MANAGEMENT ASSESSMENT OF PERFORMANCE, RISKS AND OPPORTUNITIES, AND OUTLOOK

ASSESSMENT OF PERFORMANCE VERSUS TARGETS

We communicate our financial targets on an annual basis. We also provide updates throughout the year as appropriate. In 2017, the company delivered a strong operational and financial performance. Sales development was favorably impacted by rising consumer spending on sporting goods, supported by global trends such as increasing penetration of sportswear ('athleisure'), increasing health awareness and rising sports participation rates. See Economic and Sector Development, p. 105

The strong brand momentum, supported by innovative product launches and inspiring marketing campaigns, as well as the successful execution of the company’s strategic business plan ‘Creating the New’ drove strong sales and earnings growth throughout the year. As a result, we increased our full-year top- and bottom-line guidance in July 2017. See Table 105

In 2017, revenues increased 16% on a currency-neutral basis, driven by double-digit growth at the adidas brand. Currency-neutral sales grew at double-digit rates in nearly all market segments. As a result, revenues increased above our initial guidance of 12% to 14% currency-neutral sales growth. Gross margin increased 1.2 percentage points to 50.4%, exceeding our initial forecast of an increase of up to 0.3 percentage points. This development was due to the larger-than-expected positive effects from a better pricing and product mix, which more than offset headwinds from unfavorable currency movements. The operating margin increased 1.2 percentage points to a level of 9.8%, which was above our initial guidance of an increase of between 0.2 and 0.4 percentage points. This development was due to the gross margin increase as well as the positive effect from lower other operating expenses as a percentage of sales, which more than offset the decline in other operating income. As a result, net income from continuing operations, excluding the negative one-time tax impact in 2017, was up 32% to € 1.430 billion, and thus exceeded our initial guidance of an improvement at a rate between 13% and 15%. See Income Statement, p. 107

In 2017, average operating working capital as a percentage of sales ended the year at a level of 20.4%. This development represents a decrease compared to the prior year level of 21.1%, while our initial guidance was for a modest increase. Capital expenditure (excluding acquisitions) amounted to € 752 million in 2017, below our initial guidance of around € 1.1 billion, mainly reflecting fewer-than-expected store openings throughout the year. Investments were mainly focused on controlled space initiatives of the adidas and Reebok brands, aimed at further strengthening our own-retail activities, franchise store presence and shop-in-shop presentations. Other areas of investment included logistics infrastructure and IT systems as well as the further development of our corporate headquarters in Herzogenaurach, Germany. See Statement of Financial Position and Statement of Cash Flows, p. 111

Beyond our financial performance, we also actively monitor non-financial KPIs. See Internal Management System, p. 102

In 2017, our Net Promoter Score (NPS) saw further improvements, reflecting the strong momentum of our brands and products throughout the year. Also from a market share perspective, we continue to be very encouraged by our strong performance in key categories and key markets, as defined in the company’s strategic business plan. North America and Greater China, two of our focus markets, were once again notable standouts, as we were able to further improve our market share in these regions. Our diligence and discipline in sustainability matters continues to yield strong recognition for our company. In 2017, adidas AG was again represented in a variety of high-profile sustainability indices. For the 18th consecutive time, adidas AG was selected to join the Dow Jones Sustainability Indices (DJSI), the world’s first global sustainability index family tracking the performance of the leading sustainability-driven companies worldwide. In the sector ‘Textiles, Apparel & Luxury Goods’, we were rated industry best in the criteria Human Rights, Supply Chain Management, Impact Measurement and Valuation, Materiality, Environmental Policy and Management Systems, Risk and Crisis Management, Brand Management, Corporate Citizenship and Philanthropy, and Customer Relationship Management. See Sustainability, p. 88

