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ADS.DE - Half Year 2018 Adidas AG Earnings Call

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OVERVIEW:

Co. reported 2Q18 revenues of EUR5.3b, net income from continuing operations of EUR418m and basic EPS from continuing operations of EUR2.06. Expects 2018 net sales growth to be around 10%.



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PRESENTATION

Operator

Good day, and welcome to the adidas Conference Call for the First Half Year 2018 Results. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr. Sebastian Stefan. Please go ahead.

Sebastian Steffen - *adidas AG - VP of IR*

Thanks very much, Christina, and good afternoon, ladies and gentlemen. Also, a warm welcome to my side to our second quarter results conference call. Thanks very much for joining us at a little bit different time and from a different location this time.

Our presenters today here in London are our CEO, Kasper Rorsted; and our CFO, Harm Ohlmeyer.

Before I will hand over to Kasper in a second, I will, as always, quickly run through a couple of housekeeping items. As always, I would like to ask you to limit your questions to 2. And also, as always, please keep in mind that all figures that we will be talking about will be stated on a currency-neutral basis, and will be discussed for our continued business activities.

And with that, I would like to hand over to you, Kasper.

Kasper Bo Rorsted - *adidas AG - CEO & Member of Executive Board*

Thank you very much, and again, also, from my side, welcome to our second quarter call of 2018. The agenda is, I will take you through the business highlights, Harm will take you through the financial items. I will deliver the outlook, and then Harm and I will be more than happy to take the questions you might have.



So let's go into the second quarter, and as always, go through the strengths and weaknesses. On the strength side, we saw double-digit growth in North America, in Asia-Pacific, in Latin America and in Russia. We saw a strong growth in our Sport Performance and double-digit increases in Training, Running and Football. Football, of course, due to the World Championships in Russia.

We saw a very powerful brand activation on a global stage, not only the World Cup, but also, Run for the Oceans activity, where we activated more than 1 million runners to push running activity, and of course, run for the ocean, which is a great campaign under overall initiative for Parley. And we saw an excellent profitability improvement despite a significant increase in our marketing investment.

On the weaknesses side, we saw a flat top line in Western Europe. And as we communicated to you in May, we are facing challenges in Western Europe.

Going into the year, we did expect some normalizations to take place. And bear in mind that over the past 3 years, we have grown at a 15% CAGR, and added more than EUR 2 billion to our topline in this mature market. At the same time, we've impact -- improved our operational margin by no less than 250 basis points. However, the normalization year-to-date has been somewhat more pronounced, as we expected, into the year. This also is related to the fact that we have not executed as well in the past on our product story-telling and consumer activation. As a result, we have acted and made changes in Western European management team in order to ensure that the execution is being stepped-up.

We expect the current business trend from the second quarter to be largely unchanged for the second half as we are sticking to our disciplined approach. Secondly, with the -- [we see less] of an operation leverage masked by investments, investments into our scale of the business, but of course, also into our brand. We saw the momentum in Sport normalizing, and we saw Retail comp trend being mixed, and we'll get there into further detail.

Major P&L items in the quarter, revenue increased 10% on a currency-neutral basis, and 4% in euro terms to 5.3%. The number was similar in the first quarter with the nominal growth being 3%.

Gross margin up to 220 basis point to 52.3%, despite ongoing FX headwinds in our gross margin. We saw the operating margin up 120 basis points to 11.3% due to a higher gross margin, and despite higher marketing investment. We saw a net income from continuing operations increase 20% to EUR 418 million, and basic EPS from continuing operations up 20% to EUR 2.06. And let me just dwell there for a second. As we said on the top line, we increased our top line with 4% in normal terms, and we increased our net income by 20%. And that means we are having a 5x stronger growth on the bottom line compared to the [top, despite strong investment in our marketing activities.

When we look upon our strategic growth areas: adidas North America, 17% on a very strong to previous years; Greater China, 27%; and e-commerce 26%. So all elements outgrowing the market and gaining market share in these areas. The FIFA World Cup was a showcase in the power of our brand. There is no doubt that the World Cup is the biggest brand event, the single biggest sporting event over a 3-week period. And we were, from a brand and social media standpoint, the most visible media when you measure that. We were very active when it came to stadium advertising, which helped us drive the adidas downloads on our adidas App. We used the Creativity is the Answer campaign to push the entire value proposition around our brand. And the global jersey sales outsold the number of jerseys with it -- we sold in 2014, despite what we would call a somewhat peculiar development of the tournament.

Direct financial impact was limited on the bottom line, simply because of the way the mix was in jerseys. For overall, we sold more than 8 million jerseys during the World Cup.

Moving to the adidas brand. We saw a double-digit growth in North America, Asia Pacific, Latin America and Russia. We saw a growth of 12%, Sport Performance grossed 16%, due to double-digit growth in Training and Running and in Football. Sport Inspired [grows] 7%, driven by a significant growth in footwear and apparels. And we saw footwear sales accelerating, resulting in a double-digit growth increase, up from a single digit in the first quarter.

On the Reebok side, we continue to see robust improvement in the profitability. We improved the profitability by 390 basis points, and right now, we are up at 44.9% [debt] margin, the highest debt margin that I can recall. Reebok overall, topline declined 3%. Declines came from Western Europe, but we're seeing a similar situation for Reebok as we're doing with adidas Latin American and Emerging Markets.

We saw sales in North America increase 6%, despite a significant number of store closures in the past 12 to 18 months. So operationally, we are making progress in Reebok towards our target of returning Reebok to profitability by 2020. On our income side, we continue to see excellent growth in e-com with a 26% growth driven by double-digit growth in all regions. The adidas App has now been launched in 13 countries, and more than 2.5 million downloads was done by the end of second quarter. We are now in all the Western countries of significance which has yet to come from very large [sizes], of course, Latin America and China, we expect China to be ready by the end of the year. So we are seeing the App's download being accelerated, particularly during the World Cup with the aggressive and very impressive advertising in-stadium.

With this, I'd like to stop the overview part, and I'll hand over to Harm, who will take you through the financial highlights.

Harm Ohlmeyer - adidas AG - CFO, Labor Director & Member of Executive Board

Thank you, Kasper, and warm welcome out of London this time. A good morning, good afternoon, good evening, wherever you are calling from.

Just to reflect on the key regions. This time, every region is contributing to the growth. Kasper already talked about the flat left in Europe, I want to go a little bit deeper on this chart now about Russia and Latin America. So Russia, of course, we got a nice uplift, given the World Cup has happened in that market, and we did a lot of on-site sales around the stadiums, and we definitely had more traffic than we originally had estimated there. But you also should see the net sales in line of 180 stores that we have closed in 2017 and another 50 stores that we closed in 2018. And at this stage, I think, we're getting closer to it, that we have found the bottom from a top line point of view. And then Russia we can build on that one going forward. And of course, Latin America has also been positively impacted through the 2 Federations that we had on our contract, which was Columbia, Mexico and Argentina, hence, a very good double-digit increase in the second quarter for Latin America.

