

**adidas Group First Quarter 2014 Results**

**May 6, 2014**

**Q&A session**

**adidas Group participants:**

**Herbert Hainer, adidas Group CEO**

**Robin Stalker, adidas Group CFO**

**John-Paul O'Meara, Vice President Investor Relations**

**Matthias Eifert – MainFirst Bank**

**My first question is about brand adidas and the running business in the US. How was that going recently and, in particular, in relation to Boost and Springblade? How are they selling through in the US market? And secondly, also about running, but here on the Reebok side, you mentioned there were too many running shoes in the market which caused the weakness in the Reebok US business during the quarter. What exactly happened there?**

**And also related to the whole running topic, you said that more than nine million Boost shoes should be sold this year. Does that include what you expect from the basketball business and how much of the basketball business and the D Rose product launch in the third quarter are related to him coming back to the game?**

**Herbert Hainer**

Let me start with the first one, the running business in the US. It was slightly down in the first quarter. However, Springblade and Boost are doing very well. Unfortunately, we did not have enough Boost for the first quarter because, as you know, we had higher demand than what we could deliver. But now we are delivering to the US market and we are improving our situation there, as I already said during my presentation.

In terms of Reebok, we are running against some comparables from the previous year within the running category due to lapping strong RealFlex sales. This is why we are down in the running category but, as I said, we are already up in all the others and the running category will come back, with the likes of the Z series, when we finish lapping these comparables.

In the third quarter we will bring Boost to basketball. Obviously, this is a smaller part. The biggest part of the nine million pairs of Boost is by far from the running category, as you can imagine. But basketball is included in this nine million pairs. And obviously, we're all hoping that Derrick Rose will be back on the court. He will most probably play during the summer months for the American national team and then obviously play in the season games.

In addition, you almost certainly have seen that some of our players, such as John Wall and Damian Lillard, have developed well during the last season and particularly during the playoffs. John Wall brought the Washington Wizards, against the Chicago Bulls, to the next round, for which we are extremely happy. The next draft, as you might have heard, includes three of our key guys, so we feel we have already won there and consequently we are very optimistic about our basketball business going forward. However, it is still competitive in America as you know, but we are definitely optimistic.

### **Antoine Belge – HSBC**

**Three questions. First of all, regarding the golf market's growth – I understand that you are expecting much more innovation in the following quarters, but is your expectation of growth resuming here still based on the assumption that the market itself will recover somewhat?**

**My second question is regarding the World Cup. Can you explain to us if the timing of deliveries is different from the two previous World Cups? I don't recall that so many deliveries had been in advance in Q4 in previous ones and also not all the re-ordering happening in Q2, so was there any difference in timing compared to the previous World Cup?**

**And finally, regarding Originals, what gives you the confidence that we should be seeing an improvement for the remainder of the year? Is it based on your wholesale orders? Can you maybe give us a bit more information there?**

### **Herbert Hainer**

Starting with your first question on the golf market growth. Honestly, I don't see a big improvement in the market growth in 2014. Obviously, we expect the second, third and fourth quarter to be better. And you might remember that, in the first quarter, it was very cold, especially on the East Coast of America, which is by far the biggest market.

Yes, we are constantly bringing new products to the market. We will also retain our market leadership in metalwoods and in irons. But unfortunately, the market is going down, as we have seen with the lower rounds-played numbers, and this is causing some high inventories in the market for all the industry players. And this is why we didn't ship so many products in the first quarter to the market. So overall, I don't think that in 2014 we will see a big boom in the golf market's growth. Obviously, as I've said, we're bringing a lot of new products to the market which will help.

Secondly, your question on the World Cup – as was the case in the previous World Cups – the biggest shipping months are in the fourth quarter of the year before and then in the second quarter, which we are now in. And this is when we can really feel the World Cup excitement starting. We're shipping all the jerseys, the balls, etc., etc. Therefore, as I said before, the second quarter is definitely a football quarter and is definitely an adidas quarter.

