

adidas Group Investor Day 2015
Q&A session / Part 3: TaylorMade-adidas Golf & Financials
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adidas Group participants:
Herbert Hainer / adidas Group CEO
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David Abeles / President TaylorMade-adidas Golf
Sebastian Steffen / Vice President Investor Relations

Robin Stalker

I can probably start the Q&A session, since we had two relevant questions from the floor earlier. So, one was about the CapEx, and I think I addressed that during the presentation. We're going to be spending a bit more, around 3.5% to 4.5% of sales. Second one was if this is not sort of back-end any longer and if growth will be at the same level every year. Well, actually, yes, we are definitely going to grow our business and our profitability every year, but we need that agility to react to whatever the circumstances are, that ultimately lead us to investing where we need to invest for the long-term health of our brand. And that leads also to the question that came out for Mark in the last Q&A session, whether it could be that we wouldn't be as profitable in some years as others. And I think that's probably quite valid. Some years, we're going to be better, more profitable than others in America. We make these choices. But the key point is overall and every year for our Group, we grow our top line and we grow our bottom line.

Ralf Stromeyer – Allianz Global Investors

I would like to have some clarification on one target that you mentioned concerning speed. Having 50% of your range on the speed program, what exactly does that mean? What falls under the speed program? Does it mean anything with lead times lower than six months or what does it mean? And does 50% mean 50% of sales? Could you make it a bit clearer to us?

Herbert Hainer

So, it does not mean that everything will be reduced by 50% - from 90 days to 45 - because all the products have different lead times. A T-shirt has nowadays a lead time of 18 days and we can replenish it very fast, whereas a new football boot, as you see there, the Ace and the X, has a much longer lead time. But in general, our core concepts will be reduced by 50% and this, once again, falls into what we are trying to tell you the whole day. We are focused and we will put everything behind our key franchises, be it the distribution in the stores, be it the distribution in our own retail, be it the money which we spend behind, be it operational performance, sourcing, replenishment and speed. All of that we will put behind our big

franchises to make them even bigger. And you have heard a few of them, be it ZX FLUX, be it Superstar, be it Stan Smith and Tubular, just to name four of them.

Ralf Stromeyer – Allianz Global Investors

And it's all based on the lead time on shipments, not the whole process of developing it?

Herbert Hainer

No, no. It is the whole process. It doesn't help us if we need 12 months to create a product and then shorten the transportation by two weeks. This is why we reorganized the whole company to make, as Robin said, faster decisions. It refers also to what is the final product? What is the final material? Where do we produce it? How do we ship it, etc.?

Robin Stalker

And there is a lovely chart in Claire's presentation about the impact that this has, because it's creation-to-shelf, driving levers around full-price sell-through, less clearance, better stock turns and ultimately higher margins.

Antoine Belge - HSBC

One question on golf. I think looking at the chart, you're expecting to gain market share in a market which is going to continue to shrink. As the clear market leader, isn't your mission to actually try to revive the market and fight against those demographics? Can you remind us why this market is doomed and what could be your own actions in terms of demographics or maybe looking at new markets like China which seem to be a bit disappointing on that front.

David Abeles

First of all, there are a lot of different initiatives in golf right now to generate more participation into the game. The governing bodies of golf, United States Golf Association, the R&A out of Scotland, The PGA of America which has expanded into China, affiliates in Japan, they're all working on new and innovative ways to play golf, and it's really the entry point. The core golfer, the avid golfer hasn't been the one leaving the game, it's the periphery. So, 20% of the avid golfers in the United States and around the world make up roughly 80% of the total consumption, which is why they want technology and innovation so fast. They keep coming back and they want new, better products. So we're involved. We have certain initiatives. We support those organizations. Prior to my arrival at the organization, we launched a concept called 'Hack Golf', not really for the name but it was more about the technology, which was an open-source crowd sourcing of ideas to bring new interest into the game. There are wonderful initiatives at the junior level called the PGA Junior Golf League right now which is team golf for kids, which is very exciting and rates are improving quickly. The First Tee foundation designates money

toward the growth of the game. So, the good news is that there's a lot of energy around growing the game initiatives, it's a great game. And I really believe that the game will grow once these initiatives really take traction. It just doesn't happen overnight. As it relates to our growth. Firstly, we still have quality growth within our current market share. Secondly, there are secondary categories in which we have secondary or even tertiary positions, as I talked about earlier which, given the strength of our brand, the strength of our global distribution, and the resources we have to bring those products to market, I believe, we can grow there as well. So, we are and we remain very confident that the future of golf will get better and that participation rates will increase. There are wonderful initiatives and we have invested capital against it, and I think the right thinking is in place now to move the game forward.

