adidas GROUP

FINANCIAL RESULTS PRESENTATION

Nine Months 2012 Speech

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John-Paul O'Meara
Good afternoon ladies and gentlemen and welcome to our nine months 2012 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. They will be covering our strong financial performance so far this year, and will give you some insights into the various initiatives we have planned to continue our momentum for the remainder of 2012 and into 2013. So, let's get started and over to you, Herbert.

Herbert Hainer
Thanks JP and good afternoon ladies and gentlemen.

I am very pleased to report today another set of robust and record financial results for our Group.

For the first nine months:

- Currency-neutral sales increased 8% or 14% in euros to over 11.5 billion euro, with growth across all geographical areas.
- Through proactive gross margin management and disciplined control of our operating costs, we were able to achieve an operating margin improvement of 40 basis points to 10.1%.
- And as a result, Group net income and earnings per share have jumped 22% to 798 million euro and 3 euro 82 cents respectively.

We again had many highlights in the third quarter, but there are three real standouts:

- Firstly, it is the power and global strength of the adidas brand, where we enjoyed 10% currency-neutral growth.
- The second is our gross margin performance, which increased 30 basis points despite continuing pressures from input costs. This allowed us, for the seventh consecutive quarter, to grow our bottom line both faster than sales and at a double-digit rate, being 14% for the quarter.
- And thirdly, we continued our industry-leading inventory management, which resulted in another quarter of sequential decline, as inventories were down 1% currency-neutral compared to the prior year period.

These strong results continue to be a reflection of our relentless focus on driving quality and sustainable top-line growth. Unlike many in our industry, we have not only preserved, but created opportunities to improve and grow our margins. And we have done so without the need to sacrifice important investments into our brands and infrastructure, critical to sustaining our future success. This is clearly one of the key strengths of our Route 2015 strategy.

Our powerful global reach and brand appeal is reflected in the strong and broad-based sales growth seen in all of our geographic areas in the first nine months. In particular, our key "attack markets" of North America (up 5%), Greater China (up 16%) and Russia/CIS (up 17%) have once again delivered significant category and market share victories. And even in Western Europe, we were able to grow Group sales by 4%, which is impressive given the region's economic challenges.

Our performance also in the first nine months also reflects our dedication to creating the industry's most desirable brands, which we are doing by consistently driving product innovation, brand authentication and investment. So let's have a look at our brand achievements for the period.

Starting with adidas. The momentum we are currently enjoying with the adidas brand is unprecedented in the last decade. With sales increasing 10% currency-neutral in the third quarter and 12% year-to-date, we have marked our 10th consecutive quarter of double-digit growth for the brand. Sales are up at a double-digit rate in all regions with the exception of Western Europe, which increased 7%.

All around the world, the brand was front and center in the summer of sports, be it

- The success of our cooperation with Team GB at the Olympic Games, where they won 65 medals,

- Andy Murray's first Grand Slam victory at the US Open and Olympic gold in Wimbledon,

- and our success on the world marathon stage, which includes Geoffrey Mutai and Mary Keitany being crowned 2011-2012 World Marathon Majors Series Champions.

These are just some of the inspirational athlete achievements that continue to inspire and showcase to the consumer, why adidas is the best performance sports brand in the world.

This is also fully underlined in the diversity of the brand's growth by category. All of our key performance categories – football, running, basketball, outdoor – as well as adidas Sport Style have grown at strong double-digit rates this year. And our innovation led growth is reflected in the brand's gross margin, which was up a healthy 70 basis points in the third quarter.

In football, our year-to-date sales are up 17% currency-neutral and at a high-single-digit rate in the quarter, as we built on our dominance at the UEFA EURO 2012. During the quarter, the Predator and key football club apparel launches such as Chelsea, Bayern Munich and Real Madrid have all seen year-over-year increases of over 20%.

In running, our growth rate accelerated in the third quarter, with sales rising 17%, driven by the continued success of our adizero and Clima franchises. In addition, several new introductions such as the adizero adios 2 racing shoe, the Kanadia trail shoe and our Supernova technical apparel all received industry awards during the period, highlighting the strength of our offering across the full breadth of the running market.

