aadidas Group First Half 2012 Results
August 2, 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

John-Paul O'Meara
So just before we start the questions and answers session I would like to remind everyone that the dates for our Investor Day are the 20th and 21th of September. At this event we will have an update on Route 2015, presentations from TaylorMade-adidas Golf, adidas America and the basketball category as well as updates on the Reebok strategy.
If you could register with us by September 3rd we'd greatly appreciate it so we can get all of the logistics sorted out. So now we will start with our Q&A session.

Matthias Eifert - MainFirst Bank AG
The first question I have is: Can you give us a bit of flavour, going forward? What's going to happen with Reebok? 26% decline in Q2 looks quite big. And given that India is also probably not going to improve, how should we look over the next two to three quarters? Is it with a similar impact and then hopefully to grow in 2013?
And the second question would be about the current trends you are seeing in China. You've had very impressive growth of 13%, but everyone talks about the high level of inventories of specific goods in that market. What is your sense of the current market growth and what do you expect for the second half in China?

Herbert Hainer
So let me start with the first one. Yes, as I said already regarding Reebok I am also disappointed about the results. When you take the one-time effect then the underlying business is down as well but single-digit only, and this is what I believe will continue going forward. We indicated to you already at the beginning of the year that 2012 will be a difficult year with the non-renewal of the NFL licence business. And now we also have the India case. And as I said, unfortunately, we were not able to bring new concepts to market as we did with EasyTone, Zig and Flex. And these helped us enormously in both 2010 and 2011 to grow our business. But you will see in 2013, Reebok will be back to that mode with new concepts. We have already shown our new concepts to the retailers, especially in the US, and now starting in Europe. And we have got very positive comments. So there is no doubt that we will grow in 2013 again with Reebok. As we go through 2012 we will clean up our India business and we will bring new innovative products into the markets in spring/summer 2013. We will also bring new products in the second half of 2012, but they will not be enough to really stimulate sales as we get back into positive territories with Reebok. But from 2013 onwards we will grow again and we will give you all the details and also the product concepts in Carlsbad in September.

On your second question on China – I cannot comment on the difficulties other sports brands have in China. I can only tell you that our growth is very healthy and sustainable. And you might remember we discussed the clean-up of the market after the Beijing Olympics and the economic crisis. And I also told you it will take a little bit longer because we want to do it the right way, and that we would return to growth in the second half of 2010. And this is what we have done and now we are growing and growing. And what are we doing differently to our competitors? I believe we have a great focus on sales with our franchise partners because this is the most important thing. It doesn't help if we push products into the market and they cannot sell them. Therefore, we have invested a lot in IT systems with our key franchisees such that we get instant information about what is selling and what isn't selling. This leads us to have the highest growth rate at the moment in China and we also have the lowest inventory. There were a few Chinese customers here last week in London and they're all very happy with the way in which we're dealing with them because they earn the most money with us. They have less promotional activities because inventories are clean, sell-through numbers are good, and they are also positive about 2013 as well. Yes, in general the market might get tougher in China, in 2013, but I believe we will also be the frontrunner in China in 2013. And in the second half of 2012 our backlogs which are already on our books are also very good.

Andreas Inderst – Exane BNP Paribas
I have a couple of questions. The first one on your development in Latin America. This was a very poor development in the second quarter.

Herbert Hainer
This is not correct. adidas grew by 8%, this is only Reebok.

Andreas Inderst
Yes. Maybe you can elaborate on what action you are going to take on Reebok in this market in respect to your joint venture partner? And when do you expect renewed growth? Maybe you can give us a sneak preview on your 2014 strategy for Brazil?
The second question, your like-for-like growth in own retail was plus 8%, which is a quite nice development compared to your competitors. Maybe you can give us more details how the growth rates were by region, so what was this for China, the US, and Western Europe on a like-for-like basis?
And my third question is related to the current economic situation. In 2008 and 2009, you experienced a significant profit decline. What's the difference today? How are you positioned differently today compared to then to reassure us that we won't see a similar development as happened in 2009? I understand inventories are developing nicely compared to the past, brand adidas is better positioned, but maybe you can give us more information on that side? Thank you.

