adidas Group First Quarter 2015 Results
May 5, 2015
Q&A session
adidas Group participants:
Herbert Hainer, adidas Group CEO
Robin Stalker, adidas Group CFO
Sebastian Steffen, Vice President Investor Relations

Louise Singlehurst, Morgan Stanley
A couple of quick questions from me please. I wonder if you can just talk about the marketing costs and the lumpiness that we should expect throughout the year. Clearly, there will be a little bit more, I guess, for Q3 and the back-to-school season, particularly as we look at the US market.
Then secondly, if we could just contextualise Boost, because obviously that's growing phenomenally well. If you can please give us an idea of the volumes as a total and what that actually means in terms of volume for the total footwear. Thank you.

Robin Stalker
Okay, Louise, yes, our marketing spend is obviously going to be different to what we spent last year, which was largely related to the World Cup event, but I can't call out a particular lumpy quarter because, as Herbert said, we're investing heavily into our brands. And that investment has already started in the first quarter.
So, I think that you can expect that in the first half of this year we're going to be significantly higher than we were in the first half of last year. But it evens out a bit in the third and fourth quarter because that's when we really started last year to increase our marketing spend, as we announced, I think, in our third quarter of last year. So the difference will be mainly in the first two quarters.

Herbert Hainer
To the second question, Louise, as we have already said, we will build further out our Boost technology. So we are forecasting around 12 million to 13 million pairs of Boost shoes in 2015, compared to around 7 million pairs in 2014.

Louise Singlehurst

Thank you. And just one final question on the marketing, can you just talk to us a little bit about the category spend, where you're allocating the funds, the order of priority, I know you've spoken a lot again about the US, and how much of it is going into digital? Thank you.

Robin Stalker
There's nothing new in digital, Louise. Obviously, digital has been a significant part of our expenditure over the last couple of years, and I think we've shown great response from the consumers. However, as we called it out last year, the key investment need for us is in our more mature markets, and that's predominantly America, and a bit in Western Europe. And that's for the categories that are relevant in those markets.
Herbert mentioned in his speech the heavy investment into American sports, such as the NFL and the players there. I think you should expect us to be more and more relevant for the American consumer, and that's where we're putting our marketing spending.

Louise Singlehurst
Great. Thank you.

Adrian Rott, Deutsche Bank
Two questions, please, from me. Firstly on Group gross margins, you've mentioned the pressures from FX and FOB costs, yet the Group gross margin has remained stable. So I was just wondering whether you could comment on how big the pressure was from either side on the Group level. And what you have done specifically to mitigate this in terms of mix and pricing architecture - what has happened there?
And then secondly, on the US, as you have mentioned, the marketing working budget for the US is up sharply, and we've seen that the operating margin for the region is down some 4 percentage points year over year. I was just wondering whether you could talk about the scope that you see for gross margin improvement here, i.e. how can mix improve, going forward? What are the terms of collaborations with Dick's and so on? That would be helpful, thank you.

Robin Stalker
Okay, thank you very much for that. And that's why I put it into my prepared comments because I think that this is a really positive development. The fact that our gross margin is at the same level as last year is really significant taking into consideration the input price increases that we had, which were around 1.4 percentage points. Obviously, we've had significant FX pressure as well, particularly if you think of the impacts in Russia with the rouble. So what we've done is we've been able to enjoy a better product and category mix, and also price increases. We've called it out in Russia that we've put up prices double digit, but that has not just been limited to

Russia. So, the improvement in product mix and pricing was of something over 1.4 percentage points.
In terms of the US, and our profitability there, I think we've already mentioned that we expect to be profitable again in the US already from the second quarter. But here, as I think Herbert mentioned in his comments, this is a marathon for us; it's not a sprint. So we're investing in improving the recognition and attractiveness of our brands in this important market. But we're doing so there for the long-term benefit, aiming to hopefully grow sustainably the profitability. It's not just about significant improvements one quarter over another. It's a longer-term impact.

Adrian Rott
Can I just follow up on the US quickly, because I think the long-term investment probably relates to the marketing spend, but if you roll out those collaborations with Dick's and so on, can we expect the mix to improve as well, so that gross margins, which are currently 12 percentage points below Group, edge up a little bit over time?

Robin Stalker
Well, firstly, you have to recognise that in the American market, and this applies for our competitors also, the profitability, definitely at the gross margin level, is significantly lower than what it is in Europe and in Asia. That has to do with the make up of the retail environment in America, but also the sort of the product that the consumer buys there.
But everything that we've been undertaking over the last few months aims also to fundamentally improve the prices that we can achieve at the point of sale. And that, obviously, will also improve our gross margin. So, yes, expect improvements to come there as well. All I'm saying is that you don't expect them to be seen in just one quarter to the next.

