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# EDITED TRANSCRIPT

ADS.DE - Full Year 2019 Adidas AG Earnings Call

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## OVERVIEW:

Co. 2019 reported operating profit of EUR2.7b. Expects 2020 sales growth to be 6-8%.



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## PRESENTATION

### Operator

Ladies and gentlemen, thank you for standing by. I'm Stuart, your Chorus Call operator. Welcome, and thank you for joining the adidas AG Full Year 2019 Conference Call. Throughout today's recorded presentation, all participants will be in a listen-only mode. (Operator Instructions).

I would now like to turn the conference over to Sebastian Steffen, Senior Vice President, Investor Relations. Please go ahead.

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### Sebastian Steffen - *adidas AG - SVP of IR*

Thanks very much, Stuart, and good afternoon, ladies and gentlemen, and welcome to our full year 2019 results conference call. Our presenters today will be our CEO, Kasper Rorsted; and our CFO, Harm Ohlmeyer. As always, we will kick it off in a second with some prepared remarks from Kasper and Harm, followed by a Q&A session. (Operator Instructions)

And now, without any further ado, over to you, Kasper.

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

Thank you very much. What I'll do is as normal, I'll give you an update on the business and then later in the presentation, Harm will take you through the details of the year, and I will finish with the outlook. And then we will then go through the questions you might have.

The year was a year with many highlights. We celebrated the 70 years of adidas. We had Run For The Oceans. We sponsored -- was a key sponsor for the women's World Cup. Messi, again for the sixth time of the world -- for the sixth time, became the best football player in the world. Patrick



Mahomes, was MVP (sic) [MVP] during the Super Bowl. We signed Arsenal; and we also signed the best skier in the world, Mikaela Shiffrin. All elements that continue to drive brand strength for the short-term and for the long term.

We also brought a number of cool new products into the marketplace, whether it's our home of Classics or 100% recycled hoodie or the signature of Ninja or the collab with Pilot to mention a few. But probably one of the most significant event for us, the opening of our London flagship store, the most digital store in the world and probably the best sporting goods store right now in the world also. So a continued strength of building the adidas brand in the short and the medium term.

But now let me take you through briefly the strategic update, where do we end up when it came to making progress on our strategic priorities. You all know our Creating the New brand -- slide, and the essence of it is to drive top line and market share growth to expand our operating margin. And particularly, on the top line and the market share, we grew slightly above market. On the operating leverage, we did expand. Our profit margin came in at an all-time high. So overall, a year very much in line with what we communicated approximately 1 year ago.

If I look upon some of the foundational elements, we continue to develop our leadership groups to ensure that we have the right channels to fill the positions, predominantly from within across the company, being in the regions on strategic business areas. We have further expanded our LTI to now encompass our top 3,000 leaders, and they are now in a consistent systems, also with the management completely aligned with the guidance we have given to our shareholders. And on top of that, we have more than 5,000 employees participating in our employee stock purchase program. And lastly, we continue to make progress on our diversity efforts, with more than 34% -- 32% -- 34% of our leaders being female.

When it comes to executing our strategic priorities, I'll just give you a couple of highlights. I'm not going to a great level of depth, but on our Speed programs, we're now at 47% of our products, 40% of our revenue being generated by products that are Speed-enabled business in our 6 key cities have now reached EUR 1.7 billion, very close to the approximately EUR 2 billion target we have for next year. In our open source, we surpassed 11 million pairs of ocean plastic shoes, so making progress in establishing Parley and Primegreen and Primeblue, which I'll get to in a second, as the predominant brand within sustainability in the sporting goods world.

However, we also have 4 accelerators that we've defined 4 -- 3 years ago. And briefly, Reebok continued to improve its performance and came in with a 12% revenue growth in our home market in North America. Our adidas North American business, where we have a target of EUR 5 billion by 2020, came very close in the past year, reaching EUR 4.8 billion. In our efforts to drive standardization, consolidation to ensure operating leverage, we have now more than 1,000 people in our global business services. So from almost nowhere 3.5 years ago, we've surpassed the 1,000 mark that allows better, more standardized and more efficient way of operating our processes. And in our digital efforts, we have more than 30 countries now live using our app. And we have sales to our Creators Club has reached EUR 1 billion by now. So we continue to make progress in the areas that we've communicated to you before, whether it's the 3 strategic priorities or the 4 acceleration areas.

Now let me spend a bit more time on the business update. We continue to progress in our strategic growth areas. We saw Greater China and eCom, achieving double-digit growth rates. We saw top line driven by all market segments, and we did see our European business returning to growth. As you remember, last year, we started out by minus [3%, 3%] and then 0 and then a very strong fourth quarter, bringing us to growth for the full year. We continued also to see further strong profitability growth and believe we have created an attractive model for cash return to our shareholders, returning more than EUR 1.5 billion of cash to our shareholders.

At the same time, there are elements that we were not happy with last year, starting with the supply chain challenges from the beginning of the year, which we guided will cost us between EUR 200 million and EUR 400 million on the top line and also a substantial amount on the contribution line. We came in at the lower part of the range. But the supply chain shortages particularly impacted our efforts in the U.S. We saw a muted growth in our wholesale business, with much less traction than what we see in our DTC business. And we saw the gross margin trading negative in the second half. Harm will take us through that in more detail. We also saw limited operating leverage. But this is simply due to the change in the business model, with an 18% growth in our DTC business, where we continue to expand not only better stores but also a much better distribution network.

If I look upon and say what was the results versus the guidance we gave 12 months ago. 12 months ago, we said we will come in between 5% and 8%. On the top line, we came in at 6%. The gross margin was guided to around 52.0%. We came in at 52.0%. The operating margin was expected



to go to 11.3% to 11.5%. We came in at 11.3%. And the net income was guided to grow between 8% and 12%, and we came in at 12%. And of course, we had a higher increase when it comes to EPS, due to a lower share count due to share buyback. So overall, we delivered financially very much in line to what we gave as a guidance a year ago.

If I'll break it one further down, we saw our North American business grow 7% and now up EUR 2.5 billion since 2015. Our Greater China business growing 15%, up EUR 2.7 billion in the same time period, and our eCom business growing 34%, adding more than EUR 2.1 billion since 2015 and approaching now the EUR 3 billion mark. So consistent strong growth in our strategic growth area.

The adidas brand grows in all markets and with a double-digit growth in Asia-Pacific and the emerging markets, with 7% overall. Sports Performance increased by 5% and Sport Inspired by 8%. And we saw a balanced growth between our footwear business and our apparel business.

Our Reebok business continued its profitable growth and came in at 2%. We saw strong growth in our North American business in Emerging Markets and Russia. Classic's growth was low single-digit, and Sport recorded a moderate decline. So overall, Muscle Up is all about establishing a profitable growth scenario, so we continue to drive Reebok towards a more sustainable financial position by year 2020.

