adidas

adidas Full Year 2016 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

John Guy - MainFirst

Good afternoon gentlemen, thank you very much for taking my questions and Robin, I wish you all the best for the future, and welcome to Harm. Maybe if I could start with digital, please. Kasper, you've doubled the initial target to EUR 4 billion. If we think about the richest gross margin distribution channel for you, it probably is digital with a gross margin of in excess of 60%. So when you're guiding to an 11% operating margin for 2020, how much incremental or extra gross margin are you effectively reinvesting into the business because the EUR 3 billion target on my estimates would drive roughly 90 basis points of incremental EBIT margin, so with EUR 4 billion, you could be looking at 12% to 13% of EBIT margin. So maybe you could just give us an idea of how much you'll have to reinvest in the business to drive those top-line expectations? And then, maybe just around price mix opportunities versus growth. You've guided in 2017 to a gross margin of up to 50 basis points, but if we think about the higher full-price sell-through, which is probably running at close to 50% now, the higher evolution of the e-commerce sales and, of course, the unhedged position on the Russian rouble and Argentine peso, et cetera, that tailwind running through into 2017. Again, are you not a little bit conservative? Thank you.

Kasper Rorsted

So let me just give you some details. It's clear that the dramatic expansion that we're expecting in e-commerce, does also require substantial more investments in systems, in infrastructure and the way we run the business. So not only does it have a different OpEx profile, but it has a substantially different CapEx profile. We need to build new warehouses, we need to have different systems, and we're in the process of doing that. So it does require substantially higher CapEx than we've seen before, and that's really where I want to leave it at. Right now, we are guiding for EUR 1.1 billion CapEx in 2017. So you can see we are investing very, very heavily to ensure that we can actually deliver upon consumer expectation but, of course, it does have an accretive impact for us, and it does carry upfront some costs that we don't have in the system today because we have a different business model. That's pretty much the level I want to leave that at because I don't want to reveal anything further. I can't comment on your model – rightly or wrongly.

Robin Stalker
And John, the question about gross margin development and price mix, yes, we are very confident that we are still increasing the amount of our business that we're getting at full price. There's still a long way to go, however, and also don't forget that despite the tailwind of the unhedged portion of the rouble and the Argentine peso, as you've mentioned, we've still got for the total year 2017 an inferior hedge rate compared to 2016. It's not as bad as we had from 2016 over 2015, but we're still a few points behind that and that will also put pressure on the gross margins.

John Guy
Thanks, Robin. So just one very quick follow-up. Kasper, you mentioned just at the end with regards to the EUR 25 billion to EUR 27 billion turnover target that excluded TaylorMade and CCM Hockey, and you also talked around some unforeseen FX impact, which I appreciate because when I was looking at my calculations on that 10% to 12% growth, you should be getting around EUR 27.9 billion to EUR 30.5 billion. So are you basically factoring in roughly 2% negative FX a year just to be on the safe side? I mean, the actual shortfall of around EUR 2.5 billion basically would take out the TaylorMade elements, CCM and also Reebok, so I'm just wondering whether or not I'm on the right track or thinking about something different?

Kasper Rorsted: You're not far away. Basically, what we said is that it's completely unpredictable four years out. And if we build a model and when we look back at it, everything is reported. So we've made a call, which is very similar to what you're looking for. It's very much a management call and says what we think is a realistic number looking upon history and some parts and that gets us to that range. I think the most important part was that we drive the EPS at the primary range, but we wanted to convert the EPS into a meaningful revenue figure. And that was why we give this range, so that's where it is, but I just want to stress, for us it's more important to drive the EPS. But of course, in the context of driving markets, we are not going to drive EPS up and then lose market share. So it's about getting the balance right and that gets us to that EUR 25 to EUR 27 billion. Whatever the currency will then be, we'll always smile in 2020.

Antoine Belge - HSBC
I have a few questions, but I will only do two this time. The first is regarding your marketing investment, and if I remember correctly in the previous plan, I think the first two years for basically 2015 and 2016 were supposed to be seeing a sort of dilution on margin from marketing and then as from 2017 some kind of leverage on marketing, and I think you've announced your willingness to be sustaining the growth in the US market, also the development of e-commerce, which may require some investments. Could you maybe guide towards how the marketing to sales ratio is supposed to be evolving from 2017? And my second question relates to the US market. Have you done some analysis of what could be the

consequence of, on the one hand, the implementation of some kind of bold attacks and then maybe, on the positive side, if the tax rate was going to be declining in the US? Thank you.