In basketball, sales also accelerated in the third quarter, growing 30%, with in North America up almost 60%. This was fuelled by strong footwear sales driven by the Rose 3 and the Crazy Light 2, as well as strong growth in apparel, as we anniversary last year's NBA lockout.

And finally, it goes without saying that our connection to the lifestyle consumer is only getting deeper. Sales increased 23% currency-neutral in the third quarter, driven by double-digit growth at adidas Originals and at adidas NEO label. A particular highlight was the strong reception to our "all Originals Represent" campaign which resonated strongly in the back-to-school period all around the world.

Now, moving over to Reebok, where reported sales declined 25% currency-neutral in the quarter, and 20% year-to-date. If we exclude the impacts from our clean-up of Reebok India and our decision to discontinue the NFL licence and the reporting change of the NHL business from Reebok to Reebok-CCM Hockey, revenues declined 6% in the third quarter. While this is still by no means satisfactory, it is an improvement in trend compared to the second quarter decline of 10%.

This confirms what I told you back in August, that we do see encouraging signs for the brand, particularly in markets led by own retail and controlled space. In fact, comparable store sales globally are up 11% in the third quarter. In addition, I also now believe we can call out that our Classics business is moving into a sustainable upward trend. Reebok Classics sales were up double-digit in the third quarter, supported by strong new product introductions such as those with new brand ambassador Alicia Keys.

Finally, let me wrap up my comments on the period, with a review of TaylorMade-adidas Golf. Sales in the first nine months increased 21% currency-neutral. In the third quarter, sales increased 4% currency-neutral, with strong double-digit growth in North America and in metalwoods offset by lower sales in Europe and in irons due to the timing of this year's product launches.

Our strength in innovation has once again shone through on this year's six major professional golf tours, with TaylorMade drivers winning 49 events already. Also several of our Tour Staff pros played starring roles in the Ryder Cup Matches, including Dustin Johnson, Justin Rose, Sergio Garcia, and ultimate hero Martin Kaymer.

So ladies and gentlemen this completes my review of the period. I'll be back in a few moments to talk about the rest of the year and some initial flavour on 2013. But before that, let me hand over to Robin who will discuss the third quarter financials and business developments in more detail.

Robin Stalker
Thank you, Herbert, and good afternoon ladies and gentlemen. As you have just heard, our Group is having another excellent year both operationally and financially. For my comments today, I want to focus on three topics:

a) A look at our third quarter top-line performance trends by region and channel, also adjusting for this year's one-time items
b) The reasons for the strong development of our gross and operating margins
c) And finally, our continued progress and discipline in balance sheet and cash management

In the third quarter, currency-neutral sales increased 4%, or 11% in euro terms to 4.2 billion euro, with every region except North America posting sales gains. If we exclude the impacts from the NFL licence and Reebok India, sales for the Group in the quarter increased 7% currency-neutral.

In Western Europe, despite the widely commented macroeconomic challenges in many parts of the region, Group sales grew 1%. This was primarily a result of strong sales growth in the UK, France and Poland, which offset declines in the Southern European markets. Both the UK and Poland saw very strong results, as we benefited from tremendous brand visibility during the major sports events, with currency-neutral revenues gaining 19% in the UK and 27% in Poland.

In European Emerging Markets, Group sales increased 19% currency-neutral. This strong performance was mainly driven by Russia/CIS, where revenues were up 21% currency-neutral, again driven by strong comparable store sales growth of 14%.

In North America, Q3 Group sales decreased 5% on a currency-neutral basis, mainly as a result of sales declines at Reebok, which more than offset sales growth of 11% at adidas and 13% growth at TaylorMade-adidas Golf.

In Greater China, currency-neutral sales increased 11%, with double-digit growth at both adidas and Reebok. Comparable store sales at all of our sub-labels are very strong, and a particular highlight for the quarter is the adidas NEO label, which saw double-digit comps driven by our first-ever fully integrated campaign featuring two of Asia's biggest youth icons Eddie Peng and Angelababy.