On the eCom side, we saw another year of exceptional eCom growth. It represents almost EUR 3 billion by now. And we saw China being the biggest growth contributor, with sales increasing with more than 50%. On the Creators Club in the U.S. and Europe, members sales account for more than 50% of our eCom. So we do see the more we actually bring into the marketplace, the more we can tie up or track the consumer into our environment, the more attractive it is for the consumers to buy our products. And from a Runtastic standpoint, we integrated it, Runtastic, into our digital ecosystems and now offering a seamless digital experience. And also now the Runtastic users can collect Creator points. So you're now getting a much more integrated, holistic ecosystem.

So on review, we did deal successfully with the challenges that we had during the year. We saw different levels of innovation driving our growth. We continue to invest with impact. We have the highest relative marketing investment in the industry at this stage. We did deliver overproportion of net income growth, and we did challenge -- address the challenges we have. Predominantly, the 2 biggest one was the supply chain challenge and also returning Europe back to growth. And Europe is growing also as we exited the year in our guidance for the full year. And we do not expect any significant or any impact on the supply chain from last year's challenges in this year.

With this, I'd now like to hand over to Harm, who will give you the details of our financial performance. Harm, please.

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

All right. Thank you, Kasper. I want to start with the map across our 6 markets. As you can see, all markets recorded sales growth in 2019. This is for the first time since 2016. This was led by double-digit increases in Asia Pacific and emerging markets. In addition, even more importantly, operating margin increased across the board with the exception of North America, where we had to bear additional costs related to the supply chain shortages.

This time, I would like to give some more details, not just on the 3 major markets but also on the 3 smaller markets. But let's start with the 3 key markets in North America. North America, 8% growth despite supply chain shortages, which made particular in the North American market in the first half. Brand adidas up 7%, while Reebok grew double-digit, so plus 12% in its important home market. Gross margin decreased by 120 basis points to 40%, as lower sourcing costs and a better product and channel mix were more than offset by some FX and a more negative pricing mix and higher air freight costs, as we mentioned previously.

Asia Pacific, plus 10%, driven by double-digit growth in Greater China and Southeast Asia, which represent around 80% of the overall market. Brand adidas increased 11%, while the Reebok declined. Gross margin increased 80 basis points to 57%, driven by lower sourcing costs and an improved product and channel mix.

Europe, as we promised early in the year, returned to growth with plus 3% as our initiatives and reinvestments have shown the planned effect. Just from a sequential point again, in Q1, it was minus 3%; in Q2, it was 0; and in Q3, plus 3%; and then in Q4, plus 14%, resulting in a 3% growth overall.

The adidas brand accelerated 4%, while Reebok posted a slight decline. Gross margin increased 390 basis points to 51.5% and more negative pricing and product mix was more than offset by lower sourcing costs and better channel mix as well as favorable FX development.

When we talk about the smaller markets, starting with the Emerging Markets, 13% growth despite the geopolitical tensions in several countries. The adidas brand grew 12%, while Reebok was also up double digits with 14%. Gross margin decreased slightly, 50 basis points to now 52.3% as better pricing and product mix as well as lower sourcing costs were more than offset by unfavorable FX developments and a more negative channel mix.

In Latin America, revenues were up 7% in a challenging macroeconomic environment, especially in Argentina and also in Chile. Brand adidas increased 8%, while Reebok was up 3%. Gross margin decreased 40 basis points to a level of 44.5%, as again, lower sourcing costs and a better pricing mix were more than offset by a more negative product and channel mix as well as unfavorable FX development.

In Russia, CIS, sales increased 8% despite the tough prior year World Cup comparison base. Sales at brand adidas grew 7%, while Reebok was even up double-digit with 11% up. Gross margin decreased 420 basis points to now a level of 61.7% as lower sourcing costs were more than offset by a more negative pricing and channel mix.

Now let's move to the P&L. On the net sales, let's recognize that we added more than EUR 1.7 billion to our top line in 2019, delivering our guidance, as Kasper mentioned earlier. And we kept our promise to accelerate growth towards the end of the year with double-digit in Q4. On a currency-neutral basis, the growth was 6% for the full year. Gross margin, as expected, gross margin was down in Q4 and was up 20 basis points for the full year. I will comment a little bit later on some more details. The same on the OpEx side, increase in absolute OpEx reflects the continuation of overproportionate direct-to-consumer growth. And I will also give you some more details on a separate slide in a minute.

The operating margin increased to a level of 11.3%, driven by both gross margin expansion and some operating leverage overall. With that, the net income, as guided, increased by 12% in 2019. This includes a negative impact from the IFRS 16 accounting standards and our net income of EUR 54 million. Excluding IFRS 16, as you see in the highlights, the net income would have grown 15% and the earnings per share would have grown 18%. And again, the difference is given the share buyback, where we bought back more than 3.2 million shares with an overall volume of EUR 815 million in 2019.

Let's go to the gross margin a little deeper. The gross margin decreased 300 basis points in Q4, mainly due to negative currency effects and a less favorable pricing mix. And again, I want to highlight here that roughly 200 basis points of that are FX and pricing related and roughly 120 basis points of the 300 basis points have been onetime effects, either in positive nature in Q4 2018 or a onetime negative nature in Q4 2019. So please, 120 basis points of that is purely a onetime effect. And again, Q4 2019 is not indicative of what we will deliver in 2020. This, overall, was fully in line with our expectations. As it is implied by our full year guidance, we achieved an increase of 20 basis points to 52% in 2019. Looking back, we increased our gross margin each year and every year since 2015. As a result, and it now stands almost 400 basis points above the 2015 level.

In 2020, as we mentioned earlier, the gross margin development will be burned by the significant adverse impact from unfavorable currency developments as well as negative effects from higher sourcing costs. However, we expect to be able to largely compensate those headwinds by a better channel mix as well as normalized use of airfreight after last year's supply chain shortages were successfully mitigated. As a result, we expect gross margin to decline only slightly in 2020 and thus stay at an industry leading level. And again, Q4 is not indicative for 2020. And we have proven in the past the ability to defend our gross margin against external pressures. And this is not a surprise what we're heading into 2020.

Also in other operating expenses, I would like to share some more details. As you see, we keep investing into marketing and point of sale expenses, where we grew by 1% and leverage by 80 basis points. And as you can see in more detail, we deleverage on the operating overheads. But if you look at the details of what is channel driven and what is central cost driven, then it gives you a different picture. When you look at the distribution and selling expenses, they actually grew by 12%, while our D2C channel was growing 18% in net sales. So we're still leveraging in that channel itself. And from the general and administrative expenses, we actually have a leverage of 20 basis points. And that's where you see the benefits of the ONE adidas initiative and GBS, the Global Business Services, which we build up to more than 1,000 people now across the world.



