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

Antoine Belge, HSBC
Three questions if I may. First of all, you mentioned that what is happening at TaylorMade won't affect the overall guidance. Can you be a bit more precise on what you expect in terms of operating loss for the golf business in 2015? I think last year the loss was in the range of € 100 million. Do you expect a wider loss this year?

Second question, you mentioned the UEFA EURO 2016 and also the Olympics being just around the corner. Is it possible to tell us if you expect Q4 this year to be already impacted? In the last World Cup we had a strong Q4, a strong Q2 but less in Q1. Could you flag any sort of timing impact that we should be aware of?

And with regards to the cost for the Brazil Olympics, do you expect the costs to be higher than those for the London Olympics? I think Swatch mentioned that they were expecting a bit less spending for the Olympics in Brazil.

And finally, the dollar hasn't really moved in the right direction since we last spoke. Do you think that the gross margin in 2016 can be at least flat year-on-year with the current level of the dollar? Thank you.

Herbert Hainer
Okay, Antoine, let me start with the first one, TMaG. As I said during my speech already, there are several factors which have influenced our development.

First and foremost, I think that our two product introductions, the AeroBurner and the R15, are not selling through as well as we expected. They are selling through okay, but not to the level which we expected.

Then there is definitely still the market challenge. Even though rounds played are currently not going down, which is good, units sold are still down in the first six months.

I also have to say that our competitors have become better over the last 12 to 24 months, and they are catching up to the advantage we are having.

Yes, we will make a loss in 2015, but definitely not wider than we have in 2014.

Second question on EURO 2016. Yes, you can expect that we introduce the new jerseys of our teams which are participating in France already in Q4. But we're also bringing in new football collections. As you know, we are the sponsor of the Euro 2016, so we're bringing in the new match ball, etc. and this will start already in Q4.

Third question, Olympics in Rio next year. No, our costs won't be as high by far, as this time we are not sponsoring the Games. You might remember that, in 2012, we were sponsor of London Olympics, and therefore already spent a lot of money upfront. But this time, we are not the sponsor of the Rio Olympic Games.

Of course, we are sponsoring our national federations, but not the Games themselves.

Robin Stalker
And for the last question, in terms of the gross margin development for 2016. It's too early for us to give any specific guidance on this at the moment. We're not fully hedged yet but we'll do that as soon as we can, obviously.

But it's clear that, with the development of the currencies, there will be pressure on the margin in terms of the hedging rate alone. But if you look at periods where we have had this development in the past, also, we have been probably the best in our industry at being able to mitigate this.

We'll continue to do whatever we can to mitigate this as best we can. Even if you look at the half-year results we've just presented today, we've had over 2 percentage points of negative headwinds, in terms of FOB and pricing pressure. But we've been able to compensate that, at least for the largest part.

I think it's important to note, however, that as we manage our expectations for 2016 and our improving profitability goal that we have, we do not intend to cut back on our investment in marketing, or anything like that. We will manage our gross margin as best we can. We'll give you guidance on the details of that closer to the end of this year.

Antoine Belge
Just a follow-up on that subject. Which are the areas of your business where you still see potential for price increases to mitigate the impact? And where are the areas where you think it is more difficult to increase prices compared to the past?

Robin Stalker
There are obviously differences in particular markets, and there are obviously differences in some of the basic products we have. But quite genuinely, we believe that we have opportunities across the board with price increases.

We'll have to be obviously sensitive to our markets, and it won't be one particular rate for all the markets. But we are very confident there is considerable opportunity to continue to mitigate these pricing pressures with price increases.

Antoine Belge
Thank you very much.

Adrian Rott, Deutsche Bank
Number one, please, on Western Europe and Latin America. I guess you're quite pleased with the performance, and both regions certainly came in ahead of my expectations.

But it would help to elaborate a bit further on what's behind the strong growth, specifically in Western Europe. Has this been mainly driven by new product and volumes, or is it related to pricing and general initiatives? That would be great.

And for Latin America, you mentioned strong growth in retail. It would be interesting to hear about the contribution of pricing, because, if I remember correctly, you've started to raise prices in some Latin American countries already in Q1. Has it been similar in Q2?

