continue to expect full year sales to grow at a mid-single-digit rate on a currency-neutral basis. Given the health of our inventories in the market and the continued desirability of our brands, we now expect to achieve the upper end of our gross margin guidance of 48.0% to 48.5%. This further underpins our operating margin target of approaching 9.0% for the year. Despite continued negative currency translation headwinds from currencies such as the Japanese yen and the Argentine peso, we continue to forecast net income attributable to shareholders to increase at a rate of between 12% and 16% to a new record level of between 890 million euro and 920 million euro.

So ladies and gentlemen, on that positive note, let me thank you for your attention, and Herbert and I are now happy to take your questions.