When I talk about the average working capital, operating working capital, you also see the development from 2015 to 2019, from originally 20.5% to now 18.1%. I said it almost in every quarterly call now, we are very happy with the level between 18% and 19%, and 18.1% is a new record for our history. And with that, we are also feeling very good with the inventory position at the end of 2019, which was slightly impacted on the one hand by currencies, secondly, by an earlier Chinese New Year, where we shipped some product in December but have also been prepared to ship more in January as we did. So we expected that increase year-over-year due to the lower prior year comparison as well as we had a minus 5% at year-end 2018. So again, the average operating working capital as a percent of sales went down by 90 basis points to a record 18.1%. But we should also look at that as a low point, and we are guiding a slight increase going into 2020.

When it comes to the net cash and equity position at year-end, the net cash was down by EUR 86 million compared to the prior year. The increase in cash generated from operating activities was more than offset by the cash returns to shareholders, namely the payout of the dividend for 2018 as well as the repurchase of shares throughout the year. The equity ratio decreased 8 percentage points, mainly due to the balance sheet extension in the context of IFRS 16 accounting standard, as lease obligations have been capitalized on the balance sheet and more than offset the increase in shareholders' equity. But let's be clear. With an equity ratio of 36% and net cash of close to EUR 1 billion, our equity position and balance sheet remains as strong as ever and gives us a lot of flexibility going into 2020.

I would like to finish with the cash returns and the attractive cash returns to shareholders. In 2019, we again returned about EUR 1.5 billion through a combination of dividends and share buybacks. For the dividend to be paid out in 2020, we proposed a 15% increase to EUR 3.85 per share. This represents a total payout of more than EUR 750 million and a payout ratio of 39%, which is again, at the midpoint of our guidance of 30% to 50%. Together with the buyback volume of up to EUR 1 billion in 2020, this brings the planned cash return for this year up to EUR 1.8 billion. So in summary, over 3 years, that means the total shareholder return of EUR 5 billion was returned in 3 years. And that is again, shows the financial strength that we built through Creating the New, that will definitely prepare us better for whatever crisis is ahead of us.

With that, I would like to hand over to Kasper again.

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

Thank you very much. And now let me take you through the outlook. We're coming to the last year of Creating the New. And of course, what we are going to do is we are going to leverage major launches in sporting events in 2020 to make certain that we drive product activation and consumer engagement and drive product heat into the market. Our aim is to deliver double-digit bottom line growth to make certain that we have the right balance between sales growth and margin expansion. And very important is bringing Creating the New home. There are many elements of Creating the New, from a subsidy standpoint, whether it's the conversion to digital, the move to D2C, the implementation of shared services, the innovation -- the bringing in or the introduction of new products based on sustainable material that are important for us in the next strategy cycle.

These we're all focused on. And then, of course, we're focused on managing the impact from an unknown, which is the outbreak of the coronavirus, which I'll speak about. When we look upon it from a product standpoint, we are the leader in sustainability, and our clear goal is to end plastic waste through innovations and partnerships. And to do so, we have a, what we call, a Three Loop Strategy. One is the recycle loop, where we have products made with recycled materials. The second is the circular loop, products made to be remade. And the third one is biodegradable loop, so products made to be -- to regenerate.

On the recycle loop, you already know it today, it's Parley and its Primeblue, where we are using plastics to design and build products for our athletes and for our other consumers, being in footwear or apparel. We have a leading position this way. And we'll continue to push the envelope to ensure that we'll come to a point where we're using recycled polyester to 100% by 2024.

The future loop, which we introduced for the first time approximately 18 months ago, will now have a commercial launch for 2021. It's a second-generation that we're seeing. We're using 100% recycled performance running shoes, so taking a running shoe, use it and then basically "reuse" all the components of it to build a new one. We are still in testing mode, but as I said, we expect to have a commercial launch planned for 2021.



And then our Biofabrics, whether it's a tennis dress that is being used for Wimbledon or the hoodies that we're making in combination with Stella McCartney, is using materials that are biodegradable to ensure that we become fully sustainable as a company. We want to make certain that we retain and remain leaders in the area of sustainability because we believe it's a key differentiator for the adidas brand.

Euro 2020 is also a Eurosport. The Euro 2020, which is taking place in 12 cities across Europe, where we are the official sponsor for teams like Germany, Spain and Belgium, all contenders to win the cup. We're looking forward to, and we will activate that tournament. At the same time, we're also looking forward to the Tokyo Olympics, which are taking place in the summer, where we are seeing some of the world's best athletes and federations but, of course, making sure that they're using our highest performance products. There's been a lot of speculation where these tournaments takes place and what is the financial impact should they not take place. Should they not take place, we estimate that the financial impact from a sales standpoint is between EUR 50 million and EUR 70 million. In the context of being a EUR 23 billion corporation, that accounts to about 0.3% of our revenue. Of course, it has a great brand exposure but that's the same for all brands. But from a commercial standpoint, the risk related to these 2 events not taking place is fairly limited.

We continue to bring new and exciting products into the marketplace, and our newest is the gamers shoe, which is how we integrate the e-gaming with a physical environment. And we've developed an insole that manages players' physical movements and converts their performance into the virtual space. That means that players that perform on the pitch will improve their skills in the mobile game. And basically, what it means is that the more you play physically, the more points you get when you play in the digital space. It is one of our first efforts to start trying to merge the two and understanding how we could commercialize the big expansion that are spent in the e-gaming space.

With our future 4D, we continue to scale our business with the most unique product in the industry, a 3D-printed material. The 4D range will be expanded across multiple product categories and price points this year. So you're going to see many more products come into the market. And the recently launched 4D Run, which you can see in the picture, is now priced above [EUR 200]. So that means that we are now getting access to a different consumer than we have before, unique innovation in the marketplace that we can continue to push towards a volume product that will be unique as one of our key franchises going forward.

And then we're very happy with the introduction of the Adizero Pro. This fast distance running shoe combining BOOST and Lightstrike midsole with a carbon plate flexibility and also responsiveness. And what it does to it is the meeting -- it is meeting the needs of the world-class marathon runners. Last Sunday, one of our young runners from Ethiopia won the [Illinois Marathon] in this very shoe. So it's clear that we are now doubling down and making certain that we regain ground in the professional running space to make certain that we get a bigger, bigger market share. In this context, we've also launched the SL20. It's a lightweight shoe for any runner at any level. And thanks to its comfortable fit of the Lightstrike technology, another way of taking our top shoe and bringing it further into the market, so we make certain that we commercialize the high-end product.