Christopher Svezia – Susquehanna Financial Group, LLLP

I was just wondering if you can talk about sourcing costs and the fact you source everything in US dollars. I know you do hedge. What's going on from a sourcing perspective, input cost, labor cost, and how you see that development over time?

Robin Stalker

This is an industry where the vast majority sources in a part of the world and pays in US dollars, but sells outside of that area. Firstly, we have the dynamics of what's happening in those markets, where we're producing and also we face currency issues. What's happening in those markets is that we're seeing a strong increase in labor charges, and that is likely to have a negative impact in the future years. But the industry has also, over the many years, looked into initiatives that lead to automation to address that in the future as well. And one other thing is the raw materials. There's a lot of speculation in the market, in particular regarding the oil price. Are prices coming down? They could do so, but we're not seeing that at the moment. What we're seeing probably for the future, is that whatever benefits you might get out of the raw materials declining in price will be outweighed by the increased labor portion. So that's one part of it. In terms of the currencies, obviously, we source in US dollars and we sell outside the US dollar area also. We hedge on a rolling 12- to 18-month basis. We have no exposure for 2015 because we're 100% hedged. So, that's all good. There's exposure for 2016. We haven't finished hedging for 2016. But we've got a lot of time also, to address these issues and whatever the developments are in terms of the sort of levers that we pulled in the past - where we source, how we re-engineer the product, and maybe also opportunities in certain markets, in certain categories for price increases. And that's an industry-wide issue by the way.

Simon Irwin – Credit Suisse

Three questions for each of you. Obviously, TaylorMade took a lot of criticism in the past for introducing product too quickly, and then it ended up being discounted too quickly. How can we be sure that you learned that lesson and that product will be brought through at a sensible time, and how long do you think it will be before customers actually trust you, that you will be doing that and that they are not going to see AeroBurners on discount in three months' time, etc.? And obviously, you've given up quite a lot of market share in the past year also, presuming that your peers aren't going to give that up readily.

David Abeles

I appreciate the question, and we're being very, very thoughtful about it. We're not just focused on revenue growth. We're focused on the quality of the revenue as we move forward and how we can drive growth through quality revenue. There's been a lot of speculation that we've come to market with too many products too quickly. What I can look back at now in the organization is how we've come to market, and I think we've learned a lot over the course of the last year in terms of some of the fundamentals that really drive energy around products and golf. And candidly, the industry is very unique in the fact a product is hot in golf before it even hits the shelf at retail. And so when we do the work with our tour assets, with our marketing assets, our brand assets, internally and externally, given the technology that we have, which is a critical advantage for us, we typically do a very good job. I think we missed in a couple of places over the course of the last year and, as a net result, we had some technology that we pulled forward and then ultimately got the situation where we saw promotional activity in the marketplace. One thing we have seen, which is, in my mind, a very good sign for the game, is that there's price elasticity northward now at retail. So, we've seen 10% price increases at retail in like products year-on-year. So, that bodes well for us because we typically don't get as much credit for the technology and performance benefits we have in our product. R15 is a very expensive product to make, as is AeroBurner. So, we're really pleased to see that consumers are willing to pay more for our products now. And we will work diligently to ensure that if we have lost trust – and based on the most recent NPS data I've seen in consumer engagement and attitudes and usage data I've seen, we've lost a fraction – I'd bet on us. We're in a much better position than most of our competitors at this point in time, and I believe that with the right products, the right launch cycles and the right messaging, we'll get back on track quickly.

Simon Irwin – Credit Suisse

Going back on what was said about the sourcing, is this new method that you're talking about with faster speed to market, bringing more back to Europe, going to lead you to smaller production runs? Because it's hard to see how bringing manufacturing shoes back to Europe gives you anything like the efficiency of Yue-Yuen or something like that. So, is this improved margin just going to come from low markdown, or do you think you can actually get manufacturing efficiencies by bringing back in itself?