When I go to the details, starting with North America, strong top and bottom line improvements, with overall 16%. For the adidas brand, revenues are up 17% driven by double-digit growth in Training, Running and Football. And especially, there on the Sport Performance side, very good sales revenue growth with one of our key partners was DICK'S Sporting Goods.

Reebok brand revenues grew 6%, that's something that we always highlighted as a strategic KPI for us, that we're back to growth in North America with Reebok, despite also there is a significant number of store closures in 2017 and only a small number of closures in 2018. But again, back to growth was 6% in North America.

Gross margin decreased of 60 basis points to 40.8%. There was better pricing mix offset by less favorable channel and category mix. And still there, I mentioned it in the first quarter, we are still impacted slightly by some clearance activities given the hangover of our warehouse constraints in 2017. And that gross margin we should see improving Q3 and Q4 and as well going forward. But overall, given the cost leverage, our operating margin increases 3.8 points to 16.7% now. And so the leverage of the operating expenses more than compensated for the decrease in the margin.

We go to Asia Pacific. Again, strong double-digit growth driven by Greater China. We mentioned the 27% growth in Greater China already. Overall, adidas brand sales increased by 19%, double-digit growth in Training, Running, Football and Sport Inspired. In the Reebok brand, revenues up 7%, double-digit growth in Training in that region. Gross margin up 30 basis points to 57.5%. Again, better pricing, channel and category mix compensates for some FX headwinds in that region.

Operating margin, up 1 percentage point to 34.2%. Again, due to a higher gross margin and some operating leverage, despite the fact that we are investing into the market to build 1 region in Asia.

When it comes to Western Europe, Kasper mentioned, already the flat development in Q2, so that is given our expectation that we also announced after Q1.



Adidas brand revenues are still up 1%, driven by significant growth in Football on the back of the World Cup activities. But I also want to mention the comps to last year, where the adidas brand grew 18%, and the Reebok brand sales decreased 10%. Again, reflecting a tougher prior comp of 33% Q2 growth in 2017. And of course, we've talked about the future marketplace initiatives that we not just did in Europe, but we started in Europe, where we prepared for quality growth and are more selective in our distribution and it is, of course, to some degree impacting the top line, but also shows the gross margin improvement of 330 basis points. Because this is really where we started with these quality growth initiatives, and that is paramount to the top line growth. But no question, we are not happy where we are, and that's what Kasper mentioned, we have acted on Western Europe pretty much immediately.

Now coming to the financial results overview, and I want to chew on this a little longer and have an additional chart on the operating expense on the next slide, but I want to go back again what Kasper said. We delivered another quarter after Q1 according to our guidance. It is [on the] 10% top line currency-neutral, and we have a factor of [5] when it comes to a net income of 20%. So for the first half, [19%] operating net income which is slightly above our full year guidance of 13% to 17%.

Again, when we talk about the gross margin, definitely, up this 230 basis points. I have to admit, it's a bit better than we originally had planned for. We had good jersey and ball sales in the second quarter, overall driven by the World Cup, it had some impact. I talked about the future marketplace initiatives that is definitely contributing to the quality of the margin. So we're really happy with seeing progress that we have made on the margin. But also, we will definitely get some questions later on, on the margin development, I want to state that very clearly already here, there are very different comps in the second versus the second half of 2017, where we had a more than 100 basis points higher margin compared to the first half in the 2017. And there will be some unhedged portions of our currency, especially Latin America, Chinese RMB, and there will be some other impacts to the margins in the second half that I want to explain later on, but this is really where we are guiding our margins, but also want to remain positive on the margins, that there is opportunity when we look at the full year.

I also want to highlight when we come to the cost. The other operating income is up to EUR 70 million compared to the EUR 24 million in the previous period. Other operating expenses are up by 9%, and again, I want to give you some more details on the next page when we talk about the bridge of the operating expenses to give you some more transparency.

Overall, despite investment into the brand, the operating profit is up by 17% to EUR 592 million, with an operating margin of 11.3% for the second quarter, up again 120 basis points. All of this resulting into a net income from continuing operations to EUR 418 million, and 20% up over prior year.

Now we go to the operating margin expansion, somewhat more a decomposed. On the first end, the really significant increase of the gross margin as to some degree has been used to invest or continue to invest into the brand with 120 basis points. So if you look at the marketing working budget, the major driver of that cost increase in Q2 was our accelerated marketing spend. We leveraged the World Cup while continuing to invest overproportionately into our brands and to sell through of our products. As a result, our marketing invest increased by close to EUR 100 million in the second quarter, or 120 basis points as you see in the chart. So we always should see the investment into the brand and the gross margin on our quality growth, both in consideration to drive quality growth for our brand and ensure the sustainable top line development, not just in 2018.

On the operating overhead, I put a little box around the operating overhead expenses and other operating income, so the operating overhead first and foremost. We continued our investment efforts into our scalable business model and hence, recorded a somewhat more pronounced increase in operating overhead expenses. In some examples, there have been some start-up costs for our global business services. That is definitely scaling significantly in 2018. We prepared for that in 2017, now we are full action in 2018. We keep investing into our IT-related expenses to drive our digital transformation, but also building One Asia, where we continue to roll out our ERP systems to drive one standard around the world, which we are going to finish early 2019, to be on really one standard as a company. We also further transformed our operating model in Latin America by further reducing our fixed cost, primarily related to local production capacities. And we remain proactive to look at our retail fleet from the closure point of view and from an impairment point already in Q2. So these are some of the one-offs that you're seeing in the operating overheads. While [certain] inter-year fluctuations can occur, we will deliver on our commitment to generate operating overhead leverage for the full year. We just aren't going to focus every quarter exactly on what we said, but we are sticking to your guidance for the full year to generate leverage.



On the operating overhead income -- on the other operating income, it's up to some release of prior operational provisions and litigation gains. To be clear, we had not declared any of these provisions when building them in 2017. So this is mainly profits organically generated in the past that are now showing up based on our conservative accounting approach in 2017.

As a summary, as you can see from the chart, the net of the operating overhead expenses and other operating income actually only added 20 basis points on our operating margin. And hence, what you can see in absolute terms, the additional investment reflects in our operating overhead increase exceeds the gains that led to the operating -- other operating income hike.

When it comes to the average operating working capital, I'm pretty happy where we developed here with a 20.1%. I always said, I ideally want to see in 2018, late into 2019, that we get to the below 20% line. We are getting very close to it, it's 20.1%. And one of the main reasons for that is our disciplined action on the inventory. So we are acting on the sell-through that we are seeing. We are adjusting our [advice] accordingly and stay very disciplined, our pull model across most of the markets, and that is leading to efficiency in the operating working capital. Given the strength in the operating working capital and disciplined inventories, you all see the net cash position developing positively from last year Q2 2017 from a minus EUR 735 million to now a positive EUR 89 million, including the share buyback. And that is also what I said, we wanted to generate the cash to then act on what we do as a return for the shareholders, and that is what you see in the next page. We are executing on what we said, after -- in March, we're going up to EUR 3 billion for the share buyback towards 2021. The timeframe is May 2021, and we also said up to EUR 1 billion already in 2018. And you can see there is 2.8 million shares being bought back since the March 22 until the end of June in the amount of EUR 544 million. So we are well underway, and we are always in the market to continue that program in 2018 and beyond.

