
ELEVATION CAPITAL MANAGEMENT LIMITED:
ADIDAS AG [ADS:GR]



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ADIDAS: ADIDAS GROUP

adidas®
GROUP

adidas®

TaylorMade®

Reebok 

11% REVENUE*



2% REVENUE*



76% REVENUE*



9% REVENUE*

ROCKPORT

2% REVENUE*

ADIDAS: HISTORY

1924

The foundations of the Adidas brand were laid in Bavaria, Germany, during 1924, when Adi Dassler registered “Gebrüder Dassler Schuhfabrik”, the beginnings of the modern day Adidas. He set out to provide the highest quality athletic equipment, a market in its early stages of development.



1948

As a result of a bitter feud (which lasted until they both died), Adi and Rudi Dassler split the assets of the Company and founded Adidas and Ruda (which became Puma)

1995

Adidas went public on the Deutsche Börse stock exchange.

1997

Adidas acquired Salomon and its brands. With the acquisition of the Salomon Group and its brands TaylorMade, Mavic and Bonfire, the Company changed its name to Adidas-Salomon AG.



2004

Adidas ran one of its most memorable marketing campaigns, based around the slogan ‘Impossible is Nothing’.

2005

Adidas and Salomon would go their separate ways, when the latter and its brands (excluding TaylorMade) were sold to Amer Sports. Adidas acquired Reebok, including the brands Rockport and Reebok-CCM Hockey, and brought together two of the world’s most respected and best-known companies in the sporting goods industry.



2006

After selling off its Salomon brand, the Company was renamed Adidas AG.

2009

TaylorMade acquired the golf company Ashworth.



2011

Adidas acquired the outdoor specialist Five Ten.



2012

TaylorMade acquired the golf equipment company Adams Golf, a specialist in utility woods and beginners golf equipment.



ADIDAS: TOP SPORTS BRANDS

2014 Forbes Top 10 Sports Brands – Brand Value*

#1 Nike - \$19.0B

#2 ESPN - \$16.5B

#3 Adidas – \$5.8B

#4 Sky Sports - \$4.5B

#5 Under Armour - \$4.1B

#6 Reebok – Brand Value: \$880M

#7 YES Network - \$680M

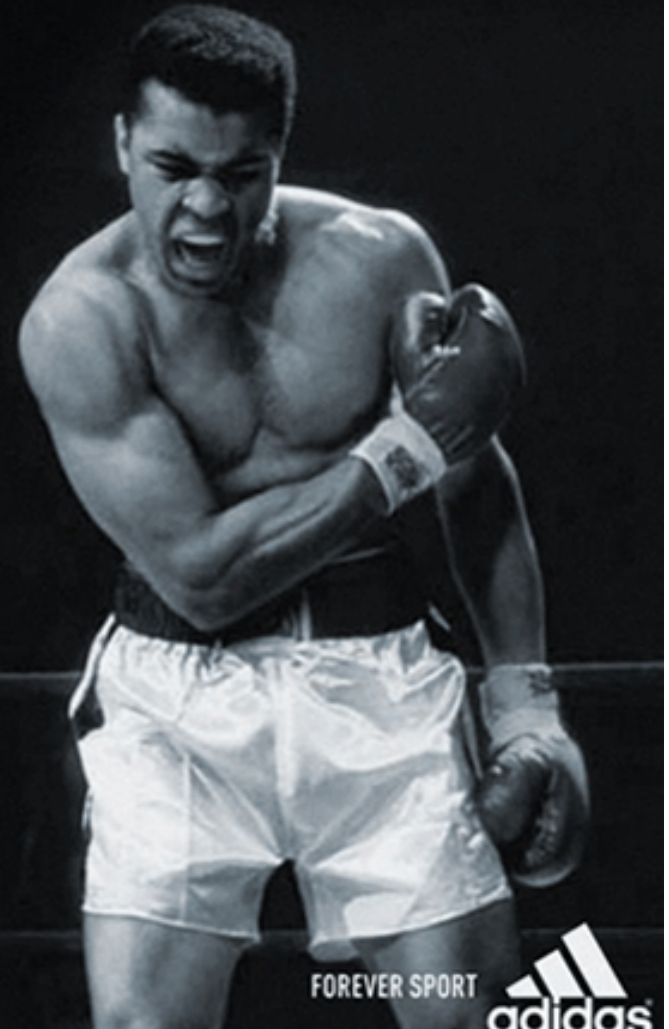
#8 NESN - \$525M

#9 Major League Baseball (MLBAM) – \$520M

#10 Ultimate Fighting Championship (UFC) - \$440M

IMPOSSIBLE IS JUST A BIG WORD THROWN AROUND BY SMALL MEN WHO FIND IT EASIER TO LIVE IN THE WORLD THEY'VE BEEN GIVEN THAN TO EXPLORE THE POWER THEY HAVE TO CHANGE IT. IMPOSSIBLE IS NOT A FACT. IT'S AN OPINION. IMPOSSIBLE IS NOT A DECLARATION. IT'S A DARE. IMPOSSIBLE IS POTENTIAL. IMPOSSIBLE IS TEMPORARY.

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FOREVER SPORT



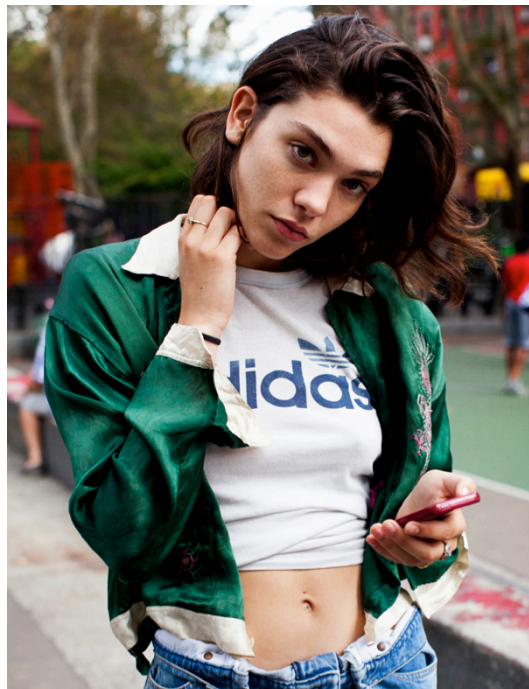
* [HTTP://WWW.FORBES.COM/PICTURES/MLM45FHKLG/FORBES-FAB-40-THE-MOST-VALUABLE-BUSINESS-BRANDS-IN-SPORTS/](http://www.forbes.com/pictures/mlm45fhklg/forbes-fab-40-the-most-valuable-business-brands-in-sports/)

ADIDAS: FASHION WORLD

More than any other sporting brand (that we are aware of) Adidas has developed extensive brand diffusion, increasing penetration to a wider audience and beyond the sports & fitness categories.

