adidas Full Year 2015 Results
March 3, 2016
Q&A session
adidas Group participants:
Herbert Hainer, adidas Group CEO
Robin Stalker, adidas Group CFO
Sebastian Steffen, Vice President Investor Relations

Antoine Belge – HSBC
Three questions, if I may. First of all, would it be possible to quantify the main driver of the gross margin in 2015? I think there are four main drivers: One is FX. The other one is FOB. The third one would be pricing. And the fourth one would be the channel mix. So, any granularity on this would be appreciated.
Second question: You just mentioned that Russia would still see declines in 2016. I think that business achieved € 85 million operating profit in 2015. Do you still expect that business to be profitable in 2016?
And finally, a question on the US. I think you had good traction with Foot Locker, especially with shop-in-shops. How many shop-in-shops within Foot Locker did you have at the end of 2015? And how do you think this figure will evolve throughout 2016? Thank you.

Robin Stalker
Thanks, Antoine. Yes, indeed, the gross margin development is tremendous news for us. And it is indicating that, although we've had these considerable headwinds from sourcing and indeed the currencies, the brands are really showing pricing power. And that together with the mix in terms of channel and product is really helping us to compensate for that pressure.
So, basically, if I was to look at the fourth quarter, you'd pretty much break it down a third coming from the pricing, the channel and the product mix. And that being said is pretty much the same for the full year.
In terms of the Russian business and our profitability there, as I said in my prepared comments, we're really pleased that we were able to maintain strong profitability there, despite the significant decrease in the top line and the economic pressures there. And I think that shows that our management there has been able to manage their costs very diligently. We took 30% out of the operating expenses in 2015. And we're very confident that, even with the continued challenges in the Russian market, we can match our costs to keep the business profitable. We will continue to show some store closures there. And we will keep the Russian business profitable in 2016.

Herbert Hainer

And, Antoine, on your third question on the US: Yes, you're absolutely right that we see traction in the US. And on Foot Locker, we have increased our shop-in-shops to 200 from 20 a year ago. And of course, this will further develop. But, it's not only Foot Locker. It's also around 600 shop-in-shops for our football segment within Dick's and there is a lot going on with the other customers as well. So, we will significantly increase our presence in US retail going forward.

Antoine Belge

Okay. Thank you. Maybe just a follow-up on the gross margin. In 2015, if I said that just the FX headwind was around 200 basis points, is it a fair assumption?

Robin Stalker

Yes, that is correct.

Adrian Rott – Deutsche Bank

Hi, everyone. Thanks for the update so far. Just two questions, please. Firstly, on growth in the US: You mentioned that brand adidas' 12% growth acceleration was driven by Originals and neo. So, I was wondering how the performance side of the brand is doing. And I'm thinking of running above all. It's been remarkable to see the UltraBOOST on top of weekly sell-through tables in the broader running category a couple of times, actually, year- to-date. But, how are the sell-throughs and orders looking for the commercial price points, let's say, from Bounce up to EnergyBOOST? And have inventories at retail normalised in running in the US?

And then secondly, on cash and capex, besides the working capital measures that Robin has talked about, lower capex has helped free cash flow, too, in 2015. I think you've been about € 90 million below guidance, which I suspect are some bigger projects that have been moved into 2016. But, can you maybe decompose your capex guidance of € 750 million for this year a little bit and share some thoughts on how you've prioritised them? Thank you.

Herbert Hainer

Hi, Adrian, let me take the first question and Robin takes the second one. With regards to US running, let me remind you that we grew our performance business by 10% in the US in the fourth quarter. So it was not only Originals. And you're absolutely right, in running, UltraBOOST is THE running shoe also in the US.

And obviously, as you mentioned, there are some other models, which we're now bringing into better price points. We believe that running as a category in general will grow double-digit in 2016. And the US will definitely help us in that respect because UltraBOOST and all the other Boost models have an extremely good acceptance by consumers.