Herbert Hainer

Well, what we have been trying tell you during the day is there is a mixture of a lot of initiatives. Full-price sell-through, for example. Full-price sell-through definitely gives us the opportunity to have less clearance and therefore get better margin. Full-price sell-through we get by better planning, better ordering, faster replenishments. Speed is definitely one of the things we do. Better margin, we get by a more holistic product assortment around the world. Not every country can pick and choose. It's clear brand leadership. We tell our countries what we want to see. It's bringing much more power behind the franchises, as I said. For example, the Stan Smith and Superstar, we sell millions of pairs every year. There is no reason why it should be discounted. These are the so-called cash cows, which we will even further strengthen in the future. Turning to production, don't get the wrong impression that we desperately want to bring the production back to Europe. We want to bring production where the consumption is. And if we have robots who can do the production, then you can put it into America, into Germany, into France, into the UK, wherever we need it. Today, we don't have production in Germany, France or in America because it's too expensive. In the future, this will make us much more flexible. And as we said, we do believe that in a few years - 2017, 2018 - we will have the first prototypes here in Scheinfeld, Germany where we have our factory here and we will try them. And this gives us much more flexibility in the future. But it's not primarily our desire to bring production back to Germany. We want to bring production where the consumption is.

Kelly Chen - Telsey Advisory Group

My question would be for TaylorMade. In the presentation, you talked about how the equipment market has been down about 22% over the past couple of years. You talked about mid-single-digit growth for TaylorMade going forward. Could you just clarify what your expectation is for the golf market over the next couple of years and is that embedded in your assumption? And then also, in the past, I think you've mentioned that you believe you can bring TaylorMade back to historical rates of profitability. So, could you speak to your confidence about that now? Do you still think you can get back to peak margins, and at what pace can we expect that recovery? Thank you.

David Abeles

Let me take the last one first and let me see if I can remember the first one when I come back to it. The short answer is yes. On two fronts. One, I talked about pricing a bit, so that bodes well for us as we move forward. We're also looking at better opportunities to source our products more efficiently, which will enable us to enhance our margins. And we're looking towards a mix shift, more in-line products relative to transition products. So, those three areas themselves lead me to believe that we have a high level of confidence in our understanding of how to bring stronger margins back to our business. So, I think that's good. Regarding the first question. The underlying assumption is that we believe the market will be relatively flat in the near term. What's interesting when you look at that chart, and I think this is worthy of noting, even though over a three-year period the equipment market – that was the U.S. chart – was down 22%, the large majority of that was in metalwoods. And if you look at 2011 and 2012, when we brought products like R11 or Rocketballz to market, we drove the market. So, really, in 2013 and 2014, we had good products, great performing products, but they didn't perform in the market to the standard that we're accustomed to seeing. And for the reasons that we have discussed in terms of how we launch those products and what our go-to-market strategies were. So, as a market leader, we have a responsibility to drive the market and that's how we really manage our business. And so I do believe that we're going to see the market not only steady but with the right product introductions and we've got a lot of great ones coming. I think you're going to see better momentum in the equipment markets as well.

Omar Saad – Evercore ISI

Appreciate all the information and disclosure today, it's very helpful. Two questions. My first one is about the organizational structure. I think one thing that was clear today is the level of complexity in the adidas Group, different brands, sub brands, geographies, channels, categories. Help us understand, from an organizational structure standpoint, how the businesses are being managed from an execution standpoint and then maybe where the P&L responsibilities lie, is it in the channel managers, the geography managers or the category managers? And how that's changed from the last five years, what's different about how you're managing your company versus the last five years? And then I have a follow-up question.

Herbert Hainer

When you say complexity about geographies, distribution channels and brands, I think even if you look at only one brand, then we would have geographies and we would have distribution channels. But I think the fundamental difference is what we said today that we are consumer-obsessed and therefore brand-led in our organization. In the past, we have been too much around the markets and not focused enough in our execution, to drive our brand messages and our core concepts through the whole world. This has now changed. To give you an example, the

football business unit manager in the future is completely responsible for his \$2 billion business and his margin and the profitability. And he's also responsible for the advertising, for the go-to-market strategy, etc. which he wasn't before. He was responsible for products, and then we had somebody who was responsible for the go-to-market strategy. And then we had an advertising department, who made the advertising. So, now, every category is fully responsible for its business. And its incentive program, bonus, etc., is clearly targeted on all these measurements, market share, full-price sell-through, everything we can measure here as KPIs. So, even in the complex world, we can make people accountable, measurable. I think Eric said, what gets measured gets done. And we also can hold people accountable and make them responsible for that. And I think that this is what you see already, maybe not today, but in our company how people take the responsibility and unleash the complexity of the structure which we had before, taking more freedom and more responsibility for that. Your second question?