Kasper Rorsted

I'll answer the latter and then Robin will answer the first. Of course, we've done considerations, but if you start having tax barriers, it will hit the entire industry. If you start having different tax breaks, you can say it might benefit some of our competitors that are paying their primary tax rates in the US, but also I would say we've got high levels of consumer spends. So we've looked upon it, we have not modelled it, because I believe that the current planning or the current outlook for the US regarding those two scenarios is so uncertain at this stage that it does not make very good sense for us to model it. I think there could be an upside should you have tax cuts at both levels, even at an individual level, but also at a corporate level, because corporate level eventually will get into the market. On borders, we have not done it because everybody will be in the same boat.

Robin Stalker

That's correct, we said that we will continue to invest heavily in marketing, we would believe that that's also one of the reasons why we're being so successful at the moment in America, particularly. But actually, what's happened in 2016, because the business has grown so much faster than we had initially anticipated, the actual percentage of marketing as a percent of sales has come down somewhat and that level we should be able to maintain. Maybe it'll be a little bit less than that in 2017, but don't be concerned, we continue to invest strongly in marketing, we have to continue to go up. We've guided also last year to the change in where we are putting the weighting on our marketing spend to get more of our total spend into the activation of it and therefore somewhat less than what we've previously had, 50% of our marketing spend being on sports marketing, to have that somewhat under 50% as we go towards 2020.

Antoine Belge

Maybe just from a qualitative point regarding marketing related to the step-up in digital, what would be the share of that budget dedicated to digital and what could it be by 2020 versus today?

Robin Stalker: We won't go into that detail. But what you can definitely take from all of the comments we've had over the last few quarters, and what Kasper said today as well, we are investing heavily in digital and, over the last various quarters, more and more of our communication with our consumers in any case has been digitally led. So away from the traditional activation, more into the digital platform, that's common I think not just in our industry.

Simon Irwin - Credit Suisse

Could you just talk a little bit about Originals. Obviously, with lifestyle up 45% and footwear up 21%, there's some very big drivers here. In the past, I think you have given us volume numbers for the key franchises. Can you do that again? And is there any thought, that at some stage, you may need to slow down the growth in some of these key franchises in order to not over-expose them. And just a second question: Are you expecting all of this digital to come direct or does that include using other online platforms?

Kasper Rorsted

So the EUR 4 billion is expected to come direct. We'll, of course, in parallel also work with platforms, and we've had great experience with working with our partner Zalando here in Germany. So we believe that offers an additional opportunity for us of course. We have partners like Zalando, Dick's Sporting Goods or Foot Locker that all represent opportunities for exploring the digital space further, but the number we put out here was the number that we can directly influence, which is the EUR 4 billion, but we believe that the partnering model will evolve over time and, of course, the digital element of the partnering model will become more and more important also for our traditional wholesalers.

Robin Stalker

You're right Simon, at various times over the past few years we might have mentioned volume of a particular product or so, but it's not something we do regularly. We're not going to go into volumes today. The most important thing to know is that I think we're managing the exposure here to a fashion or lifestyle trend extremely well. As Kasper said, in any case the border between what is performance and what is lifestyle is very blurred and for us in terms of the product that we have been very successful with under the lifestyle branding is including now a new product that is being used also for sport or it can be used for sport. We have in 2017 about a 50-50 split between what you might know as the iconic originals product and that would be the Stan Smiths and the Gazelles and the Superstars, –etc, and 50% would be these new franchises of NMD and similar products. We think here it's important that we are now managing these franchises much better over the life of the franchises and thereby managing our risk in this area.

Simon Irwin

So Robin could you just explain that, when you talked about the 50-50 split between the two, are you saying that, last year, the newer franchises made up 50% of sales within say Originals or lifestyle?

Robin Stalker

No. I'm not saying that, I'm saying that from 2017 onwards our offering is 50-50.

Piral Dadhania - RBC Capital Markets

Good afternoon, gentlemen. Thank you for taking my questions. If I could just go back to your marketing investments could you confirm that the corridor as a percentage of sales remains at 13% to 14%? I appreciate you've come out towards the lower end of that corridor in 2016 as a result of the increase in sales. But if I think about the market environment and the fact that competitors are performing perhaps not as well as you, the expectation could be that they might step up marketing spend. So I'm just curious to understand why you might take the foot off the gas in 2017? That's my first question. And then my second question just relates to your CapEx guidance. Should we expect this level of EUR 1.1 billion to be the go-forward rate from 2018 onwards or is this more of a one-off? Thank you.

