Flash Note – Adidas AG

APRIL, 2020

Adidas	
Ticker MyBolsa/website BiG	ADS
Ticker BiGlobal Trade	ADS
Ticker BiGTrader24	ADS
Ticker BiG Power Trade	ADS
P/E Ratio 2020E	22.01
P/BV Ratio	6.19
EV/EBITDA	2.49

Source: Bloomberg;

Price and Performance (Values in EUR)	
Price	214.80
52 Week High	317.45
52 Week Low	160.10
YTD	-25.9%
Average Daily Volume (mn)	892,565
Market Cap (mn)	43,049
Beta	1.02
Dividend	3.85
EPS	9.70

Source: Bloomberg;

Consensus (last 5m)	
Buy	17
Hold	22
Sell	3

Source: Bloomberg;

Financial Information	
Sales (EUR mn)	23,640
EBITDA (EUR mn)	3,882
Nº of Employees	59,533
ROA	10.9%
ROE	30.0%
D/E	0.1%
Dividend Yield	1.8%

Source: Bloomberg;

Notes:

All quotes were updated in Bloomberg at 15h35 of April 10th, 2020.

Relevant Information:

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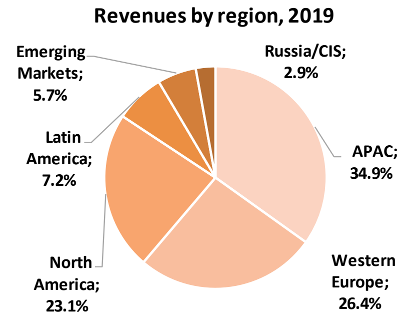
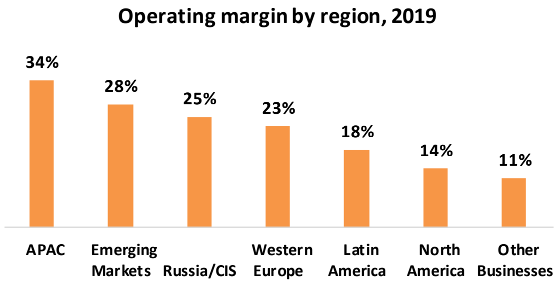
Adidas (Ticker: ADS)

Description

Adidas AG is a Consumer Discretionary company, which manufactures sport and athletic products, including footwear, apparel and accessories. It was founded in 1924 in Germany, Herzogenaurach and now it is present in the major markets, namely North America, Latin America, Asia-Pacific, Europe and Emerging markets. Adidas employs more than 59 thousand people. The company owns two strong brands – internally developed Adidas and Reebok, acquired in 2006. Both brands are associated with high quality and loyal customer base. The main aim of the company is to develop a digitalized business, which produces innovative products and revolutionizes health and fitness into the lifestyle concept. The major growth drivers of the company are the North American and the Asian market (Greater China) as well as e-commerce.





Source: Company´s data

Investment Points

After the massive devaluation caused by the covid-19 pandemic Adidas is now trading with a P/E of 22, which is attractive for a company that: has a sound financial position: low amount of debt; has strong cash flows (over the last year were enough to cover capex, dividends and share buyback); is robust throughout a recession; has been improving its cost structure lately; and still has market opportunities to expand (China and USA)

Corona Virus Impact

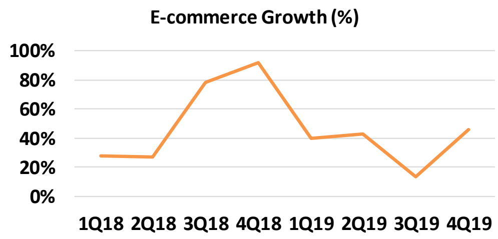
- The global spread of the coronavirus during the first quarter of 2020 led to a **significant number of store** closures and a **pronounced traffic reduction** within the remaining store fleet.
- The significant revenue declines the company has been experiencing in Greater China since the end of January as well as in Japan and South Korea in March drove to **Asia-Pacific sales decline of 45%**. This development was mainly driven by a sales **dec**line of **EUR 800 mn** (-58%) in **Greater China**, which also reflects product takebacks in a triple-digit-million-euro amount to manage inventory levels in the market.
- While stores in **Greater China** and **South Korea reopened** during **March**, **closures** came into effect in **most other parts of the world** following the global spread of the coronavirus - more than **70% of the company's store fleet is still closed**. Up until this point, the company had recorded ex-forex revenue growth of 8% outside of Asia-Pacific for the first two months of the year. The negative impacts from the subsequent closures offset these sales increases, thereby significantly weighing on the first quarter sales in **Emerging Markets (-11%), Europe (-8%), Latin America (flat), North America (+1%)** and in **Russia/CIS (+9%).**
- Regarding shareholder compensation, adidas decided to **suspend the share buyback** program to preserve cash and, since it received a EUR 3,3 bn revolving facility from KfW and other banks, had to **cut** its **dividend** distribution as well, for 2020.