From an apparel standpoint, we've introduced RDY, that means we continue to innovate on the performance apparel side. RDY is a new holistic performance concept that basically means you're covered in all conditions. As an example, HEAT. RDY merges the best materials, fit and design to help assets perform in the heat. And these materials will be used and are used in the design of our products for the Olympics, where we know that the athletes will compete in very high temperatures and high humidity.

Our Superstar is celebrating its 50th anniversary. It started as a basketball shoe and is one -- is now one of the most iconic silhouettes, and we have a number of releases and collaborations through 2020. Whether it's high in fashion releases or one of the newest one, where we made a combined shoe with Stan Smith, called the Superstan, you'll continue to see many iterations of the Superstar this year to make certain that we continue to build one of the unique -- one of the most unique franchises in the industry.

And one of the latest launches is our Beyoncé launch of Ivy Park, which was a great success. Taking place in January, it was completely sold out, and we expect a similar run rate throughout the launches we'll have this year. We will launch a broader and a more varied set at different price points for this year. But also want to say, which we've communicated consistently, we are not driving a big commercial business around Beyoncé in 2020. We are building the platform to ensure that this will take place in the future. And the demand profile we've seen give us any -- every confidence that this will happen.

With Yeezy, we found new ways to bring hybrid into the market, and this will also continue in 2020. We'll continue to manage volumes in a disciplined manner in 2020 to sustain the desirability. But 2020 will be the year where the most launches we've had and the most set of new products, not in volumes. One of the unique products we launched not many weeks ago was our basketball shoe at the basketball weekend in New York, approximately 3 weeks ago. So Yeezy has now also entered the world of basketball.

And with Reebok, the Zig launch was extremely well perceived, with strong D2C sell-through rates. The brands also keeps leveraging its classic silhouettes like the Club C. And with the logo rebranding in November, we received great feedback from consumers and partners. So continue to expand and build the Reebok business into a sustainable asset by 2020.

If we look upon how we look upon the business before the coronavirus, and that's where we have to start. We expect to grow sales between 6% and 8%. We expect a slight decline on the gross margin, despite FX headwinds, as Harm explained to you. We expect operating margins to increase to 11.5% to 11.8% and net income to be double digit. This is without the corona impact.

And now let's try to work our way a bit more through the details. The details are also that we're now coming to the last year of our Creating the New. And here, we're giving you a highlight of where we're taking Creating the New from March 15 to -- from starting an operating margin guidance of 9.9% to now 11.5% to 11.8% and a sales number of EUR 22 billion to approximately EUR 25 billion and a net income CAGR from 15% to 24% to 25%. So consistently upgrading the outlook throughout the period.

When it comes to the coronavirus, it's clear that the health and the safety of our people remains our top priority. We need to make sure that people feel safe and feel well informed when they're working in our company to make certain, and that's the only way they can deliver their best. We have put a dedicated task force team in place to ensure that every question our employees might have will get answers. We proactively communicate what is happening in our organization should cases come up. We have a temporary closure of office locations and stores in China due to the first outbreak in China. We have restricted the international business travel to make certain that we don't become a bearer of the disease. And as I said, we have an ongoing guidance and support to our employees with a hotline to our top management at any given point of time.

If we were to try to articulate what we're doing now, which is different to the past, in a normalized business, we will run our business based on a guidance of 6% to 8% and have consistent setup globally. Because of the magnitude of the impact we've had in China and because we want to protect the rest of our business, so we don't have a spillover effect from the Chinese side, we have divided our business into 2 and think how do we defend and eventually recover our business in China and put a dedicated task force to look upon that. And then looking upon the rest of the business, where the impact has been marginal so far to ensure that we continue to expand and win market share and drive margin expansion so we don't have a spillover effect where there is none. And that's why we're looking upon the market this way. We're guiding, if in a normalized environment, a 6% to 8% growth. We're saying we'll quantify where the impact in China is on a quarterly basis because we don't know what's coming, but we know what was. And then our target is to grow the remaining part of the business with 6% to 8%.

And here is an assessment of the coronavirus development. What we know is, at the beginning of 2020, Greater China performed strongly. So for the first 3 weeks, we saw a stronger performance of our China business than we've seen before. Between Chinese New Year and end of February, our revenues were approximately down 80% year-over-year. In March, we're seeing a slight improvement. That means stores and warehouse are gradually opening up, and the traffic is picking up but from a very low base. And of course, we're working together with our wholesale partners to keep inventory levels healthy, which means it could result and will result in significant takebacks. We want to make certain that we have fresh inventory in the channel. And particularly, when we move from one season to another, this is fundamental for the future success.

Q1 revenues in China, we estimate to be approximately between EUR 800 million and EUR 1 billion below prior year, which already includes a significant amount of potential takebacks. The operating profit in Greater China is expected to be between EUR 400 million and EUR 500 million below prior year. Global sourcing activities have not seen a major impact. What we don't know is how -- and this is where the situation keeps evolving with many unknowns. What is the further recovery rate and acceleration in China? What is the extended spillover into other countries? So far, we've seen business impact in Japan and South Korea only. And should there be, which we have not seen, availability issues of raw materials. And that's why in the context of this, we can only give you the guidance we have given, and we cannot be more specific than we are at this stage. Everything else, we'll be getting.

If we then look upon an assessment of the coronavirus in the first quarter. As I mentioned, in addition to China, we see a negative business impact in Japan and South Korea. In total, we expect our Q1 net sales to be down between EUR 0.9 billion and EUR 1.1 billion combined across China, down EUR 0.8 billion to EUR 1 billion, and Japan and South Korea down EUR 0.1 billion. At the same time, the rest of the world is expected to grow 6% to 8%, which will partially offset the decline in APAC. As a result, we currently expect total net sales to be down more than EUR 700 million in the first quarter. From a profit impact, the net sales decline in China, Japan and South Korea is expected to translate into an operating profit decline of approximately EUR 500 million to EUR 600 million year-over-year. In contrast to top line growth in the rest of the world -- in contrast, top line growth in the rest of the world will not offset the decline in APAC as we lose high-margin businesses in APAC and will carry last year at the same level of central costs. So we expect our total company operating profit to be down by more than EUR 500 million in the first quarter.

At the same time, we still see that the sporting goods business is in a very attractive business. The coronavirus is causing temporary dip in a long-term growth story in China. We have grown our China business revenue double-digit CAGR from 15% to 19%, and we expect to return to a sustainable growth path in 21-plus, supported by several structural growth drivers, growing middle class, increasing importance of sport and visa, et cetera. So we do not see that the underlying fundamentals have changed. What we see is an impact, which is, at this stage, difficult to put a time horizon on that will slow down the current trajectory. But when it ceases to exist, we expect that we'll get back to the same fundamentals as before.

