JD SPORTS / FOOTASYLUM

PARTIES' OPENING SUBMISSION OF REMITTAL

SUBMITTED ON BEHALF OF JD SPORTS FASHION PLC

& FOOTASYLUM LIMITED

30 APRIL 2021

JD SPORTS FASHION PLC / FOOTASYLUM LIMITED
PARTIES' OPENING SUBMISSION ON REMITTAL

A. <u>INTRODUCTION AND EXECUTIVE SUMMARY</u>

1. This is the initial submission of JD Sports Fashion plc ("**JD Sports**") and Footasylum Limited ("**Footasylum**") (together "**the Parties**") on the remittal.

2. As the CMA is aware, prior to the pandemic, the structure of supply of sports-inspired casual footwear and apparel was unusual for a UK retail market. First, the Parties depend on two global brands, Nike and adidas, for the vast majority (around **[✄]**%) of their respective footwear sales (less so for apparel). Second, these brands decide on respective "**allocations**" to various retailers, deciding exactly how many units to supply of, most notably, their most desirable product lines or "franchises". The brands also reserve certain lines to themselves. Third, at the same time, the two critical suppliers compete directly via their "Direct to Consumer" (**DTC**) propositions with the Parties and all other retail rivals that sit in the brands' so-called "wholesale channel". Online sales accounted for a substantial proportion albeit not a majority of overall UK multi-channel (store and online) consumer spending.

3. In this context, the COVID-19 pandemic[1] has caused a very substantial acceleration of three overlapping competitive forces:[2]

   (a) **Digital** or e-commerce growth – where customers either purchase online or there is a digital component or online driver to a sale in store, e.g. because the customer identified the product on their smartphone (or desktop) but bought in store;

   (b) **DTC** growth – a significant increase in Nike and adidas' pandemic-period sales and a step-change in their publicly-announced post-pandemic strategy (linked

[1] Non-essential retail stores have been closed during the following periods as a result of the COVID-19 pandemic: 23 March to 15 June 2020; 5 November to 2 December 2020; and 19 December 2020 to 12 April 2021 (in England); 23 March to 22 June 2020; 23 October to 9 November 2020; 19 December 2020 to 12 April 2021 (in Wales); and 28 March to 10 June 2020; 27 November to 11 December 2020; 26 December 2020 to 30 April 2021 (in Northern Ireland); 4 April to 29 June 2020; 19 December 2020 to 26 April 2021 (in Scotland). The pandemic has also affected customers' shopping and other social behaviour both generally and as a result of social distancing requirements.

[2] See *JD Sports Fashion plc v. Competition and Markets Authority* [2020] CAT 24 at [248].

to the growth in digital);

(c) **Disintermediation** – a rise in progressive disintermediation made public by the brands where, linked to their confidence in the growing DTC share of access to consumers, Nike and adidas cut out the "middleman" by dropping, or allocating less stock to, those less important third party retailers who do not offer the brands sufficient incremental value to reach new customers. At a time when, as DTC's share progressively expands, the wholesale channel's share of total sales progressively declines.

4. The three market dynamics above – DTC, disintermediation and digital – are changing the market fundamentally and the evidence presented in this submission shows that they will continue to do so over the next few years (and beyond).[3] In summary, a predominant store-based "wholesale channel" market, with a large number third-party retailers, is undergoing a fundamental shift in balance towards to a highly digitised DTC-driven market, with fewer chosen third-party retail partners thriving, or surviving.

5. Given the role of the brands in determining product allocation for themselves (DTC) and among wholesale channel retailers, the structure of this submission first considers the step change in DTC strategy, then disintermediation, and then the digital shift more broadly.

(i) DTC

6. As public companies, Nike and adidas have both announced to investors how they have altered their strategies to focus on further accelerating digitally-inspired DTC growth following the COVID-19 pandemic. They have an incentive to do so because DTC sales are significantly more profitable, and increasingly have the ability to do so because of the growth in digital, which facilitates a direct emotional engagement, and retained commercial relationship, between brand and consumer.

7. In terms of results, Nike and adidas have both enjoyed fast multi-billion-dollar growth in their DTC sales during the COVID-19 pandemic and have accelerated their strategies to capitalise on and reinforce future growth:

[3] See fn. 32 below for discussion of the relevant time horizon.

(a) **Nike's DTC sales grew by 6.5pp in the pandemic.** In its FY to 31 May 2019, prior to the COVID-19 pandemic, 31.5% of Nike's global[4] sales were DTC.[5] This figure rose by 6.5 percentage points to ~38% in Q2 and Q3 FY to 31 May 2021. Nike's sales in the financial year to 31 May 2020 of over $37 billion and an annualised run-rate of 38% DTC translates into more than $14 billion in total DTC sales per year.[6]

(b) **adidas's DTC sales grew by 8pp in the pandemic, a 2-3 year acceleration, with a new 50% target.** In its FY to 31 December 2019, 33% of adidas's global sales were DTC.[7] This rose by 8 percentage points to 41% in FY to 31 December 2020, a period that significantly overlapped with the COVID-19 pandemic.[8] Given adidas' total sales of €19.8 billion, and an annualised run-rate of 41%, this translates to €8.1 billion in DTC sales per year.[9] adidas's CFO, Harm Ohlmeyer, considers that the COVID-19 pandemic had accelerated DTC by two to three years.[10] adidas's "*Own the Game*" strategy announced on 10 March 2021 involves a "*business model change … from a wholesale-driven business model to a DTC-led business model*".[11] It aims to increase considerably the proportion of global sales that are DTC to 50% by 2025.[12]

8. Nike and adidas describe their incentives to increase DTC sales arising because they: (a) earn higher gross margins,[13] as there is no need for third-party retailers to take a cut; (b)

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4 Nike and adidas do not publish DTC or digital data that is specific to the UK, but (i) the long closures of non-essential retail in the UK suggest that DTC grew more significantly in the UK than globally; and (ii) as the UK is amongst the more digitally advanced of European countries, it is likely that the UK will outperform the targets set by Nike and adidas for their global DTC growth.

5 See Note 16 on p. 148 of Nike's 2019 Annual Report. The figure is calculated as 100 * (12,306m / 39,117m). In FY to 31 May 2020, this figure increased to 34.7% (see Note 16 on p. 90 of Nike's 2020 Form 10K (Annex 293)), but this period included the initial phases of the COVID-19 pandemic.

6 See Table 1 below.

7 See adidas Annual Report, 2020 (Annex 190), p. 80 (giving prior year data).

8 See adidas Annual Report, 2020 (Annex 190), p. 80.

9 See Table 2 below.

10 See transcript of Q2FY20 earnings call from Seeking Alpha, "Adidas AG (ADDYY) CEO Kasper Rorsted on Q2 2020 Results - Earnings Call Transcript", 06 August 2020 (Annex 195), p. 16.