As we are convinced that our employees’ feedback plays a crucial role in our pursuit of creating a world-class work environment, during the course of 2017, we kicked off a new approach and system platform (‘People Pulse’) for a monthly measurement of the level of employee satisfaction. Following the implementation of this approach in June 2017, our monthly participation rates toward year-end exceeded our minimum participation rate target. In 2018, we aim to further expand People Pulse across the organization and build on the key learnings from the surveys. See People and Culture, p. 81

Finally, we continue to enjoy a strong level of on-time in-full (OTIF) deliveries to our customers and own-retail stores. In 2017, OTIF saw a slight improvement compared to the prior year level and we are well on track to achieve our mid-term target. See Global Operations, p. 74
ASSESSMENT OF OVERALL RISKS AND OPPORTUNITIES

Our Risk Management team aggregates all risks and opportunities reported by Risk Owners and Executive Board members through the half-yearly risk and opportunity assessment process. Results from this process are analyzed and reported to the Executive Board accordingly. In addition, the Executive Board discusses and assesses risks and opportunities on a regular basis. See Risk and Opportunity Report, p. 131

Taking into account the potential financial impact as well as the likelihood of materializing of the risks explained within this report, and considering the strong balance sheet as well as the current business outlook, we do not foresee any material jeopardy to the viability of the company as a going concern. This assessment is also supported by the historical response to our financing demands. adidas therefore has not sought an official rating by any of the leading rating agencies. We remain confident that our earnings strength forms a solid basis for our future business development and provides the resources necessary to pursue the opportunities available to the company. Compared to the prior year, our assessment of certain risks has changed in terms of likelihood of occurrence and/or potential financial impact. The partial changes in risk evaluation have no substantial impact on the overall adidas risk profile, which we believe remains unchanged compared to the prior year.

ASSESSMENT OF FINANCIAL OUTLOOK

In March 2015, adidas unveiled ‘Creating the New’, its 2020 strategic business plan, which defines strategic priorities and objectives for the period up to 2020. The strategy is designed to drive brand desirability which, in turn, is expected to spur top- and bottom-line growth for the company in the years to come. Our successes since 2016, as measured by financial as well as non-financial KPIs, are a direct consequence of relentlessly executing Creating the New. Therefore, we will continue to focus on further executing against our strategic business plan, while at the same time fine-tuning it wherever needed and whenever necessary.

In March 2017, Creating the New was updated with complementary initiatives in order to grow the top and bottom line even faster than initially projected. This will ensure we continue our momentum in the years to come, resulting in strong sales and profitability improvements until 2020. Consequently, we increased our financial targets for 2020. We project currency-neutral revenues to increase at a rate of 10% to 12% on average per year until 2020 compared to the 2015 results. By outperforming the sporting goods industry, our brands will increase market share over the period. This, in combination with the expected gross margin improvement and our ability to generate operating leverage, will significantly increase our profitability. As a result, net income from continuing operations is expected to grow at a higher rate than the top line. While in March 2017, we projected net
income from continuing operations to expand by 20% to 22% on average per year during the five-year period, we now expect net income from continuing operations to grow by 22% to 24% on average per year, following the strong operational and financial performance in 2017. See Corporate Strategy, p. 62.

Through our extensive pipeline of new product launches paired with brand-building activities, the positive effects from major sporting events, including the 2018 FIFA World Cup, as well as through tight control of inventory levels and stringent cost management, we project strong revenue and profitability improvements in 2018. Our net income is expected to benefit from a further expansion in gross margin and the positive effect of lower other operating expenses as a percentage of sales. See Subsequent Events and Outlook, p. 128. We believe that our outlook for 2018 is realistic within the scope of the current trading and economic environment.

Assuming no significant deterioration in the global economy, we are confident that we will achieve strong top- and bottom line improvements in 2018. However, ongoing uncertainties regarding the economic outlook and consumer sentiment in both developed and emerging economies as well as persisting high levels of currency volatility represent risks to the achievement of our stated financial goals and aspirations. See Economic and Sector Development, p. 108. No other material event between the end of 2017 and the publication of this report has altered our view.