That leads me to the retrospective accounting treatment of the Reebok trademark in 2016. You saw it in the press release this morning, and you will see a clear announcement in the afternoon, in the (inaudible) and Bundesliga as well. It is an accounting restatement. We had the routine audit from the FREP in 2017 for the year 2016. And we -- in so they confirmed the methodology that was aligned with our auditors. We had some discussion around the input factors for our future prospects of the Reebok brand, hence, the accounting's restatement in 2016. It has no cash impact or any P&L impact in '17 or '18. We are restating 2016, and it will be an impact on the equity in the amount of after-tax of EUR 475 million that changes the equity and the opening balance of 2017. And in 2018, you don't see it as a comparison to 2017 as we are changing in the opening balance in 2017 already. I want to be very clear, this is 2016-related only. It's backward-looking. Forward-looking, we started the Muscle-Up initiative in '17 and '18 with significant progress. And what you're seeing is the Q2 results with 390 basis points up in the margin to historical strong margin with Reebok. We are making good progress when it comes to Muscle-Up. And there is no impact to our future prospects of the Reebok brand. With that, I want to hand over to Kasper to explain a little bit the outlook for 2018.

Kasper Bo Rorsted - *adidas AG - CEO & Member of Executive Board*

Thank you very much, Harm. I will now go through the outlook and also speak about some of the new exciting product launches we have. For 2018, we have and plan to have the right balancing between market share growth and margin improvement. And that is really the essence of what we're doing with our company. Drive market share and drive margin in the short, medium and long-term to ensure we expand our position, but also expand our position in a financially meaningful way. We have and will continue to strive for high quality growth, which I hope you've seen we've done in the first 6 months, with 3% nominal growth and topline and 19% income growth. So we've been able to get both. We're seeing a product pipeline to support the planned topline expansions. I will take you through some of the new products we're bringing to market. We have been and will continue to overproportionately invest in brands and products, so the scaling (inaudible) we're getting the margin right now is having -- is getting a negative impact from our marketing investment budget. So we are heavily investing in our brand and will continue to do so to make certain that we're pushing the brand for the long term. We continue to implement a scalable business model, which also has a onetime costs associated with it, and we expect the margin expansion and an overproportionate net income growth.

Now let me take you through just a couple of the products just to give you an highlight where we are. Starting with the existing products in franchises. UltraBOOST. In the past 3 years, we've built one of the most converted franchises in our industry, the UltraBOOST. The success continues with this franchise, growing close to 50% in the past quarter. So we are a long way from being saturated. We have reactivated the UltraBOOST collection this season in July, and the first [drop] of collaboration with a streetwear label, a kind of (inaudible) have sold out instantly. You are going to see more of the special edition collaborative UltraBOOST releases in the remainder of the year. This leads up to the launch of the next generation of the UltraBOOST in early 2019. And this will be the next leg of growth for the UltraBOOST franchise and drive it towards the EUR 1 billion mark.



When it comes Football, we're going to build on the excitement we created around the World Cup. Just days after the Finals in Moscow, we have collectively launched the latest iterations of our 4 big football franchises: X, Predator, Nemesis and Copa. This comes right in time when the kids are shopping for back-to-school and cannot wait to get back on the pitch in a new pair of football boots. Those iterations will we won by some of the game's bigger players: Gabriel Jesus, Paul Pogba, Messi, [Talari], for the kickoff of 2018 and '19 season. All of them, of course, available in the stadium [game] and street version in order to maximize our commercial impact as well as range synergies.

When it comes to Superstar and Stan Smith, speaking of 2 successful franchises, let me give you an update on the 2, because I know you care, and there seems to be some misconception. Let me be clear, we have proactively managed those 2 franchises down after they surpassed their piece in this current title. In fact, Stan Smith and Superstar have been managed down from the past 18 months now which did not get in the way of our continuous topline growth, as you know from the numbers we reported to you year-to-date and also for 2017. Today, Stan and Superstar each only account for low single-digit percentages of our total sales.

Volumes out in the market are very healthy. If anything, there is more small demand than what we want to supply right now. As such, standard Superstar continues to be the leading example of disciplined life-cycle management. And you can expect us to handle other maturing franchises similarly prudent. When it comes to launching new products, the P.O.D. within Sport Inspired, we are consistently delivering newness. In the past few months, through Deerrupt, Arkyn, [EQT] Commander, Sobakov among others. But P.O.D. is, without doubt, going to be the most visible Sport Inspired franchise in the second half of 2018. What is unique about the P.O.D. is it's inclusion of 2 different types of foam on a sole, boost of the heel and EVA cushion on the forefoot. Store selling and activation is also much bolder and more focused than was the case in the past. We involve consumers around the globe, both physically and digitally. Together with them, we bring P.O.D. to life, be it through interactive, creative workshops in our [key street] London or (inaudible) creator space in Brooklyn.

Solar. Meanwhile in Sport Performance, we're completely relaunched our technical running offering and created a holistic franchise for our running consumer, Solar. Solar Boost, which has successfully launched in May is leading the direction for Solar and it's going to be complemented by several modular additions, mainly Solar Glide and Solar Drive. This way, we're covering all of the relevant price points between EUR 120 and EUR 160.

The franchise is gaining weight quickly, and will contribute a mature triple-digit million euro amount to our revenue already in 1 year. Solar features a ton of innovation, leading to a superior comfort, fit and support in lightweight form. But I want to highlight 1 benefit that we offer to the consumer. The transparent franchise setup. It will ensure a consumer friendly segmentation. Consumers will be able to identify the best fit product within the Solar across the different price points, rather than being overwhelmed by an over (inaudible) of different models. At the same time, the holistic franchise setup of Solar enables us to realize range efficiencies.