Robin Stalker

And you're right about the capex. Timing of capex is often related, obviously, to the availability of retail. And indeed, for 2016, the significant increase in our capex plans there relate to direct-to-consumer investments. And this is the roll-out of new shops, some of which have been also mentioned in terms of the highlight shops in some of the key cities. So, the majority of the capex is probably in this direction, with the rest being warehousing, system investment and some headquarter infrastructure.

John Guy – MainFirst

Good afternoon. Just three questions, please. The first question is with regard to TaylorMade-adidas Golf. I appreciate that the review is ongoing and will be finalised over the first quarter, but is there any clarification that you can give today that, effectively, you'll be reviewing just the TaylorMade part of TaylorMade-adidas Golf and that the adidas Golf element will effectively stay within the adidas brand?

Herbert, within your letter to shareholders, you talk about the business being in great shape, and you say that you're prepared to fully compensate the cost pressures and input costs, labour cost, etc., in 2016. So, with regard to your gross margin guidance of down 50 to 100 basis points: Say relative to one of your peers, Puma, for example, which has guided a flat gross margin from an FOB perspective, you're facing very similar trends. So, could you explain why you're still effectively guiding to a decline in the gross margin?

And with regard to the capex allocation, maybe on the stores, if you could give us a little bit more clarification as to exactly where the main bulk of capex is going on a regional basis. I know, you've talked about your key cities. But, if I think about your store network in China, for example, that's significantly elevated in terms of store formats relative to some of your Western European and North American stores. So, is that where the bulk of capex is going? Thank you.

Herbert Hainer

Hi, John. Yes, you're absolutely right: We definitely will not talk and discuss about adidas Golf because this would mean we separate the adidas brand. And this would definitely not be a wise decision. No, it's only TaylorMade and obviously Adams and Ashworth.

Robin Stalker

Coming to your question about gross margin, John, I'm actually a bit surprised: If we can keep the reduction in the gross margin to this level of 50 to 100 basis points, I think that's tremendous. And I don't think it's appropriate to compare with other companies who may be in a totally different situation. And they have totally different hedging, not just this year, but previous years also.

For us, it's very clear that there's significant FOB pressure also because of the change in currency. If you remember our tutorial workshop, we said that the hedge rate would be about 13% worse in 2016 than it was in 2015. You've seen that pricing, product, and also channel mix have been very strong at the end of 2015. That gives us great hope that we'll definitely be able to manage our gross margin in 2016 within the levels that we have guided to.
Your third question about the allocation of capex? That continues to obviously be more in the emerging markets, so MEAA and Greater China. But also Western Europe will see a significant allocation of capex this year.

John Guy
Thanks, Robin. If I could just ask one follow-up with regard to a comment that's in the annual report talking about significant opportunities to streamline the cost structures going forward – and you had about a 20 basis point reduction in the operating overheads in 2015. Could you maybe talk about or even quantify where you see the opportunity in 2016?

Robin Stalker
Yes, that's a great question, John, because I think that speaks to the other part of your previous question about how we compensate for the FOB pressure on the gross margin. And in fact, we have already started to benefit from the initiatives we took as part of Route 2015 in terms of restructuring and streamlining a lot of our operating expenses. If you think of services: We've been able to combine above market the consolidation of warehousing. And then our efforts at the end of last year and also in this year to streamline our product offering and to build on our key product franchises, that all helps us. And then, overall, brand leadership and the way we now run the operations, which also gives us some opportunities for improved efficiency. Other areas are the consolidation of operating units: You saw the consolidation of our five key operating units in Europe into one part of Western Europe. That takes cost out of the business. And we're looking for continued leverage and improvements coming from eCommerce and further improvements in our retail profitability.