Analyst:
João Calado, CFA

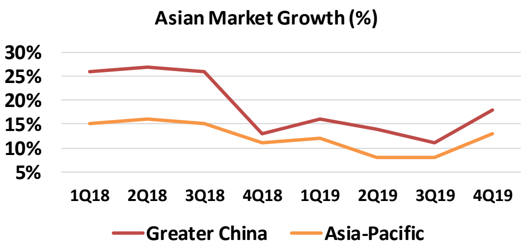
With the contribution of:
Francisco Fonseca

Research:
research@big.pt

Investment Case



Source: Company´s data



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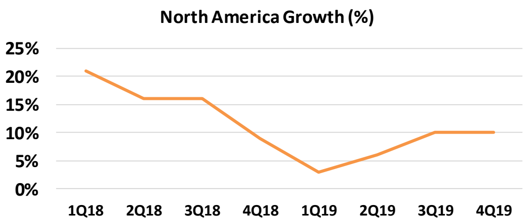


Source: Company´s data

		2016	2017	2018	2019
Adidas	Revenues (EUR mn)	16334	18993	19851	21505
	Growth (%)	*22%*	*16%*	*5%*	*8%*
Reebok	Revenues (EUR mn)	1770	1843	1687	1748
	Growth (%)	*6%*	*4%*	*-8%*	*4%*

Source: Company´s data

E-commerce. Since the initiation of e-commerce, it proved to be a significant sales channel, which adds value to the business. In 2019, E-com was the fastest-growing channel with a 34% increase YoY, confirming the strategic importance of segment. Right now, 90% of adidas advertising budget allocated to digital platforms. Clients have no borders now, and when a product is released, it's is released everywhere. That's why the connection with physical and online experience is fundamental, since e-commerce not only generates sales but also drives traffic to the stores. In 2019, this accounted for only 13% of total revenues yet, during this pandemic, as e-commerce demand is expected to increase even more, this segment will be crucial for the company in 2020.

Asian Market (China): According to Kasper Rorsted, adidas' CEO, China is the biggest growth opportunity for the German brand, especially the Chinese market. The middle class in China is growing at a fast pace, and with it, consumer spending as well. In this region, Adidas and Nike control the market. Even accounting with the covid-19 impact, China will remain the fastest growing market for adidas.

North American Market: It represents the biggest market in the sporting goods industry with a total share of approximately 40% and is one of the biggest growth opportunities for the adidas, where, for example, adidas only has a market share of 5.9% in sportswear. That's why Adidas has made North America one of the strategic priorities and started to significantly increase its investments into the region – people, infrastructure, marketing and point-of-sale. In 2019, adidas North America was impacted by supply chain shortages, but still grew 7%.

European Market: Over the past years the European market has been reporting low single digit growth, and according to the CEO, that's happening due to the low demand for sports products – globally 2/3 of revenue are originated through sports product sales, yet in Europe that percentage it's only 50%, being the remain attributed to casual. To mitigate this ussie and increase sports product demand adidas has increased its exposure in sports events and teams (ex. signing a contract with Arsenal FC to brand their jersey, sportswear, etc.).

Divestiture of brands/Reebok. In recent years Adidas AG engaged in divestitures of smaller brands in the portfolio as they were not generating revenues. Taking into consideration Rebook's slow growth since the acquisition in 2005 for USD 3.8 bn, Adidas was contemplating divesting the brand if it underperformed. Nevertheless, it did not pursue that path, and to increase the profitability of the brand, the German company has closed underperforming stores and allowed some licensing deals to expire, cutting sales at the long unloved sporting brand, which lead to a decrease in 2018. In 2019 sales grow once again as Adidas started to rededicate more marketing dollars to Reebok, making some long-overdue improvements to Reebok's website and digital marketing strategy, and revamping its product assortment to ride the popularity of retro sneakers.

Campaign with Beyonce. In 2019 Adidas signed a partnership with Beyonce to start a new line of athletic and lifestyle products. Following the successful Kayne West campaign (in 2016 Q2 Adidas brand sales increased by roughly 30%, and in 2019 estimates point that this shoe line generated USD 1.5 bn in sales), this strategical move is even more promising, as Beyonce has a well-established reputation. The official launch occurred in January 2020, and the stock available was sold out within a couple of minutes.

