FINANCIAL RESULTS PRESENTATION

Nine Months 2014 Speech

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Good afternoon ladies and gentlemen and welcome to our first nine months 2014 financial results conference call. Our presenters today are Herbert Hainer, adidas Group CEO, and Robin Stalker, Group CFO.

To allow for ease of comparison, all sales-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.

Our financial performance in 2014 has not lived up to our high standards. Although we have enjoyed encouraging and solid top-line growth in the majority of our key categories and markets, significant negative headwinds from our golf business, weakening consumer sentiment in Russia/CIS and unfavourable currency movements have held us back from growing our bottom line.

In any sport, to reach your goals, tactics and desire are critical to compete and win. We are here to do both. And while certain external factors have gone against us over the last 18 months, we know we have to raise our game especially in difficult conditions. Over the last months, we have acted quickly and urgently, implementing a series of initiatives to drive more consistent growth and more profitability for our Group. So what have we done:

- We have been proactive taking decisive steps to stabilise the underperforming areas of our business, particularly at TaylorMade-adidas Golf.
- We have adjusted our investment plans to account for current market risks, with Russia being a key focus,
- We have completed a major reorganisation of roles and responsibilities in our marketing and sales organisations, to speed up decision making.

- We have stacked talent, both internal and external, to revive momentum and growth in North America.
- We have increased marketing spend particularly in the developed markets.
- We are working swiftly preparing our next strategic plan, taking the powerful capabilities we have built during Route 2015 and applying them with more vigour and intent.
- And finally, we have adjusted our capital management and shareholder return policies. The current low interest rate levels are a good opportunity to reduce our cost of capital, and ensure we are well funded for future investments and shareholder returns.

Before I get into the results of the last quarter, let me give you an update on some of these areas, starting with those that have most affected our results in 2014.

TaylorMade-adidas Golf has been our weakest performer in 2014, with sales declining 29% and an operating profit deviating by around 150 million euro compared to the prior year level. While the sport has structural challenges with declining participation levels, the biggest headwind to a faster recovery is the amount and slow liquidation of old inventories in the marketplace.

Therefore, we have remained laser-focused on inventory management, taking a leading and responsible role for the industry clean-up. We purposely chose not to chase sales for the second half of 2014 despite being up against the successful launch of the SLDR driver last year.

We also completed the major elements of the restructuring programme we announced in August during Q3, commencing the closure of our Adams Golf facility in Plano, Texas, and reducing our golf segment global workforce by around 15%.

These actions amounted to a charge of around 10 million euro in the third quarter. As a result of all these steps, I am confident we will stabilise and grow sales and margins in 2015, returning the segment to profitable levels.

Turning to Russia/CIS, a market that is highly prosperous for us but also facing significant near-term challenges. In the first nine months, sales in Russia/CIS increased 18%. While this is positive, negative effects from the Russian rouble, higher promotional activity as a result of weakening consumer sentiment and our efforts to accelerate inventory reduction significantly impacted our margins and therefore our results by around 100 million euro compared to our initial plan for the year.

We have an enviable and strong position in Russia/CIS, being one of the most established and desired consumer brands with a wide-reaching network of over 1,100 stores. While we firmly believe in the long-term potential of the market, due to the rapid depreciation of the

Russian rouble, which hit a record low today, and the considerable risk of further deterioration in consumer spending, the short-term fundamentals of the business have changed materially.

This warrants an even heightened level of capital and risk management as we plan for 2015. Therefore, we have and will continue working on accelerating our real estate and inventory management initiatives. This has resulted in net store closures in Russia/CIS of 27 stores since the end of June, and we have reduced our net opening plans even further to around 30 per year for 2014 and 2015. In addition, we continue to work hard on driving down inventory levels, with an ambition to reduce inventories by a double-digit percentage rate in 2014, and to continue reducing absolute levels of inventory in 2015.

Finally a quick word on currencies. In total for the first nine months, negative translation effects wiped out around 550 million euro of revenues from our Group's result. Taking the effects of translation as well as less favourable hedging rates, which impacted the Group's gross margin by 50 basis points, operating profit was impacted by roughly 150 million euro.

While these issues have been a steady burden through the year, we definitely should not ignore the strong successes and improving momentum in many other key parts of our business. In fact, we even saw some trends accelerate in the third quarter.