11 See the adidas Investor & Media Day slide pack, 10 March 2021 (Annex 193) ("**the adidas Slide Pack**"), slides 157 and 164. All emphasis in quotes in this submission is by the Parties unless it is expressly stated to be in the original.

12 See the adidas Slide Pack, slides 153, 156, 170 and 177 and the accompanying press release "Adidas presents growth strategy 'Own the Game' until 2025", 10 March 2021 (Annex 189) ("**the adidas Growth Strategy release**").

13 See the adidas Slide Pack, slide 157 and Nike's Q3FY21 earnings call (Annex 262), pp. 6-7. On 25 June 2020, in its Q4FY20 earnings call (Annex 281), pp. 9-10, Matt Friend, Nike CFO explained why the economics of digital sales are attractive to Nike: "*On average, a sale of an incremental unit via digital*

build "*increasingly direct and personalised connections with consumers*",[14] which in particular reduces customer acquisition costs and makes repeat customers more likely;[15] and (c) improve their understanding of customer behaviour supporting the use of "*advanced analytics*",[16] which in particular reduces customer acquisition, retention, and inventory costs. The brands' ability to achieve strong growth in DTC, and to be confident publicly to investors about its upward trajectory over the next several years, is derived in large part from the shift to digital, which is addressed in more detail in point (iii) below.

(ii) Disintermediation

9. For Nike and adidas, selling via third party retailers results in lower gross margins, a weaker relationship with consumers and less understanding of consumer behaviour (i.e. the converse of all of the drivers to increased DTC described in paragraph 8 above).

10. In a world where DTC is expanding rapidly, the brands have less need for third-party retailers, their allocations will support fewer retailers, and the number of such occupants in the wholesale channel will be reduced.[17]

11. Nike and adidas are therefore both in an ongoing process of dropping less important retailers that offer them less added value:

(a) Nike's strategy is to "*restructure the wholesale marketplace*",[18] increasingly leaving behind "*undifferentiated retail*".[19] This reflects a strategic change as Nike has "*shifted from a* <u>*legacy wholesale*</u> *distribution model*."[20]

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generates <u>*double the revenue versus a sale to wholesale, with a higher gross margin, translating into two times the operating income dollars*</u>."

14 Nike's Q3FY21 earnings call (Annex 262), p. 6 and adidas's Annual Report, 2020 (Annex 190), p. 80 ("*Selling directly to the consumer is beneficial to our top- and bottom- line and delivers deep consumer insights*.").

15 Nike's Q2FY21 earnings call (Annex 282), p. 19 (Matt Friend, Nike CFO, explained: "*We know who those customers are, and we have the ability to react and reengage them at a lower-cost to us or a lower acquisition cost*").

16 See the adidas Slide Pack slides 134 ("*DTC business provides a wealth of consumer data*"), 135 (describing the value of data & analytics) and 164 ("*valuable customer insights*") and Nike's Q3FY21 earnings call (Annex 262), p. 6, referring to current usage in North America.

17 In addition, the brands benefit from costs savings in managing fewer wholesale accounts. For example, fewer accounts to manage means the brands require less individuals to manage those accounts which reduces the brands' costs.

18 See Nike's Q3FY21 earnings call of 18 March 2021 (Annex 262), p. 6.

19 Although in competition law terminology all retail markets and retailers within them are "differentiated", in these markets, the Parties believe that "differentiation" as used by Nike in this context means a combination of distinctive retail proposition and/or elevation, while an offer that lacks sufficient distinction/elevation is referred to as "undifferentiated". The latter class of retailer offers less and less (or indeed no) "value add" to the brand (at all).

20 Nike's Q4FY20 earnings call (Annex 281), p. 5, per John Donahoe, CEO.

(b) As noted above, adidas's "*Own the Game*" strategy announced on 10 March 2021 involves a "*business model change ... from a wholesale-driven business model to a DTC-led business model*".[21] adidas's wholesale strategy is to "*Focus on alliance partners*" with "*Stronger integration with key influencer accounts*", to operate "*Fewer direct accounts*".[22] adidas is explicit that it will prioritise e-commerce and its own retail experience.[23]

12. This shift in DTC's favour will be at the expense of third-party retailers. In choosing third party retail partners, the brands are favouring those with global coverage and a presence in key cities (with the ultimate goal of reducing the brands' costs to serve these markets by cutting the number of third party retailers accounts they have to manage).

13. Nike and adidas are also extending their control over the remaining retailers in the following ways: (i) by demanding that retailers share increasing amounts of purchase/customer data;[24] (ii) by adding QR codes to the products sold within retailers' stores (which allow customers to purchase directly from the brands' website from within retailers' stores);[25] and (iii) through their connected inventory (or Anatwine) solutions which allows the brands to make direct sales with customers through third-party retailers' websites.

(iii) Digital

14. The strong growth in DTC and the brands' reduced demand for the wholesale channel are both linked to the strong growth in digital. Most of the growth in DTC occurs in the online channel (with some through the brands' own stores, which are integrated with their digital offerings). And the brands need fewer third-party retailers when a smaller proportion of demand passes through retailers and a growing share of those retailers' sales occur online.[26] Back in a world where the large majority of customer purchasing was via stores, the brands' store networks needed (more) third party retail store partners to reach incremental store customers. As a consequence of the increased online sales, the

21 See the adidas Slide Pack, slides 157 and 164.
22 See the adidas Slide Pack, slide 120.
23 See the adidas Slide Pack, slide 145.
24 See for example, the discussion in [✂].
25 See for example, paragraph 65 which discusses this in more detail.
26 A retailer can serve the whole of the UK through a single website, whereas store networks generally provide incomplete geographic coverage.

brands are in a much better position to reach those online customers themselves, especially in light of the COVID-19 pandemic.