And then, secondly, on gross margins again. You stated that half of the decline is due to TaylorMade, so still some declines at adidas and Reebok as well. You mentioned labour costs and FX. Could you just split up a little bit further, what has been happening in terms of pricing mix, and whether mid-season sales played a role here as well?

And then, lastly, on own retail. New guidance for net store closures is only 40 for the full year, rather than 60. Is that mainly driving the upgrade in your full-year guidance for retail growth? Thanks very much.

Herbert Hainer
Let me start with the first one, Western Europe. As I have said in my comments, Western Europe was definitely a key area for us 18 months ago. We are very pleased with our development, especially compared to last year where we were selling the German DFB jersey, which sold a huge amount.

It is broad based. I told you that football is doing very well as well as training; of course Originals too. But it's really broad based. When I look at the future, which means the next six months, then I'm just as excited as I have been for the first six months.

We are, more or less, growing in every country in Western Europe. The biggest challenge, as I have just said, is in Germany, because of the big comparisons. But even here, we are doing quite well. Be it in France, England, Spain or Italy – our momentum is quite exciting.

It's coming from new product introductions, better distribution across our channels, stronger marketing and of course, also price increases, where we do believe we have price elasticity, because we are bringing new better products to the market.

The same is true for Latin America. This is even more surprising because last year, we had Argentina, Mexico, and Colombia, all our World Cup participants had strong sales.

And I think this is the 10th or 12th year in a row where we grow at a high-single or double-digit rate. In Q2 last year, we grew 33%. And now, again, we are growing at a high-single-digit rate. This is quite an exciting time. Once again, this also is a mixture of the initiatives I have just talked about.

Robin Stalker
For your second question, addressing the development of gross margin, yes, we are down 90 basis points for the quarter. 50 basis points are specifically due to the poorer margins at TaylorMade.

On a gross basis, we've had FOB increases of about 1.2 percentage points. Combined with others, the negative FX impact was around 1.4 percentage points in total. But we've been able to compensate the vast majority of that with price increases, and also with our pricing mix. The pricing mix has been favourable.

So of that 40 basis points that's not TaylorMade, net-net, 50% of that's probably FOBs and 50% of it is probably pricing.

In terms of your third question, retail: no, it is definitely not correct that our confidence and increased guidance for retail comes from the fact that we're only closing a net 40 stores now, instead of 60.

The major reasons for this are the continued positive development of e-commerce. But also, as you've seen from our profitability development in retail, retail is doing well for us, and it's not because of the net closures.

Adrian Rott
Alright. Thanks very much, gentlemen.

Robin Stalker
You're welcome.

Chiara Battistini, J.P. Morgan
The first question on golf. And your statement in this morning's release, that you're exploring options, especially for the smaller brands. If you could elaborate a bit further. And especially on TaylorMade, if the opportunity of a good disposal came up, if you would consider that?

The second question on Russia. Firstly, if you could give us a like-for-like in Russia for the second quarter. And on the gross margin, I've noticed that gross margin in Russia was down just 100 basis points in the second quarter, which was much better than what I was expecting. So if you could comment on what measures you took to protect the gross margin so well.

And finally, on marketing as a percentage of sales. I see that the decline in marketing as a percentage of sales in the second quarter, comes mainly from the adidas brand. So I was wondering whether this is just operating leverage coming through, or rather your decision to start cutting marketing as a percentage of sales. And then, how are you thinking about full year 2016, please? Thank you.

Herbert Hainer
Let me answer your first question on TaylorMade-adidas Golf. Yes, I have said, we definitely will explore all future options in the golf business.

We are first looking at the non-core assets - Adams and Ashworth. But as I said, we are looking at all options. And this could also include taking hard cuts, and this could include talking about a disposal of TaylorMade. But we have not taken a decision yet, because we still have to do some more analysis.

Robin Stalker
And in terms of your second question, Chiara, Russia's like-for-like was down 15% in Q2. You said the gross margin hadn't deteriorated as much as you had anticipated, yes, that's great. But it's also, unfortunately, due to some of the currency effect also at a Group level. But in terms of the Russian business, you might recall that we have been very successful in putting up prices, which has helped mitigate some of that.