And finally, on your Originals question. The reason for our confidence for Originals is two-fold. On the one hand, it's due to our Originals products. As I said and you might have seen it – we re-launched Stan Smith after we took it away from the market for quite some time. This has been a huge success. And we are also bringing in other new products through our collaborations, such as with Topshop or the Farm collection, which is a label in Brazil. But the biggest part is by far the ZX Flux shoe. This is the fastest-sold shoe in the last two weeks at Foot Locker Europe, outpacing, as I said, our competitor's best shoe, which was the Roshe, and we are selling better than this. This is one part. The other part is that you have also heard that we have recently announced some extremely exciting collaborations with a lot of stars and celebrities in the music scene. Celebrities such as Kanye West and Pharrell Williams, when you may have seen prominently wearing adidas Originals, with the 3-stripes, at the likes of the Oscar awards or on other TV programmes. But we have also started a collaboration with Nigo, the celebrity Japanese designer and music producer. And all of these give me such confidence and we can already see this in the market and we can see how we are bringing momentum back to our Originals business.

**Antoine Belge**

**Thank you. Just as a confirmation, so nothing special this year compared to previous years regarding the phasing around the World Cup? I know that always the balls were delivered in Q4, but I don't recall that jerseys from the national teams were pre-delivered ahead of time, but maybe my memory is failing me.**

**Herbert Hainer**

No, but there are some specifics. The official match ball is always launched at the beginning of December. And also, the new jerseys are launched ahead of Christmas because these are always a big part of our business during the Christmas season. But in the first quarter it slows down. And then when the momentum for the World Cup comes, which is starting now with the Champions' League final, we will bring a complete new football footwear package, the Battle Pack, which you might have heard about. We are also bringing the ball for the final, as well as all of the other brazuca ball related products. As you know, additionally we have a new fan-based merchandising programme. Therefore, the second quarter, in terms of football-related products, is definitely stronger than the first quarter.

**Jurgen Kolb – Kepler Cheuvreux**

**Three questions also from my side. First, on TaylorMade, when did you make the decision to change the pattern of deliveries here and how shall we see the coming quarters? Shall we see a major ramp up in the second quarter in terms of product innovations and product launches? And do you also see other competitors following your shift in product cycle? That's all on TaylorMade.**

**Then secondly, you talked about the football business which apparently was up 27% in this quarter. Can you break it down a little bit into apparel and footwear, please? Have you seen similar growth rates specifically on the footwear category?**

**And then lastly, on the US, which seems to be an on going topic here, what do you think you can do differently in order to present the brand much more successfully at the wholesale level? I mean I think in the past you've tried various things, but so far we haven't really seen the breakthrough. So, what are you thinking about how to really get the brand stronger in the US market?**

**Herbert Hainer**

Let me start with the golf market. We announced this already, during the summer months last year, that we would start shipping higher volumes in the fourth quarter, because we want to give them a longer life cycle from January through to April, May, June, etc. But unfortunately, in the first quarter, as I said, the weather was very bad and rounds played were down again. So, we started this shift already last year and I would expect that as we are by far the leader in the golf market, I believe that the other industry players will follow. This is because if we are the earliest ones to bring new products into the market, then everybody else will start to do the same. We will bring new products into the golf market during the course of the year and this will help us to get close to similar sales results as last year. But this is still a lot as with sales of approximately EUR 1.3 billion we are, by far, the number one golf brand, as you know.