15. Nike and adidas have both reported strong digital growth and expect acceleration.

(a) In 2017, Nike set a goal for 30% digital penetration (i.e., online sales through both owned and partnered sales channels) by FY 2023.[27] Following acceleration of digital adoption as a result of the COVID-19 pandemic, in June 2020, Nike commented that it would soon reach 30% and raised the goal to 50%.[28] By March 2021, as the effects of the COVID-19 pandemic continued, Nike reported over 35% digital penetration.[29]

(b) In March 2021, adidas forecast that its e-commerce business will "*double from currently*" by 2025 to €8-9 bn.[30] Its CEO, Kasper Rorsted, described the effect of the COVID-19 pandemic as marking a two- to three- year step forwards in a single year in digital.[31]

(iv) Impact of the three changes on the competition analysis

16. The pace and scale of these intertwined effects significantly affect the forward-looking competition analysis of the transaction:

(a) DTC The growth in DTC means that the brands' projected DTC-to-wholesale ratio (as captured in the brands' investor statements) will have undergone a material shift relative to pre-pandemic forecasts; as a consequence, Nike and adidas are already closer competitors to the Parties than prior to the COVID-19 pandemic, and the evidence on trends points unambiguously in the direction of their becoming stronger rivals still over the foreseeable future. In essence, this is because (i) they will always control allocation of their own products; (ii) their recent pandemic-period DTC success stories speak for themselves; and (iii) the

27 See https://s1.q4cdn.com/806093406/files/doc_events/2017/10/updtd/NIKE-Inc.-2017-Investor-Day-Transcript-With-Q-A-FINAL.pdf, p. 1.
28 See transcript of Nike's Q4FY20 earnings call of 25 June 2020 (Annex 281), p. 6.
29 See transcript of Nike's Q3FY21 earnings call of 18 March 2021 (Annex 262), p. 6.
30 See the adidas Growth Strategy release (Annex 189), p. 3.
31 See transcript of Q2FY20 earnings call of 6 August 2020 from Seeking Alpha, "Adidas AG (ADDYY) CEO Kasper Rorsted on Q2 2020 Results - Earnings Call Transcript", 06 August 2020 (Annex 195), p. 18.

pandemic has accelerated the shift to digital which will support the brands' ambitious plans for DTC growth. [32]

(b) Disintermediation **[✂]**. In considering whether to deteriorate Footasylum's offering in an attempt to improve group profitability through a unilateral effects strategy post-merger, the merged group would need to factor in the obvious risk that Nike and/or adidas would cut or terminate allocations as, post-pandemic, a degraded third party retail proposition will not stock desirable or premium Nike or adidas products for very long.[33]

(c) Digital. The ongoing, strong growth in digital makes Nike's and adidas's online offerings closer competitive constraints to the Parties' multi-channel retail propositions, including their store estates. In addition, the brands have been explicit that the shift to digital involves their obtaining data about consumers shopping in third party stores, which leaves the wholesale channel vulnerable to the brands using that data to acquire direct customer contact and relationships and increase their (more profitable) DTC sales when that customer makes their next purchase. Access to this consumer data (currently held separately by their retail partners) will give the brands a unique advantage and allows them to tailor their offer and target promotional activities for each customer, whether based on exclusive releases, early releases, discounts, or a combination.

(v) Structure of the remainder of the submission

17. In the remainder of this submission, the Parties further describe the three changes – growth in DTC, progressive disintermediation and growth in digital – in turn in sections

32 In reviewing the time horizon over which the effects of the transaction are considered: (i) adidas has made public statements forecasting its growth in DTC to 2025, implying both an ability reasonably confidently to foresee the position four years out and a belief that the market is expected to change considerably over those four years; similarly, RBC Capital Markets have forecast Nike's CAGR EPS out to FY26 and other analysts have forecast sustained strong growth in DTC over several years (see paragraph 18 below); the Parties submit that in circumstances where suppliers and analysts are forecasting to 2025 or 2026, the CMA is able to gather sufficient evidence to make forecasts extending beyond two years and it is important to do so in order to avoid overlooking some of the significant dynamic changes that are in progress; (ii) paradoxically, the near term may be harder to forecast than the medium term in this case: nobody expects the CMA to make forecasts about whether new variants of COVID-19 might take hold in the UK that are resistant to current vaccines and might result in further lock-downs. The Parties welcome the confirmation in the CMA's letter dated 20 April 2021 that it will be taking a "*dynamic*" assessment of competition.

33 Whilst JD Sports is confident that it could give Footasylum a distinctive voice enabling it to maintain supplies of the most desirable stock from Nike and adidas (**[✂]**), **[✂]**.

B, C and D, before describing their implications for the Parties (section E) and the competition analysis (section F).

B. DTC

(i) History and context

18. JP Morgan Cazenove published a detailed note, "Global Sporting Goods Primer" on 14 September 2020[34] (the "**JP Morgan Cazenove note**") which analyses in detail the shift to DTC by major global sporting goods companies (including by Nike and adidas,[35] in each case prior to the strategic shifts in 2021 described in section A above). The JP Morgan Cazenove note explains (regarding the wider group of global sporting goods companies, not just Nike and adidas):

(a) Recent and prospective growth in DTC:

> "*owned retail (stores + e-commerce) has increased on average from 25% of sales in FY15 to 33% in FY19 with our models pointing to c. 45% penetration over the next three years*".[36]

(b) The benefits to brands of increasing DTC sales:

> "*the acceleration of global brands [sic] DTC is instrumental for customer engagement/acquisition, storytelling, and brand control while quantitatively positive for top and bottom-line financial algorithms*".[37]

(c) More specifically:

> "*DTC enables companies to:*
>
> - "*Have direct, and hence stronger, engagement with consumers, better conveying the brand's messages and positioning as well as better presenting the latest product launches…*
> - *Benefit from stronger and tighter brand control, not just regarding how the brands are portrayed to the consumers but also, and as importantly, in terms of pricing and discounting activities.*
> - *With the roll-out of key technologies such as RFID, allowing for higher visibility on inventories, overall companies should also be in a better position to manage stock and goods purchasing, possibly maximizing the share of sales at full price and hence gross margins.*
> - *Maximize sales, profit, margins and ROCE as brands capture the full retail mark-up.*"[38]

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34 See Annex 275.

35 The JP Morgan Cazenove note (Annex 275) covers suppliers offerings as a whole, including "*athleisure*".

36 See JP Morgan Cazenove note (Annex 275), p. 1.

37 See JP Morgan Cazenove note (Annex 275), p. 1.

38 JP Morgan Cazenove note, p. 7. See also Retail Dive, 23 March 2021, "How Nike is using DTC and data to expand its empire" (Annex 290) and Investors Chronicle, 25 March 2021, "Can JD Sports survive the threat of direct-to-consumer shopping?" (available at:

19. The brands are extending their influence over the wholesale channel by leveraging the rise of e-commerce marketplaces and partnership programmes in which brands are transacting directly with consumers on a separate platform.[39] While the estimates detailed in this section likely reflect the brands' internal terminology of DTC sales comprising transactions through their *own* website, stores and apps,[40] it is important to recognise that the brands' DTC efforts may drive sales to third-party platforms (such as Zalando, Next and ASOS) where the brands can also transact directly with consumers.

(ii) Evidence from Nike and adidas

20. As noted in section A(i) above, Nike and adidas have both enjoyed growth in their DTC sales. adidas has a target date of 2025 to reach 50% of sales through DTC and has changed its business model from a wholesale-driven business model to a DTC-led business model. In the remainder of this section the Parties provide further detail about Nike's and adidas's publicly stated strategies.

Nike

21. Table 1 shows the acceleration in global DTC growth caused by the COVID-19 pandemic from 31.5% in FY to 31 May 2019 to ~38% in Q2 and Q3 FY 31 May 2021.