Analyst:
João Calado, CFA

With the contribution of:
Francisco Fonseca

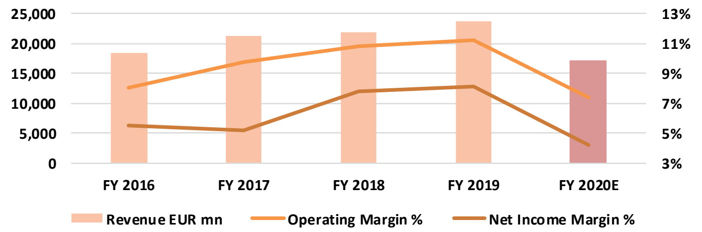
Research:
research@big.pt

Income Statement

Income Statement (EUR millions)	2019	2018	2017
Revenues	**23,640**	**21,915**	**21,218**
Other Revenue	210	177	132
COGS	(11,347)	(10,552)	(10,514)
Distribution Expenses	(4,997)	(4,450)	(4,307)
Marketing and Administrative	(4,694)	(4,577)	(4,292)
Other Expenses	(152)	(146)	(167)
Operating Expenses	**(21,190)**	**(19,725)**	**(19,280)**
EBIT	**2,660**	**2,367**	**2,070**
Net Interest	(102)	10	(47)
EBT	**2,558**	**2,377**	**2,023**
Taxes	(640)	(669)	(668)
Others	59	(5)	(254)
Net Income	**1,977**	**1,703**	**1,101**
Earnings per share	**9.70**	**8.46**	**6.68**

Source: Company´s data

Total Revenues increased by 7.9% in 2019, and COGS follow that same trend increasing by 7.5%. Despite higher distribution, marketing and administrative expenses the operating margin significantly increased to 11.3%. Net income from continuing operations increased by 12% to EUR 1.918 billion, including the negative impact from the first-time application of IFRS 16. This translates into basic EPS from continuing operations of EUR 9.70, representing an increase of 15% versus the prior year period.



Source: Company´s data

Free Cash Flow

Free Cash Flow (EUR mn)	2019	2018	2017
Operational Cash Flow	**2,818**	**2,646**	**1,648**
Operating Profit	2,558	2,378	2,023
D&A, impairments	1,206	487	483
Taxes	(692)	(815)	(556)
Change Working Capital	(248)	712	(271)
Others	(6)	(116)	(31)
Investment Cash Flow	**(927)**	**(635)**	**(677)**
Capex	(695)	(621)	(750)
Net Treasury Investments Inflow	(80)	(56)	(132)
Others	(152)	42	205
Financial Cash Flow	**(2,274)**	**(990)**	**(768)**
Debt change	(42)	584	(273)
Share buyback	(813)	(1,003)	(87)
Dividends	(666)	(529)	(406)
Repayments of finance lease obligations	(597)	(2)	(2)
Others	(156)	(40)	0
Change in free cash flow	**(383)**	**1,021**	**203**
Other and forex	**(30)**	**(29)**	**(111)**
Cash and equivalents at end	**2,220**	**2,629**	**1,598**

Source: Company´s data

- **Operational cash flows** in 2019 increased by 7.6% mainly due to higher operating profits and D&A's (caused by the depreciation of right-of-use assets related to the first-time application of IFRS 16).
- Investments in **capex** remain stable, just below EUR 700mn. New or remodeled stores as well as in shop-in-shop presentations of brands and products accounted for 47% of total capex (vs 32% in 2018). Further development of the major corporate facilities in Herzogenaurach, Portland and Shanghai, aggregated 26% (vs 36% in 2018). The remaining was allocated to IT (13%), administration (7%) and logistics (6%).
- Regarding **dividends**, in 2019 there was a 25% YoY increase, which goes in line with the growth historically reported. Nevertheless, due to covid-19 impact dividends for 2020 were suspended.
- Adidas had the intention to **buyback** EUR 3 bn of shares between 2018 and 2021, yet to protect the financial flexibility the company suspended the program.