The second point was on football. So on that, apparel had stronger growth than footwear. And your last question was on the US. And this is a good one because this gives me an opportunity also to make a statement on the US. I mean, yes, we are by far not growing as fast in the US as Nike, but we have been growing in the last two years. So we were growing at a double-digit rate in 2011 and in 2012. But what is even more important, we have really increased our margin in the US market and this is the quality growth we planned for over the last three years. We have, as you might have seen, raised prices. We worked with retailers on all of

the trade terms – how we go to market, etc. – and, therefore, we have increased our profitability in the US market significantly, which obviously has helped us to get to our numbers for the total Group. Where I do see opportunities in the future is quite clear. As I mentioned in my speech, we have been growing our owned stores, which increased by 13%. That has been even more evident in our concept stores. And this clearly shows to me that when we have the opportunity to showcase a collection to the consumer in an appropriate way, showing the breath and the depth of our concepts holistically, then we have a better chance. And this will be one of our focus points with the key retailers going forward, making sure that we work closely with all of the key retailers in the sporting goods industry, particularly in the malls. And that we get the proper presentation space in the future. Obviously, this depends on the in-store visuals which we provide and working together with them on how we bring products to market, and activate, etc. – but this will definitely be the key to success for us in the US.

### **Jurgen Kolb**

**And one quick follow-up on Originals. You have indicated that you may have missed some trends. Any learnings from that? We all know that you have scouting people on the ground, but for some reason and for some time, obviously, you must have missed some trends. So any changes to that so that it doesn't reoccur?**

### **Herbert Hainer**

Yes. First and foremost, I think it's fair to say that we have had a nice ride on Originals' performance for the last 10 years, with sales up to approximately EUR 2.5 billion. And yes, we missed some trends a little bit, especially in the US where there was a trend to more athletic running silhouettes for the leisure product and not back to the old styles. But as I said, we have adapted relatively fast to that and we see tremendous success already in Europe. And I'm sure when you are out in the market and asking retailers, you will see this and they will tell you the same thing. And we're seeing relatively similar developments in the US as well. Therefore, we are quite optimistic that Originals is back on track.

### **Chiara Battistini – JPMorgan**

**Just a couple of questions from me. First of all, just to follow up on the World Cup and the football category, you mentioned quarter one was up 27% and you mentioned quarter two should be stronger than quarter one, so should we expect an acceleration there?**

**And then, question number two is on the inventories being up 18% currency-neutral, which is on the high side. So I was wondering whether you could give us some more colour on the breakdown of these inventories and to what extent these are related to build-up ahead of the growth that you're expecting in the second half of the year and to what extent this is excess inventories that you still need to clean up, in Russia especially?**

### **Herbert Hainer**

Coming back to football, I didn't mean that we are growing faster in the second quarter than the 27%. I said that the growth this time, because of the World Cup, in the second quarter will be bigger than in the first quarter.

### **Robin Stalker**

Chiara, for the inventories, yes, as I said, we have a large increase in inventories due to goods in transit, which gives me confidence that this is the product that we are anticipating is going to be sold in the next few

quarters. We still have, however, as a part of this growth year over year, the Russian inventories. You will recall we really only had growth in the Russian inventories in the second half of last year. And the release of those or rather the better comp we expect will really come through in the second half of this year. But from a trend and from the ageing perspective our inventories are very good. So it is largely the anticipation of increased sales over the next two quarters.

#### **Julian Easthope – Barclays Capital**

**Yes. Good afternoon, everyone. I have three questions. First of all, starting off on Russia. Given all the issues that have been going on there, I just wondered if you'd seen any sort of changes toward the end of the quarter or how is that actually progressing? We hear from our partners here that there's been strength within St. Petersburg and Moscow, but other areas have been weaker. I was just wondering if you could give a bit more detail on the Russian business.**

**Second is the distribution centre in Osnabrück. I think it's been up and running for a quarter now with all the products going through. I was just wondering how that was performing relative to expectations and whether or not you can see some inventory benefit for that by the end of the year?**

**And lastly, a thing that came up earlier – you were saying that you'd actually received some bids for Rockport and that you were considering selling it. I just wondered if you could confirm that?**

#### **Herbert Hainer**

Okay, Julian, let me start with Russia. As you have seen, we had a very strong first quarter in Russia with plus 29%. And obviously, all the turmoil in the Ukraine is certainly not strengthening the confidence of consumers in the Ukraine, but in Russia we don't see this impacting consumers at all. But you should also have in mind that Ukraine is less than 10% of our total Russian business. So far, knock on wood, we haven't seen a negative impact. But obviously, we are watching it very carefully and our management is working diligently with the whole situation and hopefully it will be peacefully resolved soon.

