FINANCIAL RESULTS PRESENTATION

Nine Months 2013 Speech

November 7, 2013

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

John-Paul O'Meara

Good afternoon ladies and gentlemen and welcome to our nine months 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.

It has been a busy, exciting but also challenging first nine months for the adidas Group. While I am disappointed we had to reduce our 2013 full year guidance in September, on balance, we continue to make good progress on our most important Route 2015 strategic initiatives.

Despite the mounting headwinds from negative currency movements as well as a softer than originally expected performance in some of our key markets and segments, I am pleased to report that we delivered stable earnings for the first nine months.

The key financial highlights of the first nine months were as follows:

- Sales remained stable currency-neutral or declined 4% in euro terms to 11 billion euro
- Gross margin increased 2.1 percentage points to a nine months record level of 49.8%
- Operating margin increased 40 basis points to 10.5%
- And earnings per share was virtually unchanged at 3 euro 81 cents.

Starting with the negatives, three areas in particular obstructed our initial growth plans in the quarter and also for the year as a whole. Firstly, and most severely, the persistent weakening of several currencies versus the euro throughout 2013, such as the Japanese yen, Brazilian real, Argentine peso, Turkish lira, Russian rouble and Australian dollar, has put a significant strain on our reported results in euro terms. In the third quarter alone, Group sales suffered a 7 percentage point negative impact from currency movements. Accumulated for the first nine months, currencies wiped out 500 million euro from our top-line result.

Secondly, in one of our most important Route 2015 markets, Russia/CIS, we had an unexpected short-term distribution constraint in Q3 as a result of the transition to our Group's new distribution facility in Chekhov, close to Moscow. This significantly impacted the quantity of new product deliveries to stores, which was a major contributor to the double-digit comp store sales decline we saw in that market during the third quarter. Our Global Operations and local management teams have worked speedily to rectify the matter, and I am pleased to report that we are making good progress on returning the shipping quantities back to normal levels.

Thirdly, due to the continued softness in the global golf market, where TaylorMade-adidas Golf is the dominant leader, we took the decision in the third quarter to be more consequent and accelerate the rebalancing of inventories to healthier levels in the marketplace. As a result, sales declined 16% in the segment in the third quarter and gross margins decreased over 10 percentage points due to additional markdowns and incentives. This alone had a 70 basis point negative impact on the Group's gross margin performance in the third quarter.

Again here, our actions have delivered the desired result. I am confident we will see a solid fourth quarter, which will be driven by recent product launches such as the SLDR driver and fairway woods, as well as our new Speedblade family of irons.

Quick and focused actions like these show our Group's determination to always be at the forefront of creating consumer excitement in our industry. And while we had our challenges in the period under review, these were definitely outnumbered by considerable and broad-based successes in many of our categories and regions.

These successes include:

a) the continuation of our industry-leading momentum in key emerging markets, with sales in Latin America and Greater China increasing 15% and 7%, respectively.

b) strong growth in our focus adidas performance categories, where running revenues in particular were up a healthy 14%, with growth in all regions due to groundbreaking product innovations such as Boost and Springblade.

c) continued success in sports lifestyle with Originals & Sport Style sales up 4%, driven by strong market share gains in the action sports category, where sales jumped over 60%.

d) the further distribution roll-out of our highly successful teenage label, adidas NEO, where sales expanded 12%.

e) and finally, strong improvements again in the quality of the Reebok business. Sales grew 5% in the third quarter and gross margin expanded 6.4 percentage points to 40.4%, the highest level we have achieved with the brand. Excluding the NFL licence impact, Reebok revenues are up 3% year-to-date, and I can confirm that Reebok will grow for the year as a whole.

These positive developments clearly highlight the effective execution of our strategy to fundamentally improve the long-term sustainable profitability of our brands and our Group.

To ensure we continue to drive these kinds of results in all of our key markets, we have been working diligently behind the scenes on the further implementation of organisational measures to drive faster and more efficient decision-making processes as well as ensuring we more fully leverage the power of our Group.

As such, to continue to lead the game on our home turf, we recently announced our decision to go forward with one aligned strategy for Western Europe. There is no question that Europe is changing: country borders are becoming less relevant for both our consumers and customers. They are looking for the best product and they want it fast. This strategic initiative therefore will harness even more the potential of our innovative brands by driving higher levels of excellence in our routes-to-markets and back-office functions.

Similarly, to maximise the potential of both adidas and Reebok in North America, we are uniting both organisations under one management team. Our goal is to strengthen, invest and enable faster growth for both brands following the good work of the past three years where we have been winning with our key consumers – namely the High School Kid for adidas, the Fit Generation for Reebok and the avid sports fan through our Sports Licensed Division.

To ensure our brands remain focused on their respective objectives, Portland will remain the home of the adidas brand in the U.S. and the Reebok brand will continue to be based in Canton. Each location has a unique and powerful culture grounded in the respective brand's values and goals. We want to continue to foster the positive effects of this energy and, at the same time, harness the collective power of both brands. The dual location approach will also enable us to have a strong East and West Coast presence for our customers.