Balance Sheet

Balance Sheet (EUR mn)	1Q20	2019	2018	2017
Assets	**20,782**	**20,680**	**15,612**	**14,017**
Cash and cash equivalents	1,975	2,220	2,629	1,598
Short term investments	10	292	6	5
Goodwill	1,271	1,257	1,245	1,220
Receivables	2,794	2,625	2,418	2,315
Inventories	4,334	4,085	3,445	3,692
Property Plant & Equipment	2,350	2,380	2,237	2,000
Intangible Assets	1,175	1,164	1,040	960
Right-of-use assets	2,759	2,931	0	0
Other Assets	4,114	3,727	2,056	1,767
Liabilities	**13,852**	**13,621**	**9,248**	**7,999**
Short term Debt	964	43	66	137
Long term Debt	1,592	1,595	1,609	983
Payables	2,494	2,703	2,300	1,975
Accrued Expenses	2,118	2,446	2,324	2,265
Lease liabilities	2,962	3,132	0	0
Other liabilities	3,722	3,702	2,949	2,639
Total Shareowner's Equity	**6,929**	**7,058**	**6,363**	**6,018**
Total Equity and Liabilities	**20,782**	**20,680**	**15,612**	**14,017**

Source: Company´s data

- **Assets** increased by 32% in 2019 mainly due to the first-time application of IFRS 16, mentioned before. Now, these assets need to be incorporated in the balance sheet as right of use assets and financial liabilities.
- As of 31st March 2020, Adidas received a **EUR 3.3 bn revolving loan facility** (EUR 2.4 bn from KfW and an additional EUR 600 mn from a consortium of Adidas's partner banks). This facility as maturity of 15 months.
- Considering that it holds around **EUR 2 bn available in cash and equivalents** (around two-thirds of which is held at adidas AG and hence is directly accessible), the German company has a **net debt** position of **EUR 0.6 bn**.
- By adding the KfW syndicated loan of EUR 3 bn with the EUR 1.3 bn directly accessible cash, Adidas as a **financial flexibility of EUR 4.3 bn**.

Last Earnings (1Q20):

Adidas reported **revenue** for the first quarter of EUR 4.75 bn, **-19% y/y**. Mainly due to the quarantine restrictions applied in China since January, the **Asian-pacific segment** dropped **-45% y/y** to EUR 1.18 bn. In addition**, European sales** also decreased **-8.1% y/y**. Due to low double digit in the first two months of the year supported by a strong e-commerce growth in March, the **North American sales** was able to offset stores closures, and the first quarter reported a **3.8% increase**. Operating profit dropped -93% y/y to EUR 65 mn, due to negative impact of EUR 250 mn from product takebacks in Greater China, purchase order cancellations and higher bad debt allowances.

Analyst:
João Calado, CFA

With the contribution of:
Francisco Fonseca

Research:
research@big.pt

Management

Kasper Rorsted (CEO) joined the company in **2016** after leading **the chemical and consumer goods** company Henkel - the value of the company doubled under his management. He holds a degree in **Business Studies** and several degrees of Executive Programs at **Harvard Business School**. Rorsted also has **experience in IT sector**, due to various management positions in Oracle, Compaq and Hewlett Packard. Rorsted is following the strategy to increase market share in US and conquer Nike, which remains the main sports apparel and footwear producer in the market. Rorsted has a **direct and transparent leadership**, and he gives his team a lot of freedom to execute their job. As a sports enthusiast person, coming to adidas was a “childhood dream” and he defends that he actually has “the best job in the world”.

Thomas Rabe (Chairman) has been a member of the adidas Supervisory Board since May 2019, and Deputy Chairman of the Supervisory Board since this same point in time. After a board meeting was held on February **2020**, Adidas has confirmed that Thomas Rabe will take up the role of chairman. Before joining the German company, he was appointed to the Executive Board of Bertelsmann, a **global media, services and education** company, as CFO in 2006. Six years later, he was appointed as Chairman and CEO since 2012, positions that still hold. Rabe studied Business and Economics at the RWTH Aachen and the University of Cologne. After earning a degree in **business administration** in 1989, he obtained his **doctorate in economics**.

Harm Ohlmeyer (CFO) holds a degree in **Business Studies** from the University of Regensburg, Germany, as well as an **MBA** from Murray State University, USA. He started his career with adidas in 1998 and gained extensive experience in the areas of **Finance and Sales**, including responsibility as Senior Vice President Finance TaylorMade-adidas Golf in Carlsbad, USA, Senior Vice President Finance adidas Brand and Senior **Vice President Finance for Global Sales** (adidas and Reebok). From 2011, he led the company’s e-commerce business as Senior Vice President Digital Brand Commerce. From 2014 to 2016, he held additional responsibility as Senior Vice President Sales Strategy and Excellence. In **2017,** Ohlmeyer was appointed to the Executive Board and subsequently became CFO and Labor Director.

Martin Shankland (COO) joined the German group in 1997 and throughout his wide experience at the company he has held several positions of responsibility. The last one was **Managing Director** for the group’s business in **Middle East, Turkey, India and Africa**. Prior to that, he had been Managing Director for the group’s operations in Russia for seventeen years. Under his leadership, adidas Russia/CIS became clear market leader through the development of an extensive own-retail network for both the adidas and Reebok brands. He started at adidas as **Finance Director** for adidas **Russia/CIS**. l. He holds a Bachelor of **Commerce degree** from the University of New South Wales, Australia, and completed the Professional Year Program at the Australian Institute of Chartered Accountants.