Adrian Rott
Alright. Thank you.

Jörg Philipp Frey, Warburg Research
First of all, you've managed quite a good gross margin development. So what measures are you actually taking, right now already, to counterbalance the expected sourcing price increases due to negative currency effects you could see in 2016? That's the first one.
And the second one, we saw now 480 basis points margin increase in Other Businesses, despite a weak gross margin. And with your new product launches, I expect you can see gross margin improvement for the remainder of the year. Can you give us a bit more colour when we could see gross margin improvement in TaylorMade, particularly? That's it for the start.

Robin Stalker
Okay. I'll cover the second question. No, I'm not able to give you any more colour on that. Herbert's called out also that the business should be improving. We are releasing products that we believe will be able to be sold through without discounting. That improves our margins.
In the first quarter I know that in Other Businesses, there was some discounting in Reebok-CCM Hockey that affected the margins. And that, presumably, goes away during the rest of this year, so we look for improvement there.
Your first question was about 2016, and it's still too early to give a definitive answer to what the situation is going to be for us in 2016. Obviously, the dollar-euro, and the dollar with other currencies also, is such that our hedge rate will, obviously, be inferior to what we've enjoyed in 2014, and definitely what we're enjoying in 2015.
But the actions that we will be taking are just the sort of actions that we've already shown also in the first quarter, and what we've, indeed, done previously. That is relying on the product mix; the category mix; also reengineering product where we can. And, yes, it also means putting up the prices where we believe that is acceptable in the market.

But don't forget, this general question about sourcing costs, and particularly the point of the dollar, is something that everybody in the industry suffers. It's not something just for the adidas Group.

Jörg Philipp Frey
No, definitely, it's just that I wanted to make sure that you are going to prepare for that. To add something on that one, do you see any potential of having some savings from lower raw material prices in general to just compensate you a bit in 2016? Or would you say that we should not have high hopes on that side?

Robin Stalker
You can definitely have hopes. And definitely, it is true that certain of the raw materials are probably going to be more attractively priced in the later seasons. However, it's not just the raw materials that is the issue for us here. The majority of the pressures at the moment in terms of input prices is coming through labour costs, and that's something that I suspect, if you think of the countries where we are having our product manufactured, those sort of pressures are likely to continue.

Jörg Philipp Frey
Thanks a lot.

Fred Speirs, UBS
A couple of questions from me. Firstly, on the wholesale business in Greater China; obviously, very strong performance in Q1. Just wondered if you could give us a sense, on how the wholesale sales growth split out between new doors being added by your partners, versus higher orders from the existing stores? And also, just a comment around recent sell-out performance there.
Secondly, on retail comps; I think you shared these are at around 4% overall. Just wondering what those were ex-Russia.
And then, also, if we look at the Reebok comps, if you could make a comment around how the FitHubs specifically are doing. Thank you.

Herbert Hainer
Fred, let me start with your first question on Greater China. As I have said several times in the past, we are very happy with our business in China. We started, after the crisis in 2009, to really clean up our store base and the inventory. And I can tell you, just having had meetings with the two biggest accounts, Belle and YY, that our sell-throughs are the best within the industry. Therefore, our inventory is the lowest and, therefore, the profitability with us is the best. And they have seen our collections for fall/winter and spring/summer 2016. I definitely do believe that we will see the positive continuation of our China business. Of course, not at a 20% plus range, as we have seen it in the first quarter, which was a little bit helped by the Chinese New Year, but the overall positive trend in China will continue.

The third question on the Reebok FitHub comps. Let me tell you that we just have started to build up the Reebok FitHubs, and they are definitely helping us to transport the image of the new Reebok as a fitness brand to the consumers.
Therefore, as in all the retail developments, we have to build it up first. We already see some very good results but, on the other hand, we also have some stores where we still have to educate the consumer. The biggest success we definitely see is where we combine the Reebok FitHub stores with a CrossFit gym or a close-by gym.

Robin Stalker
And the comp store sales growth, excluding Russia/CIS, was a positive 7%.

Fred Speirs, UBS
Thank you.

Ashley Wallace, Bank of America
I have a follow-up question on the comp store sales; particularly if you could give us some indication of what the comps were in Russia, and how they trended over the quarter, and maybe what you're seeing into the second quarter.
Then, just on TaylorMade, given Q1 was quite weak, down 9%, can you maybe give us a bit of an update on why you're so confident in your double-digit growth for the full year?
And then, just lastly, on your hedging rate, US dollar-euro in 2016, if you already have that in place.