- Sales for the Group increased 9% in Q3 and are up 6% year-to-date. Strong momentum continued for our brands in the emerging markets, with European Emerging Markets, Greater China and Latin America increasing 19%, 13% and 16%, respectively.
- Our business in Western Europe grew 10% as we continue to rebound in the region, driven by stronger product assortments in adidas Football and Running and continued double-digit growth at Reebok.
- In Retail, we also enjoyed another quarter of positive comparable store trends in all regions. Our efforts to drive more leverage on store costs also yielded a very satisfactory 2 percentage point reduction in operating expenses as a percentage of sales. In fact, our total concept store business excluding Russia/CIS will deliver record sales and profitability levels this year, which reaffirms our great confidence in the power and value of this business model.

At adidas, sales increased 12% in the third quarter and 11% for the first nine months.

In football, sales year-to-date increased 31%. The success of our sponsored teams and players at the World Cup as well as new product introductions such as the Predator Instinct will ensure we reach our aspiration of more than 2 billion euro in sales this year. The World Cup has been our most successful event activation ever.

In running, sales for the first nine months are up 14%, with a strong acceleration in the third quarter, where sales increased 20%. Our industry-leading Boost technology continues to grab market share and mind share, being hands-down the best-performing product on the world's major marathon scene.

Just remember the Berlin Marathon, where adidas athlete Dennis Kimetto ran the fastest marathon in history wearing the super-lightweight adizero Adios Boost. Since its launch, the adizero Adios Boost has won 27 major marathons and most recently completed the male and female double at the New York Marathon.

In Originals, after a difficult start to the year, sales recovered sharply, growing 9% in the quarter. The ZX Flux remains a top seller and key franchises such as the Stan Smith as well as the first product launches in a series of new collaborations, for example with Pharrell Williams and Rita Ora, are driving heat for the Trefoil.

And finally, the adidas NEO label also delivered another remarkable quarter, with sales up 33% as we expanded our product offering in key winter styles in footwear, jackets and denim.

Let me come to Reebok. At Reebok, we recorded our sixth consecutive quarter of growth, with sales increasing 7%. The brand's positioning in fitness is resonating well around the world, particularly in markets where we are driving our own controlled space agenda. Sales increased at a double-digit rate in Western Europe, European Emerging Markets, Other Asian Markets and Latin America.

On a category level, Fitness Training, Walking and Studio were the key drivers, increasing 25%, 30% and 52%, respectively. I expect these trends to continue, as we broaden our partnership network and product offering to new and upcoming fitness disciplines.
This will also ensure that Reebok further increases its gross margin. While the brand's gross margin was down 1.4 percentage points year-to-date and 3 percentage points in the third quarter, this was all down to the challenges in Russia/CIS as well as activities to streamline Reebok even more towards its fitness positioning in North America. In the US, this is mainly related to old footwear closeouts as well as preparations to rationalise the brand's factory outlet business in North America, which we plan to reduce by 20% over the next 12 months.

Speaking about North America, regaining our form in this market is the top priority on our Group's agenda, and we have made this market a key priority for all senior management in the company. As I mentioned earlier, we have carried out a significant change in leadership in our North American organisation this year, stacking high-calibre talent from various parts of our Group and adding key external talent, particularly in design, as you may have red.

We also have been very active getting back on the field of play, whether it be investments in established or young NBA talents or the return of the 3-Stripes footwear to the NFL. We will share more specific details on our future plans as part of our strategic update planned for the second half of March 2015.

So, ladies and gentlemen, as you can see, while it has been challenging in 2014, there are many achievements we can also be very proud of.

Attention now turns to completing the year. Despite facing into the first major wave of World Cup product launches, we have plenty to play for in the fourth quarter. Some highlights to look out for include:

- The further expansion of our Boost offering into new running models and categories.
- We will fully leverage the return of the NBA with a series of new icon products for Derrick Rose, John Wall and Damian Lillard.
- We will have our largest ever winter apparel marketing campaign, Open All Winter, supporting our most technologically advanced ClimaHeat products.
- Originals will introduce several new products, including Pharrell Williams and Nigo collaborations as well as a bold new silhouette born from some of the brand's most creative minds – the adidas Originals Tubular.
- And, we also have a few product and partnership surprises to come at Reebok, which we will announce shortly before the end of the year.