Analyst:
João Calado, CFA

With the contribution of:
Francisco Fonseca

Research:
research@big.pt

Main Segments

Adidas AG owns several brands – Adidas, Reebok, Runtastic and Adidas Golf – which are either acquired or internally developed. All segments represent wholesale, retail and e-commerce activities.

Adidas is the primary brand developed by the company. It includes two subdivisions, namely **Adidas Performance** and **Adidas Inspired**.

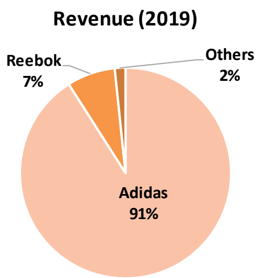
- Adidas Performance develops equipment for professional athletes in the areas of basketball, football, running and training. The brand is well known for the collaborations with Chelsea FC, Brotherhood, Adidas by Stella McCartney and others.
- Adidas Inspired, in contrast, is a brand that develops products combining sport and fashion. Thus, the main campaigns include Adidas Originals: lifestyle oriented retro and old-school style footwear and apparel, which is well known for the legendary Trefoil logo; Y-3: collaboration with Japanese designer Yohji Yamamoto since 2003; Yeezy: collaboration with Kayne West since 2015.

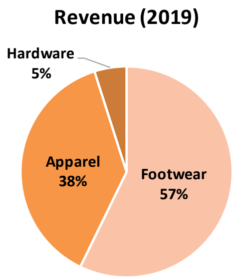
Reebok is a brand acquired by Adidas AG in 2006. Brand focuses on fitness, running, CrossFit footwear and apparel. It is mainly known for the Classic division, which includes models, such as Classic, instaPump, Club Classic 85 and others. The most famous partnerships are the CrossFit followed by the newly presented logo Delta; campaign with Victoria Beckham and the latest partnership with Pyer Moss in 2018, which released sneakers, inspired by 90´s.

Runtastic is another brand acquired in 2015. It develops health and fitness tracking applications. The brand is mostly promoted in various Adidas sustainability campaigns as the main tool to track the development of fitness.

Adidas Golf is another brand, which produces footwear and apparel for golf players.

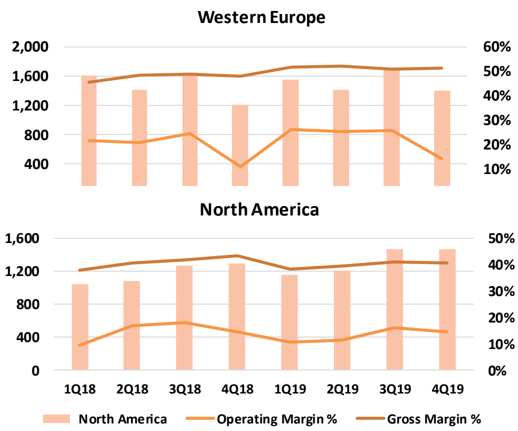
The latter two segments make a minor part in the annual sales, therefore they are not being reported separately.





Source: Company´s data

In terms of revenue generating segments, six major divisions are identified: Europe, North America, Asia-Pacific, Russia/CIS, Latin America and Emerging markets.



Western Europe (26.4% of total Sales, operational margin 23.2%, growth +3% ex-FX): A decrease of 2% in Reebok sales was offset by an increase in sales of Adidas brand of 4%. This was driven by low-single-digit sales growth in Sport Inspired and mid-single-digit sales growth in Sport Performance. Gross margin increased by 3.9 basis points to 51.5% due to favorable pricing and lower input costs. Operating margin decreased by 3.2 basis points.

North America (23.1% of total Sales, operational margin 13.5%, growth 8% currency-neutral): Both Adidas and Rebook brands generated higher sales of 13% and 18%, respectfully. Both subdivisions of Adidas grew on low-single-digit. Gross margin decreased by 1.2 basis points to 40%; operating margin declined 1.4 p.p. in 2019. While U.S. tariffs on all consumer goods average just 1.9 percent, they average 11.3 percent for footwear – more than half of Adidas net sales. In addition to that, the company has very a limited production line in the US, which lead to higher transportation costs, and, ultimately, to a lower operating margin when comparing with the European and the Asian market.