Robin Stalker

First question is about the marketing spend, you're right, we had guided around 13% to 14%. We will definitely come into the lower end of that and I think, over the medium term, you should be expecting somewhere more between the 12% and the 13%. In terms of CapEx, the significant uptick in the CapEx here has a lot to do with our investment in our direct-to-consumer business. Kasper called out digital previously, but also we have about 2,700 of our own shops and these need to be refurbed in the new formats of our presentation to consumers, such as the wonderful stadium concept we have in our new flagship in New York. Within our CapEx budget, we also have further investments in our infrastructure – be it in our IT systems or,in warehousing. Lastly we are also investing in the expansion of our headquarters in Herzogenaurach, Germany, where we are investing in new buildings. So over the next year or two, I think you'll still see around this level and then for the future guidance you'll have to wait for a future period, but that will depend very much on our investment in retail.

Adrian Rott - Deutsche Bank

Firstly, on the limited availability of product that you've called out. I guess this relates to BOOST first and foremost, where is the bottleneck currently. Is it the supply of raw material from BASF or is it capacity constraints? I'm quite sure you've managed to convince your partners to scale up, but how do you incentivize them and what's the timeline for the BOOST capacity ramp? And then secondly, one on Russia, where you expect double-digit growth in 2017, after 3% in 2016 and a negative FX development, I'm just wondering what's the latest from Russia, any anecdotes that point to an inflection, that would be helpful. Thank you.

Kasper Rorsted

So, let's start with BOOST. On the capacity constraints: We have a great relationship with BASF. In this context, I would argue it is a positive problem. I'm happy that we don't have any other problems. We expect it will take another 18 to 24 months before we get the full capacity up. But we are working towards a moving target. What I mean by that is through every meeting with BASF, we've asked for more supply. And they have helped us with more supply, but we have asked consistently of taking the number up, so it would be wrong to point the finger in a certain direction. Where we can point the finger is that it has been an immensely successful market take-up and that's why the demand continues to grow forward and that's why we are in supply constraint position. So, we believe it's not the ideal position, of course, but it's a better position to be in and we have a very strong and very productive relationship with BASF and I can only praise their flexibility. The reason why they are interested is because they make more money. That is like anybody would be, to make money and the more they sell, the more they make, so I don't think it's more complicated than that. When it comes to Russia, let's start with the overall company guidance, because I think that is the most important one. On the overall company, we are very confident with the guidance we put out. Russia today equates for approximately 4% of total revenue. In the heydays, it was more 9% to 10%, so you can see that it's not only a very big difference between the heydays and now. And when it comes to profitability, Russia has been able, through making its cost base much more flexible and variable, really to adjust to a different market environment and we've seen that through the last two or three years. And as you know, the Russian crisis didn't come around yesterday and won't go away tomorrow. So, while it is dependent on how the market situation will evolve in Russia, we don't see that impacting our overall guidance and we actually are pretty convinced that with the profit contribution that we should be getting from Russia, we might be getting a different growth profile. But frankly, that is at this stage, far too early, to expand upon. You can see that the Russian currency could further weaken, but you're also seeing a strengthening of the oil price. So, there are a lot of moving parts. From a revenue standpoint, the stability we've been able to derive, from an earnings standpoint, this is not one of our key concerns for 2017.

Geoff Lowery - Redburn

My questions refer to China. Can you help us understand the performance of the top line, in terms of you and your partners adding space, e-commerce growth, price and volume. How are you managing to sustain these sorts of sales numbers? Secondly, for a long time, you have been waiting for the Chinese margin to fall and it's another year of stability, despite the growth and the investment. How would you estimate the margin for Greater China for the next three years?

Robin Stalker

You're right, China continues to be extremely strong. The good news is that we are seeing nothing that would suggest that it is weakening at all. The brands that we have are being very well received. I think we've got an extremely solid management in China with great experience in communicating with the consumer very credibly. There are positive trends for our overall industry. The government is keen on encouraging healthy living and sport generally and that plays into our hands. That's why you also see significant growth in sports categories such as the 22% increase in football. I think we have a solid base of franchise partners. We have over 10,000 mono-branded franchisee stores in China at the moment. I think here we've worked better than our competitors with our franchisees, helping them understand how they can be more profitable also in their own franchise stores. For one of our key franchisees we manage some of the product purchasing and other operational items and they can see that those areas are more profitable for them than some of their other ones. At the moment, I can't give any guidance on longer-term operating margin, but I can only repeat that we are very confident, that the operating margin as it is can be more sustainable than we had thought. I still believe it is still a very high percentage and I think what I've always guided to as we grow and continue to grow our absolute business in China, it could well be that the operating margin in percent comes down, but it's still at that sort of level fundamentally accretive to the company and helps us improve the overall company operating margin. That's our view at the moment.

