

adidas Group First Half 2013 Results

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Q&A session

adidas Group participants:

Herbert Hainer, adidas Group CEO

Robin J. Stalker, adidas Group CFO

John-Paul O'Meara, Vice President Investor Relations

Michael Kuhn – Deutsche Bank

A few questions from my side. Firstly on the pricing environment, you mentioned price increases in the first half. I would be interested in a quantification of that statement. And also looking into the second half and currency headwinds, price increases could be one part of the reaction. How do you see the environment at the moment and the potential for further price increases?

Secondly, on your so-called key attack markets, Russia, China and the US – all three have relatively modest growth in the first half of the year. Maybe some impressions, what dynamics you expect into the second half of the year and what drivers you expect behind an expected recovery? And especially I would be interested in the performance of adidas in the US at the moment because there seems to be some weakness lately.

And finally, you mentioned the combined production capacity of Springblade and Boost into next year as one of the drivers for the running category. It would be interesting to get an insight on how many units you plan for those categories.

Herbert Hainer

So, Michael, let me start with the first question on price increases. I guess your question relates to the difficult macroeconomic environment and are we able to bring price increases to the market and what will this look like? As you have seen with Boost, with Springblade and with ATV, just to name a few of our products, let's not forget Nitrocharge, whenever we bring innovative products to the market we are able to charge higher prices. This is because the innovation is so strong that the consumers are demanding these products and are ready to pay the higher prices.

Of course we also have areas where we have to be more careful on pricing and sometimes be more aggressive. But we will prudently use this mix according to the consumer needs and demands and we will keep an eye on our strong gross margin going forward.

When you said in our key attack markets, US, Russia and you mentioned also China, the results are also good. First and foremost, let me make it clear that I'm very happy with our results in China, sales growth of 6% in first half. And compared to all the other brands in this market this is an excellent result.

In the US and in Russia, we have two different dynamics. In Russia there is definitely an economic slowdown, of that there is no doubt. Also, there are more malls being built, this means more square metres and therefore traffic in some of the malls is down. As we are by far the clear market leader and are, more or less, selling in all the key malls across Russia, this is therefore impacting us. But we are improving our product offerings, at the end of the month of August we are bringing more innovation to the Russian market, such as Boost, Springblade and so on. We saw in the second quarter that we have already positive comp store growth. And I definitely expect to see trends improve in the second half of the year.

In the US, the second quarter was marked by the slower sales in the basketball category in that market. Obviously since Derrick Rose was not able to play, this also didn't help our basketball sales. Additionally, we had a lot of new products in the first half of 2012, which made the comparables a little bit tougher. But nevertheless, for the US the same applies as in Russia, that

we're bringing a lot of new innovative products into the market. The second wave of Boost already started at the end of June, now we've just introduced Springblade this past week. The results, I'm sure you have seen already, are outstanding, and not only via eCommerce, but also with our retail partners where we have launched it. We will continue with Originals and with basketball and then later with football during the second half of the year.

In China, we will continue to grow. It also is becoming a little bit more challenging, but the research with the 60,000 consumers, which I mentioned within my speech, clearly shows that since 2009 when the tough crisis impacted that market, we are taking the right steps to win back the hearts and minds of the consumer in China. And therefore we are having much more success than most of the other brands with whom we are competing in the Chinese market.

And last but not least on volumes – so for Boost we sold already around 500,000 pairs in the first half and we are planning to sell around about another 1 million pairs in the second half. And for Springblade we will give you the numbers later in the year, because we have a staggered launch approach. We are starting in America, we have also started in Brazil and now at the end of the month we are going to introduce it into the Russian market and then in 2014 in the rest of the world.

Michael Kuhn

Just one quick follow-up on pricing. Any comment possible on the effects of price increases in the first half of the year?

Robin Stalker

Michael, I think as we've seen over the last few quarters, we've obviously had some benefit from price increases, but it's also the product mix and the regional mix that is helping us maintain a good margin despite the negative hedging developments.

Matthias Eifert – MainFirst

The first question is about Russia. Can you update us about your store openings there at the moment? Where do you stand in terms of store count? And if I take your comments into account in terms of payoff from IT investments, consolidation of the warehouse infrastructure there, it sounds like you might be even able to increase the profitability there going forward. And I think you have already acquired a high level of profitability. Or would it be already a good result if you're able to maintain your high level of profitability? It would be interesting to hear your thoughts about Russia.