Scaling and innovation. Our Future 4D Craft we are incredibly proud of. Our collaboration with Carbon has enabled us to be the first brand to create 4D printed shoes for our consumers and to commercialize it. We will bring this innovation to many more consumers in the second half as we increase volume at retail by tenfold. 4D will scale and in the future will be featured in our pinnacle products across several categories. And Parley, we are just as proud of our collaboration in this area. Parley is our way of proving that you can do good and do business. As we communicated to you before, we are on track to deliver 5 million pairs of Parley shoes this year, up 1 million a year ago. Each pair of Parley shoes prevent approximately 11 plastic bottles from entering the world's oceans. And we haven't even started telling you about the apparel. We are also going to have million pieces featuring Parley this year. Taking this ability to a product label and scaling it makes a real difference, also for our P&L. We are also leveraging the industry's largest and deepest archive to seize commercial opportunities. At the first ever rerelease of the Continental 80, a classic trainer from our archives in the late 1980s is a runaway success. Harm and I were sitting here in London and was walking down to the nearby store, and we couldn't get it. It's a great thing to see that we continue to launch successful products, and I can only encourage you to look upon the Continental 80. Yung1 and Falcon as well as Reebok Aztrek, all bulky (inaudible) celebrating looks of the '90s, also strong performers in terms of sales growth. Those show a significant commercial relevance already, and definitely have the potential to soon become as big as some of our well-established franchises. So we have been all but surprised by the emergence of these themes and we are all but done with playing with them in a commercial, meaningful way.

As I earlier explained, how we score at global sporting events, as the example of the World Cup, but of course, there is life after World Cup. Football clubs returned to the stage, and we have some of the biggest global symbols for you. You went us by [Byon] with Real Madrid and Man United. We will continue to leverage those assets globally and seize commercial opportunity as they arise. We've got too many great sport assets, both in



teams and individuals to mention at this place. But I want to call out (inaudible), who's victory in Wimbledon was huge, and it raised even more awareness for rule-breaking collaboration with streetwear brand on the biggest stage in tennis. On World Ocean Day, on June 8, we entered our second Run for the Oceans, a month-long campaign to raise worldwide awareness for the oceans and fight for (inaudible) pollution. Driven by our adidas runners community, we saw close to 1 million runners getting involved, supporting -- supported by more than 200 events in 60 countries across the world. In total, participants, including more than 12,000 adidas employees, collected over [12 million] (inaudible) through the Runtastic App. This increased not only the awareness but one of the most pressing challenges of our time, but at the same time act as an incredible platform for us as a brand and allowed us to connect with consumers around the world. And as I said, about doing good and doing business. Last, but certainly not least, I want to talk about our partnership with Kanye West. It's been 3 years now since we started the most significant collaboration ever created between a non-athlete and athlete brand. Together, we have created global brand power in an unprecedented away with many of the products having developed in the most sought after and fast-selling footwear models in the history of our industry. We're excited to build on this partnership and continue to explore new territories. Kanye has repeatedly stated his aspirations to democratize the YEEZY brand. We share his aspirations and we are working hard to bring this vision to life. Watch out for more. Now this brings me to the outlook for our 2018. And this remains. We confirm our net sales to continue to increase by around 10%, gross margin up 30 basis points, operating profit up between 9% and 13%. The operating margin should land between 10.3% and 10.5%, and the net income from continuing operations should grow between 13% and 17%. Also want to repeat what we have said on several meetings with many of you through the second quarter. In our outlook, we believe there is more challenges on the topline than on the bottom line, but we expect to deliver upon the promise we've said here, and ensure that we build the foundation also to deliver upon our promise towards 2020.

So in summary, first half of 2018 is going according to plan. Secondly, we're seeing progress across strategic growth areas. We're acting upon the situation in Europe, but we want to make sure that we build a sustainable solution and not a onetime blip, and that's why we have taken the time to fix -- to make certain that we will get Europe back into the state where it needs to get to. We're accelerating our marketing activities to support brand and product. We're seeing strong profitability improvements, despite investment in brand and business. And we focused on executing the second half of Creating the New.

With this, I'd like to thank you for your attention so far, and Harm and I look forward to take your questions over the next 50 minutes.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question today comes from Antoine Belge from HSBC.

Antoine Belge - HSBC, Research Division - Global of Consumer and Retail Research

Antoine Belge, HSBC. Two questions. First of all, you just mentioned that the topline remain a bit challenging compared to last time, last time we spoke in May. Would you say it's a little bit less challenging now that you've got the Q2 quarter behind you? And maybe some kind of visibility on the back-to-school season, and so, the gross margin outlook looks really conservative. I understand the unhedged currencies, but you're doing 30 basis points when you've done already 118 in the first half. It seems quite conservative. On the second question is about Western Europe. I think you mentioned some management changes. I wanted to make sure I understood that correctly? And also, what's the plan for the second half on 2019? Wouldn't you agree that maybe you underinvested in Western Europe and maybe because you were focusing on other, not really, but concentrating on the U.S. and China? I know, it seems that Nike has been growing faster. So what's the plan for Western Europe?

Kasper Bo Rorsted - adidas AG - CEO & Member of Executive Board

So the outlook for Western Europe is that we remain (inaudible) as we've seen. I completely disagree that we underinvested in Western Europe. If you look upon our plans in Western Europe compared to others, I don't see that being the case. We believe that the challenges we had were in 3 areas: product launches, distribution and, probably, focus. We have changed our management structure in Western Europe to ensure that we



are building a plan to sufficiently address the challenges that we have. But I say very clearly, that we are not underinvesting. If you look upon our actual marketing spend, I believe that, compared to the competitor that you just mentioned, we are close to mid-double digit, and they are high single digits. So I just want to be clear that we're speaking of the same facts. When it comes guidance, which I assume is what you're speaking about. We believe that the current guidance is the appropriate one. We also with a [backup] situation, we think that the guidance we have is appropriate and we will have some challenges in the second quarter. That's why we said that we see more challenges in the topline than the bottom line. The second quarter was positively impacted globally, of course, by the World Cup.

Antoine Belge - HSBC, Research Division - Global of Consumer and Retail Research

Okay. Maybe just a follow-up regarding the management changes in Europe. Are they more at the original level or in certain countries, more specifically?

Kasper Bo Rorsted - adidas AG - CEO & Member of Executive Board

It is at the top of the house. So it was the head of -- the guy that ran Western Europe, and of course, we put a plan in place to look upon all levels to ensure that we will execute in our Western European organization similar to across the board.

Harm Ohlmeyer - adidas AG - CFO, Labor Director & Member of Executive Board

I think I'll address the gross margin question, I don't want to forget about this one. Yes, we have tougher comps on the gross margin. This alone will not explain it, but we have some unhedged currencies that are moving, especially in Latin America but also the Chinese renminbi, given the growth that we have in China. And there is some other smaller effect that we had that I don't want to go into the details, but we remain bullish on this one. We definitely had a fantastic start, a little bit better than expected in the first half. But we want to stick to the guidance, because we also want to be opportunistic on supporting sales and we want balance and to gross margin improvement, obviously topline delivery in 2018, and make sure that the sell-through remains healthy.

Operator

Our next question comes from (inaudible) of UBS.

Unidentified Analyst

Two questions for me, please. The first one is on the footwear momentum you're seeing at the adidas brand. It looks like performance footwear has stepped up by quite a few points quarter-on-quarter. And just be very interested to get a little more detail around why that's accelerating in terms of by which sports, which franchises, which price points?? And the second would be a broader question on the gross margin. Obviously, you've been seeing some very strong improvements on the price mix. You talked earlier about working harder on the pull model. If we come back to the angle of boosting full price, sell-through if you like, could you just sort of talk to us where you are on this journey? Some of these full price benefits come to earlier than expected? Just some more color on that's going to (inaudible)?