Andreas Inderst - Macquarie
I have got two questions, the first refers to your Speed programme. You made excellent progress in 2016 reaching 25% speed capability. That's actually better than the 20% that you initially guided. How is it possible that you have been faster here? What has been the impact on the gross margin actually from better full-price sales, and regarding the target to reach 50% of sales on those Speed programme by 2020, is that still a valid target or could we reach this goal even earlier? The second question is on cash flows that have been very strong in 2016. You will reinvest some of the cash flow in CapEx, as you have guided for the next one, two years, but what else is on the agenda? You have mentioned that you might get some triple-digit cash inflows from the two or three disposals, maybe you can elaborate on that, what is the plan here? Thank you.

Robin Stalker
In terms of Speedfactory, I need to correct a couple of the numbers. I can confirm that it's 50% of our offering that we want to get on shortened lead times of the Speed programmes. It is 25% of what we are offering at the moment, what we are expecting is 20% uplift on our full-price sell-through. We haven't articulated exactly how much of our progress is on full-price sell-through at the moment, but clearly reported that it's improving. I can't give you a specific breakdown of what impact that has had on the gross margin, but clearly it was a positive, and that's one of the reasons that we've been able to compensate for the negatives on the FX. So, good news regarding Speed. In terms of cash generation: we've been able to generate good cash for quite some time now and to reconfirm - we are not expecting to do anything with this cash in terms of acquisitions or anything like that. We believe that we have a good portfolio. Kasper has given you more details about the portfolio today. What we have done however, is we have continually increased our dividend payout and we have put focus on the shareholder return

programme, completing also in the last few months the third tranche of our share buyback programme, and there are still some open amounts there should one choose in the future to do further tranches.

Cedric Lecasble - Raymond James
My questions also relate to Speed. Could you tell us what exactly you can do today and how much volume we can expect at the two Speedfactories in Germany and Atlanta and what should we expect from these facilities by 2020? What would the ramp-up phase look like and what products would go through these factories, would they be dedicated to e-commerce or to some other usage? That would be very helpful.

Kasper Rorsted
We'll give you much more information regarding our Speedfactories next week, because we believe that this actually does require a greater level of detail that we don't feel comfortable with giving on the phone, but we'll be happy to answer to a certain level of detail of course, not to the level that you asked. We'll elaborate next week, if that's okay.

Jürgen Kolb - Kepler Cheuvreux
Two questions from my side. The first refers to the CapEx line: you mentioned that the CapEx of EUR 1.1 billion includes a portion for headquarters investment. I guess that's pretty much a one-off. Could you please give us an indication how much of this EUR 1.1 billion is reserved for the headquarters expansion? My second question is related to one of your Performance category. You mentioned that in some categories of the Performance area, you obviously can still do better. I was wondering if you could elaborate a little bit on the football category in here, not so much on the apparel side. You said that you re-gained market leadership in footwear overall, I guess that is supported by the apparel line. Maybe you can say something on how you've seen the trends in 2016 on the footwear side and then also where you see that trending maybe going forward? Thank you.

Robin Stalker
We're talking about the long term with the influence of the headquarters improvements here. But there is a period that's a little bit in 2016. We've got more in 2017, but also some sort of figure in the triple-digit millions in 2018 as well.

Kasper Rorsted
On the footwear side it's particularly with the stadium to the street concept that we do have different iterations of the different cleats and of course at very different price points but in a very clear and stringent hierarchy. There is no doubt that the feedback we are getting both from

consumers, but also our key retailers, is positive: we have the leading design and also functionality in our cleats and we see that over and over again, which we are extremely happy about. And you can also see, I don't know if you follow that, but we did introduce a different business model, which I find is quite interesting and you can then say it doesn't have an impact on market share at this stage, but it's called Glitch. The business model around Glitch is based on a subscription service that offers football players different uppers for the football boots on a regular basis. So you can change the boot's appearance. So it is a stadium to street concept with different price points, different functionality and really I think we have the hottest products at this stage, so we are very happy with what we have with the overall football franchise, which is really the core DNA of our company but we will be able to speak in further detail next week and also show you some of the current products that we have and those that we have coming. We believe that we have a very strong line-up, not only in the store, but also for the future that's coming. With this, I'd like to thank everybody for the questions today and I'll hand back to Sebastian.

Sebastian Steffen
Thank you very much, Kasper and Robin. This completes our conference call for today. Thanks very much also to all of you for joining us today. As we've said, we are very much looking forward to having as many of you as possible here in Herzogenaurach next week for our Investor Day. If you have any questions, be it on the Investor Day, the releases today or on any other topic, please don't hesitate to reach out to us. That's it for today. Have a great day. See you next week and bye-bye.