

adidas Group

Price EUR131.15

Third Tutorial Workshop Feedback: "Creating the New": so far so good!

Fair Value EUR124 (-5%)

BUY

Bloomberg	ADS GY
Reuters	ADSG.F
12-month High / Low (EUR)	131.6 / 63.7
Market Cap (EUR)	27,439
Ev (BG Estimates) (EUR)	28,361
Avg. 6m daily volume (000)	930.3
3y EPS CAGR	19.8%

	1 M	3 M	6 M	31/12/15
Absolute perf.	11.9%	23.1%	46.9%	45.9%
Consumer Gds	5.6%	1.2%	7.2%	-2.0%
DJ Stoxx 600	4.0%	-1.6%	3.1%	-7.4%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	16,915	18,877	20,169	21,697
% change		11.6%	6.8%	7.6%
EBITDA	1,442	1,766	2,000	2,239
EBIT	1,059	1,332	1,516	1,718
% change		25.8%	13.8%	13.3%
Net income	630.0	888.3	1,030	1,170
% change		41.0%	15.9%	13.7%

	2015	2016e	2017e	2018e
Operating margin	6.3	7.1	7.5	7.9
Net margin	3.7	4.7	5.1	5.4
ROE	11.1	15.8	16.5	16.8
ROCE	10.0	12.5	13.9	15.2
Gearing	8.1	16.5	8.8	2.1

(EUR)	2015	2016e	2017e	2018e
EPS	3.32	4.10	5.03	5.71
% change	-	23.6%	22.6%	13.6%
P/E	39.5x	32.0x	26.1x	23.0x
FCF yield (%)	2.2%	1.7%	2.7%	3.1%
Dividends (EUR)	1.60	1.85	2.15	2.40
Div yield (%)	1.2%	1.4%	1.6%	1.8%
EV/Sales	1.6x	1.5x	1.4x	1.3x
EV/EBITDA	19.4x	16.1x	14.0x	12.3x
EV/EBIT	26.3x	21.3x	18.5x	16.1x

ADS Group presented its new consumer-centric organization in March 2015, which was built around three strategic choices (i.e. Open Source, Key Cities and Speed). These appeared to be quite abstract concepts at that time. Although there were less detailed figures than the two previous Tutorial Workshops, it enabled the group to make a comprehensive status update and to show that this new organization was directly responsible for the impressive operating improvement.

ANALYSIS

- I – Open Source to ensure that brands remain desirable.** Indeed, one of the group's major lessons from the previous Route 2015 plan was to avoid the dilution of brand desirability and being disconnected from customers (U.S. example). In order to win the consumers' hearts and minds (and their wallets!), adidas has opened up its brand to consumers, creative types and athletes who all bring their talents. Two illustrations of this open source mind-set: **(i) Creator Farms** such as the Brooklyn Farm (opening this fall '16) which hosts Nike's three former footwear designers. In the future, ADS will count on several Creator Farms across the globe, mostly in key cities that will be part of the product creativity and innovation; **(ii) Kanye West:** adidas and Kanye West have decided to bring this successful partnership one step further by opening stores devoted to the adidas + KANYE WEST brand.
- II – Key cities, where "The New" is created...** As cities encompass 50% of the world's population and 80% of the global GDP, ADS is focusing on six key cities (i.e. Los Angeles, NYC, London, Paris, Shanghai and Tokyo) where fashion trends are formed. At the Investor Day last year, ADS reminded those present that the contribution of London alone was already higher than Finland! Hence the group allocates more resources (marketing, retail concepts, etc.) and aims to double its business in these key cities by 2020. As an example the Boost Energy League, in which 11 districts of Paris are facing each other during running sessions, enabled the brand to increase its awareness and conversion rates in the running category. Globally, the Net Promoter Score is up a HSD/DD rate and sales increase at a strong double-digit in all these key cities.
- III – Speed: a key driver to increase brand desirability and profitability.** Three main models are used to better serve customers: **(i)** "Never Out Of Stock" (NOOS) to ensure that evergreen/iconic products are replenished on a constant basis, **(ii)** "Planned Responsiveness" (PR) to reproduce seasonal best-sellers and quickly respond to a higher demand and **(iii)** "In-Season Creation" (ISC) to capture the latest industry trends. All these business models enable ADS: **1/** to reduce the risk of overbuying stock (= less markdowns), **2/** to have constant fresh and desirable products available in stores and **3/** to decrease lead times and time to market, improving by 20% the group's share of full-price sales by 2020. As a reminder, the group also has the 2020 objective to generate 50% of its net sales with speed-enabled products vs. 30%e in 2017, 20%e in 2016 and 13% in 2015.
- SPEEDFACTORY is a key enabler for these three strategic choices.** ADS' first automated footwear factory in Germany will begin large scale production in mid-2017 (~100k pairs) and a second plant in the US will bring the production capacity to ~1m pairs in 2018. Although volumes are quite limited compared to the total group's footwear production (~301m pairs in 2015), this game-changing manufacturing initiative will reduce the supply chain complexity (logistics costs, shorter time to market, etc.) whilst increasing the group's reactivity and flexibility, as highlighted on the graphs overleaf.