Adidas Originals has proven popular, with high profile marketing campaigns involving Katie Price, Pharrell Williams and Rita Ora.

In 2003, Adidas established a partnership with Japanese fashion designer Yohji Yamamoto to develop the Y-3 brand. It followed this up in 2004 with an agreement with British Fashion designer Stella McCartney having launched a joint venture line of women's fitness clothing.



stella mccartney

ADIDAS: FASHION WORLD (2)

DAY 6

MARC JACOBS



Susan Riley

@Susestylist



Marc Jacobs wears Adidas trackies for his final bow #likehisstyle #nyfw

2:57 PM - 14 Feb 2014

1 RETWEET



STYLIST.co.uk

FASHION WEEK BLOG

NYFW BLOG AW14: ADIDAS TRACKIES AT MARC JACOBS

STYLE.COM

The Year Adidas Popped

Marc Jacobs doesn't have his own Adidas collection, but he did give the brand a huge cosign when he wore these track pants to bow after his Fall 2014 show.

ADIDAS: MUSIC WORLD

A black and white portrait of Kanye West, looking directly at the camera with a serious expression. He has a short haircut and is wearing a thick, multi-strand chain necklace. The background is a light gray geometric shape. Two large Adidas logos are positioned on either side of his head, partially overlapping the background shape. The Adidas logo consists of three slanted stripes above the word 'adidas' in a bold, lowercase sans-serif font, with a registered trademark symbol (®) to the right.

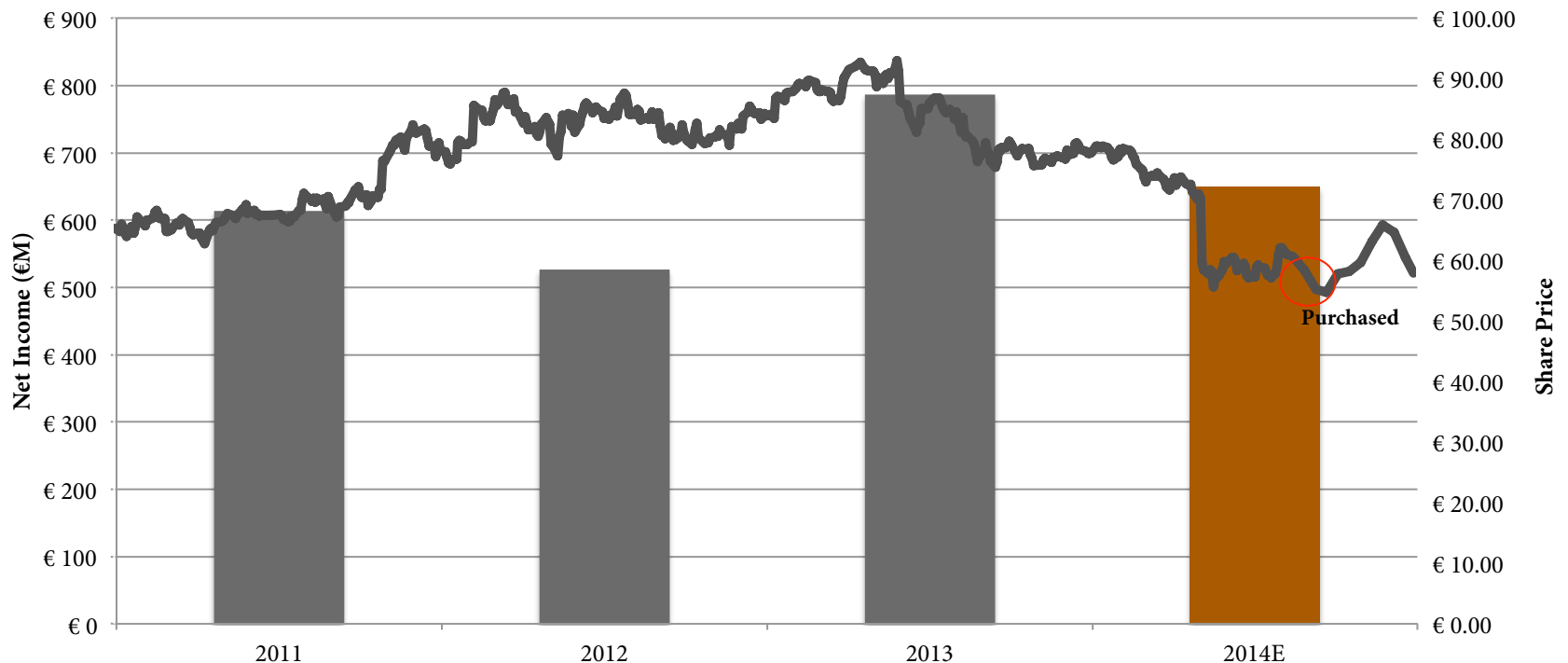
adidas[®]

adidas[®]

KANYE WEST x ADIDAS

ADIDAS: RECENT NEGATIVE HEADLINES PRESENT AN OPPORTUNITY

- Negative currency movements (-€450M impact to revenue year to date, as at 30 June 2014)
- Difficult trading conditions in the golf industry (18% sales decline for TaylorMade in FY2014 1H)
- Geopolitical risks in the Eastern European region (e.g., Russia), a region in which Adidas has invested heavily over the past two years
- Share price declined 40% from €92.92 (Market Cap = €19.4B) on 22/1/2014 to €55.5 (Market Cap = €11.6B) on 7/8/2014
- Share price as at 10/12/2014 = €57.80 (Market Cap = €12.1B)



ADIDAS: RUSSIAN MARKET EXPOSURE

- Russia is the most profitable region for Adidas as it is the most dominant player in Russia, with a ~60% market share
- The below infographic produced by the Company in 2011 shows its focus on the Russian market



ADIDAS: COMPARABLE COMPANIES

- Adidas is currently trading at a sizeable discount to its global peers:

VALUATION	P/E (TTM)	P/E (NTM)	PRICE / SALES	EV / EBITDA	PRICE / BV	DIV. YIELD
ASICS	29.7x	26.1x	1.5x	15.3x	3.0x	0.6%
Callaway Golf	45.3x	24.2x	0.6x	19.6x	1.9x	0.5%
Gerry Weber	20.0x	17.1x	1.6x	9.0x	3.0x	2.3%
Mizuno	24.4x	22.5x	0.4x	10.7x	0.8x	1.7%
Nike	29.3x	24.7x	2.6x	16.1x	6.5x	1.1%
Puma	32.6x	24.6x	0.9x	9.6x	1.6x	0.3%
Skechers	22.7x	17.2x	1.2x	9.9x	2.4x	0.0%
Under Armour	73.3x	57.7x	3.9x	27.9x	9.2x	0.0%
Adidas	18.8x	17.1x	0.8x	8.9x	2.0x	2.6%
Peer Group Median	29.5x	24.4x	1.4x	13.0x	2.7x	0.6%

