adidas

adidas First Quarter 2017 Results
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Q&A session
adidas participants:
Kasper Rorsted, adidas CEO
Robin J. Stalker, adidas CFO
Sebastian Steffen, Vice President Investor Relations

Fred Speirs - UBS
My first question refers to your North American wholesale partners. We're seeing very strong sell-in at the moment. But in the past, we've seen cycles that showed that this could be the moments where you have to be vigilant, regarding the stocks you're holding in the channel. Can you talk about your visibility on inventory and sell-out to your key partners, and also how timely that data is? The second question relates to China. If the proposed deal for Belle goes through, do you think there's much risk of changed business terms with you?

Robin Stalker
Regarding the visibility that we have on the retail partners in America, you will appreciate that we've had very good momentum in our business there. And the business that we have is also quite good because they keep ringing us and asking us for more. So I don't think you should anticipate any issues with inventory overhang with these partners in the U.S. We're in a very strong position with the brand and also for the inventory levels.

Kasper Rorsted
And as it relates to China and Belle: I was there two weeks ago and I met with the management, which also asked us to meet some of the co-owners of the company. At this stage, we have no reason to believe that it will change our business relationship with Belle. The rest would be pure speculation. We have a very strong and very good relationship with them which has grown significantly over the last couple of years. There is no indication that this relationship will change, irrespective of a change in the ownership structure.

Cedric Lecasble - Raymond James
My first question is a follow-up on China and the commercial dynamics, which are very strong for the adidas and Reebok brands. Could you talk about initiatives and explain why in your opinion the adidas brand is so hot today in China and especially versus your main competitor? And on Reebok, what was the most recent initiative? You said you had some retail expansion in China. Would you elaborate a little bit? And the second one is about your adidas comps, the 7% FX decline in Russia/CIS. Could you maybe provide us with the numbers in North America and Western Europe?

Kasper Rorsted
In China, it's a set of initiatives that we have in place. Firstly, we continue having new store openings in China and also franchise openings with our key partners. Secondly, we are seeing very strong growth in our online initiatives in our business in China. And thirdly, some of the products that have a global but also a local side particularly come across very well with our Chinese consumers. So it's more stores, it's more franchise stores, it's e-commerce. And I think at this stage, we have the right product for the Chinese consumer. So we're not seeing any slowdown in that context. With Reebok, it's as if we are re-engaged with Reebok in China. We started with Reebok in China several years ago and right now we have an agreement with one of our partners to open a set of Reebok stores, which we are seeing the early signs of. This had no significant impact on our overall Chinese growth in the first quarter. But I do think it is a continuation of the growth rate that we've experienced for a long period of time now and we continue to outgrow the market and also gain market share. If you go to China and you see the quality of the stores in the larger cities, you will see that they are on a level or above the level of what you see from a quality standpoint in the Western world. So very high-quality product positioning in the market.

Robin Stalker
And let me point out the comp store sales in the two markets, Western Europe and the U.S. Western Europe is flat, largely impacted by the UEFA EURO last year. And the U.S., very solid, double-digit growth of plus 14%.

John Guy - MainFirst
The first question is with regard to gross margin. I'm looking at the estimated impacts of FX and wage inflation. As you said, the FX impact is around 180 basis points. And is it also fair to say that, when you're looking at the product margin mix comparisons year-on-year in the two affected regions, Western Europe and Latin America, you saw more high-margin jerseys in the first quarter of 2016? Stripping that product margin mix impact out, your gross margin could have been slightly positive on a Group basis, potentially around 10 to 20 basis points positive. Just wondered if you could comment on that. And I guess by that rationale, by Q4, you'll be selling in ahead of the World Cup series. So we should see further acceleration, given the margin accretion that the apparel business brings. A second question around marketing spend and timing: You mentioned that it was a phasing impact around marketing. Should we expect to see marketing increase in the second half of 2017? And, as we move into a tournament year in 2018, what are your expectations around marketing spend?