There's no doubt that Creating the New has made us stronger. Healthy fundamentals ensure that we still have a very strong future outlook. We look upon, we have record profit in check cash generation, EUR 2.7 billion operating profit and EUR 2.8 billion operating cash flow. We have a stronger balance sheet than ever, equity position of EUR 6.8 billion at year-end 2019. We have a resilient business model, proven again in the context of our supply chain shortages. We'll continue to make the right short-term decisions to protect the long term, and we are a leader in a very attractive industry. These fundamentals are not changed.

So a look upon the fundamentals that we've spoken to you about many times, athleisure is here to stay and sportswear, a permanent component of the fashion landscape. We're seeing a structural shift in the consumer mindset, rising sports participation rates as well as awareness for health and sustainability. And there is no doubt, even in the current environment, that health -- a focus on health will get an even greater focus moving forward. We're seeing the direct-to-consumer relationship accelerating, we're talking about storytelling and leveraging firsthand consumer insights. We have made a dramatic change in our direct-to-consumer business in the last 3 years, which will benefit us not only during the crisis, but also the years to come. And the sporting events will continue to be a global stage, where frequent opportunities to make our assets and brands and product shine. And lastly, the supply chain upside, the scope to increase the industry's speed to market. Overall, we operate in a very attractive industry as a leader in a very attractive industry.

And that means, from a summary, we have proven our resilience in '19 and again delivered double-digit earnings growth on a like-for-like basis, 15%. We continue to ensure that our shareholders participate in the company's ongoing success. We're investing back into the brand and business for future profitability, having the highest relative spend in the industry. We're leveraging the company's strength to manage to the extent that we can, the coronavirus impact and we want to make sure that we continue to focus on bringing Creating the New home, making the substance changes that will make us successful in the future. And if you look over the last 4 years, we have delivered on net sales, operating margin and net income. We've had a plan to do the same for this year. We need to understand that the external factor, in this case the coronavirus, to which extent that will impact our business. And we'll keep you informed to the best of our capability, but a lot of the information will be at the point of happening because making forecast at this stage is equally important for everybody -- equally, impossible for everybody.

So with this, I thank you for your attention to detail and Harm and I look forward to take your questions, and we hope we can answer them in the best possible way. So back to you, Sebastian.

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**Sebastian Steffen** - adidas AG - SVP of IR

Thanks very much. So Stuart, we're ready for the Q&A part now.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) First question is from the line of Graham Renwick from Berenberg.

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**Graham Ian Renwick** - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

Just 2 questions for me, please. Just firstly, on the wholesale take backs of products in China. I was just wondering what confidence you have that you can clear that inventory through other channels at full price and without greater discounting, which could hit margins negatively later in the year? And where are you seeing the demand for that excess product, particularly as the virus starts to impact other markets? That's the first question.

And secondly, just on management incentives, how will you keep management incentivized in 2020? I understand bonuses are linked to guidance, but guidance is likely to be missed due to the coronavirus. And do the LTI targets for 2020 also remain unchanged? Because there's also a risk, the lower end of that, the EUR 140 million net income growth also becomes out of reach. I mean, given the current devices and exceptional circumstances, could incentives actually change to keep the management incentivized for example, focusing on the business, excluding China?

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

So on the wholesale side, we feel very comfortable we can clear that when the China environment, it will be cleared through our own factory outlets, so it will be cleared also "at a lower price," but we're very confident that it could be cleared. We will take a substantial amount of product back because we have an interest of having the freshest products in the channel to make certain that we return to growth as quickly as we can.

When it comes to management incentives, that has been discussed on several occasions at the Supervisory Board level to ensure that we do the right thing for the company. And the Supervisory Board does have the discretion to override the normal model. One of the elements that we have put into management incentive, and I'll speak very directly here is, the Supervisory Board have implemented in our short-term incentive for the Management Board a market share target for our China business. So while we're taking China out, we believe, all of us, it's important that whatever happens in China that we should maintain or grow our market share position. So market share has been added in as an element. And the second is, that the Supervisory Board has taken the liberty to say that they will override to ensure, if possible, if necessary, that management is appropriately incentivized.

I can say the following that there is an immense focus on the management side. It is quite, I would say, frustrating where we are because we have felt that we were uniquely positioned to deliver what we've worked for very hard for 4 years. And right now, I do not see any kind of lack of focus. On the contrary, senior leaders in the company have all canceled vacations to ensure that we bring this home and eventually, I'm certain that the company will treat the senior managers appropriately like we have already communicated to the company, that we will ensure that people are incentivized appropriately. But in the context of also what is appropriate in a shareholder view.

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**Graham Ian Renwick** - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

Now that's very clear. And just a follow-up on the first point. So the take backs of product in China, you'll be clearing that through outlets, and therefore, that will be discounted products. You won't be trying to find retailers or partners that can take that product on a full price?

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

No, for very basic reasons, if you try to clear a winter product in April, it's going to be very difficult to find somebody who wants to wear a winter jacket in April. That is the same for everybody in the industry. So you should expect that some of the products that are seasonal related, will, of course, can only be cleared at a lower cost. But that actually opens up the way for having a product at full price sell-through, being at the right place where the consumers are, so our franchise partners and our key retail stores.



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**Operator**

Next question is from the line of Geoff Lowery from Redburn.

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**Geoff Lowery** - Redburn (Europe) Limited, Research Division - Partner of Non-Food Retail, Luxury & Sporting Goods Research

Just one question, please. Can you talk about your approach to managing your marketing budget this year? I appreciate that there's some elements of flexibility around some of it and none around your longer-term contracted relationships. But how hard are you prepared to work your marketing budget this year to protect profits versus maintaining it to deliver out-year growth?

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

So let me first say the following: we've spent above the industry consistently. And every time there's been an upside, we've been the first to invest in. That's why we have above, I would say, above industry average. Of course, we are looking upon, if you have and I'll give you an illustration, there's no point in spending marketing in the last 4 weeks in China because everything was closed. So of course, in areas where it has no impact, you're not going to spend. But we have no interest in squeezing our marketing budget and we've proven that now for 4 years in a row, we'll continue to probably lead in the marketing spend. But we have to spend what makes sense. If you cancel an event, for instance, for the sake of this conversation, of course, you're not going to have any marketing spends associated with that. So we are not contemplating canceling any contracts, we'll continue to invest into assets, and we'll continue to invest into revenue and brand driving activities, but of course it has to make sense.

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**Geoff Lowery** - Redburn (Europe) Limited, Research Division - Partner of Non-Food Retail, Luxury & Sporting Goods Research

And just on inventory, sorry, the second one, just slipping it in, but are you confident that if the world normalizes in the second half of the year that you would be able to enter 2021 clean?