ADIDAS: ADIDAS VS NIKE - TRADITIONAL METRICS

- Nike is more profitable – Higher ROE, ROA and Net Margins
- Adidas has a stronger position in a number of sports including golf, soccer, rugby, cricket and ice hockey
- Adidas is trading at a significant discount to Nike based on P/E, P/B, P/S and EV/EBITDA metrics, while supporting a higher dividend yield
- Adidas has considerable scope for a turnaround and/or divestments which should see a re-rating in time versus Nike

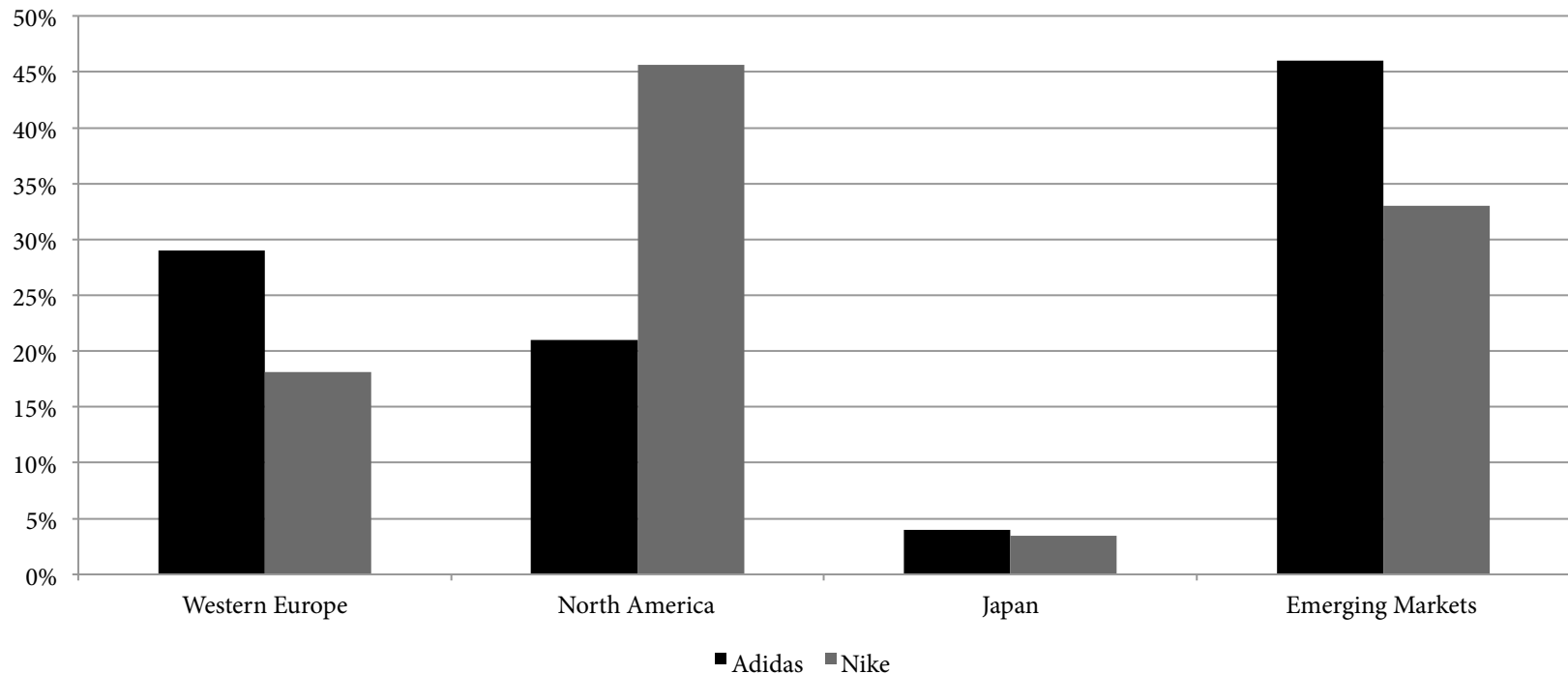


10.6%	ROE	25.7%
5.4%	ROA	15.9%
48.3%	Gross Margin (2013)	45.2%
4.3%	Net Margin (2013)	9.7%
7.0%	Revenue Growth (5Y CAGR)	7.9%
25.3%	Net Income Growth (5Y CAGR)	7.2%
21.0%	Debt / Equity	12.1%
18.8x	Price / Earnings (TTM)	29.3x
2.0x	Price / Book	6.5x
8.9x	EV / EBITDA	16.1x
2.6%	Dividend Yield	1.1%

ADIDAS: ADIDAS VS NIKE – MARKET EXPOSURES

- Adidas has a higher exposure to emerging markets which currently is a performance drag
- Political and economic uncertainty in Europe (especially Russia) also weighs on Adidas versus Nike
- As long-term investors, we prefer Adidas' higher exposure to the emerging market consumer

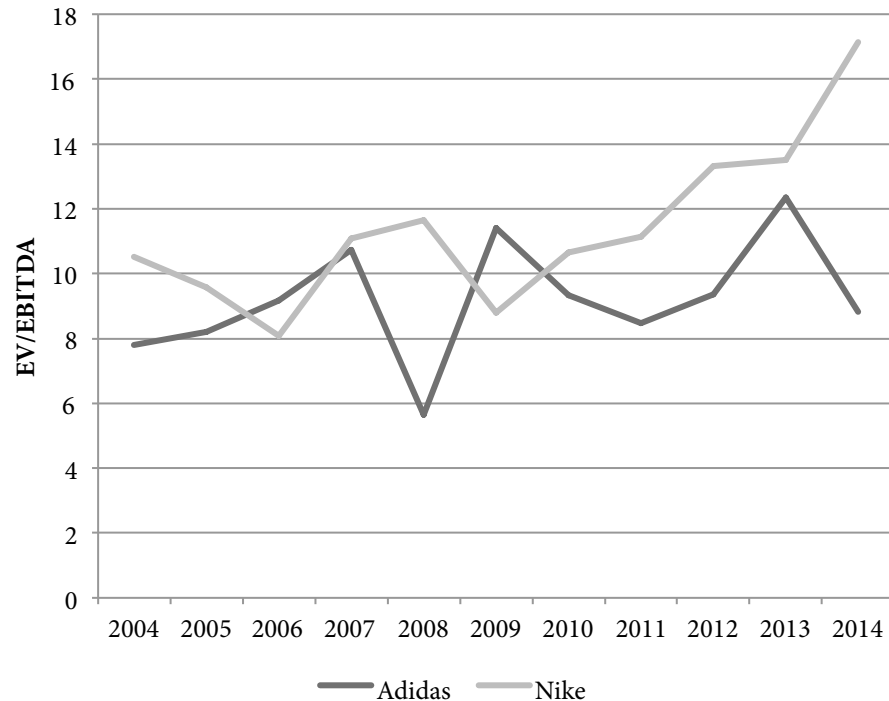
Adidas vs Nike – Revenue Breakdown by Region