I am convinced that both of these initiatives will drive our competitive position to new heights over the coming years and will give us a stronger and more effective platform to further improve and extend our market shares.

In terms of current trading in these important markets, both have started to trend in the right direction. In Western Europe, where revenues were down 6% in Q3, sales were again impacted by the comparisons with last year's sport events. In particular products related to the London 2012 Olympic Games accounted for approximately two percentage points of the decline.

However, in core countries such as Germany, for example, revenues have turned positive during the third quarter, with running and NEO being particularly strong. Moving into the fourth quarter and on into 2014, I am sure the positive trend will gather pace and become more widespread.

Moving over to North America, sales decreased 1% in the first nine months and 5% in Q3, mainly due to the sales declines at TaylorMade-adidas Golf. For adidas, sales remained stable in the first nine months, as growth in Sport Performance, led by training, was offset by declines in other categories. At Reebok, sales in North America excluding the NFL impact are up 2% year to date. Just like in Western Europe, also in North America, trends are picking up for both brands, particularly adidas which saw running deliver double-digit growth in the third quarter. With more volume of Boost and Springblade hitting the market in the next few months, as well as the current above-expectations sell-throughs we are seeing on the D Rose 4, I am also confident we will see momentum accelerate in North America as we turn into the new year.

I will come back to the fourth quarter in more detail in a moment, but before that, let me hand over to Robin to go through the rest of the nine months financials in more detail.

Robin J. Stalker

Thank you Herbert, and good afternoon ladies and gentlemen. When looking into our key financial KPIs, let me reiterate what Herbert has said, that our Group's discipline and focus on improving the fundamentals of our business continue to show that we are making good progress.

These fundamentals are best represented by our gross margin, which increased a strong 2.1 percentage points to 49.8% in the first nine months, and 1.9 percentage points in the third quarter to 49.3%.

This performance was driven again by product and pricing mix, as well as regional and channel mix, which more than offset negative effects from a less favourable hedging rate as well as lower margins at TaylorMade-adidas Golf. The negative hedging effect amounted to 50 basis points in the third quarter and 70 basis points in the first nine months, while the impact of markdowns at TaylorMade-adidas Golf reduced the Group's gross margin by 70 basis points in Q3 and 40 basis points year-to-date.
With the exception of TaylorMade-adidas Golf, gross margin increased in all brands and channels.

By channel, gross margin for the Wholesale segment was up 2.7 percentage points for the quarter and year-to-date, driven by pricing as well as a more favourable product and regional mix. Retail gross margin increased 2.5 percentage points to 61.5% for the third quarter and 1.6 percentage points to 62.6% in the first nine months, mainly due to a more favourable pricing and product mix.

Looking at our operating expenses, other operating expenses as a percentage of sales were up 2.6 percentage points for the third quarter and 1.9 percentage points for the first nine months. This was due to

a) the accelerated pace of own-retail roll-out,
b) investments in the Group's infrastructure,
c) and the decreased leverage due to the lower top-line growth than originally expected.

Sales and marketing working budget as a percentage of sales increased 90 basis points to 11.7% for the third quarter and were up 40 basis points to

12.1% for the nine months period. Nevertheless, due to the strong gross margin improvement year-to-date, Group operating margin expanded 40 basis points to 10.5%. In the third quarter, operating margin improved 10 basis points to 11.9% compared to a year ago.

During the third quarter, we added 69 stores to our Retail portfolio, bringing our net openings for the year to 165. At the end of the third quarter, our Retail segment operated 2,611 stores. Of the total number of stores, 1,483 were adidas and 369 were Reebok branded. In addition, we operated 759 multi-branded factory outlets. During the first nine months, we opened 375 new stores, 210 stores were closed and 86 stores were remodelled.

While on Retail, revenues in the third quarter and first nine months grew 6%. Comp store sales however were down 3% for the quarter and 2% for the first nine months. Beyond Russia/CIS, Retail trading was quite robust during the third quarter, as most other regions posted comp store sales increases, with Latin America and Greater China being particularly strong. By brand, adidas comp store sales were down 2% for the quarter and 1% year-to-date. Reebok comp store sales decreased 7% and 4% for the quarter and the first nine months, respectively. Our eCommerce business continues to do extremely well, with sales increasing 57% in the third quarter and 67% for the first nine months to 166 million euro.

Moving back to the P&L: Looking briefly at the non-operating items of the P&L, net financial expenses decreased 7% in the first nine months. While net interest expenses were down 21% due to lower gross borrowings, this good progress was partly offset by higher negative exchange rate variances which increased to 13 million euro from 6 million euro in the prior year. First nine months tax rate decreased 10 basis points to 27.7%.