Kasper Bo Rorsted - adidas AG - CEO & Member of Executive Board

I will take the first question, and Harm will take the second. We're seeing the growth in footwear coming primarily from the Sport side, from Training and Running. Of course, one of the key franchises we have is UltraBOOST, which I spoke about, which grew almost 50% in the last quarter, and we're seeing a significant impact on our very strong UltraBOOST franchise. We're also trying to see the first early signs of Solar coming in and is trying to make it's contribution.



So it's really -- UltraBOOST and Solar coming in, it's in the area of Training and Running. Then we'll continue to iterate our Ultra BOOST models, as I said, and we'll launch the next generation of UltraBOOST coming into '19. On the second question, Harm will take that.

Harm Ohlmeyer - *adidas AG - CFO, Labor Director & Member of Executive Board*

I just want to comment again on the full-price sell-through. I mean I said now for many quarters that it's difficult to get a solid number through all the wholesale accounts. So we have (inaudible) to see, but I really don't want to comment on the full price sell-through percentage anymore. But rest assured whatever the full price sell-through is, a key for us is that, on the one hand, we remain disciplined on our pull model, that we don't sell in more than the sell-through is. This delivers better pricing if we continue to full price sell-through. And secondly, what I mentioned earlier, would contribute to our gross margin improvements as well to our future market place initiatives, where we are very clear with whom we want to grow and whom we want to grow in a healthy way, that we actually stepped away with one or the other. We closed a distribution center that we didn't consider to be healthy.

Operator

(technical difficulty) John Guy of MainFirst.

John William George Guy - *MainFirst Bank AG, Research Division - MD*

A couple of questions from me, please. The first one on gross margin. I appreciate the unhedged positions you have in LatAm regions, et cetera. And the tougher comp, but if we're starting to see a more positive contribution coming through from Reebok, we're seeing a double-digit performance in direct-to-consumer. The fact that you lock in your procurements 12 months in advance and you talk about positive FX, given where the euro has moved on the way that you basically deal with that. So it seems that up to 30 basis points, guidance is still reasonably conservative. And I appreciate that labor and raw materials remain headwinds, but can you maybe just sort of flesh out why you're sticking to the up to 30 basis points? Because it does seem overly conservative. My second question is around Reebok, and clearly we've seen a very strong gross margin performance here. I think a lot of investors in the past have basically viewed Reebok as a free auction. And Kasper, you've now highlighted more of a timeframe on Reebok's turnaround to 2020. If we effectively get Reebok closer to group gross margin averages, would that lead up to at least a 60, if not closer to 100 basis points EBIT margin uplift at the group level. And that's my second question. And my final question around cash flow. A very, very strong performance in your working capital and you're going to net cash position, even after looking at the balance of having continued with the share buyback, et cetera. Is the EUR 3 billion that we have running through until 2021, it's still reasonably conservative, given the kind of cash generation that we're seeing, and would that leave further room for future buybacks after the EUR 3 billion charge that we have over the course of the next few years?

Kasper Bo Rorsted - *adidas AG - CEO & Member of Executive Board*

Let me just start with the gross margins and then taken to a bigger context. If you look at our annual report, we guide in 15 parameters. There is no doubt that sometimes there's a slight upside on one and sometimes there's a slight downside on one. What we are trying to prevent is sitting and giving re-guidance in 15 parameters at every quarter, because it's actually a misleading indicator. I think the most important part, and we've hopefully been very clear on it, we're trying to drive market share expansion and margin expansion, and the key KPI that we have is net income, which is between 13% and 17%. We are right now at [19%]. And that's why we try to guide you and say, we look upon -- there's probably more risk to the topline and than there is to the bottom line. That means that there is somewhere else in the model that we will have some relief. But I think, as Harm said very wisely is, when we see relief, we also take the opportunity and make investments that is good for the brand in the long term. So that I'm just saying, we are closely looking upon this strategically on where we're going to take the company, but he also look at one [objectively] and if there's opportunities that are good for the company, we'll take those opportunities and will address them. The best part was explained today in the operating overhead, where you saw an increase in risk. Harm mentioned, but I just want to re-guide you back to 1 single number. Look up under net income development, there is no headcount increase in our development. So you can rest assured that we are building a company for the future. And that's why we don't want to go in and have 15 iterations of guidance revisions quarter-by-quarter. And so that was number 1. On



the Reebok side, of course, there is margin upside when we get there, but what I do want to say is, I think it's increases that you shouldn't sell the bear before you've shot the bear, we gotta make sure that we continue to do repurposed Reebok, both on the possibility side and the growth side. And there's no doubt that today, it's highly diluted to the margin. In 2020, we will also dilute it to the margin, but to a lesser extent so that over time, of course, Reebok and even now, is helping on the margin expansion. I believe that the right point will be when we get closer 2020 we will give an outlook of what are the opportunities in value creation for Reebok.

Harm Ohlmeyer - *adidas AG - CFO, Labor Director & Member of Executive Board*

Yes. I just want to add to that, John, I mean at one end of the gross margin, I can now go to the details of the model that we have been telling you, of course. When we talk about oil prices going up or the share of the North American growth that we've had relative to other markets, but if it does stay, we remain optimistic on this one, and if we exceed the guidance that we have, we definitely will invest back into the company in the right way. So just rest assured, the we are optimistic with our guidance when it comes to gross margin. And this is where I would leave it for now. When it comes to the working capital, you're absolutely right, we put more discipline in there. I'm very happy where we are within the inventory discipline, that we are staying disciplined with our pull model. And quite honestly, the share buyback probably has helped also to instill the discipline in the company to focus on cash. And that's something that I have said from the very beginning, that profits are an opinion, but cash are facts, and this is what we are driving through the company. And it's definitely too early to say what's coming up as with that share buyback plan, because this is the biggest ever that we have done. Let's execute diligently the EUR 3 billion until 2012 and then there is life after 2012.

Operator

We will now take a question from Piral Dadhania of RBC Capital Markets.

Piral Dadhania - *RBC Capital Markets, LLC, Research Division - Analyst*

If I could just start with investments that you have referred to in terms of scalability of the business model and reinvesting gross margin gains. Are you able to quantify in euro, million terms, of how much those investments are in the second quarter? And then looking forward, how long do you expect those investments to last and when they might sort of complete? And then secondly, just a quick question on receivables, which I know is up 15%, relative to sales growth up around 10%. Is there any sales booked in the second quarter for wholesale deliveries for back-to-school in the third quarter?