In Other Asian Markets, Group revenues were up 1% driven by strong growth in Japan and South Korea, which was partly offset by the negative consequences related to Reebok India. Excluding these effects, sales growth for the region would have been up 6% for the quarter and 13% year-to-date.

Finally, in Latin America adidas Group sales accelerated significantly in the third quarter, increasing 16% on a currency-neutral basis. Double-digit sales growth both at adidas and in Other Businesses more than offset revenue declines at Reebok.

Moving on to profitability, we continue to be rewarded for our hard work and strategic focus on driving quality sales growth. Similar to previous quarters, the Group faced challenges from higher input costs. In fact, the total negative impact was 2.5 percentage points in the third quarter, which we were able to fully mitigate, delivering a margin increase of 30 basis points for the period.

The key drivers to achieving this expansion are similar to those outlined in our recent earnings calls:

- Firstly, and most importantly, price increases, product engineering efficiencies and a more favourable product and regional sales mix.
- Secondly, the over-proportionate sales growth in our Retail segment, which carries higher margins.

- And lastly, our hedging strategy yielded us a slight positive tailwind. However, I would like to add, that we expect this to reverse and become a headwind in 2013.

For the first nine months, that means we are now closing in on our target of a gross margin of around the prior year level of 47.5%, with year-to-date gross margin now down only 40 basis points. By the way, for the period, input cost pressures were a 4.1 percentage point negative.

Moving below the gross profit line, we continue to make very good progress towards one of our key Route 2015 goals: leveraging our growth and operational scale to drive operating expense leverage.

For the quarter and year-to-date, other operating expenses increased 14% and 13%, respectively. As a percentage of sales, other operating expenses were up 0.7 percentage points in the third quarter, however year-to-date they decreased 0.5 percentage points.

Thereof, sales and marketing working budget expenditures increased 9% for the third quarter and 8% for the first nine months. As a percentage of sales, sales and marketing working budget was 10.8% for the third quarter and 11.7% for the first nine months.

Group operating profit increased 19% in the first nine months to a new record level of 1.2 billion euro. This translates into an operating margin of 10.1%, up 40 basis points. In the third quarter, operating margin expanded 10 basis points to 11.8%.

Turning now to the non-operating items of the P&L: Net financial expenses decreased 25% in the first nine months compared to a year ago. This mainly reflects a 22% increase in interest income and a 60% decline in negative exchange rate effects. Lower interest expenses also contributed to this development.

The tax rate for the first nine months increased a slight 40 basis points to 27.8%, which is due to a less favourable regional earnings mix, and fully in line with our guidance of a tax rate increase to 28.5% for the full year.

As a result, net income attributable to shareholders for the first nine months increased 22% to 798 million euro, which translates into basic and diluted EPS of 3 euro 82 cents.

Third quarter net income attributable to shareholders as well as basic and diluted earnings per share increased 14% to 344 million euro and 1 euro 64 cents, respectively.

By segment, currency-neutral Wholesale revenues were flat in the third quarter and increased 4% for the first nine months, as sales growth at adidas more than offset revenue declines at Reebok.

Gross margin for the segment was up 0.9 percentage points for the quarter, to 41.3%, and is now down only 50 basis points year-to-date. Price increases as well as a more favourable product and regional mix helped to more than offset the headwinds from input costs in the third quarter.

In the Retail segment, comparable store sales growth continued to be a key driver for segmental revenues, contributing 9% of the 15% currency-neutral growth for the quarter. For the first nine months, comp store sales also expanded 9% currency-neutral, while total segmental sales grew 16%, currency-neutral.

By brand, currency-neutral adidas comp store sales increased 8% in Q3 and 9% in the first nine months, while Reebok comp store sales grew a very healthy 11% and 9% for the quarter and the year-to-date period, respectively. Sales from eCommerce were also very strong, growing 63% in the third quarter and 65% year-to-date.