Therefore, with plenty to look forward to, I can reiterate the top- and bottom-line guidance we gave you in July of mid- to high-single-digit currency-neutral sales growth and net income to shareholders at a level of around 650 million euro for 2014.

For 2015, we are also very confident that we will maintain a solid growth trajectory and, despite tough football comparisons, we expect sales to grow at a mid-single-digit rate on a currency-neutral basis. We will also grow our earnings at a faster rate than the top line. However, as there are still a number of moving parts, most notably the continued volatility of the Russian rouble, we will give a more specific quantification in March 2015.

That's it from my side today. Let me now hand over to Robin to give you some more details on the financials.

Robin Stalker

Thank you Herbert, and good afternoon ladies and gentlemen.

As you have just heard, our Group had a solid third quarter, with robust top-line momentum. For my comments today, I want to focus on the following topics:

a) A look at our performance trends by region and channel.
b) A review of the moving parts in our margin development.
c) And finally, an update on our balance sheet and recently announced capital management measures.

In the third quarter and the first nine months, sales increased 9% and 6% respectively, with every region except North America posting sales gains. In particular, the emerging markets continued to do extremely well, with sales in European Emerging Markets, Latin America and Greater China increasing 19%, 16% and 13%, respectively.

In Latin America, the Group was able to keep the strong momentum from the previous quarters with revenues up 16% in the third quarter. This was driven by a 17% sales increase at adidas and 11% growth at Reebok. Comp store sales grew 17% in the third quarter.

In Greater China sales grew 13%. Of particular note is clearly the strong development at brand adidas, where revenues grew 14%, driven by a 32% sales increase at adidas Originals & Sport Style. Our retail expertise continues to pay dividends in the market with revenues up 32% during the quarter, driven by an 18% comp store sales increase.

In European Emerging Markets, Group sales increased 19% in the third quarter. Sales growth was once again broad-based across the various markets, with strong double-digit increases in Russia/CIS, the Middle East and Africa. In Russia/CIS, sales in the quarter were up 16%, with comp store sales at the prior year level.

In Western Europe, sales were up 10% in the quarter, driven by double-digit increases in Germany, Spain, France and Poland. Several key performance categories, amongst others football, running and basketball all grew at double-digit rates, while Originals & Sport Style was up 8%.

In Other Asian Markets we saw ongoing strong momentum at both adidas and Reebok, with sales growing 11% and 33%, respectively. TaylorMade-adidas Golf remained challenged with sales down 39% in the quarter. As a result, Group revenues in Other Asian Markets grew 6%.

Finally, from a regional perspective, in North America, Group sales declined 1%, as sales growth at adidas was more than offset by double-digit sales declines at TaylorMade-adidas Golf and Reebok. At adidas, football and running were once again stand-out categories, growing 45% and 12%, respectively.

Moving on to profitability. Group gross margin decreased 1.3 percentage points in the first nine months or 1.9 percentage points in the third quarter to 47.4%. The main reasons for the decline in the third quarter were:

- Higher input costs negatively impacted the margin by around 80 basis points.
- Increased clearance activities as well as negative currency effects in wholesale, the latter mainly in Latin America, also impacted margins by 80 basis points.
- Lower margins in Russia/CIS related to the high levels of promotional activity, as well as the negative effects from the rouble devaluation resulted in around 50 basis point headwind.
- Finally, less favourable hedging rates accounted for around 40 basis points of the Group's gross margin decline.

These impacts were partly offset by an improved product and channel mix.

Moving below the gross profit line, other operating income and expenses increased 7% in euros or 9% currency-neutral in the third quarter. Some modest operating overhead leverage gains in the quarter were offset by an increase in sales and marketing working budget expenditure, which was up 10% currency-neutral for the third quarter and 11% currency-neutral in the first nine months.

Turning now to the non-operating items of the P&L: Net financial expenses decreased 66% in the third quarter, or 31% in the first nine months compared to a year ago, driven by a 9 million euro positive swing in exchange rate effects in the third quarter as well as lower interest expenses.

