adidas Group Nine Months 2012 Results
November 8, 2012
Q&A session
adidas Group participants:
Herbert Hainer, adidas Group CEO
Robin Stalker, adidas Group CFO
John-Paul O'Meara, Vice President Investor Relations

Andreas Inderst – Exane BNP Paribas
I have a couple of questions. My first one is on inventory management. Excellent development here. Robin, maybe you can elaborate a bit more. How come that you are so much better than the competition right now? You mentioned the focus on inventory management, but what exactly are you doing? And what are the prospects for 2013 on inventory management?
The second question is on cash flow. Extremely good development here as well. In terms of utilisation of cash, what can we expect in terms of dividends, share buybacks or acquisitions? Maybe you can give us a hint here.
My third question is on the one-offs related to India. Can you quantify the one-offs for Q3, please? And then my final question is on 2013 on the sales growth and what you expect. Are you happy with the consensus forecasted for a 5% or 6% growth rate?

Robin Stalker
I'll take the first couple of questions. I'm not sure I can specifically identify what our competitors are doing with inventory, but I can tell you what we are doing. Over the last few years we have been really concerned that we have good visibility on our inventory and that we keep a focus on clearing the inventory as quickly as possible. And you may also see that we proactively take action, involving taking trade-off positions in this respect. Sometimes we need to clear product and achieve lower margins just to make sure that we have very clean inventories. Perhaps one of the best examples compared to our competitors is when you look at our performance in China. One of the reasons we're very well positioned in China is that we took certain decisions in 2009 to go deeper into cleaning up our inventories and then maintaining a very current inventory level in that region.

So, we will continue to keep everybody focused on that and I think that will also help us over time to increase our stock turns and therefore, obviously, further our use of cash and our cash flow generally.

Regarding the use of cash, no, there's no change in the guidance that we've given over the last year. Our first priority is to continue to generate good cash flows and to pay down the debt. Secondly, we have said that we will continue to invest in our operations. And we have what we believe is a very good dividend policy and you have seen us slightly increase our dividend over the last couple of years. And you may anticipate us increasing that in the future. We still have some room to go within our guidance. And we have no plans for any sort of major acquisition or any sort of share buyback at this stage.

Your third question was about India. Reebok India and the one-off impacts this year. We gave guidance earlier in the year that we're expecting the one-off charge this year to be around EUR 70 adidas GROUP

million. Year-to-date at the end of the third quarter we've probably got about EUR 60 million in there and we've probably got another EUR 10 million to EUR 15 million to go in the fourth quarter.

Herbert Hainer
Andreas, your fourth question was about sales increases in 2013. You can be sure that our deep desire is to first grow our business in 2013, as I already said in my speech. But bear with us, when we have the final results presentation at the beginning of March we'll give you all the details on this.

Jurgen Kolb – Cheuvreux
Again, on the inventory side, a very strong performance indeed. Any concerns that there might be, in the next quarters, the need to ramp up your inventory side? Or is that at a level you think you can continue on, on a sustainable basis?
And then regarding the raw material impact in the third quarter, another 250 basis points. The trend is obviously improving, but how could you, or how do you see the next quarters trending from that perspective? Maybe also looking into the first half of 2013.
And, sorry if I may have missed it, but the gross margin for the Group in Q3, excluding India, how did that develop?

Robin Stalker
Regarding the inventory level, we're quite confident we can sustain this. As I said in reply to Andreas' question, we're trying to improve our stock turns here, so we're getting more efficient in our inventory. We definitely also want to drive sales, but on this we're not anticipating that we have to see our inventories increase. We want to maintain them at this good level.
In terms of FOBs, yes, you've seen that in this quarter the trends have been better. And although for the full nine months we're still suffering something like over 400 basis points negative impact because of the FOBs. It is getting better, and we would anticipate that this will be a smaller impact in the future quarters, particularly because we're starting then to anniversary, or to do the comparison with, the significant increases we saw at the beginning of 2012. So you should look at this to be something that is not the headwind in the future that it has been in the last few months.
And in terms of the gross margin impact from Reebok India, it's minimal, if anything at all on the Group basis. But in terms of the Reebok segment, it's about 1.2 percentage points from the gross margin.