Analyst:
João Calado, CFA

With the contribution of:
Francisco Fonseca

Research:
research@big.pt

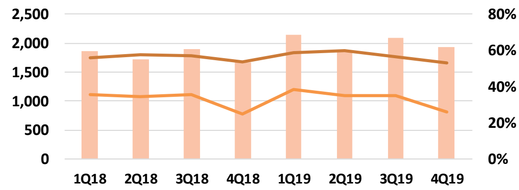
Asia-Pacific (34.9% of total Sales, operational margin 33.7%, growth 10% currency-neutral). An increase in Adidas sales by 12% was the main driver of growth, as Reebok decreased by 11%. Sport Inspired and Sport Performance grew on a double-digit. Gross margin was up by 0.8% due to favorable pricing and decreased input costs. In addition, operating margin increased by 0.9% due to higher marketing costs. The segment has the highest operating margin since 73% of the manufacturing partners are located precisely in Asian, compress the transportation costs.

Russia/CIS (2.9% of total Sales, operational margin 25.4%, growth 8% currency-neutral): The increase in sales was mainly driven by the higher revenues generated by both Reebok brand (+13% YoY) and Adidas (+10% YoY). More specifically, Sport Inspired sales grew at a double-digit rate, revenues in Sport Performance increased at a mid-single-digit rate. Gross margin was down by 4.2 p.p. (unfavorable pricing and channel mix more than offset lower sourcing costs and positive currency effects) and operating margin was up by 0.8 p.p..

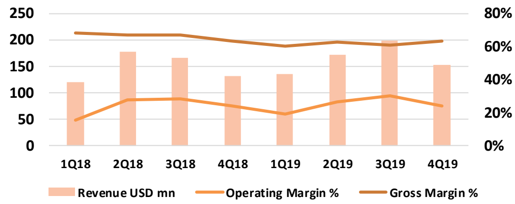
Latin America (7.2% of total Sales, operational margin 17.8%, growth 7% currency-neutral): Adidas and Reebok sales increased by 2%, while Reebok sales decreased by 1%. Double-digit growth in Sport Inspired was partly offset by a low-single-digit sales decline in Sport Performance. In addition, gross margin increased by 2.8% (negative currency effects and an unfavorable product and channel mix were only partly offset by lower sourcing costs and a favorable pricing mix), and operating margin increased by 0.7% p.p..

Emerging markets (5.7% of total Sales, operational margin 28.2%, growth 13% currency-neutral): Revenues generated by Adidas brand increased by 12% driven by double-digit growth in Sport Inspired and high-single-digit growth in Sport Performance. It was followed by the 14% increase in Reebok sales. Gross margin decreased by 0.5% (negative currency effects and an unfavorable channel mix more than offset lower sourcing costs and a favorable product and pricing mix), and operating margin increased by 0.4%

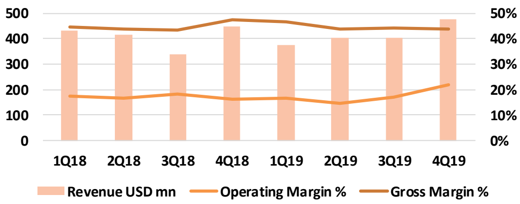
APAC



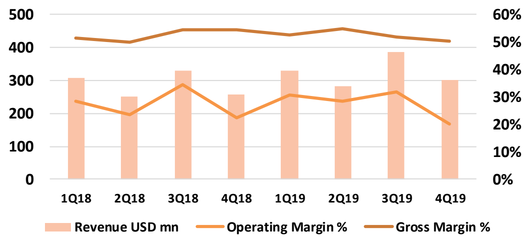
Russia/CIS

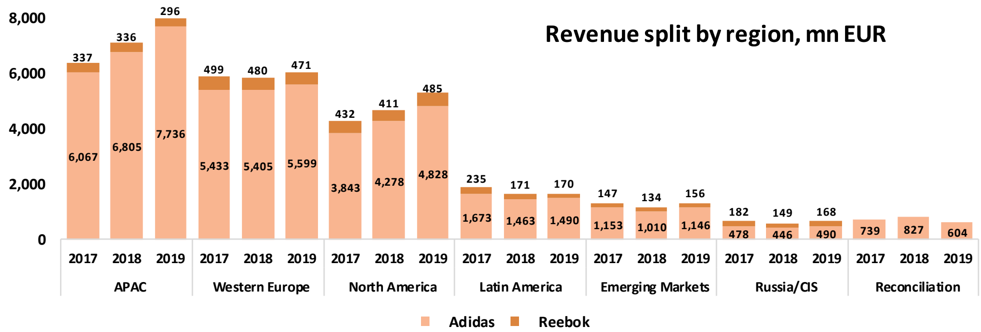


Latin America



Emerging Markets





Source: Company´s data

Operating Margin Evolution

	2017	2018	2019
APAC	33%	33%	34%
Emerging Markets	25%	28%	28%
Russia/CIS	21%	25%	25%
Western Europe	20%	20%	23%
Latin America	14%	17%	18%
North America	11%	15%	14%