Robin Stalker

Firstly, on the gross margin. Yes, that's absolutely true, obviously in the first quarter of last year we had some influence from the higher profit margin product sales. And I'd be cautious however, about reading too much into what that might mean for the fourth quarter of this year. Because I think if you go back and look at the fourth quarter of 2016, we also had a very strong development in the gross margin. But fundamentally, you're correct. Regarding your second question on marketing: as Kasper said, this is really because of the event. We are definitely not reducing our investment in marketing. We're not giving any guidance specifically for 2018 at the moment. But you should not expect that our marketing spend as a percentage of sales will go up. In fact, as we've said, according to the plan to 2020. There will be slight leverage on this, so no increase in the percentage. Obviously, we continue to strongly invest in marketing.

Jürgen Kolb - Kepler Cheuvreux

Two questions, first of all on the licence business. You mentioned that you're seeing some weakness in the licence business. I was just wondering if you could give us an indication how big that is as a percent of your total apparel business and how you see that development going forward. And if that might even influence your decision with respect to new endorsement partners you might want to sign, or existing ones that are running out? And secondly on the key KPI that you just mentioned as being the EPS number, maybe some thoughts as to why you focus so exclusively on the EPS number. I assume in the KPIs is also still the NPS as a core indicator, but some thoughts as to why EPS is so crucial for you.

Kasper Rorsted

Now we cannot disclose the licence part of the overall apparel business, but you have to take a couple of things into account. One was we were in a non-event year. So that has an impact of course on the jerseys that are related to the national teams. The second one, as we said, was related to Chelsea. I think it's far too early to make any conclusion whether this is a sustainable development or a short-term development. And at the same time I also think that it is far too early to make any correlation between this and the pricing of the major assets. Because one thing that we're seeing very clearly is that the major sporting assets in football are migrating from local to regional to global. The vast majority of growth in the sports teams is seen outside the region of their origin. And that is a completely different set-up than we saw five or six years ago. Major assets like Manchester United, Bayern München, Real Madrid or Juventus have huge potential. They have not yet utilised the growth, expanding to a global position. So I think it will be far too early to say that. And I don't think that any of those assets have exploited the global position at this stage. I think that's where particularly the relationship with adidas and the global footprint that we have does come into account. The reason why I was so specific on EPS and of course NPS plays a key role, but I was distinguishing between what we call the short-term development and the long-term development. In the short term, all of us, including us in the management team, are measured on margin, revenue growth, NPS. Because that is what we look upon every single day because unless we get the short term right, we can't get the long term right. So these are the components of the short term. In the long term, it is only EPS. But the point is also you can't long-term drive EPS growth if you have a strongly deteriorating NPS because that is the indication to buy. So we are separating these two. And EPS, we have chosen this indicator for the long term because it is a transparent KPI that the investors can get aligned to. So when we deliver guidance around long term, it's EPS and that is actually also what triggers or doesn't trigger the payout on the LTI scheme. So it's very important we're taking a very transparent KPI for LTI, but it does not leave out any focus that we have on NPS, the short term.

Louise Singlehurst - Morgan Stanley
Two questions from my side. Regarding North America, can you help us to understand the margin progression? I understand, presumably this year or near term, we've got some marketing shift in the second half. But as we look to more annualised medium term, I'm not after numbers but in terms of the thought process, presumably there's a fairly fixed costs structure for the potential for that business to maintain quite a good acceleration on the margin. And then secondly just on the pricing environment, as we look between sports performance, and sports lifestyle: I would like to know whether you think there's any difference in price sensitivity between those two categories.

Robin Stalker
In terms of the U.S., yes I can confirm your assumption here. Because we've always said that there is a significant opportunity in America. But that’s also why it's so significantly important in our strategy to grow our business particularly on profitability in the States because there's good upside here. So yes, the margin development should reflect the top-line growth here.