And your third question, we have increased our marketing working budget 9% in the quarter year-over-year.

Chiara Battistini
As a percentage of sales it's down, no?

Robin Stalker
But it's a small percentage on a percentage of sales and we're getting leverage out of this and that's what we've guided to as well for the full year.

Chiara Battistini
Perfect. Then maybe if I can just follow up on the like-for-like for Russia, a negative 15%, if that's for quarter two, not for H1?

Robin Stalker
Yes, that's correct.

Chiara Battistini
And would you be able to give us the mix between pricing and volumes?

Robin Stalker
No, I can't give you that; I don't have that. But they've done what they've been able to do in the market with pricing but we can't compensate for everything with pricing. There's a volume impact as well.

Chiara Battistini
That's perfect, thank you very much.

Robin Stalker
Welcome.

Julian Easthope, Barclays
I think a couple of my questions have been asked already. But I was just going to come back to the comments in the press the other day that you're looking to sponsor James Harden in the basketball category.

Nike actually reported last year that they had about $3.7 billion of income from basketball and you're clearly a tiny fraction of that. Is it actually possible, do you think, for you to compete within the basketball category in total?

And, in fact, do you actually need to be in that category? I know it's a big category, but it's so dominated by Nike that is it not just putting an awful lot of money behind something where it's going to be incredibly difficult to compete, given the dominance of the main player? Thank you.

Herbert Hainer
Yes, this is correct, we have invited James Harden to join our brand. We definitely do believe that basketball is a sport we have to be in. We always have been. This goes back into our history with a lot of players, Kareem Abdul-Jabbar just to name one of them.

Basketball is a big sport in the US, but not only in the US but also in China, for example. We definitely want to compete in basketball and, therefore, we will build our roster of athletes. We have already great athletes. Just think about Andrew Wiggins who we took last year and he became Rookie of the Year, with Damian Lillard, John Wall, Derrick Rose.

We definitely want to be competitive in this area. This is a tough place in the US but we definitely think that we have the right to play there.

Julian Easthope
Okay, thank you. Can I ask a really nerdy question, just coming back to Chiara's question on the Russian margin? Did you say that some of the fx on the rouble was actually taken at the unallocated level? Because according to my numbers at least, your unallocated gross profits actually fell just a little bit, so it didn't seem to have made that much of a difference at that level. Is that where it's actually taken?

Robin Stalker
No, in fact we haven't hedged, so there's nothing. For the stuff that we have hedged, we have had some small hedges in the past and they were all at the headquarters. But during this period, there's no hedging in the rouble, so there is nothing at the headquarters in regards to this at the moment.

Julian Easthope
Okay, thank you.

Robin Stalker
Welcome.

Louise Singlehurst, Morgan Stanley
Three questions from me. Firstly, can you just talk about cost savings? I think Herbert alluded to a few comments earlier on in the call.

And following on, on the sponsorship and asset question, are there ways that you can take away some of the spending from older areas where you're obviously prioritising some of the new relationships, such as the James Harden point made previously?

Then secondly just on golf, can you help us think about the EBIT losses and the contribution of Ashworth and Adams in the context of the overall golf division? I know they're relatively small on the revenue contribution, but what they are in terms of the EBIT loss.

And then finally on Runtastic, can you just talk about the integration process there and how we should think about the revenue opportunity? Obviously, there's the usual subscription, but how you're integrating that across the sales opportunity for the broader Group? Thank you.

Herbert Hainer
Let me start with the last one on Runtastic. There is no integration. We will leave Runtastic in Linz, because we definitely do believe this is the cell of the digital nerds, who are together there. There are around 130 highly engaged people; they are a young workforce, and we don't want to bring them into the corporate life, to give them the freedom for creativity.

Of course, we will use all the synergies which we have between, for example, our miCoach system, our data, our science which we have. There's no other company that knows more about athletes than we do, and combine it with the fast and reactive tendency Runtastic has.