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

Yes, absolutely. We are confident that as Kasper said earlier, we have the -- we have expanded our factory [all network] in China, already significantly over the last couple of years. So we are feeling good with the level of take backs that we're envisioning right now to clear that through the end of the year. And in other markets, it's a similar situation. And as you might know, here and there, as we had a very clean inventory position already in 2019, we actually had some planned buys as well in factory outlets that we're not going to need anymore. So we are feeling very confident, given the current state, that we will end the year or the second half clean in inventory.

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**Operator**

Next question is from the line of Antoine Belge from HSBC.

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

It's Antoine Belge at HSBC. Two questions. First of all, I'd like to come back on this estimate you gave in case of events such as the Euro, the Olympics would be canceled, first of all, could you confirm, it was 15 to 17 again? I find that quite small. So can you elaborate because you've already shipped quite a lot? Yes, a little bit surprised by the low amount.

Second question relates to actually outside of China. I'm actually surprised to see that you're putting so much focus on China and still have a very optimistic view about U.S. and Europe growing 6%, 8%. Yes, I mean, what gives you that level of confidence that we could then have a significant impact in certain parts of Europe and actually maybe, unfortunately, the U.S. as well?



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

So when it comes to the two activities, of course, a lot of the sales has already taken place. Some of it is already at the end user. You're selling shoes that people continue to run in. So actually, the event itself is not the primary transaction place. It is prior to the event and that's why a lot of the "product sales" are taking place prior to the event. That's point one. Point two is a lot of the products we sell, particularly around the Olympics, are running-related products and people buy running shoes one way or the other anyway. That's why the event has this size, if you look upon it, because there's a gross element and there's a net element. It's not like people say because the Olympics is not taking place, I'm not going to run tomorrow. Well, I'm not going to buy a new jersey because there's not going to be any football. So that's why we feel very confident around that number.

When it comes to the spreading of the virus in the U.S. or somewhere else, I don't believe that we -- or you or anybody can give a viable forecast. And that's why what we're giving is, we're giving a forecast under the conditions that we're seeing right now. Should those conditions materially change, of course it will change the forecast, but it will change for everybody, it would change for the global economy. But frankly, it will be inappropriate if we were to sit here and make assumptions on certain things. We are making assumptions based on what we see today. If that will fundamentally change, then our core forecast will fundamentally change. That's why we have given the clarity that we have given you at this stage. And that's why we've been so clear also on the business development in China, when we saw it had a material impact, we gave that guidance. Right now, we're not seeing it. If that changes, we will let you know.

**Operator**

Next question is from the line of Jürgen Kolb from Kepler Capital Markets.

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

Very good. Two questions. First of all, the number you mentioned in terms of the EBIT reduction in Q1, the around EUR 500 million, apparently also looks like a pretty big number. I was just wondering if you could maybe give us some additional details as to what is included in that EUR 500 million, i.e., have you already incorporated some costs with the inventory take backs?

And secondly, with respect to the flexibility in costs, you talked about the marketing. Have you also already made some order cancellations on the production side, maybe for H2 this year? That would be helpful, any comment here.

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

Yes, on the first question on the EBIT reduction of around EUR 500 million in Q1, it's based on the EUR 800 million to EUR 1 billion in China. If you look at the margins that we have in China, it's of course, without disclosing it recently, it's north of 50%. So it's pretty much that's what we are losing there. And secondly, yes, the potential take back is already included in that number. What's also included in the number is that we couldn't react significantly on the OpEx side in China because we have a low marketing working budget, low flexibility. We cut everything possible on the flexible part and then of course, when it comes to the cost, we're dealing with our franchise partners. So where we gain the full margin, don't run the cost. We still have the employees to be paid. We had retail employees to be paid. So the running cost is pretty much still in force in China. That's why pretty much what you lose in top line, you're losing gross margin and that's why the impact is pretty significant.

And as Kasper said, outside of China, we keep the corporate headquarter pretty much as is and are not going into a significant restructuring program as we speak, as we believe it's going back to normal in the second half. And to that question, a good hand over to this one, we assume, in the second half, we are back to normal. We have not fundamentally changed our order book into our factories. Of course, what we have done to order -- in order to clear the excess inventory, primarily in China, we have reprioritized our orders for our factory outlets. And of course, depending on the development, we are looking at it on a weekly basis. If it will continue, we would start canceling more orders. But right now, assuming the second half is pretty much back to normal, and that's why we haven't fundamentally revised the order book for the second half, and we were focusing on reducing it for the factory outlets to clear the inventory, as I mentioned earlier.



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**Operator**

Next question is from the line of Jamie Merriman from Bernstein Research.

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**Jamie Susan Merriman** - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

Two questions. So on the first one, I'm just wondering about shipments into China post-February, have you reduced those? And are you able to divert those shipments into other regions? And then second, I appreciate the comments about no impact as of now in terms of global supply chain. But are any changes being made there that are worth calling out in terms of how you're thinking about managing the supply chain on an ongoing basis?

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

So let's start with the supply chain. The supply chain has not been the issue. Actually, the supply chain has been the least of our concerns. Our manufacturers are all running up at full capacity at this stage. So the supply chain itself and the construct of the supply chain has not caused us any fundamental issues. What we are looking upon is, of course, redirecting orders within the supply chain. So some of the orders we have in one location, we redirected in the other locations. So of course, we didn't place any new orders in February in China into our supply chain because we're sitting on full inventories in stores that were closed. So you don't need to place orders. So the supply chain has worked exceptionally well, what we are doing now is, in March with the take backs, of course, we start shipping back into our stores in China. So we take the products back, redirect them to the factory outlets, and then we start shipping into our -- the stores in China at a normal rate because we're basically flipping the inventory because we want to make certain we have a seasonally relevant inventory. But just to confirm, our supply chain is not the issue and it's not the concern. It is consumer demand in an environment where you have 80% of the stores being closed.

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**Operator**

Next question is from the line of Piral Dadhanian from RBC.

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**Piral Dadhanian** - *RBC Capital Markets, Research Division - Director of Premium Brands*

My first question is just a clarification. The EUR 500 million EBIT hit in Q1, is that a gross or a net impact? Because I believe in the press release, it was referred to as the Greater China hit. But obviously in Q1, if you're implying that everything outside of China is still growing 6% to 8%, then I would assume that there's some marginal profit offset coming from other regions, so at actually a group level for Q1, the EBIT hit would probably be less than EUR 500 million. So any clarification on that would be very helpful.