Kasper Bo Rorsted - *adidas AG - CEO & Member of Executive Board*

So on the first question, Piral, of course, we have some details on what we invest on the scale of the business model, if it's around GPS or rolling [RFP] systems in Asia. I'm not going to go into details of this every quarter. But as a guidance, I mean, look at the additional income that we are -- on the other operating income and assume the increases that we had there. It's probably in the ballpark of what we invested in the second quarter as well. Does it stop in the second quarter? No, we keep investing. But that is significant investment at the end of the second quarter. But we will continue to do that where it's required and that's why I look at it as 1 bucket. But it doesn't prevent us to keep investing. But I stick to the guidance that there will be leverage for the full year. But I'm not that worried about quarter by quarter. On the second question about the receivables, yes, the receivables are higher than the currency withdrawals for the quarter. They, of course, indicate that the [aging] is very healthy, that was a good in June. But there was no extra effort compared to last year what we had done on shipments. There were probably some small initiatives, but I don't want to quantify these because they are not meaningful. As we shift a little bit more in the year getting ready for the back-to-school season, because back-to-school is still a big season for us. And we want to make sure it's not all of our warehouse constraints have been overcome year. We have been to some degree opportunistic to move in June, but again, it's nothing to be significant or meaningful to record out. But rest assured, we are preparing operations to have a good back-to-school in North America.

Operator

We now move to a question from Jurgen Kolb from Kepler Cheuvreux.

Jurgen Kolb - *Kepler Cheuvreux, Research Division - Analyst*

Two questions in the area of products mainly. First, you mentioned that YEEZYs and that you're thinking about rolling them out, maybe more volume-wise. I was wondering if you could just give us maybe an early teaser here as to when we should expect that to happen? Is that going to be U.S. first in certain category or whatever? Maybe any additional comment here. And similar question with respect to Parley. You mentioned how big the size and the contribution from Stan Smith and Superstar is. Maybe any indication how big Parley has grown since you initiated it and now has become obviously a big franchise for you?

Kasper Bo Rorsted - *adidas AG - CEO & Member of Executive Board*

So I'm very happy you asked me the question around Kanye West and the issue because we think it's very exciting. I can only say no comment and wait and see, but we think we have a good claim. Sorry for not giving any more insights to that. On the Parley side, you can see the scale that we're getting now. It was -- not long ago, it was EUR 100,000 last year, it was EUR 1 million next -- last year was EUR 1 million, this year it will be EUR 5 million. So if we increase this, it will very quickly surpass some of the franchises, of the shoe franchises you know well. Right now, some of the constraints is simply in the supply chain. It's not only collecting enough plastic but also, making the plastic from a raw material. The next thing that's happening is really happening, we'll be shipping 2 million pieces of apparel. Apparel started out in swimwear, it's just going to come into jackets. If you follow football, Manchester United and Real Madrid launched their jerseys also in Parley. So Parley is becoming a meaningful platform for us. And it's one that has a very unique, I would say, [segments] of the marketplace. And so we will continue to have a very, very strong focus on Parley. And so far, I believe that we have had constraints and I don't believe we have constraints and really driving up to scale, but 5 million pair of shoes is a significant franchise for this space.

Operator

Our next question today comes from Omar Saad of Evercore.

Omar Regis Saad - *Evercore ISI Institutional Equities, Research Division - Senior MD and Head of Softlines, Luxury & Department Stores Team*

Actually wanted to ask a little bit of a follow-up on the conversation on Stan Smith and the Superstar and as you manage these franchises down. You did a very nice job. But maybe if you could talk about what you learned from that process trying to transition the consumer, especially Originals, style-conscious consumers to a new franchise, new platforms? You mentioned with Parley, NMDs. Maybe you could kind of go back and give us your thoughts on what you learned from the entire kind of process? Because you guys stepped in when it had already become a very big franchise investment, Stan Smith and Superstar.

Kasper Bo Rorsted - *adidas AG - CEO & Member of Executive Board*

Well, what we are doing is we're building franchise models and look upon the life cycle of the model and what we expect should be the volumes, and ensuring that we've become more, I would say, cautious in selling-in. We don't want to sit on inventories. It's very difficult to say that we move the consumer from franchise A to franchise B because some of the, I would say, Stan Smith and Superstar consumers are probably those that are moving right now to the Continental. So that is "a like-for-like." Then you have some of those are moving from a Stan into an NMD which is like for unlike. And some of them are simply going somewhere else. I think the most important part that we realize and manage those franchises with a very long term view, know that we have a very high upside over time and very thick downside. So the more we get up, the more we get it down, and manage it in that context. Maybe one last point on it. The franchise in itself is a different stages at different places in the world. So you might have a declining franchise for a Superstar in America, as an example, and a growing franchise for Superstar in Asia. So we've got look upon it in

that context also. But it's really a financial model we're looking upon and making certain that we don't get ourselves into dangerous territory, well knowing that a Stan Smith and a Superstar will start growing again in the next 2 to 3 or 4 years, and then we're going to have another hike. So we want to make certain we maintain the integrity of the brand.

Operator

We will now take a question from Zuzanna Pusz of Berenberg.

Zuzanna Pusz - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

I have 2 questions. One is on the like-for-like development, which in Q2 was exactly in line with Q1. And I could be wrong, but on my estimates, if we basically exclude Russia, which improved significantly versus Q1 due to the World Cup. But looks like, the like-for-likes underlying actually decelerated from plus 8% in Q1 to plus 4% in Q2. So would you be able to comment on that, if this is more or less the trend you've seen? And also, whether you have seen any underlying improvement towards the end of the quarter, just to get an idea where we will be heading in Q3 and Q4? And secondly also, on other operating income. So it looks like in Q2, you saw again some small benefits from the one-offs, this time it was the provision. I was wondering if there's anything else that we also expect in the coming quarters? Any releases of the past provisions, anything you can anticipate at this stage? Just have an idea of where we can expect.

Harm Ohlmeyer - *adidas AG - CFO, Labor Director & Member of Executive Board*

On the first question, on the comps you definitely have a point, when you take a CIS out of it. And we have not been happy with the comp development, and especially in Europe and in Emerging Markets. And we mentioned it in the first slide from Kasper, where we talked about the strengths and the weaknesses expect. We said the comps and concepts to us is a mixed bag, so that is a good observation from you side. But that is, again, why we're acting also in Europe, to go develop execution, especially also on the retail side, not just with -- through our key comps as well. On the other operating income, again, I by no means give any guidance now by quarter, I give in what we generate in Q2. But just by normal course of timing, you primarily have FX from the prior-year period, namely 2017 in Q1 and Q2. And it's definitely less so in Q3 and Q4, because these are mainly accruals of restructuring items that we billed in the prior year, and then you get to the actual of that in Q1 and Q2, very rarely in Q3 and Q4. So it's definitely easing compared to the first half.

Operator

We now move to a question from Andreas Inderst from Macquarie.