Secondly, about Reebok. I was quite surprised about the strong growth rate you've shown us already in the second quarter. From recent discussions I thought the progress would be a bit slower and the development more gradual. And the 11% growth for Reebok in Q2 is already remarkable. So where have you seen the super-high growth rates to get to that number? And was there any of kind of selling ahead of your launches? And what should we expect going forward in terms of growth rates there?

And also related to Reebok, I would be interested to hear why the wholesale gross margin at Reebok is just at the level of 26.7% in the second quarter compared to the adidas brand at nearly 43%? Is that a high share of just coming from the US or some effects like Latin America, where you still work with a distributor? Can you explain why there's still such a big difference there in terms of gross margin compared to the adidas brand?

Herbert Hainer

Let me start with Russia first. Yes, Russia is a very profitable market for us as you know and we are by far the market leader. And we definitely think that there are still a lot of opportunities judging by our internal research work and further optimising our business there.

Therefore, we have introduced a completely new IT system in Russia over the last 12 months which will help us to be better connected to all of our stores to get the data faster, such as what is selling and so on. And consequently, combining this with a new warehouse, which we are building, we can replenish faster and operate more effectively. And we want to be more or less never out of stock in our stores, because we found out that this is something which can be optimised to have our products permanently available in our stores, which was not always the case in the past. And we are permanently working and investing in becoming much more sophisticated and even more professional in how we do business in Russia. And this will definitely help us drive our growth and the profitability in Russia.

On store openings, Robin, do you have the exact number?

Robin Stalker

Matthias, we've had 96 stores open for the whole group net over the last six months and the majority of that will be in Russia. We have a total number of stores in Russia/CIS at the end of the six months of about 990 stores.

Herbert Hainer

That's including Reebok, yes. So this brings me to Reebok, to your second question on the second quarter. Yes, it is nice to see 11%, Matthias, but we shouldn't overestimate it. The second quarter is a smaller one. We are happy with the increase, of that there is no doubt. But what I'm even more satisfied with is that we definitely see that the Reebok brand is coming back into the mind of the retailer and the consumer and this is due to each of the individual steps which we are taking at Reebok. And in my speech I elaborated about a lot of them, be it the ATV product, be it the Shaqnosis or be it Reebok ONE, which we have just introduced. But also, when you see that we are able today to announce that a company like Les Mills is connecting with us, this clearly shows you that they have the confidence in what we are doing and what the Reebok brand can do for them.

So now we have our partnership with Les Mills, we have the Spartan race and we have the Color Run. These are some of the most spectacular and fastest-growing developments out there in terms of fitness in the US and now these are starting to travel around the world and we are partnered with it. So therefore I am really happy about the way we're going forward with Reebok. I know that we still have a lot of work to do to bring this to life in all of the markets around the world, but from the signs which we are seeing from the markets and from the retailers 2014 is looking definitely encouraging.

Robin Stalker

If we look at the total gross margin, Matthias, including both wholesale and retail, we're at 39%, which is excellent considering where they were and what Herbert's just said. Yes, there are differences between wholesale and retail, but don't forget in wholesale we've got the joint venture in Brazil and I think that would probably account for most of the difference.

Andreas Inderst – Exane BNP Paribas.

I have three questions. The first one is on your visibility. How good is your top line visibility for H2? Maybe you can share with us your order backlog for the second half of the year. And what are your expectations for the like-for-like development on own retail?

The second question is on own retail, you seem to be quite confident in your own retail business, given your store rollout plans which doubled the number you initially planned. What has

changed in your perception? Why are you doubling the number of retail stores given the current market environment?

And my third question is on your lifestyle offering. It's seeing a very pleasing performance in the second quarter compared to some of your competitors. What is your plan to keep the momentum going in the second half of the year and in 2014? Maybe you can share with us a few insights.

Herbert Hainer

So Andreas, on your first question regarding our visibility for the second half of the year. Obviously we have good visibility because we have all our pre-orders in already for the second half, but we don't provide any backlog numbers and we haven't for the past few years. Be aware of what we told you about what we expect in terms of sales development. It should give you a good indication of the trends we're forecasting.

On your second question about retail – our perception has not changed; we are definitely encouraged by our performance with our retail business over the last several years. Still we are learning day to day how to operate it better and more professionally. But when you look around the world we now have over 2,500 stores and we are quite successful. And especially given what I have mentioned before about what we are doing in Russia, and that is giving us more visibility on our retail expansion plans.