Herbert Hainer
Okay. I guess I will take the first and the third one and Robin you take the second one? Good. So let me start with Latin America. As I said already, in Latin America we have been growing by 8% with the adidas brand. We still do have the same issues on import restrictions for adidas as we have for Reebok. In addition, for Reebok we have a joint venture which continues until 2015. So this is our business model for Reebok in Latin America for that period and as you might have heard we have had some difficulties with this. They have had to close factories, they have had to release some workers and obviously this doesn't help our business either. However, because of the joint venture we have to go through that until 2015. As I said, we are bringing also new products to this region; however, it is more complicated to import products into Brazil and Argentina, due to government tariffs.
Question number three you were asking was about the economic crisis in 2009, when our and everybody else in our industry's profit dropped. So now with the macroeconomic situation getting tougher, what are we going to do to prevent this happening again? I believe that we are in a much better situation today, although obviously if the world economy collapses then it would also hit our

business as well. But when you have a look at our balance sheet, which Robin showed you, I think we are in a much better position, especially on the inventory side. All of our competitors announced their results within the last two weeks. They had high inventories, but our inventory growth is less than our sales growth. And we drove growth over 10%. So this shows you that our processes, which we introduced in the last several years, from planning, purchasing, sourcing, delivering and logistics to sell-through numbers controlling in the stores, are really flawless. And I believe, without sounding too self-confident, that we are much better than most of our competitors there. This shows you how we channel our stream of products into the market. And obviously, the situation will have an effect over the next six months because they will have to drop their products. I mean, what do you do if you have 30% over-inventory? You have to mark down products, giving less margin, et cetera. Whereas we can still continue our clear channel segmentation approach. That means, we supply products only to channels where there are consumers who can buy those products. This means we take Originals away from certain customers and give it to customers where this is the case. To give you an example, we don't sell Originals here in the UK to SportsDirect, but JD Sports obviously is our number one Originals customer. And this I think gives us a much better position than three years ago, also compared to our main competitor.

Robin Stalker
Andreas, there's a lot of good news about retail. One is the development of the comp store growth, which we can see throughout all the regions. We have in Russia 12% comp store growth, in the US 10%, in China 8%, and in Europe 4%.

Jürgen Kolb – Cheuvreux
Focusing again on India and the Reebok situation: Do you have the Reebok underlying growth excluding NHL, NFL and India? How did Reebok do there?
And then maybe a little bit of an outlook about what the impact of the situation in India will be for Q3, Q4? How is that going to develop there? On the gross margin of the Group, was there an impact from India as well?
And lastly, the EUR 70 million restructuring expenses that you mentioned for India, did that also include the expected sales decline in the Indian market or is that just the pure restructuring cost for closing down stores?

Herbert Hainer
To answer your first question: Reebok numbers excluding NFL, NHL, et cetera, would have been minus 8% for the first six months.

Robin Stalker
And yes, you're absolutely right Jürgen, obviously the issues that Reebok India had, had an impact on our margin and, anticipating that, I've got some calculated figures for you. So in terms of the Reebok India business, if that wasn't in our numbers, we would have had a 30 basis point decline in the Group gross margin. If you look at it on the wholesale basis, and I think you know that I am looking at wholesale development as well, wholesale for the second quarter was 70 basis points negative impact, 10 basis points for the half-year. And in the Reebok numbers themselves, obviously there was a significant impact for the quarter, it's 5.1 percentage points and for the half-year, 1.2 percentage points.
On your question about what we included in our so-called restructuring cost – as we gave you guidance at the end of our first quarter, we anticipate that not just the restructuring cost, but also the impacts of changing our business model in 2012 will result in less sales and less profit obviously in this period, and that altogether will be a negative, approximately EUR 70 million more

than we had anticipated. That number is still our best estimate for the full year. And of that EUR 70 million, EUR 17 million is in the first half and that does include the negative sales development.

Will Hutchings – Goldman Sachs
Two questions, one on share gains. You gave us an update on your share gain performance in the UK. I wonder if you could give us an update on a more global basis and where you think you've got good opportunities to continue to take share.
And just one on the weighting of costs – presumably there's quite a significant marketing budget going on for the Olympics. How much of that has been incurred in the numbers that we've seen and how much is yet to be incurred? Thanks.

Herbert Hainer
I unfortunately don't have any global market share numbers. I have them for individual markets, be it the US or the UK. In general, I definitely believe that we have gained share, because when you just look at the sheer size of our sales growth compared to all of the others in the sporting goods industry, then we must have gained share. I have spoken about the UK market share in my speech, because today we are here in London, and as we said at the very early stages we definitely want to become market leaders. This is why I pointed it out. But we definitely can deliver it later to you.
To answer your second question, about the marketing working budget – I think you have to have in mind what I already mentioned before: it is generally around 12.5% to 13% of Group sales. This has been very consistent over the last years. And this is what we plan to do going forward. Whether in big-event years or not, because in non-big-event years we bring much more product innovation to the market. This will also be the case in 2012. Despite the European Championship, for which all the marketing working budget costs are booked in the first half, you will see that our marketing working budget costs are not going outside of this guidance, which I've just given you. And this will also be the case in the second half of the year.