Andreas Inderst - *Macquarie Research - Senior Equity Analyst*

I have 2 questions. The first one, Kasper, you mentioned some brand activation issues was a bit optimal. What do you exactly mean here? And what is to change from here? Maybe you can elaborate on your comment? Then a second question, China was extremely strong, much stronger than we in consensus anticipated? Maybe you can provide us just an update about the current market situation there? If I'm correct, you are now #1 in Greater China. What do you see the second half? How is the inventory position? How is the franchise -- a number of franchisees in terms of stores? Maybe you can give us a quick strategic update here.

Kasper Bo Rorsted - *adidas AG - CEO & Member of Executive Board*

So let me start with the Europe. I think it's important that we're self-critical about what we're doing and try to understand the mistakes we are making. But the starting point is that we are running a company at a 10% growth rate, which is very high. And I think, when you look back sometimes, successful companies become complacent. And I think part of it was complacency in Europe, I don't think that we launched a product -- I don't



think we launched our products in the right channels, with the right, I would say, fall through, that we believe some of this selling was less than optimal. And sometimes, we got the timing wrong. So you can argue these are fundamental problems, which is why we also believe that we can fix them. But in came from a point where we need to get overall combination a better story-telling with the product. And recognize sometimes the products are not always unique. They may be very good but you've got to have a very good story telling around it. As you can see that Parley has been a unique example of the fantastic innovation, but it's taken us a while to get story telling right. So it's really, I think, I would call it, very fundamental elements that we didn't get right, getting the right products into right channels at the right time, getting the right fall through, getting the right story telling. And just being more diligent, being in the details and correcting, correcting, correcting when we make mistakes. And I don't think we did that. And it's not only I, we don't think we did that. We made the management change. When it comes to China, first of all, China will continue to be a tremendous market simply because of the size of the market and the expansion opportunity. The growth we enjoyed in the first half has been very strong. We continue to see store expansion, but at a lesser extent right now than we've seen before, simply because the physical store is also not reaching is limited in China because you still have a lot of opportunity into your 4, 5, 6 cities. But we're now starting to see stronger, stronger growth on the digital and e-commerce side. Most of our franchises are selling well, but some of them that we spoke about here in Western Europe and the U.S., we've seen similar challenges in China. We believe we have an acceptable inventory position in China. We expect continued strong growth in China. We've not seen any, really change in the market momentum. The biggest concern one can have is actually the one that Harm spoke to, around the change in Chinese currency, and whether that could have an impact in the expense of the product. But we expect for the foreseeable future very strong growth in China. The only point that I would like to comment on, of course, the bigger we become in China, the harder it's going to be to keep the same relative growth rates because we -- almost within 2 years, we're almost doubling -- 3 years we are doubling the size of China. So running at the same relative growth rate means doubling the [absolute]. And I think that's what you have to take into account, that the growth will be still very effective, but it's a bit like the overall Chinese economy, the 7% growth we are enjoying today probably reflects the 13% that we enjoyed 10 years ago. And that eventually will come to us in other partners in the Chinese market. But in essence, we continue to remain very positive about the Chinese market. Maybe one last point, we are in very close dialogue with our 2 licensed partners (inaudible) and (inaudible). I would say, we see them on a monthly basis. It's probably globally though, is that we have from a worldwide standpoint, the close relationship to (inaudible) regions and China, I would say every other week, every other month, Eric has been there, very often Harm has been there, I was there 3 times in the third quarter, I'll going there again this quarter, next quarter. So we have an extremely close contact to ensure that, of course, we are on trend, and when we're not on trend that we do course correction as soon as we see that some of the franchises are not doing as they should.

Operator

We will now take a question from Erinn Murphy from Piper Jaffray.

Erinn Elisabeth Murphy - *Piper Jaffray Companies, Research Division - MD and Senior Research Analyst*

I guess my first question is on digital, it was up 26% in the quarter. Could you just unpack how that looked by region? And then it's been pretty stable year-to-date. Is this the run rate we should expect into the second half, just in the absence of the new U.S. DCs?

Kasper Bo Rorsted - *adidas AG - CEO & Member of Executive Board*

We're not disclosing the actual number by region, we wind up double-digit by each region. Over time, we're investing heavily, as you know, in the U.S. suburban infrastructure that's appropriate to deliver upon the consumer expectation. But of course, with launches that are coming depending on how we drive those launches, are they going through wholesale, owned retail, or online, it will have a significant impact on our growth rates. And we saw, just as a reference, in a very recent months in America, we launched a hot product and the growth in our online channel was 100% that month. So it's very much of all the choice through which channels do we put which products? But as if we have seen double-digit growth in each of the major regions and that's the only disclosure that we make.



Erinn Elisabeth Murphy - *Piper Jaffray Companies, Research Division - MD and Senior Research Analyst*

Okay, that's helpful. And then on the apparel business, it was up mid-teens in the quarter. Can you just break out how that growth looked by pricing versus units? And then any update on how your women's apparel businesses is trending?

Harm Ohlmeyer - *adidas AG - CFO, Labor Director & Member of Executive Board*

Well, we never disclose that, Erinn, by pricing or what the units are by pricing. Just on the woman's question, it's pretty much going in the mid-teens we announced with overall apparel. It's pretty much on the same trajectory.

Operator

We will now take a question from [Sven Hohmann] of Citi.

Unidentified Analyst

First of all, just going back to your comments on Western Europe. You commented that the second half would look similar to 2Q. Does that include the gross margin and the strength that we saw in the second quarter in Western Europe? If not, was there any particular one-offs in Western Europe in 2Q that we should be aware of on gross margin? And then the second one on the provisions, despite the release of that you've done in the quarter, I noticed there is still over EUR 1 billion of provisions on your balance sheet and they've grown year-on-year. Can you just give us a slight idea what these consist of and what you might be looking to utilize them?

Kasper Bo Rorsted - *adidas AG - CEO & Member of Executive Board*

So on Europe, we are only guiding on topline. And so we're not speaking about gross margin guidance on the retail level. I can say the only one-off there was in Europe, and I'm not speaking gross margin right now, I'm just speaking one-off was, of course, the World Cup on the provisions. I'll hand over to Harm on this, but of course we're not driving our revenue nor our income growth through provisions, but we are, of course, when provisions are legally required to be released, we release the provisions. But as you can see, we try to make sure that we list appropriately and that's what we're doing. I will hand over to Harm for more detail on the provisional side.

Harm Ohlmeyer - *adidas AG - CFO, Labor Director & Member of Executive Board*

I don't want to go through the details of this, but there's always in the operation of business some provisions that they need to provide on the balance sheet. But the biggest change we probably have seen is the implementation of IFRS 15 that has some impact on the provision line as well. But that's all the detail I will disclose here.

Sebastian Steffen - *adidas AG - VP of IR*

Okay, then. Thank you very much. Christina, we have time for 2 more questions, please.

Operator

Our next question comes today from Simon Irvin from Crédit Suisse.