Moreover, you might remember what I told you in 2010 that in China we are working more closely with our franchise partners. This is helping give us better visibility and that helps us react faster and harmonise our systems to have a better offering and less inventory. And this progress is what is encouraging. Obviously, when an opportunity is there for good locations then we take it. And we get more and more offerings from the big mall providers because they see what the other brands can do and therefore they're offering us their locations.

Your third question was regarding our lifestyle offering. I think we have been able over the last seven or eight years to make especially the adidas brand very cool by focusing on the one hand on the performance side and being the most innovative sports brand. But we've also been capturing the lifestyle consumers through a lot of different activities, such as through our collaboration with the big designers like Stella McCartney or Yohji Yamamoto or via our Originals own store rollout plan where we get locations in the coolest and hottest places in the world's biggest cities. And obviously we will continue to do this. We have seen it in our numbers of around 8% sales growth in the first half, so I think we understand this business very well and this is what we will continue to do. You also see it with our new offerings where we are going to new consumer target groups and bringing, of course, great product but also endorsements by ambassadors like Selena Gomez or Justin Bieber and this really resonates with those key consumers.

Andreas Riemann – Commerzbank

Coming back to retail again, a few questions there. Comp store growth was down significantly in Eastern Europe. You already mentioned less traffic, but my question would be is lower comp store growth also an effect of tough comps due to the EURO 2012 in this region, i.e. could things actually look better in the second half because of this comp effect? And also you mentioned that there is more competition but with less traffic in Russia. Do you see the need to close some stores in Russia?

And another one on the 84 store openings. That's a big number indeed. So my question would be in what regions did you open these 84 stores? And is this sustainable or should we expect fewer openings in the coming quarters? That's it from my side.

Herbert Hainer

Andreas, your analysis is correct, yes, we had tougher comp store sales in the first half, especially in Russia and CIS and mainly in the Ukraine, where the European Championship obviously helped us a lot in the first half of 2012. This was mainly the result of the fact that the European Championship was in the Ukraine, together with Poland, and we were the sponsor of the Ukraine national team. But as I have said, I see already positive comp store growth coming back in the last few weeks because we are activating our stores in different ways with new innovative products. As I said, the weather has also improved, which helps a little bit, but we are definitely operating better than in the first half. And yes, we're closing stores of course because malls go out of fashion as new malls open up. This will be a permanent process.

Robin Stalker

That's exactly right, Herbert, because, as I said in my prepared comments, we closed 152 stores in this period. And of the stores that we opened, Andreas, about 80% of those were in the European emerging markets and others in Latin America, where there's obviously a lot of activity. I think at the moment you should accept that we're probably going to be opening a little bit more than we had originally planned for this year, but probably not quite at the level that we've had in the first half of the year.

Allegra Perry – Cantor Fitzgerald

I have three questions please. Firstly, on the full-year guidance on the amendment to the sales outlook, I was wondering if you could give us a little more detail around how that affects the various segment guidance that you gave previously.

Secondly, on Reebok, you flagged the strength of the Fitness and Classics categories. I was wondering if you could update us on how much those categories represent and perhaps comment on what's still in negative territory.

And then lastly, if you could give us an update on where you stand regarding the hedging rate and position for the full year '14, please

Robin Stalker

Okay, Allegra, let's start with the last question, which is the hedging. I think here last year we enjoyed a hedging rate of around about 1.38 and for this year we're probably around 1.32. And looking out, we're fairly much along those lines for the next year. In any case, with the majority of that now hedged, there shouldn't be major differences in 2014 on that level.

Your first question was about sales outlook and whether this had an impact on the segments. Not really much of a change there. I know that all we did really was widening the range a little bit and I think there we're reflecting on TaylorMade's development. That would probably be the only major impact there.

Herbert Hainer

And your second question was on Reebok Classics and Training and your question was how much is it of our total business. It's approximately 50% of our total Reebok business.

Allegra Perry

And can you maybe comment on how the other Reebok categories perform that you didn't mention? Can you just give us a sense for how the other categories are performing and how you're repositioning those?