Table 1: Nike's DTC share of total global sales during the COVID-19 pandemic

FY to 31 May	Quarter	DTC share
To 31 May 2019		31.5% (equivalent to $12.3bn)[41]
To 31 May 2020		34.7% (equivalent to $13bn)[42]
To 31 May 2021	*June – Aug 2020 (Q1)*	*~35%*[43]
	Sep – Nov 2020 (Q2)	*~38%*[44]

https://www.investorschronicle.co.uk/news/2021/03/25/can-jd-sports-survive-the-threat-of-direct-to-consumer-shopping/).

39 For example, see paragraph 36.

40 For example, this paragraph on p. 71-72 of adidas' 2020 Annual Report (Annex 190) suggests that adidas' DTC
sales estimates and projections are based on its own website, stores and apps, *"E-com continues to be our most important store. Both adidas.com and the adidas app will see enhancements across the entire consumer journey. By 2025, our e-com business is expected to account for between € 8 billion and € 9 billion of our company's net sales…The DTC business, comprising our e-com as well as our physical stores, is projected to account for around half of the company's net sales by 2025."*

41 See Note 16 on p. 148 of Nike's 2019 Annual Report. The figure is calculated as 100 * ($12,306m / $39,117m).

42 See Note 16 on p. 88 of Nike's 2020 Form 10K (Annex 293). The figure is calculated as 100 * ($12,984m / $37,403m). This period included the initial phases of the COVID-19 pandemic, but it is not possible to split out DTC sales by quarter.

43 See Nike's Q1 2021 results (Annex 284), calculated as 100 * ($3.7bn / $10.6bn).

44 See Nike's Q2 2021 results (Annex 273), calculated as 100 * ($4.3bn / $11.2bn).

	Dec 2020 – Feb 2021 (Q3)	*~38%*[45]

22. Consistent with its DTC strategy and vision, Nike has recently restructured its senior management team to put DTC experts (and proponents) at the helm of the company:

(a) John Donahoe became President and CEO on 13 January 2020, bringing significant digital expertise from his time as president and CEO of eBay and former Chairman of PayPal. Mr Donahoe replaced Mark Parker, a veteran of the wholesale channel model. The press release announcing Mr Donahoe's appointment included a welcoming quote stating:

> "*His expertise in digital commerce, technology, global strategy and leadership combined with his strong relationship with the brand, make him ideally suited to accelerate our digital transformation and to build on the positive impact of our Consumer Direct Offense*."[46]

(b) Heidi O'Neill, who played a major role in shaping the direction of Nike's DTC and digital transformation, was promoted from 1 April 2020 to president of Nike Consumer and Marketplace to continue that work. Ms O'Neill replaced Elliott Hill, who had been a long-term supporter of the wholesale channel. In reporting the appointments of Ms O'Neill and Mr Campion (see §(c) below), the trade press commented:

> "*Nike has made changes to its senior leadership team in a bid to accelerate its direct-to-consumer strategy*."[47]

(c) Andy Campion was appointed COO from 1 April 2020, having been a strong advocate of increasing DTC to benefit from the higher gross margins.

23. On 25 June 2020, in its Q4FY20 earnings call, Nike CEO John Donahoe announced that Nike's "*Consumer Direct Offense*"[48] would evolve into a new "*Consumer Direct Acceleration*" strategy:[49]

> "*Over the past few years we have shifted from a legacy wholesale distribution model to investment in a model that gives our consumers a more premium shopping experience, and this is a change that has catalyzed our digital growth*

45 See Nike's Q3 2021 results (Annex 261), calculated as 100 * ($4.0bn / $10.4bn).

46 See https://www.businesswire.com/news/home/20191022006118/en/NIKE-Inc.-Announces-Board-Member-John-Donahoe-Will-Succeed-Mark-Parker-as-President-CEO-in-2020-Parker-to-Become-Executive-Chairman. See also Business of Fashion, "Inside Nike's Radical Direct-to-Consumer Strategy", December 2020 ("*Donahoe's selection underscored Nike's growing focus on a digital, customer-first future*").

47 See https://www.retailgazette.co.uk/blog/2020/02/nike-reshuffles-boardroom/.

48 The "Consumer Direct Offense" strategy was announced on 15 June 2017: see "NIKE, Inc. Announces New Consumer Direct Offense".

49 See Nike's Q4FY20 earnings call (Annex 281), p. 5. The Consumer Direct Acceleration Strategy replaced Nike's Consumer Direct Offence Strategy that had been launched on 15 June 2017.

> *as a part of our true Consumer Direct Offense, and COVID-19 has shown that our strategy is sound… So today, we're announcing a new digitally empowered phase of our Consumer Direct strategy, the Consumer Direct Acceleration…*"

24. In that call, Mr Donahoe made clear that Nike regarded its direct sales as its first priority ahead of those through the wholesale channel:[50]

> "*consumers increasingly want a consistent, seamless physical and digital experience, and so that's what we're committed to providing, and we're committed to providing those through, first and foremost, our own digital capabilities, as well as our own … physical stores.*"

25. Nike's DTC ambitions are not only limited to its digital offering, but extend to physical stores too. In its Q4FY20 earnings call, Nike estimated that it will open somewhere between 150 and 200 new stores in North America and EMEA.[51] In its most recent earnings call Nike said that:[52]

> *"Nike physical stores are another key enabler to drive our Consumer Direct Acceleration…They will accelerate Nike member acquisition at scale while unlocking higher retail productivity. They will recapture displaced consumer demand as we restructure the wholesale marketplace. And most importantly, they will accelerate Nike digital growth by scaling online to offline capabilities as our physical presence reaches a greater number of consumers."*

adidas

26. Table 2 below shows the growth in adidas's DTC share of its total global sales from 33% in 2019 to 41% in 2020 resulting from the COVID-19 pandemic. adidas's target is to reach 50% by 2025.

Table 2: adidas's DTC share of total global sales

	DTC share
FY to 31 Dec 2019	33% (equivalent to €7.8bn)[53]
FY to 31 Dec 2020	41% (equivalent to €8.1bn)[54]
2025 target:	50%[55]

27. On 27 April 2020, in its Q1FY20 earnings call, Kasper Rorsted, adidas CEO, explained that the COVID-19 pandemic was accelerating adidas's DTC strategy:

50 See Nike's Q4FY20 earnings call (Annex 281), p. 13.
51 See Nike's Q4FY20 earnings call (Annex 281), p. 13.
52 See Nike's Q3 2021 results (Annex 261), page 5-6.
53 See adidas' 2020 Annual Report (Annex 190), p. 80.
54 See adidas' 2020 Annual Report (Annex 190), p. 80.
55 See Annex 189, p.1.