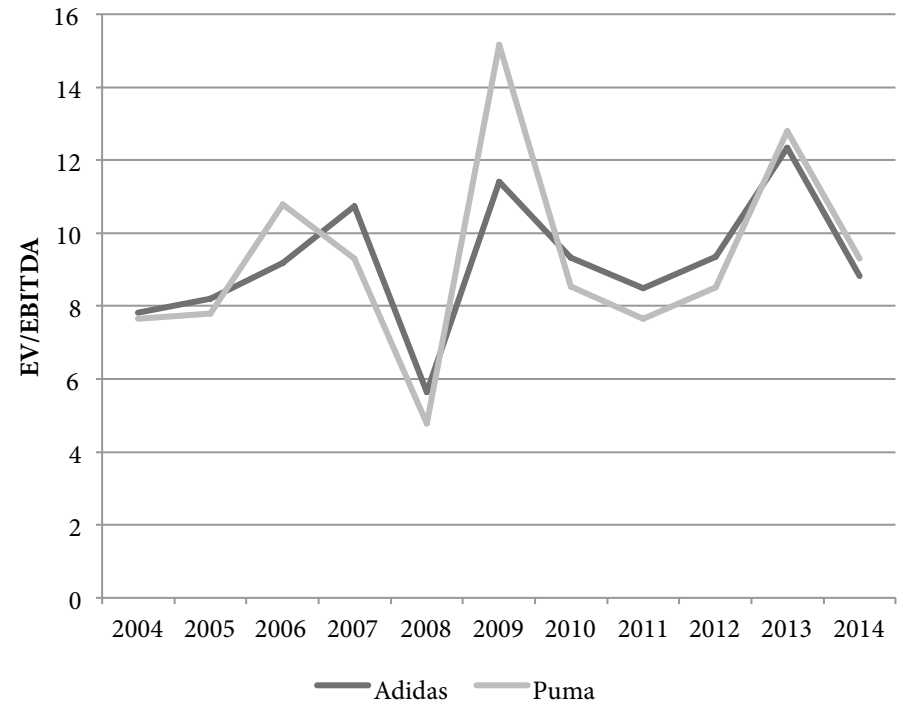
ADIDAS: ADIDAS VS NIKE VS PUMA – HISTORICAL EV/EBITDA ANALYSIS

- Adidas is cheaper than Nike and Puma based on historical EV/EBITDA spreads
- Adidas vs Nike – Over the last year, valuation multiples have diverged markedly. The valuation gap between Adidas and Nike is higher than the historical average
- Adidas vs Puma – Historically, Adidas has traded at a slight premium to Puma. Currently, it is trading at a slight discount

Adidas vs Nike - Historical EV/EBITDA*



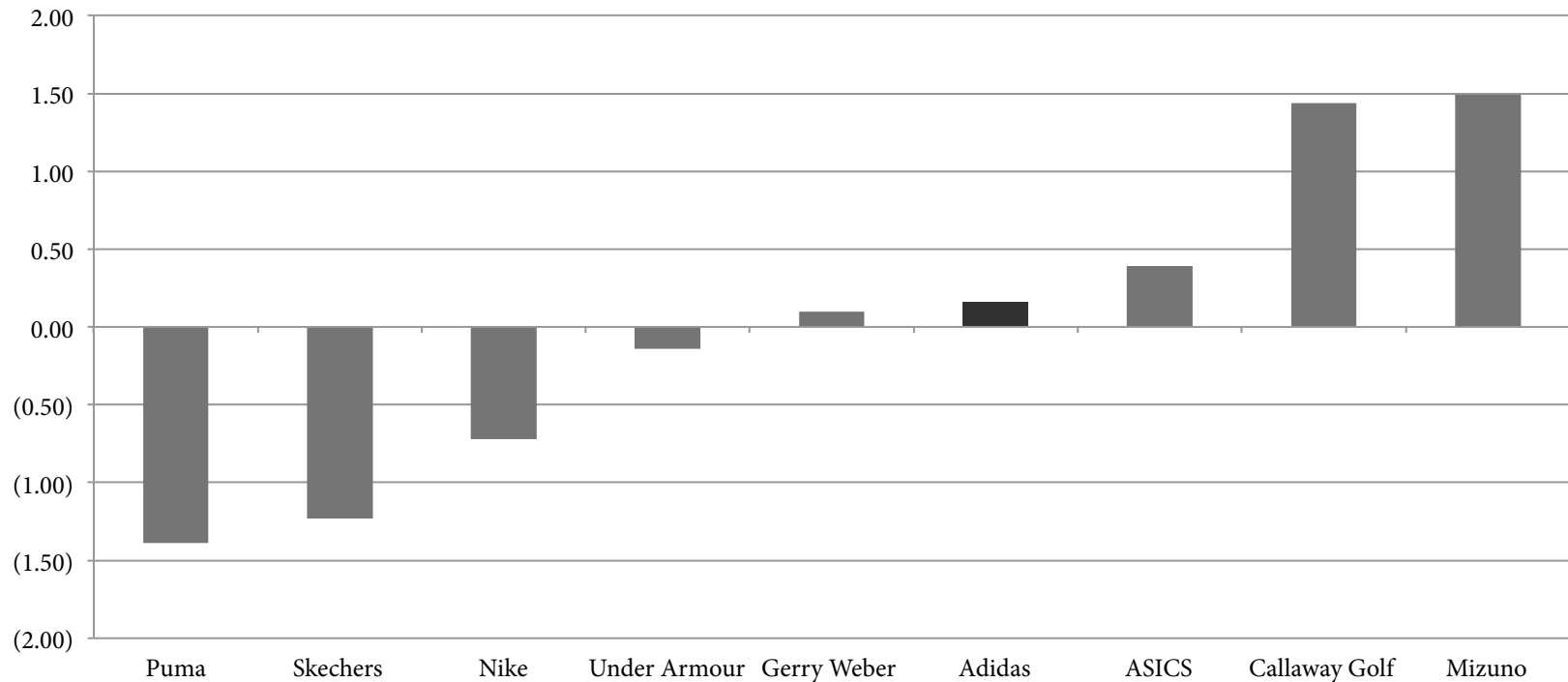
Adidas vs Puma - Historical EV/EBITDA*



ADIDAS: LEVERAGE

- The Company has higher financial leverage when compared to its peers* based on Net Debt / EBITDA ratio (0.16x)
- However, on an absolute basis, the Company's debt levels are conservative