Robin Stalker
Okay, Ashley. Yes, certainly, we just answered in the last question from Fred, that excluding Russia/CIS, the comp store sales growth is up 7%. Actually, the Russian comp store decline is minus 7%. I can't tell you how it developed between January and March, as I only have the quarterly figure.
And the third question on the hedging rate; as I answered a minute ago, no, I can't give you a hedging rate at the moment. We're hedged for 2015 probably around 1.34.
I think the actions that I mentioned in the previous question that we take to mitigate the deterioration in the dollar-euro, we'll have to wait and see how they pan out. And I'll give you more guidance on that when we get closer to the start of 2016.

Herbert Hainer
Ashley, on your second question, TMaG, obviously, we are just at the start of the season, and the next months will be important for the business. But we are quite confident because we will bring a lot of new products into the market, as I told you during my speech.
We have seen already good success with our R15 product and the AeroBurner. We will continue to extend the AeroBurner family, bringing in new footwear. By the way, on the footwear side, the Boost golf shoe is definitely the shoe in the industry, at the moment.
Yes, there are still challenges out in the market, but we are definitely confident that with a cleaner market, with our new product introductions, and with the status which TaylorMade-adidas Golf has in the industry and with the consumers, that we will see growth in 2015.

Ashley Wallace
Okay. Thank you.

Zuzanna Pusz, Berenberg
Just a few questions from my side. First of all, on gross margin, have you seen any positive hedging impact this quarter? And if so, could you please quantify it?
Secondly, maybe on pricing. You've mentioned before, you have implemented price increases not only in Russia. So in what other regions have you seen the biggest price increases that are worth mentioning?
And maybe, finally, on Reebok-CCM Hockey. It seems like the decrease of your gross margin in the Other Businesses segment is mainly due to lower product margins in Reebok-CCM Hockey. I was wondering, is it discounting, is it market or brand specific?

Robin Stalker
Okay. Zuzanna, thank you very much. I'll give these ago. Firstly, in terms of hedging, we've actually got a slight positive on the dollar-euro hedging. The rate at the moment is about 1.34, compared to last year about 1.33. However, we had negatives on all the other pairs, and they were the overriding point. It's a minimal basis point impact, in any case, in the total development in the first quarter; unlikely to be significant in the full year.
In terms of price increases mentioned outside of Russia. It's not so much by country, it's more by product class and by categories. And there, I can't call out a specific one but, obviously, we've been improving the technologies in running. We've launched a lot of products with Boost technology in it at the moment, where we've been able to generate higher price points from, etc., just as an example.
And the third point, yes, I confirm your summary. Reebok-CCM Hockey was the main reason for the decline in the gross margin in Other Businesses. But it's a very small part of our overall Group, obviously, and I suspect here this is more because the seasonality of that business is more market-driven, rather than specific to Reebok-CCM Hockey.

Zuzanna Pusz, Berenberg
Thank you.

John Guy, MainFirst
Robin, just a question for you please, again on the gross margin. I think you said, earlier on in the call, that the input cost pressures were about 140 basis points, and then product and pricing gave you a positive 140 basis points, hence, being stable. But within that, you've just talked about FX, but could you talk around any markdown activity, any specific impact that you had there?
Also, with regard to Russia/CIS, you've very kindly given us the like for like ex-Russia and inc-Russia. In terms of the space contribution, and you talked around primarily seeing a net

closure now running through in the course of 2015, what is your full year anticipation in terms of sales contribution from space in the Russian region?
And then, I guess, finally, just sticking with Russia, you talked around raising prices to offset the rouble depreciation. Clearly, we've seen the rouble-dollar move now from around USD/RUB 69 back to USD/RUB 52. Other companies have talked around implementing double-digit price increases, only now to see their product looking pretty expensive. So what are you budgeting for Russia like for like, rolling through into 2016, or is that a little bit too early? Thanks very much.

Robin Stalker
Okay, John. Thanks very much. It is probably a bit too early. I'll let Herbert answer the Russian question, in any case. But just your first question about the margin and discounting. No, I can't give you any particular flavour for any particular discounting in this quarter. Obviously, there is always some discounting. There's nothing of any significance that pulls through our gross margin development in the first quarter.