> "*there is no doubt that the acceleration we are seeing right now towards a more digital and D2C-led company is getting a huge step forward, compared to a normal setup.*"[56].

28. On 6 August 2020, in its Q2FY20 earnings call, Harm Ohlmeyer, adidas CFO, explained that the COVID-19 pandemic had accelerated DTC by two to three years:

> "*So you are going to see an acceleration of the D2C landscape moving forward. This is a 2- to 3-year, I would say, fast forward that corona is bringing to us.*"[57]

29. On 10 March 2021, adidas presented its growth strategy to 2025, "*Own the Game*",[58] which described a "*Shift to a DTC-led business model*". The announcement stated:

> "*Consumers expect to receive a brand and shopping experience tailored to their preferences, with personalized offerings in both digital and physical spaces. The transformation into a direct-to-consumer-led business built around membership, enabled by a network of own-retail stores and e-commerce, will therefore play an even more important role for adidas in the future.*".[59]

30. Similar to Nike, adidas considers that its own retail stores will be a key part of its DTC push. In its recent "*Own the Game*",[60] presentation adidas said that:

> *The transformation into a direct-to-consumer-led business built around membership, enabled by a network of own retail stores and e-commerce, will therefore play an even more important role for adidas in the future."*

(iii) Evidence from independent retail analysts

31. Morgan Stanley base their "*overweight thesis*" for Nike on its being "*in the early innings of transition from a wholesaler to a DTC brand*"[61] (where "early innings" means that strong growth is expected from the $13 billion of annualised DTC sales in the last financial year).[62] Similarly, the first point in Barclays' explanation of "*Why overweight*" is "*the acceleration of NKE's direct-to-consumer strategy*".[63] And RBC Capital Markets' investment summary for Nike is based on the "*Consumer Direct Acceleration strategies supporting a multi-year mid-teens high EPS CAGR through FY26E*".[64] It follows from

56 See transcript of Q1FY20 earnings call of 27 April 2020 from Seeking Alpha, "adidas AG ADR (ADDYY) CEO Kasper Rorsted on Q1 2020 Results - Earnings Call Transcript", 27 April 2020 (Annex 194), p. 4

57 See transcript of Q2FY20 earnings call of 6 August 2020 from Seeking Alpha, "Adidas AG (ADDYY) CEO Kasper Rorsted on Q2 2020 Results - Earnings Call Transcript", 06 August 2020 (Annex 195), p. 16.

58 See the adidas Growth Strategy release (Annex 189).

59 See also adidas's Annual Report 2020 (Annex 190), p. 71.

60 See the adidas Growth Strategy release (Annex 189), p.3.

61 Morgan Stanley, "3Q21 Earnings: High Quality Despite Headwinds" (Annex 263), p. 4.

62 See Note 16 on p. 88 of Nike's 2020 Form 10K (Annex 293).

63 Barclays, "FY3Q21 Results: It Only Gets Better" (Annex 260), p. 2.

64 RBC, "3Q Revenue Miss Largely on Supply Constraints but Momentum Strong With 4Q Guided +75%" (Annex 264), p. 2.

the analysts' views that Nike's transition to DTC is in its "*early innings*" and will "*accelerate*" and that the dynamic shifts are just starting and seem set to be maintained into FY 2026.

(iv) Evidence from the Parties' internal documents

JD Sports

32. **[✂]**[65] **[✂]**

[✂][66]

33. **[✂]**:

(a) **[✂]**[67] **[✂]**[68] **[✂]**:

"**[✂]**".[69]

(b) **[✂]**[70] **[✂]**.[71]

(c) **[✂]**[72] **[✂]**.[73]

(d) **[✂]**[74] **[✂]**.[75]

(e) **[✂]**:

65 **[✂].**
66 **[✂].**
67 **[✂].**
68 **[✂].**
69 **[✂].**
70 **[✂]**.
71 **[✂].**
72 **[✂].**
73 **[✂].**
74 **[✂].**
75 **[✂].**

i. **[✂]**[76] **[✂]**[77] **[✂]**[78] **[✂]**[79] **[✂]**[80] **[✂]**.

ii. **[✂]**[81]**[✂]**[82] **[✂]**.

iii. **[✂]**[83]**[✂]**[84] **[✂]**.[85]

(f) **[✂]** *".*[86]

Footasylum

34. **[✂]**:

"**[✂]**."[87]

35. **[✂]**:

(a) **[✂]**.

(b) **[✂]**.

C. PROGRESSIVE DISINTERMEDIATION

(i) History and context

36. The JP Morgan Cazenove note explains the background and history to the brands' progressive disintermediation strategies:

---

76 **[✂].**

77 https://otp.tools.investis.com/clients/uk/jdsports3/rns/regulatory-story.aspx?cid=222&newsid=1436252&culture=en-GB&val=637552348207162011

78 https://otp.tools.investis.com/clients/uk/jdsports3/rns/regulatory-story.aspx?cid=222&newsid=1448692&culture=en-GB&val=637552347886741374

79 https://otp.tools.investis.com/clients/uk/jdsports3/rns/regulatory-story.aspx?cid=222&newsid=1460460&culture=en-GB&val=637552347886741374

80 **[✂].**

81 **[✂].**

82 **[✂].**

83 **[✂].**

84 **[✂].**

85 **[✂].**

86 **[✂].**

87 **[✂]**.

(a) "*Historically*" "*distribution and customer reach were outsourced to third party retailers, able to provide the brands with a larger reach to a customer that usually shopped by product/category rather than by brand.*"[88]

(b) Whilst "*Wholesale [is] still a very important distribution channel*"[89] "*brands are discovering more and more how important having control of distribution, as well as a direct link to the consumer, is becoming*".[90] "*In particular, both adidas and Nike have set specific goals on how, over time, they want to reduce undifferentiated distribution to focus on fewer, but higher quality, partners.*"[91]

(c) "*In the last few years, online pure plays have increasingly become important distributors for sporting goods brands*", highlighting ASOS, Zalando and, to a lesser extent, Amazon. One of the attractions of Zalando's Partner Program is that it:

> "*enables the brands to sell their goods via the Zalando platform, and therefore being exposed to its 31m active customers, while still maintaining full control on pricing, presentation/story-telling and with access to customer data analytics... Such a differentiated approach to brand relationships, or rather true partnerships, is helping Zalando to stand out as one of the key retailers for the sporting goods brands*".[92]

37. As noted above, the brands are increasing their influence over the wholesale channel. As a result, disintermediation can comprise not only a "full" shift to DTC, but also a "partial" shift through e-commerce marketplaces and platforms.