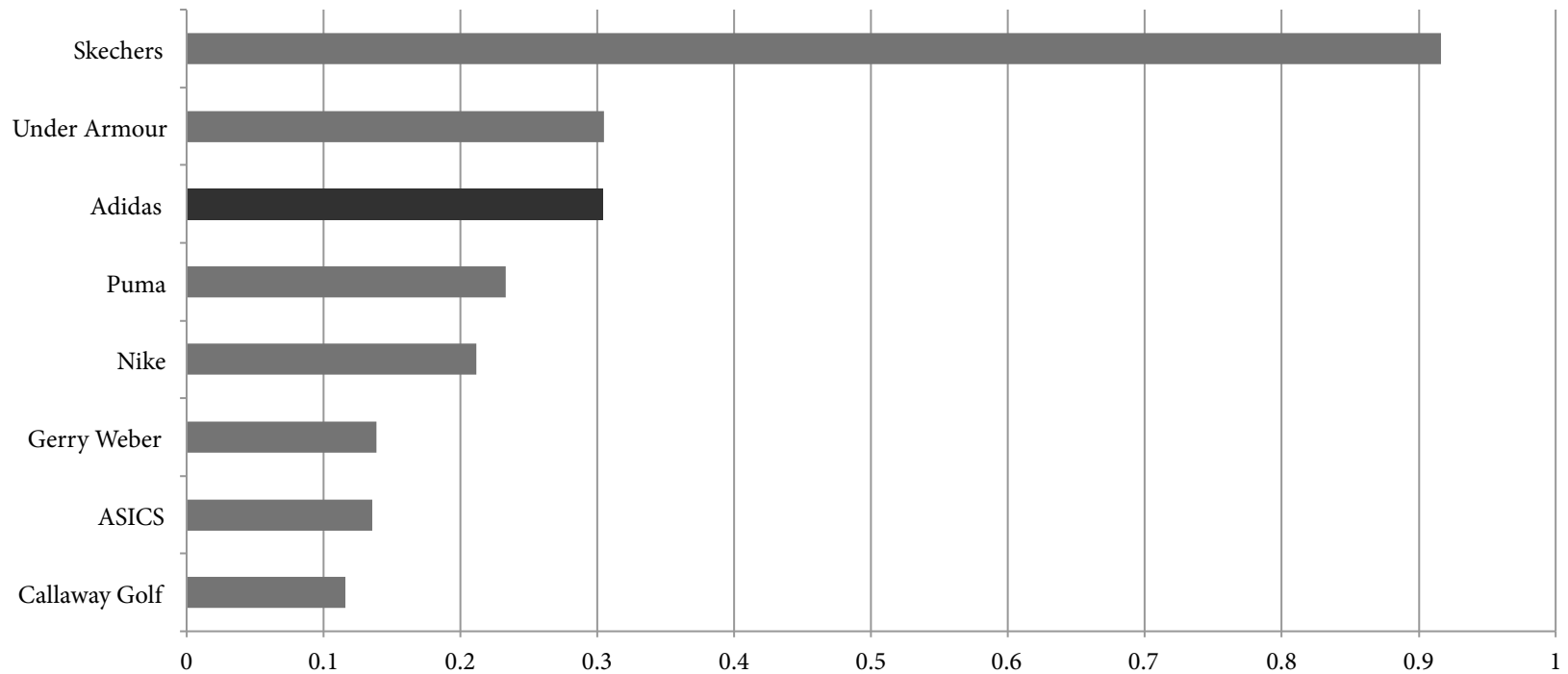
Adidas - Net Debt/EBITDA



ADIDAS: LEASE LIABILITIES

- The Company's financial position relative to lease liabilities is reasonable on an absolute basis

Adidas – Operating Lease/Equity

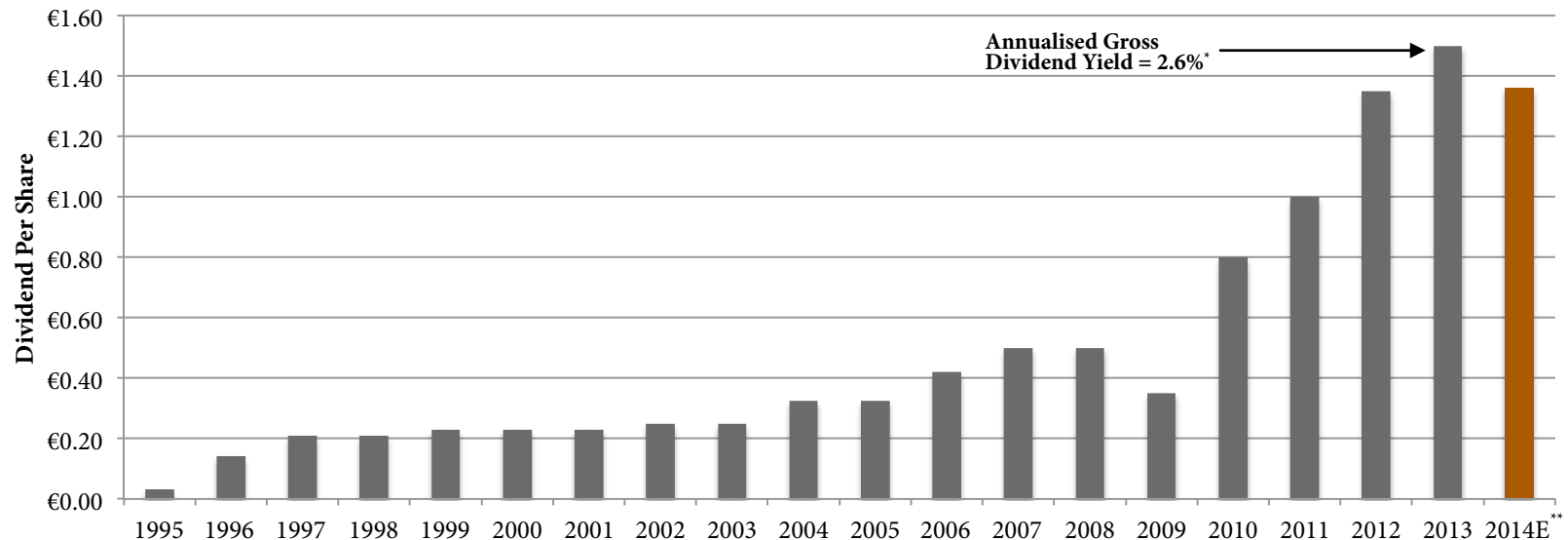


ADIDAS: DIVIDENDS

“In light of the strong generation of cash flow from operating activities in 2013, Management will recommend paying a dividend of € 1.50 to shareholders at the Annual General Meeting (AGM) on May 8, 2014... The proposal represents a payout ratio of 37.4% of net income attributable to shareholders excluding goodwill impairment losses, compared to 35.7% in the prior year. This complies with our dividend policy, according to which we intend to pay out between 20% and 40% of net income attributable to shareholders annually. Based on the number of shares outstanding at the end of 2013, the dividend payout will thus increase 11% to € 314 million”