Kasper Rorsted
Regarding the price sensitivity, I think you have to break it down to apparel and footwear. And I do think if you get to lifestyle, you will have more price-sensitive apparel, particularly in a market environment with brands such as H&M and Zara. I think in that area you do see a high level of price sensitivity. When it comes to footwear, of course, in technical footwear, you can price significantly higher when it comes to our performance part. But the mid-price segment I would say is fairly similar. So overall on footwear you have a higher price point when it comes to performance. In apparel, you will see a higher level of what you call price sensitivity, but also lower price points than we see on the performance side.

Adrian Rott - Deutsche Bank

My first one is a follow-up on North America. So as you explained, operating margin was up a couple of points, but gross margin only up a few basis points. I would just like to confirm that this is the sort of leverage you can get, despite being in investment mode, or have investments in North America temporarily been muted, for example also a marketing shift or marketing being lower in upcoming quarters. Because the roughly 100 million segmental operating profit this quarter is more than you earned in North America in all of 2015. Just trying to get this magnitude here. And secondly on retail doors, it sounds like there have been some 70 closures that aren't related to Russia or Reebok. Is that just you being opportunistic as in not extending a bunch of leases that have been up for renewal? Or more of a proactive move that can be seen in the context of what is happening online and your plan? It would be great to have an idea of what your fleet is going to look like by the end of the year.

Kasper Rorsted

So let me just follow up on the North American part, which Robin answered before. It's clear that North America, with the size of the U.S. market, represents a huge opportunity for us in the long term. And it's also clear that we need to look for long-term sustainable development and not go for short-term profit optimisation in the U.S. So you are seeing a jump in profitability in the first quarter. I would caution you when I say this. Because right now, we are not optimising the short-term profitability. We continue to see leverage in our infrastructure, as Robin was correctly saying. But what we are looking upon is that we need to get the size and the market share correct in the U.S. because that is what long-term drives the highest value for our company. So if you look at the two right now, of course, we're trying to improve the margin. But we have got to continue the high growth rates to generate market share and customer loyalty that will allow us for the long term to succeed. So, yes, we are seeing it. But we're in for the long term. And we said we wanted a 5 billion adidas business by 2020, and that's what we're looking for. And of course, you will see a different contribution by then. But if we believe it's appropriate to invest more we will invest more to make certain that we don't optimise only in the short term.

Robin Stalker

Regarding your question about the closures, you're right. We have closed, outside Russia, around 50 stores net. That's coming from factory outlets for Reebok, in line with the Muscle Up programme in the States. Furthermore, it comes from closures in some of those markets in Latin America, certain ones in the emerging markets and even a couple in Greater China. But don't forget that the closure of retail shops is a normal part of the retail business. So do not interpret that we are just suddenly seeing a shift to e-commerce and then doing more closures. That is not the case. There are those structural changes, as I mentioned, in Muscle Up. And as Kasper mentioned earlier for Russia, that will probably have a little bit of impact also in some of the Latin American countries. But we continue to open shops also. And I think I said in the past, with Greater China particularly, when we started off, there were a lot of very small shops. As that market has developed and matured, as we moved into bigger malls for example, we closed smaller old shops and opened a new shop in the mall. So it's a normal process. And I think you have to look at the net development, that we still have around 2,700 shops at the end of March 2017. It's still very much an important part of our business.

Antoine Belge - HSBC
First of all regarding the U.S. market: Obviously you have an excellent performance which tends to be a bit contrasting with some kind of a slowdown we see for some sporting goods chains. So can you comment on the market overall and then your performance? Secondly, regarding China, can you maybe refresh our memory about the initiatives that you're undertaking regarding schools, and I think you've been trying to participate in the trend towards a healthier lifestyle in China. So maybe you can give an update on how many schools you are present in, and what's your plan there.