(ii) Evidence from Nike and adidas

38. As noted in section A(ii) above, Nike is restructuring the wholesale marketplace away from "*legacy wholesale*" by dropping "*undifferentiated retail*" and adidas is changing its "*business model*" from "*wholesale-driven*" to "*DTC-led*" and is reducing its wholesale channel to focus on "*key influencer accounts*". In the remainder of this section we provide further detail about Nike's[93] and adidas's publicly-stated strategies.

88 JP Morgan Cazenove note (Annex 275), P. 4.
89 JP Morgan Cazenove note (Annex 275), P. 22.
90 JP Morgan Cazenove note (Annex 275), P. 22.
91 JP Morgan Cazenove note (Annex 275), P. 22.
92 JP Morgan Cazenove note (Annex 275), P. 23. See further section D(iv) below.
93 See also Business of Fashion, "Inside Nike's Radical Direct-to-Consumer Strategy", December 2020, pp. 7-8 which refers to the "*culling of wholesale customers*" and explains that the retained retailers are those "*offering Nike a special strategic advantage*" through better access to particular customer groups.

Nike

39. On 25 June 2020, in its Q4FY20 earnings call, Nike's CEO, John Donahoe, stated:[94]

> "*Our one Nike marketplace strategy leads with NIKE Digital in our own stores and embraces a small number of strategic partners who share our vision to provide a consistent premium shopping experience*."
>
> "*Over the past few years we have shifted from a legacy wholesale distribution model.*" [95]
>
> "*consumers increasingly want a consistent, seamless physical and digital experience… A very important piece of this is our strategic partners, our strategic wholesale partners. We envision having fewer of them but focusing on those that will share our vision of providing a seamless experience – a consistent seamless experience with physical points of presence.*"[96]

40. On 18 December 2020, in its Q2FY21 earnings call, Nike CFO Matt Friend made similar statements:

> "*Within wholesale, we continue to shift the marketplace towards differentiated retail … Looking forward over the next two years, we will more aggressively accelerate change with larger undifferentiated accounts as we and our strategic partners together reprofile the shape of the marketplace and recapture short term demand dislocation.*"[97]
>
> "*As we look forward, we are going to be more aggressive with larger, undifferentiated customers that we have been working with and we're working closely with our strategic wholesale partners in a city-by-city, mall-by-mall, street-by-street basis to work together to determine how we're going to recapture that demand. And that's absolutely our plan because … we believe that premium consistent experience for consumers across the marketplace connected to digital is the type of market foundation that we think we need as a premium brand*."[98]

41. Mr Friend's comments relate to North America, but provide an insight about what is approaching the European wholesale channel.

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94 See transcript of Nike's Q4 2020 Earnings call (Annex 281), p. 6.

95 See transcript of Nike's Q4 2020 Earnings call (Annex 281), p. 5.

96 See transcript of Nike's Q4 2020 Earnings call (Annex 281), p. 13. Similarly, on 22 September 2020, in its Q1FY21 earnings call (Annex 283), p. 4 Nike CEO John Donahoe stated: "*our One NIKE Marketplace approach leads with NIKE Digital and our own stores as well as a smaller number of strategic partners who share our vision to provide a consistent and seamless consumer experience*." In the same call, on p. 10, Matt Friend, Nike CFO – talking about the EMEA – referred to "*exiting undifferentiated wholesale distribution and focusing on our direct business and our strategic partners*".

97 See transcript of Nike's Q2 2021 Earnings call (Annex 282), p. 9.

98 See transcript of Nike's Q2 2021 Earnings call (Annex 282), p. 16.

42. On 18 March 2021, in its Q3FY21 earnings call, Nike's CEO, John Donahoe, repeated the strategy of focusing on fewer, better wholesale partners and emphasised that Nike expected to have direct digital contact with customers buying from third-party retailers:[99]

> "*We're taking even greater advantage of our vast digital opportunity as we create the future of retail. We know that our consumers want a consistent, seamless, and premium experience. And so alongside our strategic partners, we continue to consolidate the marketplace to give our consumers that premium experience.*"[100]
>
> "*we'll work with a smaller number of strategic partners that see the same future as we do, and that want to and are willing to share membership data so that we can, together, deliver a very seamless experience, a very personalized experience for our consumers.*"[101]
>
> "*I think you'll see even more movement from undifferentiated retail into a smaller number of partners and our own stores to provide that seamless premium experience.*"[102]

adidas

43. On its Q2FY20 earnings call, adidas's CFO, Harm Ohlmeyer, suggested that it would be difficult to continue partnering with retailers that are unable to engage digitally:

> "*I think it has shown us that when we control the consumer engagement, we have an opportunity to sell deeper and more frequently to the consumer, along with the wholesale partners with whom we can digitally engage like the JDs, the DICK'S Sporting Goods, the Foot Lockers or the pure plays or the Zalandos.*"[103]

44. In its 2020 Annual Report, adidas stated:

> "*We will also continue to leverage our strong relationships with strictly selected wholesale partners and 'win-with-the-winners' to ensure a holistic experience for the consumer no matter the point of sale.*"[104]

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99 Similarly, in a magazine interview in December 2020 (Business of Fashion, "Inside Nike's Radical Direct-to-Consumer Strategy", December 2020, p. 8), Heidi O'Neill, president of Nike Consumer and Marketplace said: "*We'll continue on our path to differentiated retail – to fewer, better partners, who work with us in a more connected experience so that the consumer can be recognised as a Nike member, throughout all of their shopping journeys*."

100 See transcript of Nike's Q3 2021 Earnings Release Conference Call, March 18 2021 (Annex 262), p 4.

101 See transcript of Nike's Q3 2021 Earnings Release Conference Call, March 18 2021 (Annex 262), p. 12.

102 See transcript of Nike's Q3 2021 Earnings Release Conference Call, 18 March 2021 (Annex 262), p.12.

103 See transcript of Q2FY20 earnings call of 6 August 2020 from Seeking Alpha, "Adidas AG (ADDYY) CEO Kasper Rorsted on Q2 2020 Results - Earnings Call Transcript", 06 August 2020 (Annex 195), pp. 16-17.

104 See adidas' 2020 annual report (Annex 190), p. 72. See also p. 82 (referring to working with "*key wholesale partners*" to "*ensure a holistic customer journey*").

(iii) The Parties' understandings of the brands' current positions

45. In this sub-section, the Parties set out their understanding[105] of the current tiering structure adopted by the brands.

46. As to Nike:

    (a) **[✄]**

    (b) **[✄]**

47. Nike has implemented its disintermediation strategy, including in recent months by terminating access to its products to at least 15 retailers in the US: Zappos, Belk, Dillards, Boscov's, Bob's Stores, Fred Meyer, EBLens, VIM, City Blue, DSW, Urban Outfitters, Shoe Show, Dunham's Sports, Olympia Sports, and Big Five (accounting for c.4000 stores).[106] In the UK, Nike has terminated **[✄]**.[107]

48. Although **[✄]**[108][109] **[✄]**

(iv) Evidence from independent retail analysts

49. Jonathan Pritchard at brokers Peel Hunt believes that the growth in DTC means that Nike and adidas will have to "*remove relationships with the less strong retailers, or the less progressive retailers, and increase the strength of the relationships with those companies that they think are very forward-looking and have the same thought process as them.*"[110] Similarly, one element of RBC Capital Markets' investment summary for Nike is "*paring back on undifferentiated wholesale doors*".