Regarding your first question on cost savings: yes, of course, we are dropping assets, mainly smaller ones, as we have done already and announced. Here in Germany, for example, the Bundesliga clubs of Bayer Leverkusen and Nuremberg.

We are also dropping assets left and right to really focus on what we think is important for the future. These are the creators, who are helping us in our new plan, Creating the New.

James Harden would definitely be a creator. As you know, he has been named MVP from his peers and he is a great player. He's an exciting personality.

But we're also looking for other assets. Take Manchester United, which we are very happy about. I said already before in comments how exciting the sales have been in the first few days. But, on the other hand, we also have to cut in some other places.

Robin Stalker
We don't break down the individual units of TaylorMade-adidas Golf in terms of profitability. But you must know that Adams and Ashworth is about 10% of the business there, so it's not all that significant.

Also, you should realise that when we're talking about golf and profitability generally, don't forget what Herbert said in his comments earlier today: that the adidas part of the TaylorMade-adidas Golf business, in terms of the footwear and apparel that we're selling, that's been performing better than the hard goods business, so just a small piece of information for you.

Louise Singlehurst
Okay, thank you.

Robin Stalker
You're welcome.

Piral Dadhania, RBC
Looking at the adidas brand within the context of adidas Originals and Sport style; it's obvious that these businesses have clearly outperformed with growth of approximately 40% in the second quarter. That would suggest that the performance side of the business is under some pressure, probably partly due to a tough football comparison.
Could you just share with us the actual growth or decline in the performance business and how you view the imbalance between Sport Style and Sport Performance going forward? And whether we should see a normalisation going forward?

Herbert Hainer
First and foremost, it's correct that our Originals and our NEO business are developing very well. But I think that it would be a wrong assumption to say that our performance business is not doing that well.
Please have in mind that it's highly related to the comparing numbers of football against last year. As I have said in my comments, football footwear is up 17%. So it's the football licence

jerseys business from the World Cup which are bringing the result down. Running is up 2% and training is up 6%. Training, as you know, is a big category. So performance is doing good. Obviously, there are some minor categories like basketball where we are slightly down, but bigger categories are all growing. So it is definitely due to the comparison which we have for the first half of 2014, because of the World Cup.

Volker Bosse, Baader Bank
Starting with TaylorMade-adidas Golf, your initial outlook was to return to growth in the current year. Now having first half sales figures on hand, how do you adjust your full-year sales outlook for TaylorMade?

Second on Russia, how do you see the current trend and your full-year expectations in terms of sales year-on-year?

Third question: Reebok was down 9% in North America, you mentioned streamlining process of the factory outlet business in the US. Is this something which will be finalized and concluded in the current year, so that we can expect Reebok to be up also in North America from 2016 onwards?

And last final question is on your competitor Under Armour who just recently opened its European headquarters in Munich, so how do you see or already feel the competition with Under Armour in Europe?

Herbert Hainer
I think I have mentioned all the reasons why we are not performing as we have projected for TaylorMade, so I don't need to repeat them. We expect TaylorMade-adidas Golf to decline in 2015.

Now to Reebok in America, it's correct that the decline is mainly due to the closure of factory outlets, but I think it's also fair to say that America is our toughest market, because we are growing everywhere in the world with the Reebok brand besides of America. Obviously, it's our target in 2016 to get back to growth in the US, but it's still too early to talk about 2016. We will do this in November when we speak to you again.

And finally, Under Armour, we take every competitor seriously, and it's not only Under Armour; we have ASICS, Sketchers and others. However, we have our strategy, which we believe is successful. I definitely do believe that the first half and the second quarter, specifically, is clear proof how we can drive our main brands, especially adidas and Reebok.

Volker Bosse
Okay, thank you.

Zuzanna Pusz, Berenberg
Just three questions on my side, first of all your comp store sales declined by 2% in Q2, so I was just wondering whether you could provide us more color on comp store sales growth by region, and perhaps most importantly whether you have seen declines anywhere else apart from Russia?
Secondly, maybe if you could just update us on the basketball business, how has the growth been in this quarter?
And finally, I understand that it's too early to speak about the potential impact of US dollar hedging next year, but would you be able to give us more or less the hedging rate you have secured so far? Thank you.