Robin Stalker

Yes, good. We put a lot of apparel and footwear together as you know. But I can specifically talk about apparel, which is getting better and better. When you see the collections, especially the Reebok Delta collection, the Reebok CrossFit collection, etc., this is getting real traction. We still have to work there to get better presentations in the stores for our Reebok apparel collections, but the products are really, really great and getting better and better. I mentioned the ATV already, which is in the running category, and with Reebok ONE we're bringing new running products to the market. But I think this is it more or less what we have in terms of categories.

Antoine Belge – HSBC

Three questions if I may. First of all, in terms of input costs and in particular wage growth in China, what's the current run? Is it growing at a double-digit rate and what's your outlook for the second half of 2013 and also into 2014?

You mentioned that this fourth quarter would be stronger than usual and can you maybe comment about the life cycle of products, especially for World Cup related products? Maybe compared to four years ago when you were building up to the previous World Cup, is it this that you compare it to? Are there any sort of specific factors we should consider?

And finally my third question would be on China and more specifically on the NEO brand. Can you remind us what is NEO bringing to you in China specifically? Thank you.

Robin Stalker

Okay, the import costs. Yes, obviously it's a significant part of our calculations for our future earnings. And I think for 2013 we've been very stable with what we had last year and that's obviously helping us to generate these higher gross margins. There haven't been a lot of significant wage increases actually announced yet. You're absolutely right that when they come they're normally double-digit. We are on notice that there will be likely negative pressures coming in the second half of 2014, but I haven't got any other details on that for you at the moment.

Herbert Hainer

Let me just add to the wage increases and further to what Robin has said. This has a positive and a negative side. The negative side is that obviously costs are getting higher, but the positive side is there's more and more Chinese consumers getting the incomes which can allow them to buy our products, which will help fuel future growth.

You asked about the life cycle of products for football. There is no general change in the life cycle. In the fourth quarter, we will introduce, the jerseys of all the teams which will compete at the World Cup. We expect that we will have between eight and ten. Obviously Germany is in, Russia, Argentina, Colombia, Mexico, Japan, etc. And these jerseys normally run for two years, but obviously from October/November when we introduce them through until the World Cup itself, and therefore this is by far the strongest period. The same is true for the official match ball, which we will introduce in December. And then we are permanently introducing products, especially new football footwear, on a monthly basis from our different silos, the F50, the Predators, etc.

Robin Stalker

But from a product life cycle perspective, there is no major change. And you also asked about the NEO brand in China. The NEO brand in China is not different, that's what the NEO brand should be all around the world. This should excite the younger consumer, particularly from 14 to 19, mainly female consumers, which we haven't had access to so far in such a big way. And we believe with this offering we definitely will open a new consumer group for us and also connect the consumer at an earlier stage to our brand, which should therefore help us when they grow up. And

introducing them to all the other different parts of our collections, be it style, be it performance, team sports, etc.

Antoine Belge

Maybe just a clarification. So maybe could you quantify how much is adidas Neo in terms of your total sales in China?

Robin Stalker

We don't give any specific sales number for NEO. I only can tell you that out of the 7,000 stores, around 1,000 are adidas NEO stores.

Rogerio Fujimori – Credit Suisse

Two questions please. Robin, could you update us on the raw material costs inflation outlook versus where we were earlier this year? And my second question is on football sales. Would it be possible to give us an idea of the revenue base in the first half just to help us to basically compare versus the 2 billion target you set for next year?

Robin Stalker

So actually, as I said in the previous question, I have been quite pleased that there's been a lot of stability this year over the significant cost increases we saw last year. Unfortunately it all stabilised at a fairly high level for the raw material costs. As I said also, for the first half of next year we think that stability will continue but we are at risk of having raw material price increases or wage increases at least in the second half of the year. But I have no significant quantification ability at the moment.

Herbert Hainer

And Rogerio, on your second question on football sales for the first half year, we don't give absolute numbers. However, I mentioned that I'm happy that we were able to increase our footwear sales in the football category by 6% in Q2. Obviously apparel was down because we didn't have any new introduction on the jerseys compared with what we had last year at the same time for the European football championship. But what I definitely can give you is that our target for next year is to reach 2 billion in football sales and this will be by far the highest number which we have ever achieved.

John Paul O'Meara

So, ladies and gentlemen that completes our call for today. We'll be reporting our Q3 results on November 7th and in the next few days you will receive an invitation to join us here in Herzogenaurach for what promises to be a very exciting event in December. And with that, enjoy the rest of your summer.