Omar Saad – Evercore ISI

And then another question, different topic. I think you recently hired a new advertising agency. I would love to hear some of the insights maybe what the advertising agency brought to you in their proposal about your brand. From an external point of view, what you've learned from that and how that energized you enough to bring them on board.

Eric Liedtke 72andSunny is a world-class agency. I'm not sure if you're familiar with them, but they've done a lot of work. And Fast Company named them creative, innovation Agency of the Year, last year. The work that really compelled us to kind of even start talking to them was the work they're doing for Samsung, which has been very comparative-based, especially going after an industry leader like Apple, really taking them on in a fun and creative way. That landed us to have a conversation with them, and that was the start of probably a five- or six-month discussion about where we're going and what we were looking at from business solutions, what we needed out of an agency from a partnership standpoint, and one thing led to another. And we saw some preliminary work, some pitch workers as we usually get, and we decided to hire them. They're working on, right now, a campaign that we'll break in the next three months. So, we're not taking our time with it. We went all in very quickly.

Sebastian Steffen

So, maybe we could take some questions from the webcast.

Christian Stöhr

David, thank you for your presentation. You mentioned an observed stabilization in the golf industry at the moment. Can you please elaborate on this for a moment? And secondly, do you expect industry dynamics, like new people taking up golf for the first time or number of rounds played, to turn around and improve again in the foreseeable future?

David Abeles

The data that we're starting to see at retail would indicate that we're seeing some stability in the market, which is good. Just prior to my arrival here in Herzo, I was with one of the larger golf specialty retailers in the United States, and they shared with me that their news is pretty good news. So, they're out of the gates in a meaningful fashion in what they're calling stability. They're cautiously optimistic, but I think we've seen a good start certainly in the United States. I was in Asia last week, and we're seeing solid progress there as well. So, it's a month-by-month scenario, but we're starting to see good markers. What we are seeing is increases in ASPs. So, that's real good news, which means the consumers are willing to get into new technologies and pay more for new products. As it relates to grow the game, which was the second question, similar to the answer I provided earlier about the initiatives in the United States, but more importantly or equally as importantly, around the world. The things that are happening right now in Japan that are interesting, around juniors playing golf as the population ages a little bit, and how they manage that nuance is very interesting. Markets like China are fascinating to watch given some of the political environment in China right now and how golf is looked upon by the government, but we're seeing that stability in China right now. We've got growth markets around the world that are exciting for us. The Olympics - having golf enter the Olympics next year - is going to be wonderful for secondary markets, for young kids that aspire to get into this game and play like their country champion that will play as an Olympian. So, we think there's a lot of positive energy around golf and we'll continue to do our very best to promote that energy and be a big part of that.

Sebastian Steffen

One more question from the webcast?

Christian Stöhr

Yes. That question goes to Robin, I guess. So, Robin, you talked about price increases as one of the mitigating initiatives to compensate for the current US-dollar strength, do you see a risk that major competitors won't increase pricing in regions like Western Europe, for example?

Robin Stalker

So, that depends very much on the market and the situation there. I mean, pricing is just one of the levers that we can react to. And as I mentioned earlier with regard to the FOB situation, this is an industry-wide situation. I mean, this is not something that's just unique to adidas, so I would be very surprised if others didn't also react in some way. We feel very comfortable in our track record in being able to react to FOB increases in the past. We've reengineered product and pricing increases would be part of the answer.

Suzanna Pusz – Berenberg

I just have two questions. Given the level of investment in the brands, especially at the beginning of the program, and some headwinds such as the US dollar and also the upcoming sporting events. Is it reasonable to assume that, in the initial stage, your operating profit will grow at a much slower pace than net sales? And second question is regarding your administrative costs. So, I think you've implemented significant cuts in 2014. Has the reorganization been finalized, or can we expect some incremental benefits from there to come?