Robin Stalker
Yes, maybe just to clarify the last point, I think you asked, Will, about Olympic spending. There will be some obviously in the first half, but the majority of that investment will be in the third quarter.

Mark Josefson – Silvia Quandt
Following up from Will's question, the one area, which surprised me on the positive was the SG&A expenses down 100 basis points or so. You've highlighted a 13% increase in margin, your own stores have the most spending. So where have you made savings on the SG&A and what's the outlook for that?
Unrelated to that question, in terms of some of the new brands, NEO - how is the trading density of NEO in the Chinese stores compared to non-NEO stores? Given the lower pricing points, you need much higher densities or some high densities? Are you generating that? And can you give us an update on the early days experience in Germany with the NEO brand?
And finally on Adams Golf – if I understood you correctly, about EUR 16 million [*Note by adidas Group IR department*: correct figure is EUR 8 million] of sales in June brought 16% growth for the brand in H1. So what was behind the brand strength in H1 before you achieved this?

Robin Stalker
Yes, thanks for identifying that we are making progress. But in the first half of 2012, that progress was also being helped by a lower marketing spend as a percentage of sales even though the absolute SG&A figure is up. But yes, we're definitely making progress on SG&A as well. And to achieve our 2015 goals, which some see as ambitious in terms of increasing our operating margin

to 11%, we also have to be making improvements in the leverage of our SG&A. And what we're doing here is a variety of efforts, where we are taking costs out of the organisation, not as a cost-cutting measure, but as measures to fundamentally and sustainably improve our profitability. These include efforts to standardise our processes, creating more common systems and structures across our operating units around the world. For example, taking costs out in how we run our businesses, such as consolidating warehouses. You might have heard of our major investment in Germany at the moment for a consolidated warehouse for Europe, which allows us also to close other warehouses. Various efforts like that are underway. Some benefits you can start to see already, but the vast majority of these benefits are really going to be coming through in the '13, '14 and '15 period as you see our operating margin really significantly improve.

Herbert Hainer
I think it's fair to say that we have also some leverage on the SG&A in our retail business.

Robin Stalker
That's also true. That's exactly right Herbert. As retail is getting better, their profitability is also improving.

Herbert Hainer
Coming to NEO – overall we are very, very pleased with the development in NEO, where we have seen sales up by 16% in the first half. And this is mainly coming from China and Russia as these are by far the biggest NEO markets. This shows that the product range and especially in China, which we are offering to that younger consumer is definitely a hit with them. And when you go into the NEO stores, you see exactly the consumer-base which we want to have. This is the 15- and 16-year-old boys and girls who are making their photo on the magic mirror and then posting it to their friends. As I mentioned earlier, we just opened today our 10th NEO store in Germany, in Cologne,. The overall performance of NEO is very good. But as we already said, we also want to learn. And we have learned a lot already in the first five months – be it on location, be it on logistics. Obviously, because we permanently have to refill these stores we have learned a lot about what the consumers buy and what they don't buy. We have special articles which are selling like hot cakes and others which are not selling as well and this is always the case. But the overall trend is very positive. We're permanently increasing traffic, we're permanently increasing the conversion rate in the stores, and all that we see so far is quite encouraging. Nevertheless, we will take our time – 12 to 18 months – to really experience everything in a mature market like Germany. As we said from the very beginning, if we can do it there, then we can do it everywhere and we want to achieve this before we do a rollout across Europe.
On your last question on Adams – first and foremost, I believe that Adams is very complementary to TaylorMade, because in the golfing world, TaylorMade is always perceived as very much "the longer and stronger" golf brand. And this does not relate that much to senior golfers and to the women golfers. And this is exactly where Adams is strong. Adams was the first golf brand which brought out the Hybrid or Rescue clubs 10 or 12 years ago. These clubs are much more forgiving and therefore much easier to play, so you don't have to hit the ball at exactly the right point. And this is why Adams has such success with senior players. For example, Tom Watson, Bernhard Langer and other senior golf champions, they all play Adams. Or on the women's side, the LPGA number one, Yani Tseng, from Korea, she is also playing with Adams. And they have a full portfolio of patents, about which we were positively surprised. Therefore, I think TaylorMade and Adams are the only two golf companies at the moment which are growing in the market. When you look at our main competitors then you can see this quite clearly.

And as an aside to the Adams' story, you might know that Gary Adams was the founder of TaylorMade, 40 years ago. When Salomon bought the company he walked away and founded Adams, and now with this acquisition he is back in the adidas Group family.