And then secondly, just in terms of current trading to the extent you're able to diverge. Indications are that actually footfall in certain key locations, for example, London's Oxford Street are down quite meaningfully in the last week or 2, or in the last week, I guess. Are you able to perhaps give us an indication about what you're seeing in sort of key locations in your retail network? Because the feeling really is that things are turning in Europe quite quickly. So just wanted to get a feel for what you're seeing in terms of your own network.

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

Yes, Piral, (inaudible) the first question on the EUR 500 million EBIT impact. Indeed, what we see in China will pretty much be the effect for the company as well. Because we are clearly saying, even -- so we are growing in the rest of the world outside of China and there's the profit contribution this one, bear in mind that we are allocating -- we're not allocating the central cost to China or something like that. So we are still having a centralized headquarter and we have added new DCs. Last year, we added new sports marketing contracts. So there is more cost in centrally hold contracts



that will then pretty much eat up the EBIT growth that we have outside of China. So consider what we communicate in China will also be the impact in Q1 for the total company.

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

On the traffic side, to the extent, what we are seeing, we are seeing a lower traffic in some of our stores. Of course, we have many, many stores around the world. So if you go store by store, the one you mentioned in London right now, we are seeing a slower traffic on high street. And of course, what we're using this is we're trying to see to which extent can we drive traffic away from our physical stores into our digital network, and that is the plans we're proactively working on. So we are seeing a slight slower traffic, not meaningful slow, but slightly slower traffic in some of our stores, the one you mentioned is one of them.

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**Operator**

Next question is from the line of Erinn Murphy from Piper Sandler.

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**Erinn Elisabeth Murphy** - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Two questions for me as well. I was hoping you could talk a little bit more about the period in March in China. You've talked about some improvement, even though it's from a very low base. Can you share a bit more about the consumer behavior between digital versus physical?

And then, I guess, the second question is for Harm, as it relates to the gross margin in the fourth quarter in North America, you called out negative pricing mix. Can you speak a little bit more about this? Is it kind of promotionally led? Or is there something else there? And then as you think about the outlook for 2020, can you just kind of help us think about the phasing between FX, maybe some of the pressure you talked about of clearing some of the China-specific inventory and any other kind of puts and takes?

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

So let me start, I'll do the China question and Harm will do the second question. What you're seeing in China, let me just start at a bit of a high level is we are seeing manufacturing getting more and more back to normal across most industries. What we're also seeing is a high number of people have been quarantined or been asked to stay in their apartments. And frankly, if you stay in your apartment for 2 or 3 weeks, the first thing you're going to buy when you sit in your apartment is not a new pair of shoes, it is refilling your apartment with the essential CPG products. So in that context, we are at the end of the food chain when it comes to it because you start restocking first your essential products. We are seeing a slight pickup, as I said, in the opening of the stores. We are seeing a slight pickup in the traffic in the stores, we have seen a significant pickup on the online traffic, which is, for transparency (inaudible) -- which is not -- you're not seeing the conversion rate picking up at the same rate as the traffic pickup, but you are seeing a substantial pickup on the overall traffic.

The reason why we believe we did not see the traffic pick up at an earlier stage is, when you have a complete lockdown, you couldn't get the products. So even if you order the product, you couldn't get the products. And as I said, if you're sitting locked up in an apartment, the first product you'll buy is probably not a pair of running shoes, because you can't use them. So -- but we are seeing an increasing traffic online that is growing at a higher rate than normal.

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

Just on the second question on the gross margin, I think you mentioned North America but I'll just answer on the global company for Q4. As I mentioned earlier, first and foremost, there have been some onetime effects relative to Q4 2018. And then the negative in Q4 '19, in the amount of around 120 basis points. And then, of course, we have more pronounced promotional events in Q4, and these are becoming bigger, whether it's Singles Day, whether it's Doubles Day, whether it's Black Friday, Cyber Monday, and all these things are spreading beyond the U.S. or beyond



China as well. So the level of promotional events got bigger as a share of the total business. And then of course, we have a small effect of tariffs. There's a significant effect of FX. And these are the things that we're seeing. And again, it's not indicative of what we are planning to do in 2020. And you asked the right question, is there a lower margin given to inventories. But as I mentioned earlier, we will clear most of the excess inventory through our factory outlets across the respective countries that are impacted. That's the plan that we have. And yes, maybe you get a lower margin at the factory outlet but in the overall scheme, that's nothing we are worrying about right now.

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**Operator**

Next question is from the line of Warwick Okines from Exane BMP Paribas.

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**Alexander Richard Edward Okines** - *Exane BNP Paribas, Research Division - Research Analyst*

I've got 3 questions, please. The first is, could you just give us an indication of what proportion of your circa 11,000 stores in China are open today? I imagine it's a small number. Secondly, I think you're on the newswires earlier today commenting about some concern about the effects of COVID-19 flowing through into 2021. And I was just wondering if you could explain what you have in mind here, if you're thinking of a wholesale handover or any other issues?

And then certainly, on a different topic, I was just wondering if you could give us an update in terms of how satisfied you are with the progress of Reebok. Can you confirm its EBIT margins moved forward last year?

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

So on our stores, we have about 70% of our stores are open at this stage. But a lot of them have reduced, approximately half of those have reduced opening hours, and we still see a low traffic. So you're starting to get a more normalized opening landscape but you still have to take into account that we have reduced opening hours from a demand standpoint. I believe what I said, and I'll be happy to go back and look upon it, I probably said that it's very difficult to put an end date to the coronavirus because nobody knows that. But right now, we're looking upon it in the context we're speaking about today.

When it comes to the development of Reebok, I'll hand over to Harm.

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

Just as the Reebok side, we always said we are pretty satisfied with the progress of the Reebok Muscle Up program, where we also announced in 2018, return back to profitability. And that's what we have maintained in 2019, we are very happy with the development in North America, where we grew 12%. Overall as a company, we are not happy with the 2% growth in 2019. That is not according to our ambitions. So it's a mixed bag. We're happy with the progress, given Muscle Up. We're happy in North America but overall, 2% is not what the industry should expect from Reebok. And that's what we are working on towards 2020.

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**Operator**

Next question is from the line of Cedric Lecasble from MainFirst.



**Cedric Lecasble** - *MainFirst Bank AG, Research Division - Research Analyst*

I have two follow-up questions. The first one on what could eventually happen in Europe. In terms of cost flexibility, you said you had limited cost flexibility in China, you seem to believe you have more in Europe or in the U.S. So what are the lessons you take from China? And what could you use to face a tougher situation in Europe, if the virus spread? That's the first one.

And the second one is related to materials that are used in or produced in China for the rest of the production organization. You mentioned it as something important for your supply chain. Could you come back on this potential risk? Would it imply that China goes back to worse again? Or anything special in China? Can you clarify that, please?