Jürgen Kolb – Kepler Cheuvreux
Just on the flagship store, Herbert, you mentioned in the US and New York 4,000 square metres. Are you planning to have additional stores of this size open either in the US or maybe in China of that magnitude, of that size, in 2016 or 2017?
Secondly, when we look at the key stars, especially Superstar, Stan Smith or ZX Flux and Tubular, you mentioned that you want to control distribution and volumes. 15 million pairs of Superstar, obviously a big number. Will we see that already in 2016, or is that something you want to reduce volumes in 2017, when maybe the NMD gets more volume? And so, how is the unit size traction that you're seeing?

And one last one on just understanding, in your annual report, you talk about TaylorMade-adidas Golf as a multibrand category. But, would it be possible still to keep the TaylorMade hardware and then, obviously, the adidas products and just separate Ashworth and Adams Golf so that it's not anymore a real multibrand, but just a concentrated single-brand category?

Herbert Hainer

So, let me start with the first question. Yes, you are right. Our key cities strategy includes the opening of flagship stores. We will start with New York and then go to London. Obviously, we have already one in Paris, as you know. And this will be the format where we really take these five to six flagship stores to showcase to the world what the adidas brand is all about. They will be less commercial, but much more about brand building.

Secondly, at adidas Originals, you have already seen that we played Stan Smith and ZX Flux very well in recent years. We took Stan Smith out of the market for a certain period of time. We took the Superstar out of the market for a certain period. We limited the Yeezy Boost collection with Kanye West to really spur this demand from the consumer. And the same we will do with NMD and with Tubular. And you can definitely rely on the fact that we will keep a very close eye on how we develop our Originals business.

But, to make it also clear, we will definitely further grow our Originals business because there is huge demand out in the market. And we do believe, by selectively distributing it around the globe, there is definitely potential, but with all the requirements which I just mentioned.

And last but not least, to your third question. Yes, of course, everything is possible. This is exactly why we are doing the strategic review, so that we know at the end of the quarter what exactly we want to do with the golf business. The only thing which is a testament is that adidas Golf will stay within the adidas Group. Everything else will be analysed.

Zuzanna Pusz – Berenberg

Just three questions from me, please. First of all, on the female business, you say that this is one of your areas of focus. I was just wondering whether you could give us a bit more colour on what actual percentage of your total business is the female consumer, and then what are your expectations in terms of growth going forward?

Secondly, on Boost. Clearly, the Boost franchise is seeing some great momentum. So, I was just wondering whether you could share with us the total size of the Boost franchise in terms of sales and your expectations for the future.

And then the final question. I think you mentioned during the Q3 call that you'd be limiting distribution of the key successful footwear franchises in Q4. But, nevertheless, I think you saw an acceleration of growth in Originals with sales up 45%. So, I was just wondering if this pickup was caused by the new product launches, such as NMD, or have you actually decided to continue pushing Stan Smith and Superstar to the market? Any comments on that would be very helpful.

Herbert Hainer

Let me start with your third question. No, there is less volume coming from the new introductions because we introduced them later in the year. It was mainly the Stan Smith, the Superstar, the ZX Flux and a lot of other models which we have. You might know that especially the LA Trainer is very popular in Italy. We expect the full impact of NMD and, obviously also Tubular, to become visible in 2016. In terms of Boost, we have done around 12 million pairs of Boost in 2015, thereof over 10 million pairs of running shoes, and in some other categories where we had limited editions to further increase these numbers as we spread our Boost technology to other categories and also into other price points. And as I said, we do believe that Boost long term can replace EVA completely because the material is so great. And there isn't anybody who is not excited when he steps into the Boost shoes.

And your first question was on women's and the female consumer. Obviously, I can't give an exact number what our business is on the female consumer because, sometimes, it's hard to differentiate when it comes to shirts, etc. But, let me put it this way. There is definitely a lot of potential for our women's business. And this is why we take a clear focus on the women's side with a lot of initiatives, which I mentioned already, also with the contribution of Christine Day because you all know that she built the lululemon business with especially designed and developed products only for women, similar to our PureBOOST X, which we just launched. So, all in all, we definitely see huge potential for our women's business. And this is what we want to unlock in the next few years.