(v) Evidence from the Parties' internal documents

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105 The structures adopted by the brands are not fully transparent.

106 See https://www.chargedretail.co.uk/2020/08/26/nike-slashes-ties-with-9-major-wholesalers-as-it-pushes-to-create-the-marketplace-of-the-future/ and https://sgbonline.com/report-nike-to-stop-selling-to-six-additional-wholesale-accounts/.

107 **[✄].**

108 **[✄].**

109 **[✄].**

110 See Investors Chronicle article, 25 March 2021, "Can JD Sports survive the threat of direct-to-consumer shopping?".

50. JD Sports' internal documents describe the increasing trend of disintermediation as follows: "**[✂]**".[111] **[✂]**[112]

51. **[✂]**[113] **[✂]**[114]

52. **[✂]**[115] **[✂]**.

53. **[✂]**.

54. **[✂]**[116] **[✂]**. [117]

55. **[✂]**[118] **[✂]**.[119]

56. **[✂]**.

57. **[✂]**[120] **[✂]**.

58. **[✂]**:

    (a) **[✂]**.

    (b) **[✂]**.

59. **[✂]**:

    "**[✂]**"

60. **[✂]**.

    [✂]

[✂]	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**
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111 **[✂].**
112 **[✂].**
113 **[✂].**
114 **[✂].**
115 **[✂].**
116 **[✂].**
117 **[✂].**
118 Slide 3.
119 Slide 4.
120 Slide 4.

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D. GROWTH IN DIGITAL

(i) Evidence from Nike and adidas

61. As noted in section A(iii) above, Nike and adidas both forecast significant growth in digital sales and envisage having digital connections with all customers buying their products, including those buying through the wholesale channel. In the remainder of this section we provide further detail about Nike's and adidas's publicly-stated strategies.

Nike

62. **Family of apps.** Nike's digital offerings[121] include straightforward e-commerce offerings on websites (nike.com/gb) and apps (Nike app), including specialist apps (the SNKRS app serves "*sneaker-heads*", customers with a special interest in launches, exclusives and brand narratives about Nike and Jordan sneakers). However, Nike's digital activities extend much more broadly into building the brand value and establishing direct connections with consumers, including through the *Nike Training Club* app (home workouts and fitness plans) and *Nike Run Club* (running tracker and coaching). These lifestyle apps are sometimes pre-downloaded onto electronic devices (i.e. when a customer purchases the Nike version of the Apple Watch, the *Nike Run Club* app is pre-downloaded on this). These apps become part of the consumers' everyday lives and

[121] See the JP Morgan Cazenove note (Annex 275) at pp. 4, 16 and 18; Nike's Q1FY20 earnings call transcript, p. 4 and Business of Fashion, "Inside Nike's Radical Direct-to-Consumer Strategy", December 2020, pp. 10-12.

particularly their home exercise routines (as they include heart rate and step count monitoring), which has been particularly important during the COVID-19 pandemic.

63. **NikePlus Membership "ecosystem".** Overlaid across the whole family of e-commerce and training offerings is Nike's *NikePlus* membership program which gives "*consumers a more personal relationship with NIKE*"[122]: by signing up and sharing data with Nike, consumers obtain preferential access to products (exclusives or early drops) and includes access to the Training Club and Run Club communities. For example, Nike can "learn" what football team each individual consumer supports and offer priority access to new kit launches for that team.

64. While the e-commerce space and the core "digitally native" youth demographic makes customers less "sticky" – because switching and shopping around between websites and apps is much more seamless than in a traditional store environment – the brands are able to leverage both a unique product allocation advantage and their resource prowess into a very engaging membership environment, once a customer is acquired and converted into a member. As one industry analyst explains:

> *It becomes a sticky ecosystem because, say that you've downloaded the Nike app on your phone, and you have the Nike running app or the fitness app that they have or even just their shopping app — you'll get targeted emails and they start to know what you do athletically. Or they might know your style ... They'll start to send you direct emails when there's either a new product that might be of interest to you or they'll give you a first crack sometimes at a new product that just came out.*[123]

65. As Nike's app puts its "*You get first dibs on the best Nike innovations, Member-exclusives drops and special promotions*" including via emails and push notifications for app users. Member apps offer inducements to buy DTC such as promotions, free standard shipping, exclusive or "early access" to releases or "drops" and event invites or passes.

66. **QR codes for further customer acquisition through (third party) store sales.** Nike also now includes QR codes on products and boxes which take the consumer to the Nike website and provide Nike with a further digital link to the consumer and the product.[124]

122 See Nike's Q1FY20 earnings call transcript, p. 4.

123 J. Feldman, Telsey Advisory Group, cited in C. Salpini, 'How Nike is using DTC and data to expand its empire', Retail Dive, 23 March 2021 (Annex 290), p.8.

124 Whilst initially introduced and explained to wholesale partners as an anti-counterfeit measure, in reality the QR code creates a direct link between the brand and consumer, even when the consumer is standing in a retailers' store. It can tell the consumer where it can find the product in the size and style it wants, even if it is not available in the store that they are standing in (or from that wholesale partner generally).

In practical terms, a customer can use their phone to take a picture of a product's QR code in a retailer's store and be immediately taken to Nike's website where they can purchase the product. The use of QR codes has more recently been extended so that they are prominent on labels of product that is displayed in retail partners' stores, enabling Nike to establish a digital connection with potential customers whilst they are in the retailer's store (including for example by offering a discount or other benefit for a direct purchase from Nike).[125]

67. **Strategic DTC investments**. Nike has invested heavily in its digital offering, spending over $1bn on data and analytics capabilities in 2019,[126] including through acquisitions including (i) Virgin Mega, which Nike incorporated into its digital studio, in 2016;[127] (ii) Zodiac, a consumer data analytics firm, in 2018;[128] (iii) Vertex, a computer vision firm, in 2018,[129] whose technology is used to scan a customer's foot to give accurate sizing;[130] (iv) Celect, a retail predictive analytics and demand sensing firm, in 2019,[131] whose technology is used to predict demand, plan supply, allocate product to the right stores and sharpen pricing;[132] and (v) Datalogue, a data integration platform, in 2021.[133] JD Sports also understands from discussions with **[✂]**.