Adidas 2013 Annual Report

Adidas – Dividend History



* AS AT 10/12/2014

** STARMINE ESTIMATE

ADIDAS: POSSIBLE INVESTOR ACTIVISM

- Recent press reports suggest that a group of hedge funds were seeking to acquire a stake in Adidas to pressure management for a break-up/spinoff of key brands
- These are exactly the reasons we became interested in Adidas and began to accumulate a position prior to this news

Adidas shares jump on report of hedge fund activism

Wed Sep 17, 2014 11:33am EDT

(Reuters) - Shares in sportswear maker Adidas ([ADSGn.DE](#)) jumped on Wednesday on a report that a group of [hedge funds](#) is seeking to buy a stake to pressure management to make sweeping changes, although one of the funds dismissed this.

Germany's manager magazine said hedge funds including Knight Vinke, Third Point and TCI were considering buying stake in the world's second-largest sportswear company, driving a 4 percent jump in its shares.

But Eric Knight, founder of activist fund Knight Vinke, poured cold water on the report: "We don't have a shareholding and it's not something we're following," Knight told Reuters.

Citing unnamed financial sources, the magazine said the funds would seek radical changes at Adidas, including the removal of Chief Executive Herbert Hainer and the possible spin off of fitness brand Reebok and golf label TaylorMade.

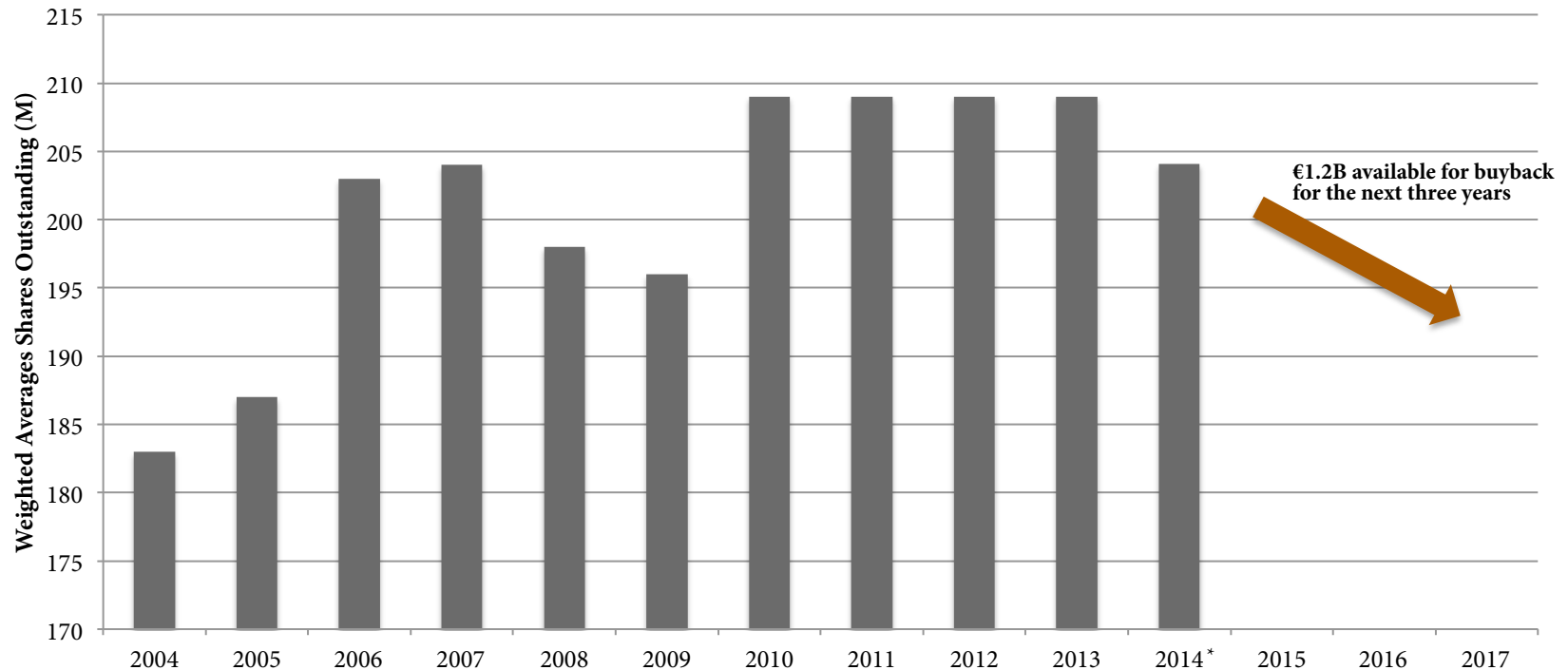
An Adidas spokeswoman declined to comment on the magazine report. But she also said: "We constantly conduct an open and constructive dialogue with investors."

TCI and Third Point declined to comment.

ADIDAS: SHARE BUYBACK - €1.2B STILL TO BUY...

- On 1 October 2014, Adidas announced a share buyback program of up to €1.5B to be undertaken over the next three years
- The first tranche of the share buyback program was commenced in November and so far 4.9M shares (2.34% of the 209M shares previously outstanding) have been bought back for ~€300M

Adidas - Weighted Average Shares Outstanding*



ADIDAS: POTENTIAL SPIN-OFFS/DIVESTMENTS

- Both Rockport and TaylorMade present opportunities for spin-offs/divestments. Adidas management have signalled that they are looking for buyers for Rockport and, based on our valuation we believe a price of €305M is achievable
- Management have not indicated that they are seeking to divest TaylorMade, however, we believe a spin-off or outright sale would realise value and allow for management to focus on the core business



Date	Acquirer	Target	Price	Price/Sales
2012	TaylorMade	Adams Golf	US\$89M	0.8x
2011	Fila Korea	Acushnet	US\$1.2B	1.0x
2011	Adams Golf	Yes	US\$1.7M	0.7x
2010	Puma	Cobra	US\$140M	0.7x
Average:				0.8x
Implied Value				€1.1B

ROCKPORT

Date	Acquirer	Target	Price	Price/Sales
June 2011	VF Corp	Timberland	US\$2B	1.40x
April 2014	DSW	Town Shoes	US\$62M	0.23x
May 2004	Quiksilver	DC Shoes	US\$87M	0.87x
July 2003	Nike	Converse	US\$305M	1.49x
Average:				1.00x
Median				1.13x
Implied Value				€305M

ADIDAS: RECENT DEVELOPMENT: REEBOK DIVESTMENT OPPORTUNITY?