Jurgen Kolb
Allow me please one add-on question regarding Southern Europe. How do you see the situation there, specifically the three core markets, Italy, Spain and France, given the current trends that you're seeing there?

Herbert Hainer
Yes, Jurgen, the Southern European countries you mentioned, they're definitely still challenging. But on the other hand, as you have seen, also during the summer months, we are able to excite the consumer through events and assets such as the European Championship with the Spanish national team, Real Madrid and a lot of others. So therefore on the one hand, as I said, it's challenging, but on the other hand I think we have been quite successful to motivate the consumer to go into the stores and buy our product. And this is what we will continue to do.

Matthias Eifert – Mainfirst
First question from myself would be: Could you help us to understand page 20 in your presentation, how to reconcile the 5% increase you are mentioning there? I don't know if that is referring to North America because I think Q3 sales were actually declining there. That is my first question.
Second question: It is extremely exciting about adidas basketball in North America up nearly 60%. Are there any categories that didn't perform as well as you expected? And if so, which ones would that be? And do you have any measures to kind of improve that going forward?
And my third question would be also about the gross margin, a bit more on a longer-term perspective. Do you think we ever will get back to the kind of levels we have seen at the adidas brand in the wholesale business of 46% in 2008? Or is it just not possible anymore due to, I don't know, continuously increasing labour costs or maybe a product mix change or something like that? Can you put that into perspective please?

Robin Stalker
So, Matthias, just for a little clarification point on your first point, we're up year-to-date 5% currency-neutral in North America.

Herbert Hainer
Your second question, Matthias, was on basketball or are there categories which are not performing so well. As I said in my speech, I'm very pleased with our categories, be it running, football, basketball, outdoor or the adidas Style business. If I would have to pick one within the adidas brand, then it would be tennis, which was not as successful as all the others. But you know tennis is not the biggest category. So overall, I must say, I am very pleased with the development of the adidas brand.

Matthias Eifert
And then for North America in particular?

Herbert Hainer
Yes, in North America in particular it's basketball, football, Originals, and our growth in apparel. These are the main categories.

Robin Stalker
And Matthias, we like challenges and we therefore believe there's still opportunity to improve gross margin, although I think we've given you over the previous years good guidance in terms of where that's coming from. There is regional mix and obviously also our channel mix. The retail margin being higher than the wholesale margin and the faster growth of retail, this effect certainly helps us.

And also don't forget that one of the major opportunities we have in further improving our margin is improving the gross margin of the Reebok brand and, as that improves, clearly that also helps the total Group margin. So we're optimistic, but no specific guidance on gross margin at this stage.

Julian Easthope – Barclays
Just three questions, if I may. The first one is on marketing spend. I see for the first nine months you're down about 70 basis points in terms of percentage of sales. Is that going to be a step change in marketing spend from this point going forward and we're looking now at, sort of, a

little over 12%, rather than 13%. Or is there likely to be a margin headwind on marketing spend for next year?
The second question I have is on the interest charge. You've now got EUR 1 billion in the convertible bond and the bonds. And you still have some private placements. So I just wondered if the bond was going to be used to pay down those private placements early or what is the actual average interest charge of the gross debt, if possible?
And lastly, a clarification on Reebok. Are we expecting, with the NFL contract being big in the fourth quarter of this year, another quarter that's going to be down by approximately 25% caused by the NFL and NHL contracts as well?

Herbert Hainer
Julian, let me start with the first question, the marketing working budget. You should know that this is definitely not a step change. As I have said already several times, I don't see this as a cost rather more in terms of investment. This change is purely just a timing effect and as we also told you, we are spending around 12% to 13% to activate and excite our consumers and I think we do it in a fairly professional way. When you look what our campaigns say, such as our original adidas "all in" campaign. Look at how much consumer excitement it created. So, the answer is no, there is no step change in marketing spend.