Cedric Lecasble – Raymond James

Good afternoon, Herbert, Robin and Sebastian. I have three questions, if I may. So, first one, on your US traction, could you give us some market share indications in North America in footwear and apparel? And what are the main metrics you're closely looking at in the US? That's the first question.

The second question is a kind of a follow-up on this one. You have a lot of events in 2016. You're putting some great efforts into North America. We saw that at the end of 2015. You guide on stable marketing expenditure, if it's correct, as a percentage of sales. How will you manage to do all that at the same time in 2016?

And the last question has to do with golf. Just to be sure, you mentioned golf as a potential gross margin driver in 2016 due to the restructuring. Is golf in your gross margin assumptions of 47.3% to 47.8% for the Group? How should we understand golf in this guidance?

Herbert Hainer

Let me start with your first question as we have a lot of KPIs to track the business in the US. Of course, the financials, but also Net Promotor Score, where we can really measure the

desirability of our brands and, as we have told you, this is one of the key metrics which we will also charge our managers with in the future and incentivise them in their bonus scheme.
I don't have any market share numbers here for footwear. We don't have any for apparel. Let me tell you that market share in the US is a little bit difficult, as the retailer is in the panel.
Your second question was how do we manage a lot of great events in sport, spending more in America, and still keeping our marketing expenses at the same level? As you know from the previous times, we always differentiate between so-called event and non-event years. In non-event years, we focus more on individual product innovations and spend the money behind them. In event years, obviously, some more money goes to the events. And this is exactly what we're doing in 2016 as well. We'll definitely be disciplined, as Robin noted already, so that we don't spend more than what we have guided to you. But, we do believe, with the increase in revenues, this will give us in absolute terms much more money and this money will help us achieve all our expectations which we have set for 2016.

Robin Stalker
And just following up on that point, don't forget, we've already upped our marketing spend in the Americas. So, we're talking about a higher base in any case. Our marketing investments are up more than 50% in North America for the whole year.
Your third question, Cedric, was about golf and the margin. But, let me make it clear for the whole profitability of golf. Firstly, our assumption for the numbers that we've guided to includes TaylorMade. And we expect the TaylorMade and adidas Golf businesses to grow in 2016. And we expect them also to be profitable in 2016. We still have some restructuring events ahead of us for TaylorMade in 2016, a very low double-digit euro number. That may lead to a loss in the segment. But, definitely the underlying businesses of TaylorMade and adidas Golf will be profitable in 2016.

Omar Saad – Evercore ISI
I was hoping you could expand upon some of the comments you made upfront, shifting to more of a brands-first management strategy. Maybe elaborate how that's different than some of the tactics used in the past and how we could expect to see that expressed in terms of marketing or category management or distribution, etc., going forward.

Herbert Hainer
Thanks very much for that question because this gives me the opportunity to go into a little bit more detail. I would say that, in the past, we have been a much more decentralised organisation, where all the countries had a certain say. And this sometimes ended that we didn't have a homogeneous product offering around the globe. We didn't have a homogeneous advertising effort around the globe. And we did not always speak with one voice.

There is no doubt that this industry is a brand- and product-driven one and, therefore, we have completely reorganised our organisation. As I said, brands first - so definitely the brand, which means the marketing department, is deciding what product we are offering, which means we will have a harmonised range around the world, which gives us the side effect that we definitely can scale down SKUs significantly.
As a result, the consumer will see our products and our brands in the same way around the world, be it in product offerings, be it in marketing activities, etc. And as I said in my speech, brand will decide, while the markets will focus completely on the local execution.

Omar Saad
Thank you. That's helpful. And can I ask a follow-up, too, on the shift you've been doing towards more sport-specific category management? Can you give us an update on how that's progressing and what we should expect there in the next year or two?