Looking at the balance sheet, operating working capital as a percentage of sales increased 70 basis points to 20.6%, due mainly to an increase in inventories. At quarter-end, inventories were up 12% on a currency-neutral basis, which reflects an increase in goods in transit given our Group's expectations for accelerated growth in the coming quarters, as well as higher inventories in Russia/CIS due to our recent distribution centre issues. To rectify the latter, we have adjusted our 2014 inventory buy accordingly, and I expect our inventory levels in Russia to normalise in the first half of 2014.

In terms of capital structure, our operational performance over the last 12 months led to another period of good cash flow generation resulting in a further reduction in net debt and an increase in our equity ratio. At quarter-end, this is reflected in the 47% year-over-year decline in net debt to a level of only 180 million euro and an equity ratio increase of 80 basis points to 49.3%.

So, to wrap up ladies and gentlemen, we are showing disciplined progress on our journey towards long-term sustainable value creation. This starts and finishes with creating desirable brands and driving quality growth. Our margins show we are doing just that.
This together with our strong control of inventories, particularly in our most challenged markets, ensures we can readily exploit our opportunities in the coming quarters. Therefore, on that note, let me hand back to Herbert who will give you a sneak preview of some of the exciting initiatives we have planned.

Herbert Hainer

As I mentioned earlier, with strong demand for our highlight concepts and innovations, upcoming initiatives around the 2014 FIFA World Cup and positive customer feedback to our spring/summer 2014 collections from all of our brands, momentum is clearly returning to our business. We already see some notable improvements in several key markets. Therefore I can reconfirm the guidance we gave you in September where we expect low-single-digit currency-neutral sales growth for the year and earnings per share to increase at a rate between 4% and 7%.

Driving these improvements will be our relentless pursuit of creating premium experiences for our athletes and consumers, and I can assure you there is plenty more in the pipeline in the coming months to be excited about, all of which will fuel a much stronger result in 2014.

This starts with football where yesterday we kicked off a fully integrated global attack which you will see us build on each and every month up to and including the 2014 FIFA World Cup in Brazil, across footwear, apparel and hardware.

This will consist of our most comprehensive footwear offensive ever which was the centrepiece of yesterday's campaign launch. The campaign kicked off with all four of our key football boot silos being featured in a creative World Cup themed pack called the Samba collection. This will be followed up next week with the launch of the federation jerseys, and in December the always highly anticipated official match ball introduction.

In the fourth quarter, we will also continue intensifying the roll-out of our industry-disruptive award-winning Boost technology by extending the technology into a broader range of adidas running franchises, as well as the further drops of Springblade, which is one of the hottest products in the US right now.

And speaking of eye-catching and disruptive technologies, we will further unleash the potential of our interactive training and coaching technologies, where our miCoach SMART RUN is certainly a game-changer. SMART RUN is the most advanced and most intuitive wrist-based running device on the market today, completely eliminating the need for cables, straps and additional sensors. Activated commercially for the first time at the New York City marathon (which was won by adidas star Geoffrey Mutai in the adizero adios boost), this is the beginning of a wave of new miCoach technologies that I am sure will grow in prominence throughout 2014.

Similarly, this winter sees a change in our pace of attack in the apparel category, with the introduction of the new ClimaWarm+ range developed with adidas ambassador David Beckham. By using hollow fibres that trap air to create insulation, the technology not only increases warmth but also reduces the garment's weight, giving the athlete an optimised warmth-to-weight ratio to maximise comfort and performance when training in cold conditions.

In basketball, we will leverage the return of Derrick Rose as the centrepiece of our basketball offensive,

and we will continue to add depth to our opportunity by broadening our activities with our portfolio of next-generation NBA stars to cultivate growth in apparel as well as in our key footwear technology silos such as Crazylight.

Finally for Reebok, we will continue to amplify the brand's holistic fitness positioning with the further global roll-out of our FitHub concept through own retail and shop-in-shops. Designed to inspire the fit generation, and to showcase the brand's pinnacle footwear and apparel offering, Reebok FitHubs are changing consumers' perception of the brand by solidifying Reebok's image as THE fitness brand.

In addition, we will also continue bringing energy to Classics, introducing several silhouettes in basketball as well as leveraging the current strength of the GL6000 franchise, which is one of the hottest products on the lifestyle scene, particularly in Asia, this year.

In summary, we have dealt swiftly and decisively with our challenges in 2013. Looking at the quality of our margin development, there is no doubt that our industry-leading innovations, strong partnership activations, and keen understanding of the global consumer, are clearly enhancing our position as the premium multi-sports company in the industry.

Great success is achieved by those with the ambition, desire and persistency to constantly improve, accept challenges as normal, and openly embrace change. This mentality is at the core of the adidas Group's philosophy and why we are fully committed to the course we set out on with our Route 2015 strategic plan. I am confident in the plan. And I am confident in our ability to execute against it.

I look forward to sharing more details on that front with you at our Investor Field Trip which will take place here in Herzogenaurach on December 2-3.

With that, we are now happy to take your questions.