John-Paul O'Meara
Also, just to correct you on the Adams sales figure, Adams added EUR 8 million to sales in June, so for the first six months, Adams sales were up 16% currency-neutral.

Julian Easthope – Barclays
I've got two questions. The first one concerns China. Your chief was in the English version of the China daily news a couple of weeks ago, saying you were going to open 500 to 600 new stores through franchise partners. How important is the stocking of those new stores within the growth rate for China and how many more stores can you open through the franchise partnerships?
And the second question relates to wholesale. You cut your expectations or guidance down to mid-single-digits now from the last quarter. So what have the disappointments been within that guidance geographically? And is that obvious from the futures orders coming through? Thanks.

Herbert Hainer
Yes, in China, this is true. However, I don't know exactly if it will be 520 or 530, but what it clearly indicates is that we have strong confidence in the Chinese market, as have our franchise partners, otherwise they wouldn't be opening these stores. And we still do believe that there is potential for much more store growth in China as we penetrate deep into the lower tier cities, but also through store and location improvements in the big cities – be it Shanghai, Beijing, or Guangzhou. But this clearly demonstrates a confidence level of what we and our franchise partners believe we can do. And as we have outlined in our strategic plan we have high expectations for China through to 2015, and we are on the best way to achieving these targets. You have seen our growth rate and I am absolutely convinced that we are connecting with the Chinese consumer. I was in China just over two months ago and I have seen consumers and the traffic in our stores, I have also spoken to the two biggest franchisees – Belle and Yue Yuen – and I have nothing to say other than being optimistic for the future for the adidas Group in China.

Robin Stalker
And Julian, the only reason we have amended our guidance for sales developments for wholesale is to reflect the situation in Reebok India. I mean, the second quarter increase of wholesale was only 1%, but had we been able to take out all of Reebok, not just the Reebok India, that would have been up 9%. And we are very confident about our growth in wholesale throughout the rest of this year, but the actual figure will be under what we initially anticipated, largely because of Reebok India.

Louise Singlehurst – Morgan Stanley
Just a couple of questions from me please. Can you talk a little more about Western Europe and the trends that you're seeing there, obviously benefiting from the events in the first half of this year and no doubt into Q3. How should we think about growth going into 2013 in relation to Western Europe?
And then secondly, again, another follow-up question on China. At this stage, obviously, you've been talking a lot, Herbert, about the double-digit growth you're expecting per annum on average to 2015. Are you quite confident at this stage for 2013 and double-digit growth? And then as a follow-up, can you tell us what the contribution of NEO is within the 13% growth to China in Q2?

And one last one, a clarification point. I think you said that you were stopping or withdrawing some of the big shipments to wholesale in the US. Is that just clearing the inventory ahead of some big launches that we should expect towards the end of the year? Thank you.

Herbert Hainer
So let me start with the last one. No, this has nothing to do with big clearance. What we are seeing is that we still have very strong demand in the US for Flex and for Zig. But what we don't want to happen is to have the market stalling because it is too full of products and we continue to ship more products into the market, causing it to explode. We believe that with these two franchises we have something with which we can build over the long term, and therefore we don't want to sacrifice this through inventory build-up and this was the reason for this segmented distribution strategy. We definitely could have sold more, which wouldn't have changed the picture in Reebok and the results, otherwise we might have done it. But we really have taken a strategic decision that we want to build these franchises on the long-term, learning from our experiences from toning. On NEO, I can't give you the percentage that the NEO contribution is. But we have around one thousand NEO stores out of the seven thousand stores which we have in China. So it is quite a significant part.
You were asking why I am so optimistic about the future, in general, in China, and what will 2013 look like. I think it's a little too early to talk about 2013 details already. However, we will cover this in September, in Carlsbad. But from what I have seen to date, and we are also already selling in for spring/summer 2013, is that we will continue our growth momentum in China. As you have already heard or seen from some of our competitors, it is quite clear that not everybody will do this. But from what I am seeing I have every reason to be optimistic going forward.
And then I believe your first question was on Western Europe, on how we have benefited from the major events there. Well, when we see that we are growing in Germany and we are growing in Spain, obviously the European Championship has helped us because we have sold a lot of replica jerseys. But I do believe that in general our business is very solid in Western Europe. When you consider that in Western Europe the market is much more performance-driven than fashion-driven and this is what we're all about – be it the football, running, basketball or training business, these are all good businesses in this market. We are very deeply rooted in Western Europe – be it in the UK, Germany, Spain or France. And therefore I definitely expect tougher times in Western Europe given the situation which we have now and over the past two years about the euro and whether it's collapsing, or not or breaking apart. But overall I think our fundamental position in Western Europe is very good.