Kasper Rorsted
Regarding the U.S., we are clearly satisfied with our current performance there. We've had that for a while now and we are growing ahead of the market. I think there's no doubt about it. We're also coming from a position from which I think it is important to understand where we are not represented in areas where we really need to be. The evolution of omnichannel and digital is helping our growth rate. In particular, e-commerce has been a growth driver for us in the U.S. As for the distribution structure, we might not have experienced the same level of store closures as maybe some of our competitors have. However, I can't really comment on competitors. But we are seeing continued growth opportunities in the U.S. with our key partners there and also through our own stores and our e-commerce. We expect to continue to outgrow the market also for 2017, which is also reflected in our current guidance. The other competitors have different challenges. We do believe that we'll have another successful year in the U.S in 2017.

Robin Stalker
And as far as China goes, yes, we're very excited about the continuing opportunities there in particular. Because now the authorities, central and local governments, are encouraging investment in sports facilities, encouraging the kids to play sport, and be more active in schools. And as you know, we have an arrangement with the ministry of education where we're supporting these activities in schools. At the moment, we're in about 8,000 schools in China and that number presumably will grow over the next quarters as we roll this programme out.

Antoine Belge

Maybe just a follow-up on what you said on the FX impact in the gross margin in the first quarter. If you were to quantify it in terms of a minus number in basis points, would that be 200 basis points or more?

Robin Stalker

We showed you the net FX figure, which is exactly 180 basis points. There's two portions of it. There's 250 basis points of actual hedge effect. And there's another 70 basis points positive on unhedged currency effects. So net, it's about 180. And as I said, don't forget that this was all planned. There's no surprises in that. And the hedge rate actually turns more positive in the second half of the year. Therefore, we reconfirm the development of gross margin for the year being a positive versus 2016, up to 50 basis points improvement.

Eric Johnson – Piper Jaffray

I was wondering if you could talk about the BOOST supply shortfall, if there are any updates over the last couple of months? And then what your continued plan is if that becomes a barrier to your long-term targets; what you are working on behind the scenes to offset that? And then secondly, I was curious on your women's business, if you would help us better understand how that business looks – with lifestyle being stripped out – to better understand how the performance side of that business is performing, and as well as what you are currently working on to drive that.

Kasper Rorsted

Regarding BOOST, the current supply profile is included in our 2020 guidance. So we will continue to have BOOST constraints until approximately 2019. Despite the fact that we have an excellent relationship with BASF, and despite the fact that they continue to put more capacity on line, we continue to up the forecast based on the consumer demand. So we believe that we are in a strong position. Of course we would like to have more supply, no doubt about that. But the current supply profile is completely calculated into our 2020 targets. And that assumes, at this stage, a supply unconstrained market condition in 2019 which we still believe to be the case. I will, however, say that we continue to grow our BOOST business quite significantly. And we all have the fortunate situation that we have a franchise that is very highly sought after not only in the performance but also in our Originals category. But it's of course the performance technology that we're using to differentiate ourselves in the marketplace. And this is what we can see from a marketing standpoint. We can also see results in our Running business, which were very positive in this quarter.

Robin Stalker

Relating to the development of the business for the women consumers, excluding lifestyle – although we don't break it down – I can say that this is a very positive development. We have very good development with the partnerships. We are enjoying not just the Stella partnership, but also recently Wanderlust, and the exciting product launches specifically for women and Running, such as UltraBOOST and PureBOOST X. And in addition to that, a significant dedicated product in Training, which is also driving good underlying growth in the women's business and in the performance category.

Piral Dadhania - RBC

Firstly, on e-commerce, obviously the growth there is very impressive. Could you firstly break out the U.S. e-commerce growth in the period? I think Kasper mentioned that this channel has been a key driver for you in that market. And then just thinking about the profitability dynamics for that channel: How quickly do you think additional operating leverage can be achieved assuming that the growth rates you saw in the first quarter can be continued and as you work toward that EUR 4 billion target? And then secondly just on China, I think you said that Originals growth was only single-digit in that market. But given the actual overall market grew 30%, are we right in assuming it is Running and potentially neo that were the main contributors? Any help just understanding where that growth came from would be very helpful.