Source: Company´s data

Production

Adidas outsources 100% of its production to independent manufacturing partners, being the majority – 73% - located in Asia. Regarding footwear, the percentage increases even more, up to 98%, being **Vietnam** and **Indonesia** the main source with 43% and 28% of the total volume, respectively. Adidas, among other sneaker makers, have steadily been easing their reliance on **China**, shifting production to places just mentioned before. Apparel is also mainly produced in Asian, with the region accounting for 91% of the total volume. Finally, in 2019, 81% of the hardware products, such as balls and bags, were also produced in Asia, being China the largest sourcing country with 37% of the sourced volume.

Footwear	Apparel	Hardware
Vietnam - 42%	Camboja - 23%	China - 37%
Indonesia - 28%	Vietnam - 19%	Pakistan - 22%
China - 16%	China - 19%	Turkey - 18%

Source: Company´s data

Analyst:
João Calado, CFA

With the contribution of:
Francisco Fonseca

Research:
research@big.pt

M&A

Adidas AG is highly focused on organic growth, meaning that it invests in innovative campaigns and partnerships with athletes, sports clubs and marketing for new production. As it is the main driver of sales, Adidas AG recently has not engaged in growth through acquisitions. Furthermore, the CEO is focused on increasing the market share by approaching the customer base and improving the brand recognition of Adidas. After the

completion of the sale of the TaylorMade, Adams Golf and Ashworth brands as well as our CCM Hockey business in 2017, Adidas is now operating with a narrowed focus on their core

strength areas of athletic footwear and apparel. The main aim is to remove less profitable business lines and fully focus on the primary brands of Adidas AG. The remaining brands in Adidas AG portfolio are Reebok and Runtastic and Adidas Golf. In 2019, there were no divestitures.

Adidas brand portfolio;
Source: BiG Research

Relative Valuation

P/E ratio of Adidas is below the average, thus it is lower than its main competitors, namely Nike and Under Armour. Since the German company cut its dividend, the yield now is under the average. In terms of operating profitably the company is stronger than its peers. Even with the EUR 3.3 bn loan, the company stills has multiple Net Debt/EBITDA under the average of its comparables.

Name	Country	Market Cap (mn)	Currency	P/E LTM	EV/EBITDA	YTD	Div. Yield	NetDebt/ EBITDA	CFO/Capex	Operating Margin
NIKE INC -CL B	UNITED STATES	131,945	USD	28.7	27.1	-16%	1.1%	0.6	5.3	12.6%
PUMA SE	GERMANY	8,824	EUR	32.7	14.9	-25%	0.7%	0.0	2.3	8.0%
UNDER ARMOUR INC-CLASS A	UNITED STATES	4,141	USD	48.9	20.7	-55%	0.0%	0.9	3.5	4.5%
SKECHERS USA INC-CL A	UNITED STATES	3,855	USD	11.2	7.3	-42%	0.0%	0.4	1.3	9.9%
ASICS CORP	JAPAN	1,589	JPY	21.5	10.1	-50%	3.3%	1.8	3.1	2.8%
ADIDAS AG	GERMANY	46,833	EUR	23.1	14.3	-20%	1.6%	0.6	4.5	11.3%
Average exc. Adidas AG				28.6	16.0	-37.7%	1.0%	0.7	3.1	7.6%

Source: BiG Research

Sportswear Market Share

Global	2017	2018	2019
Nike	16.1%	15.8%	15.9%
Adidas	11.5%	11.7%	11.7%
VF Corp	3.6%	3.7%	3.9%
US	**2017**	**2018**	**2019**
Nike	18,1%	16.8%	16.7%
Adidas	5.8%	6.1%	5.9%
VF Corp	4.2%	4.1%	4.3%
China	**2017**	**2018**	**2019**
Nike	20.5%	21.0%	21.2%
Adidas	18.6%	19.3%	20.4%
Anta Sports	12.6%	14.6%	16.4%
Western Europe	**2017**	**2018**	**2019**
Nike	15.2%	15.5%	15.6%
Adidas	15.6%	15,5%	15.6%
Decathalon	3.8%	3.6%	3.5%

Source: BiG Research

ESG

The entire sustainability element is crucial for a sporting goods company, and Adidas is no exception. The german company wants to target people that understand the importance of exercising and having a healthier life, and ultimately, a healthier world. Thus, the company is embracing the following initiatives:

- The company is currently producing shoes made of recycled ocean plastic. Over the last adidas produced a total of 14 million pair of shoes (+50% YoY);
- Polyester is the most single-used material in adidas products and, by 2024, the german brand aims to replace all virgin polyester with recycled polyester in all products where a solution exists. In 2019, 50% of all polyester used for our apparel and footwear ranges was already recycled polyester.
- By 2021 the company will launch a shoe that, if the consumer does not want to wear it anymore, he/she can return it and adidas will be able to break down the materials and produce a completely new shoe out of the old one.