The second question was regarding our CDC. It is working well. We brought it to life last year and so far we don't have any issues. And the Russian distribution centre, which you mentioned, is now also working flawlessly and we definitely have learned our lesson there.

And Rockport. Yes. I believe I have said it already several times that Rockport is not a strategic asset for us in the Group. Nevertheless, we worked hard to improve the distribution and, therefore, we grew the Rockport business last year by 6%. It will grow again this year. And I think this is one of the most attractive brands out there. Therefore we get a lot of enquiries and interest and, as the management, it is our duty to listen to these people and therefore we have asked Guggenheim, our financial advisor, to help us talk to these people and see what the situation is and at the moment this is exactly where we are at.

#### **Michael Kuhn – Deutsche Bank**

**Also three from my side. Firstly on China, which had growth of 5% in the quarter. It was a little less than what we've seen over recent quarters. Maybe some more details on that and on what you would expect for the rest of the year?**

**Secondly, one follow-up on TaylorMade and the new product life cycles. Can we expect a more stable trading pattern going forward? The brand was very volatile over recent quarters. So do you expect more stable growth there, going forward?**

**And lastly on management responsibilities. If I understood you correctly, I think on an Executive Board level Mr. Auschel will take over responsibility for the US market. I think in late 2011 you, Mr. Hainer, took over responsibility for that market. Now it seems it struggles a little and probably needs lots of care so I'm asking myself why we see that management change now? Maybe you can comment on that quickly? Thank you.**

**Herbert Hainer**

Let me start with the third question as I want to make sure that you don't have the impression that I just want to get rid of the US because it's dragging in the first quarter, as then you would have to give me the benefit for the last quarter last year as well, where we grew at a double-digit rate.

No, the reason is quite simple. We brought Roland Auschel on as a Board member for Sales worldwide in September last year. And I already said at that time, I will finish implementing the joint operating model in America and then Roland will take over North America, as well. And then he's responsible for Sales worldwide for both brands – Reebok and adidas. So, we have finished that and therefore it's quite normal that Roland should take it over. As I said, this was already announced six months ago.

In terms of TaylorMade and you asked specifically about a more stable trading pattern in the future – honestly, I believe it will take all of 2014 before the entire inventory in the market has flushed through. And I am speaking not only about just TaylorMade products, it is the entire golf market. And when this happens, then we will hopefully come back to stable trading patterns, as you said. We will continue launching new products early for the beginning of the new season, such that we give them a longer life-cycle and hopefully, therefore, achieve higher margins.

The first question was on China and particularly the 5% currency-neutral sales growth rate. I must say I am quite happy with the 5% growth in China. You saw our growth pattern since the Olympic Games in 2008, where in 2009 we first cleaned the market and then we said we will set up an information system with our two key partners so that we know exactly what's going on in the stores. And we did this such that we could drive down inventories and improve inventory control with our retail partners. Using this has helped us bring fresh products on a constant basis and bring continuous growth to this market. And I'm sure that you have realised in the last few years that we are growing faster than our main competitor there. And I must say, I am happy with this growth rate because this is healthy and sustainable growth.