Kasper Rorsted

So first, let me correct the China figure. It was 28% growth for our lifestyle business in China, which is still below the 30% that the company recorded. On the e-commerce business, let me give you a couple of points here. We mentioned the three large markets, Europe, U.S. and China, which are growing very fast. We do not break it down by market for competitive reasons. But it is a key part of our growth drivers in those markets. When it comes to the overall profit contribution, it does drive a different profile because we will have a higher level of operating overhead for e-com. However, we will also have a higher overall profitability. You will see us investing more because we need to build infrastructure to do that, but it will generate of course a higher profitability. We have not broken down the profitability, but you should assume it's accretive to earnings as we speak. So the quicker we can grow this, the better it is. But of course, what we are doing is we are pushing this quite hard because we see it as a competitive weapon and it also drives the topline. So we will invest as much as we can to ensure that we drive the top line.

John Kernan - Cowen

I wanted to go back to North America and particularly the wholesale environment in North America. Your growth is exponentially higher than any other brand's in North America right now. I'm just wondering about the fall and holiday season order book trends within North

America. There's obviously a lot of door closures going on. There's been quite a few sporting goods bankruptcies, but it doesn't seem to be affecting you at all. You're growing at an exponentially higher rate than any of your competitors. Can you just talk about what you're seeing in wholesale North America right now and what's enabling you, category-wise, to outperform the market by such a ridiculous amount?

Kasper Rorsted

Right now, you have to look upon where we are coming from. I think that's important. We are coming from a lower base and we are quite confident that we will continue to have above-market growth also in the second half. We don't comment on order book, but our guidance was that we would grow double-digits in the U.S. We have been growing quite strongly in the U.S. in the past and our assumption is that we can continue this in the future. So we're not seeing any adverse trends in the performance of our wholesalers in the U.S. that should lead us to believe something different from what we're seeing today. But I do also want to stress that we're coming from a low position and we are also coming from a supply constraint in BOOST deliveries. So there is a pent-up demand for BOOST, which we haven't been able to supply upon yet and this also helps us in our growth profile.

John Kernan

There was a big disconnect between growth of footwear and apparel last year. I'm just wondering what you're seeing in apparel, which is obviously a more difficult category for everyone globally.

Kasper Rorsted

We are still seeing footwear by far out-growing the apparel side of the business, so that is still the trend.

Jonathan Komp - Robert W. Baird

My first question is really about trying to frame up the first quarter results in relation to the full year guidance. It was helpful to see the strength and weaknesses listed and I'm asking about the magnitude of the strengths relative to the weaknesses, and whether you're more or less confident in the full year outlook based on what you've seen so far.

Kasper Rorsted

I am completely unchanged in the full year and long-term outlook because we are just a couple of months into it and I have been around for too long to get excited about something when you have fifteen quarters ahead of you. So I think that doing extrapolations can be very difficult. So for the full year 2017, we are confirming our guidance and we will of course give our guidance for 2018 in March next year. Right now, our long-term outlook also remains unchanged. We have a lot of work ahead of us and there are also going to be a lot of challenges and only looking upon the assets and not on the liabilities can be very dangerous. So, 2017 and long-term outlook confirmed and no change in any of the guidance we gave two months ago.

Jonathan Komp
Secondly, I just wanted to follow up on the adidas brand in North America. You mentioned lifestyle is up 73% in the quarter, so a very dramatic merchandising shift that continues to go on. I'm wondering, looking at the distribution, how much of the growth do you think should be, or is being, driven by your core current partners and how much of the growth is being driven by expanding the distribution to non-traditional partners for your brand? And if you could just comment on your distribution strategy given the merchandising shift?

Kasper Rorsted
So if you look upon the first quarter, there's been very little change in the distribution structure. This doesn't mean however that we don't believe that we have more opportunities for getting a broader distribution in the U.S. So, while distribution in the first and the fourth quarter was very similar, in the medium and long term, we will look for a more balanced distribution structure in the U.S. than we have today. But right now there has been no change in the distribution structure that led to any change in the current numbers you see.