And the last question on Reebok, yes this is correct. The NFL in the last quarter is a big quarter. And therefore this will ultimately influence our performance for Reebok in the fourth quarter and the decrease will be around that number.

Robin Stalker
In terms of the interest charge, you're right, we obviously have a gross debt, and we have no plans at the moment to change that structure. And with the convertible bond we have to, from an accounting point of view, also reflect this as a cost at a normal bond rate. We obviously bifurcate this cost. You may remember the coupon of that is 0.25%. We have a very good practical financing rate, but obviously through the accounting of that they go through the P&L more expensively. And if I look at the gross borrowing average cost that would probably be close to 5% at the moment.

Louise Singlehurst – Morgan Stanley
A couple of questions from me. Firstly on Europe, obviously there's been a slowdown in Q3, not at all a surprise. But can you talk about the end consumer, if there's any difference there in terms of pricing demand or if it's just footfall.
Secondly on China, given the problems all the domestic brands are having, you are clearly outperforming significantly in that market at the moment. Can you just talk about plans to push out to lower tier cities and do the current difficulties with the domestic environment prevent you from going as fast as you'd like to in those lower tier cities? I suppose I'm really trying to find out whether we should expect an acceleration in the growth for 2013.
And then thirdly, back on the balance sheet again and thinking about what Nike's been up to in terms of exiting some non-core or smaller brands, are there any plans like for Rockport or the hockey businesses, or any changes that you can expect to see with the portfolio of the Group?

Herbert Hainer
Let me start with the first question; Europe and the consumer. Yes, we definitely see in some countries, which we have spoken about before, especially in Southern Europe, that the consumer is a little bit more price sensitive. But on the other hand, as we have done over the last years, by bringing in new innovative product, this helps us to raise our prices.

I have just given the example in America with the D Rose shoes, but we have similar examples here in Europe, which I mentioned, for example our new football boots – the f50 with Lionel Messi and the new jerseys we just introduced. And as Robin said before, having a clean inventory level really helps us to keep our pricing levels in the market and not downgrade and reduce the prices for faster sales. Therefore, this clearly helps our margin. But this also keeps the reputation and the image for our brand and I think we're doing a better job than many of competitors here in that respect.

And the second question on China. Yes, we will first continue into lower tier cities. But we will do this in the right way such that we build a sustainable and healthy business, as I have told you already over the last three years. If you remember after 2008 and 2009 where I said yes, we will clean up the market first. We will install IT systems with our key franchise partners. We know exactly what the consumer is doing in the stores such that we can put in the right fresh products and we don't end up with too much inventory. And I think it's fair to say that we have been quite successful with the fundamental part of our business in China.

Honestly, I don't see any difference to that practice in the future and this will mean that we will continue to grow in China and we will expand in 2013 including into the lower tier cities. We will do this with prudence and care and we will continue to monitor the market quite carefully.

And the third question I think was on our smaller businesses. As you can imagine, we have been approached by companies that want to buy one or the other part of our business from our portfolio. And, yes, I can confirm that we have been recently approached regarding our hockey business and we are in discussions, but we haven't taken a final decision yet.

Louise Singlehurst
Actually just a quick follow-up on NEO as well. Obviously that's doing very well for you in China. Good thing for all those Justin Bieber fans out there, I'm sure. But in terms of the global roll-out, is there anything else beyond Germany, which you've got plans for that label?

Herbert Hainer
Yes, we have the NEO label in markets other than Germany and China. We have it in Russia and we have it in some of our emerging markets. But, as we said, for the core of our European business, which means the five countries, UK, Germany, France, Spain and Italy, we want to test it in Germany first. We took Germany as a test market because we think this is a highly competitive market. We have opened 10 stores, as we told you. We will take 12 months piloting these, so this means in the middle of next year we will definitely be in a better position and then we will decide how we will do the first roll-out. Furthermore, I can also tell you that the first indications that we have from our stores here in Germany are quite positive. This does not mean that all the 10 stores here are booming, but 7 out of the 10 are doing very well. For one or two we have to look at how we can improve. And we have one that is not performing to the level which we had expected. But honestly, this is exactly what we wanted because we want to learn what is working and what doesn't work before we do the roll-out. But we will definitely give you much more details next year when we speak about the expansion of NEO.