Retail gross margin decreased 3.3 percentage points to 59.0% for the third quarter and 2.2 percentage points to 61.0% in the first nine months. Increased promotional activities as well as the devaluation of the Russian rouble versus the US dollar were the main factors contributing to margin declines.

Coming to the segmental operating margin for Retail, we continued to make strides towards becoming a world-class retailer. Despite the decrease in the Retail gross margin, segmental operating margin for the third quarter declined by only 1.4 percentage points to 21.8%, and by 0.1 percentage points to 21.6% in the first nine months.

In terms of our store development, at the end of the third quarter, we operated 2,466 stores, a net increase of 65 stores or 3% versus the prior year-end level of 2,401. During the first nine months, we opened 262 new stores and closed 197 stores, while 52 stores were remodelled. Our remodelling and store upgrade efforts continue to yield significant benefits. For example, during the quarter we reopened the adidas brand concept store on Hankow Road, Hong Kong, where after the store renovation, we are seeing impressive results. In the first trading days after its reopening, sales increased 47% versus the previous year, and traffic was up 9%.

And finally, coming to Other Businesses, this is certainly one of the highlights of our first nine months performance. Currency-neutral revenues grew 7% in Q3 and 20% year-to-date, driven by strong sales increases at TaylorMade-adidas Golf and Reebok-CCM Hockey.

In euro terms, sales for Other Businesses grew 18% during the quarter to 486 million euro and 30% in the first nine months to 1.6 billion euro. Since June, the consolidation of Adams Golf added 23 million euro of sales.

The segmental quarterly gross margin decreased 0.2 percentage points to 42.7%. For the first nine months, gross margin was down 0.5 percentage points to 44.0%, mainly as a result of lower product margins at Rockport and Reebok-CCM Hockey. Improvements at TaylorMade-adidas Golf partially helped to offset these negatives.

Now ladies and gentlemen, I would like to discuss our balance sheet and cash flow development, and I am again particularly proud of the further progress we achieved in the quarter. Our conservative approach towards managing risk and our disciplined control of our inventories is certainly justified and we continue to be rewarded for pursuing this focus.

Our inventory growth rate has once again declined compared to the prior quarter, decreasing 1% on a currency-neutral basis. This is in stark contrast to most of our major competitors where inventory growth rates continue to be at much higher levels.

As a result, we were also able to further decrease operating working capital as a percentage of sales by 0.4 percentage points to a record low of 20.5%.

The combination of our tight control of working capital with our strong operational performance led to significant cash flow generation for the period. This is reflected in the 55% year-over-year decline in net debt from 750 million euro to a level of only 337 million euro. Taking all of our results together, we once again have seen a strong increase in our equity ratio which is up 2.7 percentage points to 49.6%.

Looking out to the remainder of the year, we have made some small adjustments to our full year guidance. We slightly reduced our sales outlook to high-single-digit currency-neutral growth, from approaching 10%, which mainly relates to lower sales expectations at Reebok after the first nine months performance, as well as negative impacts due to the ongoing NHL lockout.

Our gross and operating margin guidance for the year, as well as our earnings per share guidance remains unchanged.

Finally, given our strong inventory management, we expect operating working capital as a percentage of sales to be around the prior year level, compared to our earlier expectations of a moderate increase. This means we will deliver not only record P&L results, but also record cash flows from operations this year, which will be ahead of our original expectations.

So ladies and gentlemen, on that very positive note, this concludes my comments for today. Now back to Herbert to take you through our key initiatives for the remainder of the year and some indications of what to expect from us in 2013.

Herbert Hainer
Thanks Robin. Never in my time as CEO of the adidas Group have I seen momentum like we have today, and we can definitely look forward to the remainder of the year and 2013 with confidence and ambition.

While there is still a lot of macroeconomic uncertainty, both positive and negative, we have done all the right things, and we will continue to do so also in the fourth quarter, to give our Group the perfect platform for a strong competitive attack in 2013.

In terms of our expectations for Q4, where our priority will continue to be on ensuring markets and channels stay clean and fresh, there are also a few things to bear in mind.