Herbert Hainer
Yes, absolutely. As we have said, we have made our former core business unit managers General Managers, responsible vertically for their respective category. They'll get empowered with all the tools they need to drive their category forward. This means that, as an example, the football General Manager will also decide what kind of product offering we have in Brazil or in Argentina on the football footwear side, how we activate that and what kind of advertising we put behind it.

Omar Saad
When should we expect this approach to be implemented?

Herbert Hainer
It is already implemented, Omar. And I definitely do believe that we see the first benefits from that already. Officially, 'Creating the New' only started on January 1st, 2016. But, we already started with 'Brand Leadership' a year ago. And we completed the organisational change in 2015 already. Our employees are already working according to that. And for 2016, the goals and the incentives already cater towards that new organisation with a lot of financial KPIs, but also Net Promoter Score, as I said.

Chiara Battistini – JP Morgan
I have got two questions. The first one refers to the gross margin of Russia. Could you tell us to what extent this was helped by pricing power and to what extent it was product mix because I was very impressed to see gross margin up in Q4, given the very strong currency headwinds.

The second one relates to the US and the margin. The operating margin was under a lot of pressure in Q4, because of the marketing expenses mainly. How are you thinking about the profitability of the US for full-year 2016? Thank you.

Robin Stalker

Okay, Chiara, pricing indeed is positive in Q4. And that obviously speaks to the trend that I was telling you before when I was talking about the whole Group and the pricing power that we're experiencing with particularly the adidas brand, although we also have a very strong offering at the Reebok brand, for example in Russia.

For America, in terms of the profitability there, yes, as I said in my prepared comments, the profitability was impacted because we have deliberately chosen to invest more in marketing in this important market. That level of investment will continue in 2016. But, we're growing the business there also. And as you can see, we were profitable for the full year of 2015. And we expect to remain profitable in 2016 in that market.

Chiara Battistini

Should we already see an improvement because operating leverage starts coming through, or should the margin stay flat in full-year 2016 and then see an improvement from 2017 in North America?

Robin Stalker

The profit at the moment in 2015 was 2.5%. So, yes, we should see an improvement on that. But, as Herbert said earlier, all the efforts that we're making at the moment and the investments that we are taking are not short-term oriented. They aim to grow the business long term and sustainably. So, the real improvement you should expect to be coming after 2016. But, yes, it's encouraging to see that we're already experiencing good top-line growth. And I'm sure you'll see further improvements in our profitability in that market as we go through the next quarters.

Chiara Battistini

Great. Thank you. And if I can actually have another question on running: In Q4, do I calculate correctly that running was roughly flat for Q4? And if that is correct, because I am implying it from the full year up 6%, how come in Q4 it is that low? Is it just because of a timing issue as you were waiting to ship in Q1? Could you comment on that slowdown in Q4 for running?

Herbert Hainer

I think running was up low-single-digits in Q4, if I am correct. So, we were still growing. But, please keep also in mind that a big part of our running success is Boost. I think we told you during the year that we had some allocation on Boost material. And you will definitely see a double-digit increase, as I said before, in running globally in 2016. We are absolutely excited about how running is going. I think we have set the stage with Boost and also successes around the Boost shoes, such as with Mary Keitany, who won the marathon in New York twice in a row, to name an example.

Andreas Inderst – Macquarie
Good afternoon, everyone. I have a follow-up question on TaylorMade-adidas Golf and the Other Businesses, € 89 million loss on EBIT, which is quite significant against € 1.5 billion sales. Is it fair to assume a loss for TaylorMade-adidas Golf of around € 114 million?
And maybe you can better elaborate the dynamics in terms of gross margin, EBIT margins, restructuring, which have taken place in 2015 and you also indicated in 2016. And I struggle to get to a profitable number in 2016. So, maybe you can give us a bit more insight about the dynamics here. That's my first question.
My second question is on inventories, up 25% FX adjusted year on year. How much of the growth is backed up by order backlogs? Thank you.