Analyst:
João Calado, CFA

With the contribution of:
Francisco Fonseca

Research:
research@big.pt

Risks

Consumer demand and preferences. Since Adidas AG fully relies on organic growth it is crucial to anticipate consumer preferences and future trends, which could ensure solid sales growth. Also, it is important to realize, when particular models are less attractive and cut the production to avoid obsolete inventory. Over the last years Adidas, was able to meet consumer preferences in the main sectors, however, the continuing sales decrease in Europe could be a sign of different tastes than the company is offering.

Manufacturing. The production process of Adidas AG has a long lead time (the time between initiation and completion of a product): between 12 and 18 months, which makes it difficult to quickly respond to unexpected changes in customer preferences. This could lead to short-term sales loss. Also, the inventory orders are usually placed 9 months in advance, which can lead to similar consequences. In 2019 Q1 Adidas AG faced supplies shortage from Asia due to unexpectedly increased demand in North America.

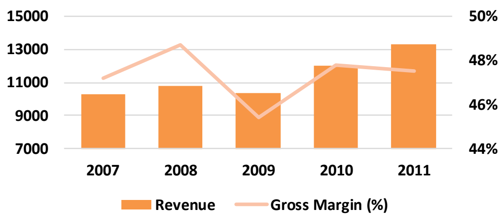
Competition. The direct competitors of Adidas AG are Nike, Puma and Under Armour. The main strategy of the company is to increase market share in North America, which requires significant investment in marketing. Currently, Adidas AG owns around 10% of the market in North America. However, failure to increase market share can lead to a revenue decrease.

Dependence on business partners. The main drivers of Adidas AG sales are the new campaigns with celebrities, sport associations and athletes. Since the contracts usually are long term, the reputation of well-known people has a significant impact on the company´s results (as with Kayne West). Also, injuries or poor performance of teams supported by Adidas could reduce the customer appeal to the brand, which can result in lower sales.

Macroeconomic events. US-China trade war has a direct impact on Adidas AG business activity. The main revenue-generating market is Asia-Pacific with the focus on Greater China. Adidas changed their manufacturing landscape in the last four years in order to diversify and to focus the Chinese production only to the national market. However, the normal U.S. consumer that buys footwear in the U.S. will be impacted since a great portion of the production is still being manufactured in China. The German sportswear maker does as much as 45% of its business in the U.S. and China, and if the two countries weaken their currencies in a competitive tussle then it will ultimately come to hurt Adidas's earnings when translated back into euros.

Coronavirus. If national quarantines stay for longer than expected, Adidas has to further delay the opening of its stores and warehouses, which deeply hurts their earnings. In addition, as long as restrictions remain, the economy will regress and a deep recession is almost inevitable, which ultimately decreases consumer spending in non-essential products, as the ones sold by Adidas, and the 2008 crises is an example of that. From 2009 to 2008 total Net Sales decreased -4% (Europe and North America -4% YoY), yet the company was able to substantially recover over the following two years, growing at a double-digit rate (Europe +12% and North America +19%, in 2020). By that time, Europe and North America accounted for 42% and 23% of total sales, respectfully. Taking 2008/2009 recession as an example, the company showed a strong capability of recovering fast, in terms of revenue, after a period of reduced consumer spending. Regarding the gross margin, in 2009, the percentage over sales decreased 3.3 p.p. to 45.4%, yet if consider only the first nine months of the year the decrease was even more severe - 4.4 p.p. -. The main reasons behind are to higher input costs (high-record raw material prices and significant wage costs pressures in 2008) currency devaluation effects (Russian rouble vs USD), higher clearance sales and promotional activity. Thus, if national restrictions persist, the gross margin can experience a similar drop once again.

Revenue (EUR mn)



Analyst:
João Calado, CFA

With the contribution of:
Francisco Fonseca

Research:
research@big.pt

Graph

Source: BiGlobal Trade (partner Saxo Bank); BiG Research

Analyst:
João Calado, CFA

With the contribution of:
Francisco Fonseca

Research:
research@big.pt

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Analyst:
João Calado, CFA

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Research:
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