Simon William George Irwin - *Crédit Suisse AG, Research Division - Director*

Two questions. Just on the U.S., can you talk a little bit about the commercial channel launch and how material that is, and what impact do you think that will have on gross margins over time? And secondly, can you just give us your thoughts around tariffs? And obviously, there are no particular impacts in the moment, but how much flexibility do you have in your model at the moment if the tariff situation worsens?

Kasper Bo Rorsted - *adidas AG - CEO & Member of Executive Board*

So let me start with the latter. We have a similar supply chain, pretty much of course all competitors in the industry. And as you can follow as well as I, the current, I wouldn't say trade war, but trade differences between America, it's predominately between America and China at this stage. While we have a substantial manufacturing setup in China, it predominantly serves the Chinese market. It serves to a minor extent the U.S. market, whereas the majority of the U.S. market we service through Vietnam and Indonesia. So I would say, a trade war that would be relating this sporting goods industry in China will probably -- might have some irritation in the short term, in the medium term it will have bare little, because of the footprint that we have. So that's more of the way we look upon -- we're actually just more concerned whether it will have an impact on the overall U.S. economy and the U.S. consumer will have less money to spend. I think that's the bigger macro [discord] between consumer companies. I think in our area -- this is not one and we mean this respectively, this is one area that we are overly concerned about. Because first of all, it's outside our agreement, secondly is, we have constructed a supply chain, where the vast majority of our supply chain to the U.S. is coming from -- when it comes to the distribution structure in the U.S., of course, we are expanding that. But we're trying to do it cautiously because we do not want to end up in bad [moors] or in different price points. We have initiated a very strong relationship with DICK'S Sporting Goods, we can see if we go in-store. You are seeing delayed timelines, not delayed, but from time implementation, you're seeing a close coming up getting different price points than TSG. We don't comment on gross margin, but I think, you should think about in the following way. We're getting to a point where we're building an infrastructure, where the infrastructure should not grow parallel to the top line. Because you will get the scaling, and with the new warehousing investments that we're making, where the systems that we're putting in place, you come to a point when you supply the very large partners. There's very little personnel expenses associated with that. Of course there is a price element associated with it, but America is still [diluted] from a contribution margin standpoint, and that is something that we have to actually address and that will be addressed almost proactively or positively also with the distribution at the lower channel. It's not going got to work against in the short and medium term.

Simon William George Irwin - *Crédit Suisse AG, Research Division - Director*

Fine. And can I ask just ask a detail question? The sale of the Reebok campus. Has that actually gone through? And was that in 2Q and in the balance sheet? Or is that not completed yet?

Harm Ohlmeyer - *adidas AG - CFO, Labor Director & Member of Executive Board*

It has been completed, yes.

Simon William George Irwin - *Crédit Suisse AG, Research Division - Director*

So the funds are on the balance sheet for this quarter?

Harm Ohlmeyer - *adidas AG - CFO, Labor Director & Member of Executive Board*

Correct.

Operator

Our last question today comes from John Kernan of Cowen.

John David Kernan - *Cowen and Company, LLC, Research Division - MD and Senior Research Analyst*

Can we talk to the North American margin for -- can you just talk to the strength in the North American margin performance? I know you there's been some capacity constraint there that's affected the margins in the past quarters, but where do you feel like you are in terms of capacity in North America? And, then how should we think about inventory levels as we go into the back half of the year? The topline growth has been well above inventory the past couple of quarters. If this continuous there's obviously going to be pretty significant cash benefits? How should we think about globally inventory finishing year-end?

Harm Ohlmeyer - *adidas AG - CFO, Labor Director & Member of Executive Board*

I should take the last question. I'm not projecting any inventory for year-end, but just going to back to the North American margin. You are actually right, I mean the gross margin has impacted some of our warehouse complaints. But they're not significantly impacted by the capacities that we have. And given the growth that we're seeing and have been planning for 2018, we'll be able to ship the products. But what I've said on previous calls, the similar agreement that we have to towards our key accounts and towards the end consumer, it's still the one piece that worries me. So we can ship it but it takes you 5 to 7 days to get to an end consumer on e-commerce on the West Coast from our warehouse on the East Coast, where you're not fulfilling the SLAs with your key accounts that, on the one hand, it doesn't make them happier. And on the other hand it costs us money as well. And the overall margin operating expenditure that we have, just the sheer level of growth and we are seeing is accelerating -- is outgrowing our growth in the infrastructure for example, you just can't build it fast enough. As I've always said, the progress that we've made on the operating margins is almost too fast, given the overall investments that we've been doing. So -- but again for 2020, as I look forward and fast-forward, we're definitely on track to deliver our target for 2020 and we start in 2020 to see North America contributing to the company then.

Kasper Bo Rorsted - *adidas AG - CEO & Member of Executive Board*

Good, let me just summarize before we close the call. We had our first strong half of 2018, we grew 10% currency neutral, we grew the bottom line 19%. We made substantial improvement on our operating margin and we have done a substantial expansion on investment to our scalable business model, integrated bear and shared services, but also most important, investing into the brand. We are completely committed to our 2020 target. So I want to make certain that we reiterate that every time. We're trying to make sure that we build it year by year and also, take as much work in front of us that we can to make sure that we build it in a way for the future. We want to be a very transparent with you as our shareholders and that's what we're saying that we are around Europe. We're trying to disclose the problems that we have. A large company will always have problems, I think. The most important part is that we hit our targets while addressing the problems that we have. And you can see that despite the problems that we have in Europe, where our initial expectation was at 5% growth in the market that is highly profitable, despite that, we are hitting or doing whatever we can to hit our target. But hitting our target in a sustainable way, recognizing that in '19 will come after. And you can see the cost consciousness upon which we're operating the company, you're seeing [zero] increase in people. And that speaks to the scalability of the business model. So I want to thank you for the questions today. Thank you for being with us so far on the journey. We believe there's a lot to come. We also believe that it continue to see challenges, but I can assure you, that the management team and the entire company, Harm and I, are very confident that we're going to make this happen, and we're very determined to make this happen. And I hope you can see that in the second quarter, the second quarter which in all ways, the way it was reported was a solid one. There are no one times, no items that was done to try to make a certain could happen because we know the third quarter is coming up now and we are sitting in it. We're very focused on (inaudible) but even more focused on hitting the target for 2020 to ensure that we are building full confidence with you as investors. Okay.

Sebastian Steffen - *adidas AG - VP of IR*

Thanks very much, Kasper, things were much Harm. Ladies and gentlemen, this completes our conference call for today. Our next reporting day for our Q3 results will be the 7th of November. We all look forward to speak and see many of you over the next couple of weeks and months. If you have any questions in the meantime, don't hesitate to reach out to Adrian, myself or any other member of the IR team. And with that, would like to thank you for participating and also thanks, at least most of you, for keeping an eye on the 2 questions asked that I had at the beginning. For some there is still some improvement potential. With that, have a great day, have a great summer, and bye-bye.



Operator

With that we conclude today's conference call. Thank you for your participation. You may now disconnect.

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