Robin Stalker

May I answer that by starting with the Route 2015 initiatives? Because the cost base of the organization was one of the areas of focus in our drive to fundamentally improve the profitability of our Group. And we've worked on a lot of initiatives, some of which I summarized in my prepared comments that have helped us to reduce the cost of running our organization. And it wasn't that we turned around last year to cut costs. That wasn't the case. I mean, as Herbert mentioned, our restructuring has an impact of also making us more efficient. But becoming more efficient on the cost side has been something we've been working on for the last several years, and that doesn't go away. We're a major company. We continue to optimize processes and our cost base. In terms of profit guidance, I've given you the guidance. The guidance is that we're going to grow our bottom line every year, and the rate of that growth, however, won't be linear. I think that this is a big statement that we're going to average 15% per year. And, yes, over this period, we will definitely outperform the top-line growth. But what is it in each individual quarter, each individual year, we'll have to wait and see, what do we have to invest and what do we have to create as our priorities for that particular year. But our focus on improving our profitability as a group every year remains.

Herbert Hainer

Let me first add one point to what Robin said on the organization because he said "when the program starts". So, don't get the wrong impression that we wait now until January 1, 2016 and then the new organization starts. This has already started. We're operating already under it. Of

course as we look into the future we're working already on forming 2016. Not everything that you see in 2015 is already done by the new organization. But the new organization is already working, and we see already the first results, as I said this morning, going into 2015. So, don't get the impression we will start them in 2016. This is a fast-changing industry, as we said.

Fred Speirs – UBS Limited

A couple of questions. First, David, on golf. I would say for the last decade, the TaylorMade sponsorship approach has been very effective. As you look ahead over the next decade, are you envisioning any significant changes to that, and specifically within that, do you think you need any more high-profile US assets to appeal to the US consumer, or perhaps could you scale back the number of golfers that you're sponsoring within the PGA? And the second question, just as we see the level of CapEx going up as we move ahead and a lot of investments being made, just thinking about R&D within all of this, R&D at the moment is maybe about 15% of what you spend on marketing. Are we seeing that balance shift at all as you look to move towards more franchise innovations, or are we going to see that stay at a similar level as it is now?

Robin Stalker

So, I can't give you any specific guidance on R&D other than re-emphasize what Eric particularly has said today. We are investing, and I'm also clear on that. We are investing in doing what we have to do to make our product the most attractive product for the consumer. And we don't believe that there's anything more that we need to be doing. We're spending what we need to spend. We're doing it with partners. We're doing it here also in this environment and other locations around the world. So, there isn't a restriction on it, but I don't expect it to significantly change over the next five years.

David Abeles

We look at our tour staff almost monthly to ensure that we have not only great players, but players that are really aligned with the values of our company. So I think about players like Justin Rose out of the UK. I think about Jason Day out of Australia. Justin happens to be one of the hottest players on the planet right now, who just won WGC down in Miami and can't seem to miss a fairway or miss a pot. So, hopefully, that momentum will continue as we move toward Augusta, which would be fantastic for us. And Sergio [Garcia], who arguably, who has been our most consistent player for the last six, seven or even eight years right now. The good news is they're all relatively young, so they're in a good place. We are looking at US athletes. There's a couple of good US athletes that are currently on tour that aren't under contract with TaylorMade that we are always discussing and having a meaningful dialogue with. And then there's the junior level. We just signed a partnership with the AJGA, which is American Junior Golf

Association, which is a partnership that was locked up with one of our competitors for the better part of the last decade. This is really the breathing ground for American golf in young and very talented golfers. So, the good news there is that we can build those relationships over time. So, at that point in time, when they turn professional, if they have the skill to do so, we'll be right in the middle of that discussion. As it relates to the overall value and the strategy, we still believe implicitly that having most of the best is the right strategy. There are different brands that compete with us that think an icon strategy is more effective. But when you really look at the golf markets, take every major category, the leader on tour with the most products in play is the leader in the marketplace. So whether it's metalwoods, irons, putters, wedges or golf balls, that formula works very well. As it relates to the valuation of the endorsement deals, that would be interesting to watch. And we're obviously actively negotiating those as we move forward. We'd like to find an American player too that we think could really bring energy in and around US golf as well.

Herbert Hainer

But as you said, David, as important for us is to be the number one driver on the PGA because this has created the market leadership for TaylorMade.