Robin Stalker
Okay, Andreas. Obviously, the Other Businesses are overwhelmingly impacted by the performance of the TaylorMade-adidas Golf segment. And in fact, I think we've said previously that we had a loss in that area of approaching € 100 million in 2014. And it was round about the same sort of figure in 2015.

In addition, however, in 2015, we had some restructuring costs in the TaylorMade unit of the low double-digit millions. And I think I've already answered the question about profitability in the TaylorMade-adidas Golf segment for 2016. We believe it's going to be operationally positive. But, we still have some restructuring costs for 2016.

Herbert Hainer
Just in addition to what Robin just said, we also used some money to clear inventories in 2015. Please don't forget that, with the new products which we are going to launch in 2016, such as M1, M2 and PSi irons, we will obviously achieve higher prices and therefore better margins. And this is what Robin said will definitely enable us to return to profitability with our core TaylorMade and adidas Golf business in 2016.

Robin Stalker
And your second question regarding inventories, the inventories are really clean. We've got good order books, although we don't tend to talk in detail about the order books. Herbert has already said on various occasions, I've repeated it, that our order books are full. We are very confident that we've got good growth in the next couple of quarters. And we need these inventories for that. There are a lot of goods in transit in this figure. The inventories are looking very clean and very good at the moment.

Andreas Inderst

Just a follow-up question on the golf segment. Herbert, you mentioned inventory cleaning activities for TaylorMade. Can you quantify the impact on the gross margins of the clearance activities in 2015?

Herbert Hainer

No, Andreas, I can't quantify it because, obviously, the gross margin comes through a lot of different initiatives, as we had, on the one hand, to price down current products, like the SLDR drivers. Then we had to give markdown money to retailers to help them drive some products through. So, I can't give you any quantification of each and every measure we took to drive the inventory down.

Andreas Inderst

Okay. That's fair enough. Thank you very much.

Julian Easthope – Barclays

Hi, thank you very much. I've got two questions, if that's okay. The first one concerns 2015. Basically, in H1, you saw 7% organic growth. And then it went up to 12% or thereabouts in H2. You've given your guidance of double digit for the year. Can we assume, therefore, that it will be a little bit more first half related on the basis that the second half has quite a lot of stronger growth from last year? And I guess that you have reasonable confidence in the first half, given the order book.

The second thing just comes through in terms of the influence that you have with your two new shareholders on the Supervisory Board. Have they indicated what they would like and what they plan to do with their Board seats and how much influence they can actually have? Thank you very much.

Herbert Hainer

Okay, Julian. Absolutely, we saw an acceleration of our growth in the fourth quarter. And definitely, this will continue in the first half, as you can imagine, as we know already our order book very detailed for the first half.

But, honestly, I'm quite optimistic for the second half as well because all the indications which we have got so far, and we have sold Q3 already, as you know, are very promising as well. So, I don't think that it is first half loaded. We will definitely see a nice second half as well.

To your second question, of course, we are in a dialogue with, hopefully, our new people on the Supervisory Board because they have to be elected at the annual shareholder meeting. But, we talk with them as investors as we talk with all the other investors. And obviously, we are talking about the business, what we can do to further accelerate. And we try to find the best arguments.

For example, GBL is a long-term investor for us. And we have seen them more or less every quarter. I'm sure they have the same interests as we do, growing our business, seeing the potential that the business has. And this is why they are investing into our business. And we welcome everybody who believes in our growth story and is investing money into our company.

Sebastian Steffen
I think that's the perfect ending. Thank you very much, Herbert and Robin. So, ladies and gentlemen, this completes our conference call for today. As you will be aware, our next reporting date will be the 4th of May for our first quarter results.

I'm sure that we're going to catch up with many of you over the next couple of weeks via the phone or during our upcoming roadshows in Europe and also the US and Asia.
As always, if you have any questions, please feel free to contact any member of the IR team. And with that, I would like to thank you for your participation and wish you a very good day.