The first nine months tax rate increased 110 basis points to 28.8%, due to a less favourable earnings mix.

Net income attributable to shareholders for the third quarter declined 11% to 282 million euro, and 21% to 630 million euro the first nine months.

By segment, Wholesale revenues increased 8% in the third quarter and 6% for the first nine months, mainly due to high-single-digit growth at adidas Sport Performance, led by the football, running and training categories. Sales at Reebok were slightly above the prior year level, driven by sales increases at Fitness Training, Walking and Fitness Running.

Gross margin for the segment was down 2.1 percentage points for the quarter and down 90 basis points for the first nine months, as the positive effect from a more favourable product mix was more than offset by negative currency effects following the devaluation of currencies such as the Argentine peso and Brazilian real as well as a higher levels of clearance.

In the Retail segment, revenues continued to grow at a strong double-digit rate, up 20% in the third quarter and 21% for the first nine months.

Comparable store sales were up 6% for the quarter and 8% for the first nine months, with growth across all regions and store types.

By brand, adidas comp store sales were up 8% for the quarter and 10% in the first nine months. Reebok comp store sales were down 2% in the third quarter and remained stable for the first nine months. The lower performance here was entirely related to the Reebok factory outlet business, which Herbert already mentioned.

Revenues in our eCommerce business accelerated during the quarter, with sales doubling in the third quarter. For the first nine months, our eCommerce business was up 78%.

Retail gross margin decreased 3.4 percentage points to 58.1% for the third quarter and 3.2 percentage points to 59.4% in the first nine months. Our performance in Russia/CIS heavily impacted these results, with the impact of promotional activity and product mix as well as currency devaluation in that market accounting for around 2.5 percentage points of the decline in both Q3 and year-to-date.

On a positive note, segmental operating expenses as a percentage of sales decreased 2.0 percentage points to 38.3% in Q3 and 40 basis points to 41.9% in the first nine months.

At the end of the third quarter, we operated 2,822 stores, a net increase of 211 stores versus September 2013. Of the total number of stores, 1,569 were adidas and 426 were Reebok branded. In addition, the adidas Group Retail segment operated 827 factory outlets. During the first nine months, we opened 277 new stores and closed 195 stores. 89 stores were remodelled.

And finally, coming to Other Businesses, revenues in the third quarter decreased 12%, driven by a 36% decline at TaylorMade-adidas Golf, as Herbert already mentioned. For the first nine months, revenues of Other Businesses were down 17%.

The segmental gross margin remained virtually unchanged at 35.3% in the third quarter. For the first nine months, gross margin was down 3.9 percentage points to 37.7%, due mainly to lower product margins at TaylorMade-adidas Golf, as a result of the highly promotional environment in golf as well as the timing of product shipments.

Finally, let me spend a minute on our balance sheet and cash flow development. At quarter-end, operating working capital as a percentage of sales increased 1.3 percentage points to 21.9%. This development was driven by an 8% decrease in accounts payable.

Although clearly impacting our margins, our strong focus on inventory management in markets such as Russia is definitely paying off, as our inventory growth rate more than halved to 7% from 16% at the end of June.

In terms of cash flow development, we ended the quarter with net borrowings of 543 million euro, compared to 180 million euro a year ago. Higher capital expenditure, including the purchase of the Spartenburg warehouse, was the main driver of this development.

To wrap up, since we last spoke, we have taken some significant steps with regard to our capital structure. In October, we successfully issued two Eurobonds, marking our first Eurobond offering since July 2009.

The 7-year Eurobond of 600 million euro matures on October 8, 2021 and has a coupon of 1.25%. The 12-year Eurobond of 400 million euro matures on October 8, 2026 and has a coupon of 2.25%.

The successful placement of our bonds reflects our Group's high credit quality and our excellent access to the capital markets. This offering allows us to benefit from current low-cost financing opportunities in the Eurobond market to secure attractive long-term financing and reduce our cost of capital.

In addition, given our expectations for future cash flow development and current low share price levels, we also announced a 1.5 billion euro shareholder return programme, which comes on top of our annual dividend. As announced this morning, we will commence the first tranche of up to 300 million euro tomorrow.

With that ladies and gentlemen, I would like to thank you for your attention, and Herbert and I are now happy to take your questions.