POTENTIAL OFFER FOR REEBOK

- Soon after the release of our initial Adidas presentation in September, a consortium of investors from Abu Dhabi and Hong Kong were speculated to have made an offer of US\$2.20B (€1.70B) for Reebok
- We value Reebok at €2.50B and see this initial offer as a positive development which may yield an increased offer and a chance for Adidas to divest an asset which has been troubled since it was acquired in 2006

Reebok + Reebok CCM	
% of Adidas Total Revenue	12.70%
2014 Revenue Estimate*	€1,970.5M
Average Peer Group Price/Sales Ratio	1.95x
35% Discount to Peer Group P/S	1.27x
Implied Value for Reebok + Reebok CCM	€2,497.7M

BBC News Sport Weather

NEWS BUSINESS

20 October 2014 Last updated at 12:14

Adidas shares up on Reebok bid speculation

Shares in sportswear giant Adidas rose 6% in early trading after a report said a group of investors was considering a bid for the company's Reebok brand.

The Wall Street Journal said Hong Kong's Jynwel Capital and investment funds in Abu Dhabi were considering an offer worth \$2.2bn (£1.36bn).

The news provided a welcome boost for the German company's flagging share price, down about 40% this year.

Adidas bought US-based Reebok in 2006, but has struggled to boost sales.

ADIDAS: ELEVATION CAPITAL VALUATION RANGE

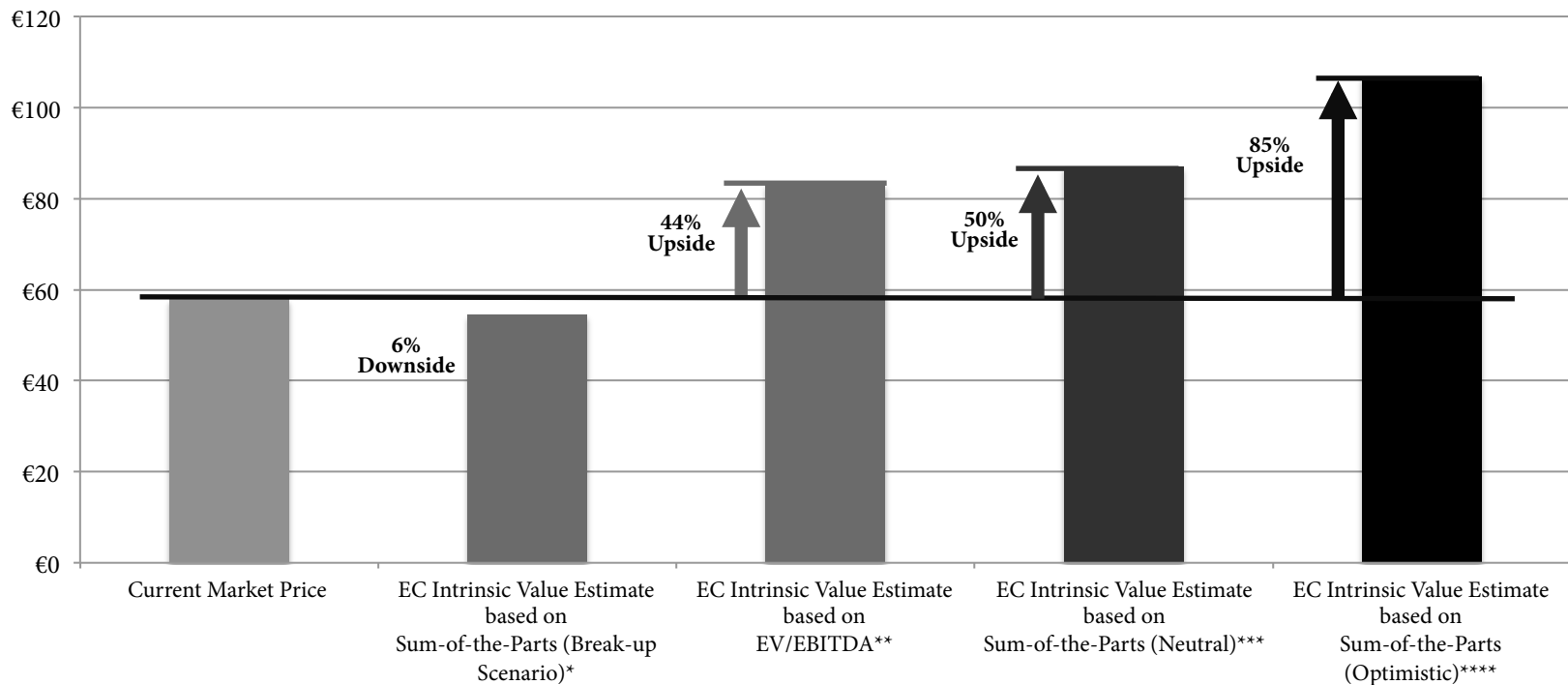
Elevation Capital Estimated Intrinsic Value Range:

€54.52 - €106.86 PER SHARE

Upside Potential Range:

+44% - +85%

Valuation Summary



SHARE PRICE AS AT 10 DECEMBER 2014

* REFER SOTP (BREAK-UP SCENARIO) SLIDE

** BASED ON PEER GROUP AVERAGE EV/EBITDA MULTIPLE

*** BASED ON 25% DISCOUNT TO PEER GROUP AVERAGE P/S MULTIPLE APPLIED TO ADIDAS AND 35% DISCOUNT TO PEER GROUP AVERAGE P/S MULTIPLE TO REEBOK BRANDS, AND AVERAGE INDUSTRY TRANSACTION P/S MULTIPLES APPLIED TO TAYLORMADE AND ROCKPORT

**** BASED ON PEER GROUP AVERAGE P/S MULTIPLE APPLIED TO ADIDAS AND REEBOK BRANDS, AND AVERAGE INDUSTRY TRANSACTION P/S MULTIPLES APPLIED TO TAYLORMADE AND ROCKPORT

ADIDAS: SUM-OF-THE-PARTS (BREAK-UP SCENARIO)