VALUATION

- Following a breathtaking rally (+47% since our recommendation upgrade last November), our FV is now below the current share price. We wait for the H1 results to assess whether there is some remaining upside potential (e.g.: operating leverage, future divestiture of TMaG, etc.) but admittedly the current share price already prices in a quite upbeat scenario in the MT in our view.

NEXT CATALYSTS

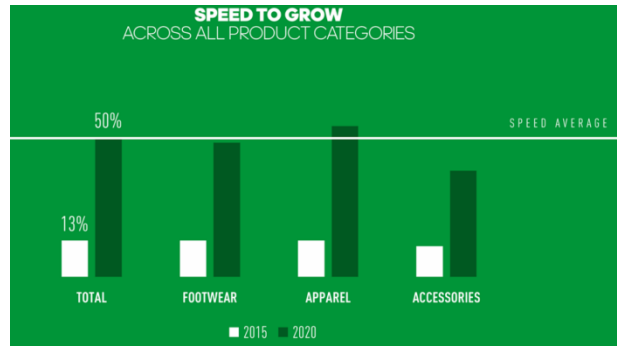
- adidas Group will report its H1 15 Results on 4 August 2016.

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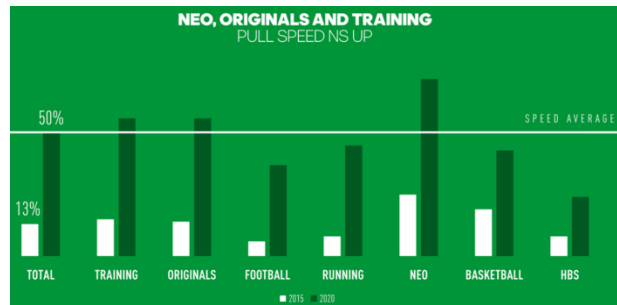
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2020 objective to generate 50% of sales with speed-enabled products: breakdown by category...



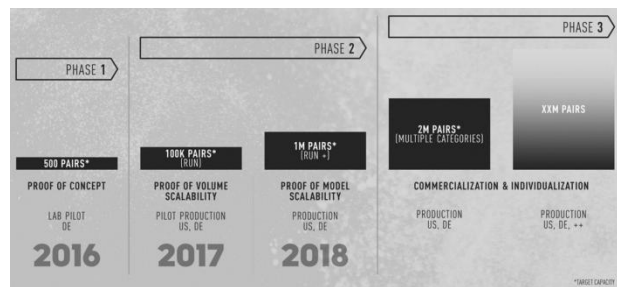
Source: Company Data

2020 objective to generate 50% of sales with speed-enabled products: breakdown by category...



Source: Company Data

SPEEDFACTORY roll-out plan:



Source: Company Data

SPEEDFACTORY: a key enabler to reduce time to market in footwear:



Source: Company Data



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