Herbert Hainer
Zuzanna, let me start with basketball. Basketball was down 7% in the second quarter, but you should also have in mind that the second quarter is not a big basketball quarter; it starts now in the third and the fourth quarter, when the NBA starts again.

Robin Stalker
You were asking about the comp store sales, if we exclude Russia, comp store sales for the second quarter were actually 3% positive, because obviously Russia is a very big market for us in retail. For the half year excluding Russia it is 5% positive.
Your last question about the dollar hedging, no, I'm not going to give an update on that at this stage. We will do that in November, as we are not fully hedged yet. Therefore, I think with the volatility it would be incorrect to give any indication, at the moment. But we are considerably advanced and we will be giving this guidance, obviously, when we close end of the third quarter.

Zuzanna Pusz
Perfect. But if I may just follow up, so regionally you didn't see declines in any other regions apart from Russia, in terms of your comp store sales in Q2?

Robin Stalker
Beside Russia, I think the only one was North America, where we've mentioned some of the reasons in respect to that, and also Latin America. But the major markets were all up; if you look at China significantly, Japan significantly, emerging markets and Western Europe are also up mid-single-digits.

Dan Homan, Citi
First of all, on Opex, just the sales and marketing investments are growing slower in Q2 than Q1, was that a pull forward of the deceleration in marketing investment that you previously flagged, or is there going to be a further deceleration in the second half?
Also on operating costs, was there any FX or hedging benefit in Q2 at all, any one-off benefit that we should be aware of?

Robin Stalker
Yes, so in terms of marketing and sales working budget investments, I think you should just recall a comment we made earlier on this in terms of timing. Obviously, last year it was an event year for us, with the World Cup – a major event, and so our expenditure was specific to that. We have the different campaigns for this year, not the event, and that is the only real reason why, from quarter to quarter, the trend and the marketing investment might be different.

Your second point about FX, the FX impact for the half-year on our Opex is around about € 160 million, but there's always pluses or minuses in certain of the balance sheet non-euro denominated positions. For this period there was a positive € 15 million, but that's something that is always very volatile depending on the rate movements at the end of the period.

Dan Homan
The final question was on Runtastic. I was just wondering if you could share any information about the growth over the last couple of years. I noticed that enterprise value when Axel Springer acquired a couple of years ago was € 22 million, so wondering what's driven the 10-fold increase over the period?

Herbert Hainer
Yes, it's definitely the growth of revenues, but even more the growth of users, which drives up the price. You have heard that Runtastic has now 70 million users and 15 million monthly active users which is an even more impressive number. They have 140,000 downloads every day. And in total, they have now over 140 million downloads.

They have 20 apps in 18 different languages and they are market leader in around 20 countries such as in France, in Italy, in Spain, etc. They have close to 10 million users in the meantime in the US and they have just gained 5 million users in the last two months, since we started discussions. They are permanently bringing out new apps, and are going to launch a new app next week. Therefore, together with some other reasons, we decided to go with Runtastic, which is one of the three key digital app companies. We are quite happy that we can partner up with Runtastic.

Chris Svezia, Susquehanna Financial Group
Thanks for taking my questions. I want to talk about running for the moment. Being up 2% I think in the second quarter, and I think up 5% year to date, why wouldn't that be stronger just given all the momentum as pertains to Ultra Boost and just the Boost platform? Are you seeing declines in other categories within your running business that sort of mitigate that?

And maybe if you can just give us some thoughts about how you think the running business will play out for the balance of the year globally, and more specifically North America?

And then my last question just pertains to the guidance, I'm just curious, you're still guiding for mid-single-digit currency-neutral growth for the total company, despite being up 7% year to date, and increasing your growth targets in a handful of key markets would seem to mitigate the pressure at TaylorMade.

So that would imply low- to mid-single-digit currency-neutral growth in the back half of the year, despite some Euro Cup shipments?

And then also on the profitability side, it also seems like it implies somewhat flattish profitability, despite some improvement in gross margin in the second half. Maybe you can just walk through that a little bit, if you could for us, in terms of understanding that dynamic? Thank you.