- Firstly, we will anniversary the sell-in of high-margin event-related products for the Olympic and Paralympic Games and UEFA EURO 2012, particularly in Europe.
- Secondly, we will continue to see negative impacts on Reebok from the NFL licence termination, with Q4 being one of the peak quarters of the negatives.
- Thirdly, as Robin mentioned, the player lockout in the NHL will negatively affect our fourth quarter results, also in one of its most important quarters.
- And finally, we will see the last of the Reebok India negatives as we finalise our clean-up efforts.
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If you add all of that up, that is a material headwind for our smallest quarter. Each of these accounts for a low double-digit million impact on profit, totalling as much as 50 million euro. But nevertheless, given strong momentum in our key Route 2015 growth categories, we expect to be able to offset many of these headwinds, as you can see by the reiteration of our guidance.

So what are the positive things going on that will fuel our underlying success over the holiday period?

Firstly on the product side, we have some significant new introductions. Here are a few examples. In basketball, we launched the Rose 3 basketball shoe on October 4 at a 160 dollar price point, 45% higher than its predecessor the Rose 2. Since its launch, it has enjoyed double-digit sell-through each week, driven by one of our most successful campaigns in history – the Rose Return – which has had 18.5 million digital views already. This clearly highlights the broad appeal of this very special NBA icon.

Another example of great product just out, is in football. Yesterday we introduced the new adizero f50 football boot, which was worn for the first time by the world's best player Lionel Messi last night in the Champions League game between Barcelona and Celtic.

And last but not least, TaylorMade-adidas Golf has unveiled its latest and most remarkable golf irons to date, RocketBladez. Inspired by the distance-enhancing benefits of the RocketBallz fairway woods and rescue clubs, this is certain to be another consumer hit when it starts at retail at the end of November.

In terms of our channels, in Wholesale we are piloting some of our latest shop-in-shop initiatives before ramp up next year. For example, in the USA we began our new adidas "Home Court" programme with Dick's at the end of last week. And with Sports Chalet, we already have 20 new Reebok Fit Hub shop-in-shops in place – and the early results of both programmes are very encouraging.

In own Retail, for Q4 it is all about driving holiday traffic and conversion in our stores. Here, not only do we have our most comprehensive winter wear offering to date, but also for the first time ever we will have a fully integrated global in-store and online Christmas campaign which launches at the end of November.

So as you can see, across the Group there is plenty going on to ensure a highly successful end to the year.

But after such a great year 2012, what can we look forward to in 2013?
Well, let me put it simply - an even better year.

We will continue in the same direction and with the same determination as we have done all through the first years of Route 2015: staying focused, implementing with excellence and, above all, placing the consumer front and centre in every decision we make.

We will create the unexpected, by bringing more game-changing innovation and freshness in more categories than any of our competitors. In particular, we will bring one game-changing revolution to market in spring which I am certain will shake up the entire running market.

In addition, you will see us continue to deepen the emotional connection between our brands and our consumers, becoming an even greater part of their lives through best-in-class brand activation on the field of play, on the street and in social media. You will see this again on every major stage, be it the NBA All-Star Weekend in Houston, Texas, the UEFA Champions League final in London, the IAAF World Championships in Moscow, or as we kick off for the FIFA World Cup 2014 at next summer's FIFA Confederations Cup in Brazil.

And you will see fantastic new brand and product collaborations with key promotional partners, such as the Derrick Rose logo and collection in basketball, our new exciting partnership with Justin Bieber for the adidas NEO label, Yoga rebel Tara Stiles with Reebok and Alicia Keys for Reebok Classics.

These are the types of opportunities and initiatives that make our Group unique. They are part of a formula that is rich in content, comprehensive to be globally relevant, and focused to maximise and grow earnings and cash flow.

I can already confirm that we expect to deliver another year of record financial performance in 2013. This will come predominantly from operating margin expansion, where we expect to achieve a level of around 9% in 2013, as well as from sales growth. This will yield another year of significant double-digit earnings growth which, I am sure you will agree, is the tell-tale sign of a high-performing company.

With that, thank you for your attention, and we are happy now to take your questions.