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

Now let me be clear on it. Right now, we have no relevant issues on our supply chain in China. What we're saying is, we put it on the chart, could something happen, we're just saying what we don't know. Right now, we don't see anything happening. So right now, our supply chain is not part of our concern. We're raising winding, eventually, it could be. But right now, it is not something that we have on the radar screen, it has not been in risk so far.

When it comes to how do we manage our cost situation, we have taken a very deliberate decision, not too short to optimize the company at this stage. We have built a brand and we've expanded our top line by almost EUR 7 billion, and we almost -- we're taking and expanding our margin line by 500 basis points and expanding our marketing spend by 150 to 200 basis points, because we believe it's the right thing to do. Of course, we are cost-conscious but we are not going to drive a short-term quarter optimization. If something then happened in Europe to drive a short-term margin because we know we are in a very, very good position, when it comes to the regional split we have, when we come to our product split. We're in a good position in our market share standpoint. And that's why, of course, we'll be prudent but we're not going to short-term optimize on something for 1 or 2 quarters to make things look prettier, that will then jeopardize our position in '21 and '22. I just want to be very clear on this. And that is what we're doing. We'll sign the right contracts if that opportunity comes in. We'll build the right products under the assumption that the market will return to normal, and that is why we're not going to shorten the OpEx model.

We will of course, be prudent, like we are, right now, the consequence of ban on international travel is, we're going to have a much less travel cost and we're taking all these costs in, but we're not going to optimize a quarter on the cost of a long term.

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**Operator**

Next question is from the line of Omar Saad from Evercore ISI.

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

A couple of questions. I wanted to start with a follow-up on coronavirus and the impact in China. And I really appreciate all the information you've given, and I also appreciate how difficult it is to forecast, but some of the dynamics that have occurred in China might be useful to help us build a framework. In the markets outside of Wuhan, from that minus 80 kind of trough level in markets outside of Wuhan, have you seen a bit of a recovery or at least some signs of moving off the bottom? And is it different in different markets across China? These kind of data points might be helpful to help us understand how it might flow through the rest of the world, if it continues to spread.

And I also wanted to ask a question on the e-commerce business, it's obviously still massively growing really well. You guys are doing a great job digitally. And as you think about it relative to your traditional wholesale and retail physical businesses, continues to take share. Do you -- over time, do you think you have to rethink that kind of split between stores and wholesale footprints as the e-commerce continues to grow at this rate? Do you think differently over time about your physical footprint across all the marketplaces out there globally?

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

So let me try, to the extent I'm capable of, of enlightening you more in China. There's no doubt that Wuhan doesn't -- Wuhan is a closed city at this stage, so the trading in Wuhan is close to 0. And what we're seeing is, of course, we are seeing a slight pickup, which you saw on the stores. We have now 7% of our stores up and running. So there is variance city-to-city, but at the worst point, everything was more or less closed down, not to the physical close down of the city of Wuhan, but from a consumer behavior, simply the consumers did not go into stores. We're now seeing that -- we're not saying returning to normal, but life is returning to normal. Our point is, that you have a delay impact in our area of the business because that was the point I was trying to make. If you're in the food business, you've got to shop every 2 or 3 times a week to fill up your fridge, that is not the case right now when it comes to footwear. So we are seeing that pickup eventually will take place. We just have an assumption that we are at the end of the food chain. And there are certain areas, if you were to break it down outside Wuhan, where they're more of course, hit by the China -- by the coronavirus and you see then, the negative impact and all. So it is a more diverse picture, with Wuhan being the worst one, and us being at the end of the food chain. So we think that we will continue to see an improvement, which we're seeing but we're seeing an improvement at a lower rate. That's why opening up of the actual number of stores is increasing but we're not seeing the traffic that we saw in the past.

When it comes to D2C, we have made enormous progress in our D2C business in the last 4 years, which has been part of the margin driver. And without lifting the lift for 2025, or you could assume that our direct-to-the-consumer business will continue to be expanded. And the role of our own retail stores is already being redefined. If you go to our London store, the full integration with our inventories, the full integration to our product sets within, in this aisle, the full integration with our online capabilities to ship from store is becoming an ever bigger competitive advantage. So from a business model standpoint, there is no doubt that the D2Cs, which you're seeing is one that's here to stay, they'll be further expanded in the future.

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

Okay. And then one last one, please. If I could squeeze it in on the Yeezy, could you talk a little bit about how some of the new Silhouettes are doing? Obviously, the franchise has done really well in those original Silhouettes but maybe any update on thoughts on the new Silhouettes and how the consumer is responding?

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

The short answer is exceptionally well. I think Chicago was a major hit, and we have seen -- we've seen the highest number of new introductions probably ever was Yeezy, we kept the volume low, we probably -- we have seen absolutely no fatigue around the Yeezy brand at all.

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

Thanks for all the disclosure. Appreciate it.

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**Sebastian Steffen** - *adidas AG - SVP of IR*

Thanks very much, Omar. And Stuart, we have time for one more question.

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**Operator**

Last question is from the line of Adam Cochrane from Citi.



**Adam Gareth Cochrane** - Citigroup Inc, Research Division - Director

I think you've answered most of these. But the one question I am thinking about is the pent-up demand. I think you've sort of said that you are at the low end of the food chain, it's going to be pent-up until they've bought other things. But as we look into the second half, when you talk about things normalizing, do you think that's normalizing at the rate it was running at before? Or could there be a slight increase as you get some caught up sales as well?

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

Unfortunately, I'm not going to give the answer that you would like to hear is, but I'll tell you what our hypothesis is built upon, what looked upon our business. We assume that the sale we didn't get in April, we're not going to double down in August. We think that, that is right now the appropriate way of thinking it. If our thinking is wrong, we will of course be the first one to correct it. But basically, the logic is, you're not going to buy the 2 shoes you would have bought over 6 months, you're not going to buy 2 shoes in one go at that moment in 6 months' time. That is the -- our assumption we've built into the business model. So we do not think the pent-up demand will lead to any substantially higher demand than the normal run rate.

**Sebastian Steffen** - adidas AG - SVP of IR

Thanks very much, Adam, and thanks very much, Kasper and Harm. Ladies and gentlemen, this concludes our full year 2019 results conference call. Our next reporting date will be May 8 for our Q1 results. There's another event in November that I want to remind you of. On November 10, we will not only disclose our Q3 results but we will also hold our investor and media day here in Herzo.

So if you still have any questions, please reach out to Adrian, Christoph or myself. I guess you know how and where you can track us down. And with that, I would like to thank you for your participation today. Talk soon. Bye-bye.

**Operator**

Ladies and gentlemen, the conference has now concluded, and you may disconnect your telephone. Thank you for joining and have a pleasant day. Goodbye.

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