**Rogério Fujimori – Credit Suisse**

**I was wondering if you could talk a little bit about Japan, any thoughts on market conditions there post-VAT hike.**

**Also a follow-up on China. I was just wondering if you could talk a little bit about your wholesale sequential trends and how in particular adidas' performance is doing in China.**

**And my third question, just curious to hear an update on the development of the miCoach smartphone watch and the potential for wearable technologies for adidas. Thank you.**

**Herbert Hainer**

Let me first start with Japan. Overall, as we indicated last year when we changed our trade terms system in Japan we had a certain shift within our savings pattern. But overall, I'm quite happy with the Japanese market. You know that we are by far the market leader in Japan. I think the World Cup and the next Japanese football matches will give us more opportunities with the team playing in Brazil. And as I said, I think we have a very

stable position in the Japanese market with a close relationship to our retail partners and therefore I'm cautiously optimistic as the market is not growing that fast in Japan, as you know.

In China, your question was on wholesale patterns. In China 95% of our sales are wholesale with the biggest customers being Belle International and Yue Yuen, plus a lot of others, but this is all wholesale related. We only have approximately 170 owned stores in China out of the 8,000 stores that we have over there.

**Rogério Fujimori**

**Yes, could you give an update on the development of your smartphone watch and the potential for wearable technology for adidas?**

**Herbert Hainer**

Yes, as you have seen, we had quite a successful launch of miCoach Smart Run watch. I would call it the Ferrari within all of these systems. And our next step will be to bring it down from a EUR 400 price point, which we currently have it at, to maybe a EUR 200 price point or even a little bit lower, such that we can then go into bigger volumes. You might have seen that we brought out in the meantime the miCoach Smart Ball. This is the next evolution of being smart and these smart products show how we will continue into the future.

**Chris Svezia – Susquehanna Financial Group**

**I have four questions. Number one, the UK – I'm just curious and I know it's been a pretty competitive marketplace there, but what are your thoughts on that market as the year unfolds?**

**The second question is on Reebok. Nice performance there. Just some colour on the sustainability of the gross margin improvement, how we should think about that for the balance of the year?**

**Then the third question is when you talk about accelerating growth in the second quarter for the entire company, is that a linear growth rate? In other words is it set to continue to build, is it sustainable throughout the balance of the year or is second quarter really the strongest year-over-year growth quarter for the company?**

**And lastly, just on TaylorMade, margins were down in the quarter. I'm just curious about your thoughts about how we should think about the margin profile development at TaylorMade given how you're now bringing product to market for the balance of the year. Thank you.**

**Robin Stalker**

Let me start with the Reebok gross margin. Yes, this is very definitely sustainable. In fact, one of our key operational goals with Reebok is not just, obviously, to grow the top line, but also to fundamentally improve the profitability of this brand. And you've seen us being able to do this. We were up even in the last quarter 50 basis points and that is despite significant negative currency trends, as you will be aware. And so we're still only at a level of about 39.6% and our aim was to be at a level of 40% by 2015. We're definitely going to achieve that and over-achieve it and so my comment here is, yes, Reebok gross margin improvements are sustainable.

On the growth trends for the rest of the year, I mean traditionally our third quarter is always the strongest quarter or the most important quarter. That'll be the same this year I think. But clearly, as Herbert said, we're looking at the second quarter also being a very good quarter, particularly in light of the poor first quarter, but it's the second and third quarters that will be the highlight quarters in 2014.

**Herbert Hainer**

Coming to the first question on the UK – the UK was slightly down in the first quarter but is improving as we saw already during the month of April with Originals and because of the collaborations I already mentioned. But we also see business coming back in the football area with the Champions League supporting this. So we definitely see an improvement in the UK business.

The fourth quarter was on TaylorMade and on its margin development. Yes, I believe we will see an uptick in the margin going forward, but honestly it will not explode. As I have said, this is because there is a lot of product in the market, not only from us, from our competitors as well. But yes, we will definitely see a better margin for TaylorMade going forward in the rest of the year.

**John Paul O'Meara**

Thanks, Chris, and thank you, ladies and gentlemen. That completes our conference call for today. Our next event will be our half year results, which we will report on August 7. We wish you all a great summer and hope you enjoy the World Cup, where I'm sure adidas will again be the winner. Thank you.