Herbert Hainer
Let me take the first question on running. I think your observation is quite right, but you have to bear in mind that as we told you at the beginning of the year we had over inventories especially in the US market.

We are quite careful, especially with our Boost technology, where we deliver it and how many quantities we put into the market. We wanted to make sure that we clean up the market and bring inventories down. Therefore, we have to be more careful with the volumes, which we're putting into the market, and this is the only reason.

As I have said several times, we think that, especially with Boost, we have a groundbreaking technology, and this should be a franchise for us for the future to come. Therefore, we are quite careful on the volumes we are putting into the market.

Robin Stalker
In terms of our guidance, well, we're giving the best guidance we can, with the visibility we have at the moment. Perhaps the only factor that you might be missing is that we have always called out that this is the year where we are investing in our brands.

We are obviously, with our new business plan, Creating the New, doing a lot of things to make sure that we're setting our organisation up to continue growing significantly, but also improve our profitability sustainably. This is a period where we invest.

Chris Svezia
If I can just ask a follow-up on that, Robin. If you think about the third quarter versus the fourth quarter, and some opportunity to get some early shipment as relates to EURO Cup product, would it be fair to say that the fourth quarter should be, from a currency-neutral perspective, stronger versus the third quarter?

Robin Stalker
The third quarter is always our biggest quarter. It's probably fair to assume that also the fourth quarter this year will be better than last year's, because of that event, yes.

Chris Svezia
Okay. All right. Thank you very much.

Simon Irvin, Credit Suisse
Just a couple of quick ones. Firstly, can you just talk about the Pump? There was a new product launch in Reebok and there's absolutely no mention of it whatsoever, which rings a few bells.

Secondly, can you just give us a few more metrics about Runtastic, in terms of revenue or anything useful like that? Your comments would seem to imply that you don't feel the need to buy anything else in the digital/social sphere. Is that it as far as you're concerned?

Then very quickly, can you just talk a little bit through the new product launch in football? Is that going to change the natural phasing of 2Q and 3Q? Have you actually dragged sales forward into 2Q, as a result of the new launches?

Herbert Hainer
Let me start with the first one, with Pump, yes, we forgot to mention Pump. Pump is an old technology of Reebok, which we re-innovated and brought back to the market in 2015, which we will continue in 2016.

As we have always said, for THE fitness and training brand, running, of course, is an important area and therefore the Pump technology plays into this category, and you will see new drops coming out of Pump going forward.

Second question on Runtastic, I mentioned already a little bit before that Runtastic has very good double-digit growth rates over the last years, and this will continue. Obviously, we don't talk about the exact revenue numbers, but what we are giving you is the users and how this is increasing.

I've said it already; they have 70 million users now, around 15 million monthly active users - more than anybody else.

They're market leader in so many countries with 20 app sites in several countries. 50% of their revenue is in Europe, around 12% - 15% in America, 25% in Asia, and the rest in Latin America; so also very internationally broad-based.

This is what I can give you in terms of numbers.

In terms of football product launches, bear in mind that with Ace and X, we just started in Q3. So, obviously we have the majority of the new products coming in Q3. This will continue in Q4, because when the EURO 2016 comes up, you know that we will start normally in the fourth quarter with our jersey launch, and then we will bring new football boot concepts into the market.

Then going into 2016, you will see some new innovative products from us as well, up to the European Championship in 2016. But from a launch cycle, this is nothing really different than what we have done in the past.

Simon Irvin
Excellent, thank you very much.

Herbert Hainer
You're welcome.

Sebastian Steffen
Ladies and gentlemen that actually completes our conference call for today. I would like to thank Herbert and Robin.

Our next reporting date will be November 5 for our Q3 numbers. But I'm sure that we're going to be in contact with you over the next couple of weeks, either over the phone or during our upcoming road shows in Europe and the US.

As always, if you have any questions, please do not hesitate to reach out to any member of the IR team.

With that, I would like to thank you for your participation and wish you a very good and sunny day. Bye, bye.