Michael Kuhn – Deutsche Bank
Also three questions from my side. Firstly, on the Other Businesses Segments, here the operating margin was down 2.3 percentage points in the third quarter. It would be interesting to

know what the reason behind that change is and whether it had anything to do with including Adams Golf? And some clarification in the same context; I think the figure of EUR 23 million was mentioned. Was that the first-time sales consolidation of Adams in the third quarter?

Robin Stalker
The figure outlines the sales for Adams and it is the total for the year to date, which is just from June. So there was a bit in the second quarter also, but it was minimal obviously. And the margin deterioration was pretty small, but it is largely across all segments.

Michael Kuhn
Then a second question on hedging. So what you said currently in terms of your dollar hedge rate. And could you explain a little more what you're referring to when you said that hedging might turn into a headwind?
And then finally on current trading. I would be interested whether you see any substantial changes in trends among the regions or whether you would say that the environment is, let's say, fairly stable?

Robin Stalker
Firstly, what I said with the gross margin is it gave us a little bit of a tailwind in the third quarter but it was only about 30 basis points. So it's not very much. And I think we'll see that flip to the other side as we go into 2013.
But overall, the hedging will be a slightly more negative figure for us in 2013 because our hedge rate at the moment for 2013 is around about 132. And we were over 136 to 137 basically for 2012. So there's a deterioration there.

Herbert Hainer
And in terms of your third question on current trading. The latest news I am getting from our own stores, and from what I can see, is that we are doing very well in China and the US. We are doing okay in Russia. Futhermore, the biggest part of Europe is also okay. However, as we have said already, Southern Europe has more challenges than the rest.

Chiara Battistini – J.P. Morgan
A couple of questions from me. As top line is slowing down in the second half of this year and comparisons for the first half of next year will be particularly tough. Shall we expect the 2013 top-line development to be more weighted towards the second half? That is my first question.
And then on the other operating income, I see that that was up 131% in Q3 compared to 44% in Q1 and 32% in Q2. So I was wondering if that included any one-off? And did this significantly boost the Group EBIT margin in Q3 and what would the Group EBIT margin be excluding those one-off effects.

Robin Stalker
I'll take the second question on the operating income. Don't just look at the percentages. I know the percentage is high, but look at the absolute. We're talking about approximately EUR 20 million to EUR 30 million a year. This is always other income, there's always a collection of various things. And in this particular period we've got insurance claim payments. We've also got the release of various accruals. But you'll see that going up and down quarter over quarter. So I don't think it has any significant figure and I definitely can't quantify each of those for you.

Chiara Battistini

Given that in the second half of this year we are seeing a top line growing slower than in the first half and in the first half of next year you will have very tough comparisons, given the major events in 2012, I was wondering if the development of the 2013 top line will be more weighted towards the second half of the year so we should expect slower growth in the first half and then a pick-up in the second half or will it be more equally balanced?

Herbert Hainer

Yes, obviously the comps in the first half next year will be tougher because of the comparisons with those major events. However, on the other hand, please keep in mind, as we have proven over the last five or six years, that in the so-called non-event years we are quite capable of pushing our product initiatives and therefore driving sales. And as we have indicated already, we believe we have a game-changing innovation, which we'll introduce in spring next year into the running market and a lot of other initiatives. So you definitely will see us growing our business also in the first half next year.

John-Paul O'Meara

So, ladies and gentlemen, that completes our call for today. Our next reporting date will be March 7, 2013 when we will give out our full-year results.

I'd like to also remind you, for those of you who haven't already downloaded our App, we have a new investor relations and media app available for the iPad with lots of extra information to help you continue to follow all of the great things going on at adidas Group and at our brands. And other than that, we wish you all a happy holiday period and look forward to talking to you in the New Year.