Herbert Hainer
And coming to the second question, John, in Russia, we have said that, on a comp store basis, we were minus 7%. In terms of net selling space, at the end of the year, I can't give you a concrete figure because we're obviously watching the market quite closely. We have said that we have already started to take action closing stores, as Robin said, and we will further continue depending on how consumer behaviour will develop. You know that it's still shaky in Russia because the economy's not improving; the rouble is now getting stronger, which obviously is a good thing, but we are still careful with the market.
In terms of price increases, luckily we saw that, within the introduction of spring/summer 2015 products, we increased some new products in price which we brought to the market. And as I said, luckily, we see that the higher-priced products, the new innovative products, are selling really well, better than the old ones which had already been in the market.
This, obviously, encouraged us to go further, but we're also watching the markets here very closely. A 10% increase over the course of the year is likely, but we take it product by product. So you cannot say that, in general, we're increasing all the prices by 10% or increasing one category by 10%; it really depends on the product innovations and on the product introductions into the market.

John Guy
Thanks very much. That's very clear.

Christopher Svezia, Susquehanna Financial Group
Just one broad question for me. For North America, 7% currency-neutral growth, even with TaylorMade down, is nice to see. With regard to the guidance, low- to mid-single-digit currency-neutral growth, even with TaylorMade accelerating probably at double-digits in Q2 and Q3, that would probably mean that Reebok and adidas grow at a much lower rate, maybe at the lower end of that low- to mid-single-digit level, certainly, lower than some of the peers out there. Can you maybe discuss why that would be the case, just given the investments and the magnitude of the investments that you're making in that marketplace? Is there something, Herbert, you're seeing in the backlogs? And I know you don't talk specifically about backlogs, but something you're seeing further down the pipeline for fall 2015 into spring 2016 that gives you that confidence? Maybe just talk a little bit more about that growth rate?

Herbert Hainer
Yes, thanks, Chris, for the question because this gives me the opportunity to clarify maybe a misunderstanding. In the 7% currency-neutral sales growth, TaylorMade is not included. This is for adidas and Reebok, and adidas was up 9% currency-neutral and Reebok was down by 3% currency-neutral, so I guess this clarifies it.
But going forward, I definitely see, for adidas and for Reebok, growth paths forward. As we have said, this is not a sprint, this is a marathon, because this is the most competitive market for us. We will build brand desirability by investing more into our brand campaigns and we started to do this in the first quarter already.
We see the first positive signs, but less in terms of sales; it is more what we get back as feedback from the consumers on our campaigns, be it the 'ThereWillBeHaters' campaign in football, be it the 'Sport 15' or the 'Be More Human' campaigns, this is building brand desirability.
Of course, we want to see growth as well and we are happy that we got it as we started fairly good in the first quarter. But as I said, America is definitely not a sprint – it's a marathon for us. But I am looking forward positively, also having in mind the backlogs that we have for the two main brands already.

Jonathan Komp, Robert W. Baird & Co
If I could just ask one more question on the North American results. The 7% currency-neutral revenue growth, are you willing to break that out by pricing versus units?

Robin Stalker
Jonathan, no, we don't do that. I think, overall, we've significantly increased the transparency you're getting for these markets now with the new segmental reporting. I'm sure there are areas that we can further improve, but we do not have volume and unit for you at the moment.

Jonathan Komp
Okay, understood. One other question then, and forgive me if you've given this already, but in terms of the currency impact for 2015, I'm wondering if you could just give the updated view overall on revenue, gross margin and profits as you sit today.

Robin Stalker
Sure, Jonathan. Basically, I reconfirmed our guidance and that is that our top line will grow at a mid-single-digit rate, that's currency-neutral obviously; that our gross margin will be between 47.5% and 48.5%; and that we will have an operating margin of between 6.5% and 7%; and our net income from continuing operations, excluding any goodwill impairment, will grow at a rate between 7% and 10%.

Jonathan Komp
Okay. But you haven't given any specifics on the currency impacts?

Robin Stalker
No. The only thing we say with currency-neutral is, obviously, the top line. The rest, obviously, has to be generated in euros and there's some positive tailwinds, but there's also headwinds if you look at Russia. So that's our guidance including everything we know about currencies.

Jonathan Komp
Okay, understood. Thanks for taking my questions.

Sebastian Steffen
Okay, thank you very much. So, ladies and gentlemen, that completes our conference call for today.

As you know, our next reporting day will be August 6 for our Q2 numbers. But let me remind you that our IR tutorial workshops will actually premiere very soon, on June 24. Our General Managers of the football, running and Originals business units will provide you with more details on their business and their strategies for the next couple of years.

A formal invitation to that workshop will follow soon and we're, of course, very much looking forward to welcoming many of you here in Herzogenaurach for this event, but, of course, we will webcast this event as well.

So if you have any questions on that workshop, or on our releases today, please feel free to contact any member of our IR team. And with that, I would like to thank you for your participation, wish you a very good day, and I look forward to talking to you soon.