It's faced lockdowns, recession and Kanye West – but Adidas can overcome all these setbacks

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The shares have halved in the face of these challenges but a company built on 'craftsmanship, quality, performance and innovation' can recover

The worlds of share-tipping and rappers rarely meet, thank goodness, but the antics of one American practitioner of this musical genre have had a profound effect on the fortunes of this week's listed company.

Kanye West, almost as famous for being the former husband of Kim Kardashian, the reality TV star, as he is for works such as *Stronger* and *Gold Digger*, until recently had a highly lucrative partnership with Adidas, the trainers and sportswear company. But Adidas dropped him after a scandal over his antisemitic comments and scrapped their joint brand, Yeezy.

"Yeezy had been phenomenally successful – it accounted for 8pc of Adidas's sales but, thanks to very high margins, about 20pc of its profits," says Jarrod Cahn, who recently added the German-listed stock to his Credo Global Equity fund. "So the end of the relationship with Kanye West really hit the shares."

Cahn describes himself as a "value" investor who likes to buy companies shunned by other investors. And there are, he says, plenty of reasons to shun Adidas at the moment, not just the Kanye West debacle.

He rattles off the list: shortages of stock in the earlier stages of the pandemic when factories were closed; a "bullwhip" effect as an overreaction to those shortages led to excess stock and discounting; the Ukraine war, which caused the company to withdraw from Russia; the cost-of-living crisis enveloping Europe and the feared recession, both of which could cause hard-up consumers to rein in spending on non-essentials such as trainers; and the lockdowns and economic disruption in China, which he describes as a "debilitating headwind" for the company's operations there.

But Cahn says Adidas is a company built on solid foundations of "craftsmanship, quality, performance and innovation" and over an investment horizon of three to five years will be able to put all these problems behind it.

"Fundamentally we think it's a brilliant business," he says. "Its products are very desirable and its geographic reach is significant. The supply chain is normalising, consumer spending has held up well – witness recent results from British retailers – and customers, especially younger ones, will still spend money on trainers, while China has reopened its economy – and the country is a massive growth engine for the company." It has also dealt with the Kanye West issue, he adds, and has the opportunity to establish new partnerships with other "influencers".

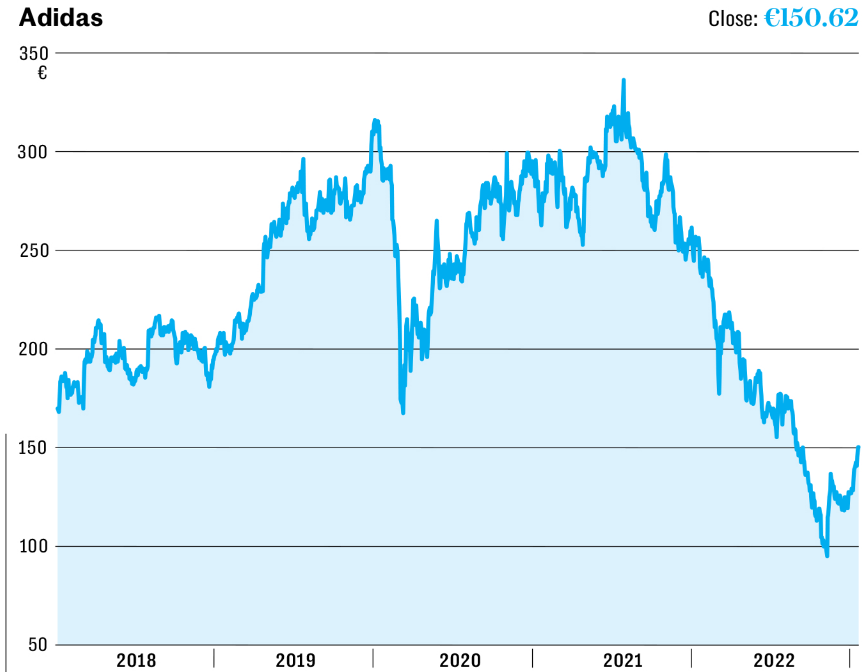
It also has a highly regarded new boss in Bjørn Gulden, who previously ran Adidas's arch-rival Puma (the two companies were founded by brothers who fell out at Adidas's predecessor company, Dassler Brothers, after the Second World War).

While Adidas shares have halved from recent highs the stock does not at first sight look cheap if you judge by its price-to-earnings ratio. But all those headwinds have compressed margins to just 2pc and they have the scope to recover to 8pc, Cahn says.

He describes the company as second only to Nike in the growing niche of "athleisurewear" – trainers and sportswear worn all day – and well placed to benefit from the shift from selling in shops to interacting directly with customers online. He says: "We think over the next three years there is far more scope for gains than losses – we expect the shares to recover to significantly higher levels."

Questor says: buy
Ticker: ETR: ADS
Share price at close: €150.62

Adidas
BUY
The company is well placed to benefit from the boom in 'athleisurewear'



Key numbers

◆ **Market value:** €27bn
◆ **Turnover (Dec 2021):** €21.2bn
◆ **Pre-tax profits (Dec 2021):** €1.9bn
◆ **Yield (Dec 2021):** 2.2pc
◆ **Most recent year's dividend:** €3.30
◆ **Net debt:** €1.1bn
◆ **Return on capital (Dec 2021):** 12.5pc
◆ **Cash conversion ratio (Dec 2021):** 165pc
◆ **p/e ratio (Dec 2021):** 20.2

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Update: Polarean
We tipped this maker of high-resolution lung scanners in June 2021 but delays in obtaining regulatory approval becalmed the shares. Finally though America's Food & Drug Administration gave the green light just before Christmas.

One investor says: "It was approved for use in patients aged 12 upwards, while it had been anticipated for use with adults.

"This clearly increases the addressable market, and chronic lung disease affects almost 37 million people in the US alone.

"Now it is all about commercialisation – selling as many machines as possible while at the same time driving consumables sales (the 'razor blade' model). The plan is to target the top 100 pulmonary medical centres initially. A busy year of execution ahead but now all within its control with FDA approval behind it." Hold.

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