- Below we present a conservative scenario in which the Company is broken up at what we consider to be low industry multiples
- Adidas currently trades at 0.8x revenue, which we discount to 0.75x to generate a base-case value for the Adidas brand
- We value Reebok based on a speculated offer price of €1.7B
- TaylorMade's valuation is based on the multiple paid for Cobra Golf by Puma in 2010. This was the lowest multiple paid for a major golf brand in recent years, clearly a conservative assumption given TaylorMade's position as a market leader
- We believe that our conservative break-up scenario valuation, while unlikely in its entirety, highlights the value on offer in Adidas at current prices

Segment	Revenue	Valuation Multiple (P/S)	Valuation	Notes
Adidas	€11,722M	0.75x	€8,791.5M	Below current P/S multiple at which Adidas currently trades (2 nd lowest in peer group)
Reebok	€1,970M	0.86x	€1,700M	Valuation based on recent rumored first offer by PE buyers
TaylorMade	€1,362M	0.7x	€953.5M	Based on multiple paid by Puma for Cobra Golf
Rockport	€306M	0.99x	€305M	Based on reported value at which Adidas is considering selling
Estimated Base Case Equity Value:			€11,750M	
Break-Up Scenario Equity Value Per Share:			€54.52	

ADIDAS: KEY RISKS

CURRENCY/GEOPOLITICAL RISKS:

Thus far during FY2014 geopolitical developments and the associated depreciation of currencies have been the most significant source of risk faced by Adidas. The decline of the Russian Ruble (largely the result of the escalating situation in Ukraine) has been a driving force in the downward pressure on Adidas' share price.

DECLINING MARKETS:

The golf market, particularly in the US, has seen a decline in the number of people playing golf and joining golf clubs as members. This change in the outlook for the golf industry has impacted the performance of TaylorMade, one of Adidas' key brands.

COUNTERFEIT RISKS:

The risk of sales being impacted by counterfeit goods, particularly in Asian markets. Adidas products have been susceptible to counterfeit operators in the past.

COMPETITION RISKS:

The increased competitive pressure in the industry recently has been driven by the continued success of the Nike brand and the increased prominence of Under Armour.



ADIDAS: KEY RISKS - CONTINUED

INTEREST RATE RISKS:

Adidas has sought to insulate itself from interest rate risk by issuing convertible bonds with low interest rates. However, they also raise debt capital in the short-term money market by issuing short maturity zero coupon bonds/notes. A sudden upturn in interest rates would increase Adidas' cost of capital substantially relative to companies which have borrowed long.

EMERGING MARKET RISKS:

There are assorted risks in emerging markets which are not present in developed countries. Adidas' recent expansion in Russia and Eastern Europe has seen the realisation of emerging market risks, as uncertainty and political instability have led to a sharp downturn in expectations despite high levels of investment.

LABOUR RISKS:

Reputational risk to Adidas is present in terms of Corporate Social Responsibility. In the past there have been claims that Adidas has utilised child labour. The last such substantiated claim was made in 2000, relating to two factories in Indonesia and publicised in an article in the UK Observer. However, we are satisfied that since this time, Adidas have implemented significant protocols to ensure a certain standard of working conditions and pay for workers globally.



ADIDAS: CONCLUSION (1)

STRONG BRAND

- Adidas is the second most popular sportswear brand on earth
- Brand diffusion, through Adidas Originals (among others), ensures growth in brand awareness as well as a diversification of income streams

DOMINANCE IN SPORT

- Adidas has held a dominant position in soccer/football for decades. However, we like their continued growth into other key sports, for instance cricket in India and basketball (a sport popular in the US as well as the Eastern European markets) into which the Adidas brand has expanded/extended

POTENTIAL SPIN-OFFS / DIVESTMENTS

- We anticipate that the intended spin-off or sale of Rockport will realise ~€300M (€1.43 per share)
- We also believe that Adidas may serve shareholders well by spinning off the TaylorMade brand. This would, based on our calculations, generate ~€1.09B for shareholders (€5.21 per share)
- The speculated US\$2.1B/€1.7B offer for Reebok by a consortium of investors also suggests possible value realisation for shareholders in the near future (€8.33 per share)



Reebok

TaylorMade



Adams



ROCKPORT

CCM



ADIDAS: CONCLUSION (2)

WHAT IF THE STATUS QUO PREVAILS?

- It's easy to value stocks based on the premise that management will take action which will result in optimal outcomes for shareholders. In the case of Adidas this would be a consolidation of the business involving the spin-off/sale of non-core brands and a renewed focus on the core Adidas brand. But, all too often management doesn't implement the necessary changes. We always ask ourselves "what if the management continues to kick the can down the road and the status quo prevails?"
- In that case Adidas is still cheap. We have assessed not only the possibility that businesses are spun-off or the Company finds strategic buyers for non-core businesses, but also the possibility that the business stays together and continues to operate as is. In this case we continue to believe the business is fundamentally cheap at these levels

SIZEABLE DISCOUNT TO INTRINSIC VALUE

- We estimate Adidas is trading at 31% - 46% discount to our intrinsic value estimates*, presenting an estimated +44% - +85% upside from the current stock price



Reebok 

 TaylorMade



Adidas



ROCKPORT

CCM



ADIDAS: CONCLUSION (3)

FAVOURABLE RISK/REWARD PROPOSITION AT CURRENT PRICES

- Adidas' earnings have been negatively impacted by geopolitical and macroeconomic events over the past six months. In the first six months of FY2014, over €100M of operating profit has been wiped off the Income Statement due to currency volatility. Although we are not naive to the risks inherent in currency movements, we do anticipate that the events which have beset Adidas' share price are short term in nature, and that Adidas remains a sound long-term investment prospect
- We view Adidas' current situation as fluid. Several potential factors such as the prospect of shareholder activism, possible spin-off/divestment opportunities and Management's aggressive turnaround effort (e.g., recent poaching of three of Nike's top designers) all suggest a more favourable risk/reward proposition at current prices. In the meantime, the stock is trading close to our conservative break-up value, suggesting limited downside risk. Lastly, existing investors are paid to wait with a dividend yield that leads the industry



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'INDEPENDENT THINKING – DISCIPLINED INVESTING'

INDEPENDENT THINKING

[In-de-pend-ent Think-ing] **ində'pendənt THiNkiNG** *verb*

Is essential to long-term investment success. We are often contrarian and do not pay attention to index compositions when making investment decisions. We believe that when you're several thousand miles away from Wall Street in a different nation, it's easier to be independent and buy the things that other people are selling, and sell the things that other people are buying. We also believe that cash is sometimes the most attractive investment.

DISCIPLINED INVESTING

[Dis-ci-plined In-vest-ing] **disciplinəd inves'ting** *verb*

The market presents opportunities every day, but disciplined investing is as much about the opportunities you do not take. Our investments are premised on the concept of "Margin of Safety" which we believe reduces risk.