Chris Walker – Nomura
Three quick questions. Firstly, you mentioned clearance for the toning products in Western Europe. Can you talk us through that and how much further there is to go?
And then secondly, what have you learned over the first half in terms of stretching the pricing architecture higher of the products, such as the Crazy Light 2 or any new price points trends coming through in the US? Does that give you confidence to stretch the pricing architecture higher or maybe more quickly over time, given how gross margins have evolved?

Herbert Hainer
The first one on toning – we definitely believe that by the end of the year we will have by far the biggest portion of toning cleared. Maybe we clear to everything, maybe there will be a few thousand pairs left. I don't know exactly because we also don't want to over-load the market. We're still getting decent prices of EUR 40, EUR 50 or EUR 60, depending a little bit on the market

in question. We still have a market like Spain where we can sell these shoes for EUR 70 of EUR 75. But the biggest part will be cleared by the end of the year.
The second question was on pricing. As we mentioned already, 12 months ago, when all the FOB price increases came in we had to raise prices. Obviously, we also did some other things to mitigate the prices as well, but we tried to stretch prices as much as we could by bringing innovative new products to the market. And Crazy Light 2 is definitely such an innovation and we can see the consumer is paying for that, given the 30% sell-through rates in the first few weeks since its introduction. But we also learned, and I have to be fair here, that some prices we over-stretched a little bit and we saw some critical price points which, when we took one notch above it, resulted in sales going back a little bit. So we are correcting this. We're looking quite carefully into the market, but I do believe that we still have further possibilities to raise prices because our products are better than those from our competitors.

Rod Whitehead – Deutsche Bank
You mentioned on input costs that there should be less pressure in the second half, and you talked about 500 basis points in the first half. Can you give us some kind of idea of what that would be? And perhaps more importantly, how do you see the outlook for 2013, where you must have some visibility by now?
And secondly, could you talk a bit about Russia? Obviously with the rouble moving how do you or have you started putting prices up to make up for that? How do you feel the outlook is for demand in Russia?

Robin Stalker
I can't give you a specific figure for the second half of the year, but we obviously already know that in relation to the costs of our product the increase is significantly lower than it has been in the first half year. I've guided however over the last several quarters to say that 2012 is still going to mean that the FOBs are higher than they were in 2011 even though their growth rate will be significantly lower. We said that for the first quarter we thought we'd got to the peak. In fact, the second quarter has actually been a little bit worse. Nonetheless, with the visibility we have now it gives us confidence that our gross margin guidance is still very good for the full year. And most of that is obviously coming through based on our expectations from FOB projected developments.
For 2013, you're right that we're expecting that these increases should be a little bit less in terms of the input prices from raw materials. However, we're still under pressure with wages. Don't forget that in most of the places where we are producing, there's still considerable wage pressure. There may be an improvement in wage pressure in 2013 compared to 2012. But it's still always growing, it's just at a lower rate.

Herbert Hainer
The second question was concerning Russia. In Russia we really have a very prominent position in the market. And when I look to our sales, they increased 15% for the first half and for the second quarter they increased by 20%. So the second quarter was even better than the first quarter. Overall, and yes also in Russia, the consumer is more critical. But I mention once again, we are bringing really innovative new product concepts to this market, and this is what the consumer is enjoying in Russia. And as I said in my speech, we are growing with both brands. Reebok is also still in growth mode in Russia and we will open more stores. And as I said, we have a dominant position for both brands. I think we are close to 70% market share. And I definitely believe we will see further growth in Russia.

Andreas Inderst – Exane BNP Paribas
Just a follow-up on retail – you mentioned a like-for-like growth of 8%, which I find quite good. What's the sales productivity gain, the sales per square metre gain you had in the second quarter?

Robin Stalker
That's a lovely question, Andreas. I'm sure you are not going to be surprised that I'm not answering those sorts of questions today. I've told you before that as we get more and more sophisticated with retail, we continue to really strive towards being a top retailer and we will obviously be making those sorts of KPIs available to the public. But at the moment, we're still developing these KPIs internally. However, you can be assured we have a close eye on all of those sorts of retail KPIs. And the underlying point that we've made in our prepared comments today was that retail profitability is getting better. And it's getting better for all sorts of reasons and obviously our productivity on a square metre basis has also been improving.

John-Paul O'Meara

So ladies and gentlemen that concludes our event and our call for today. Thank you all very much and especially for so many of you coming out here to Stratford to see us today. And we look forward to welcoming you to Carlsbad at the end of September. So enjoy your summer, enjoy your breaks if you're going on a break and hopefully the market is favourable this summer and as we go through the rest of the year.