68. **Digital sales.** Table 4 below shows the share of Nike's global sales that are made digitally (through Nike's own online offerings or those of its wholesale partners). The gaps reflect the fact that Nike does not consistently publish this data.[134] The share rose by "*more than 10*" percentage points from Q1FY20 to over 30% in Q1FY21, a step-change arising from the COVID-19 pandemic. In June 2020 Nike raised its target to 50%,[135] from the 30% target it had set in 2017.[136]

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125 The QR codes also allow Nike to establish digital connections with customers who purchase online from retailers.
126 See Business of Fashion, "Inside Nike's Radical Direct-to-Consumer Strategy", December 2020, p. 9.
127 See https://fdra.org/latest-news/nike-acquires-virgin-mega/.
128 See https://news.nike.com/news/nike-data-analytics-zodiac.
129 See https://news.nike.com/news/nike-invertex-digital-technology.
130 Nike's Q1FY20 earnings call transcript, p. 4.
131 See https://news.nike.com/news/nike-celect-acquisition.
132 Nike's Q1FY20 earnings call transcript, p. 5.
133 See https://news.nike.com/news/nike-datalogue-acquisition.
134 Note that we present different data to show the growth of adidas's own digital business in Table 6 below. The use of different data reflects the different information the two companies make publicly available.
135 See transcript of Nike's Q4FY20 earnings call of 25 June 2020 (Annex 281), p. 6.
136 See https://s1.q4cdn.com/806093406/files/doc_events/2017/10/updtd/NIKE-Inc.-2017-Investor-Day-Transcript-With-Q-A-FINAL.pdf.

Table 4: Nike's global digital penetration (Nike and wholesale partners)

FY to 31 May	Quarter	Digital penetration (%)
To 31 May 2017		<15[137]
To 31 May 2018		
To 31 May 2019		
To 31 May 2020		
	Of which Q4 2020	30[138]
To 31 May 2021	June – Aug 2020 (Q1)	>30 (up >10 pp on prior year)[139]
	Sep – Nov 2020 (Q2)	
	Dec 2020 – Feb 2021 (Q3)	>35[140] (up >10 pp on prior year)[141]

69. Table 5 shows the growth in sales of Nike's own digital sales (i.e. excluding those of its wholesale distributors) and confirms that the growth rate accelerated in Q4FY20 and through FY21 as a result of the COVID-19 pandemic.

Table 5: Quarterly global digital sales by Nike itself (excluding wholesale partners)[142]

FY	Q1 ($m) Jun - Aug	Q2 ($m) Sep – Nov	Q3 ($m) Dec - Feb	Q4 ($m) Mar-May
To 31 May 2015	238	266	354	336
To 31 May 2016	328	366	555	479
To 31 May 2017	481	546	632	541
To 31 May 2018	567	710	774	749
To 31 May 2019	770	977	1,034	1,019
To 31 May 2020	1,100	1,300	1,400	1,783
To 31 May 2021	2,002	2,392	2,226	

70. On 25 June 2020, in its Q4FY20 earnings call, Nike CEO John Donahoe stated:[143]

> "*As we look at opportunities to build deeper and more meaningful relationships with consumers, our vision is to create a clear and connected digital marketplace to match. Consumers want modern, <u>seamless experiences, online-to-offline</u>, so we're accelerating our approach… Connected data, inventory and*

137 See https://s1.q4cdn.com/806093406/files/doc_events/2017/10/updtd/NIKE-Inc.-2017-Investor-Day-Transcript-With-Q-A-FINAL.pdf, p. 1.

138 See Nike's FY20 fourth quarter and full year results (Annex 272), p.1.

139 See transcript of Nike's Q1FY21 earnings call of 22 September 2020 (Annex 283), p. 5.

140 See transcript of Nike's Q3FY21 earnings call of 18 March 2021 (Annex 262), p. 6.

141 See transcript of Nike's Q3FY21 earnings call of 18 March 2021 (Annex 262), p. 4.

142 See data to Q3FY20 sourced from https://askwonder.com/research/nike-s-ecommerce-quarterly-earnings-xvpyg8sud; thereafter data calculated by taking growth in Nike digital from quarterly earnings and applying it to the relevant quarter in the preceding year

143 See transcript from Nike's Q4 2020 Earnings call (Annex 281), pp. 6, 13 and 16. Similarly, on 24 September 2019, in its Q1FY20 earnings call, Nike's then CEO, Mark Parker (now Executive Chairman) said p. 4: "*We want [consumers] to be able to <u>move seamlessly from online to offline</u> and easily find a product they want, when they want it across the market place. Ultimately, by recognizing, serving and rewarding <u>members, they will engage with NIKE more often across multiple channels and touch points</u>.*"

> *membership will give consumers greater access to the best of NIKE with more speed and convenience than ever. We've talked about membership as a growth driver and differentiator before, but now we'll align our business to make it central to everything we do… [W]e'll speed up and unify our investments across demand sensing, insight gathering, inventory management and more.*"
>
> "*consumers, as you know, are becoming accustomed to getting what they want, when they want it, how they want it, right? And this pandemic has really demonstrated the shift toward digital being at the center of everything they do, but they want modern and seamless experiences.*"
>
> "*membership …. breaks down three simple things. Do we have a one-on-one relationship, an identified one-on-one relationship with a consumer? Can we increase our level of engagement with that consumer in value-added ways? And then does that increased engagement lead to greater retention and share of wallet if there are other purchases?*".[144]

71. On 22 September 2020, in its Q1FY21 earnings call, Nike CEO John Donahoe stated:

> "*The accelerated consumer shift toward digital is here to stay.*"[145] "*We know that digital is the new normal. The consumer today is digitally grounded and simply will not revert back. Our Digital business is already meeting our mix goal of 30%, nearly three years ahead of schedule and we will continue to grow from here.*"[146]
>
> "*I'm focused on how we will leverage consumer data and insights in our digital ecosystem to understand and serve consumers better, and ultimately increase our competitive advantage.*"[147]

adidas

72. adidas's digital offerings include its website (adidas.co.uk) and app (adidas app), and specialist apps such as the adidas CONFIRMED app which serves "sneaker-heads",

144 Similarly, on 18 March 2021, in its Q3FY21 earnings call (Annex 262), Nike CEO John Donahoe stated, on p. 4: "*NIKE's ability to sustainably grow digital for the long-term is rooted in our member connections... [W]e strategically focus on better serving and driving repeat engagement with active high-value members across all of our channels.*"

145 See transcript of Nike's Q1 FY21 Earnings call (Annex 283), p. 3. Similarly, on 18 December 2020, in its Q2FY21 earnings call (Annex 282), Nike CEO John Donahoe stated on p. 5:"*The consumer shift to digital is permanent and our digital penetration will only increase in years to come.*" And on p. 11: "*[D]igital is the new normal in consumer behaviour and we believe the trends that we are seeing are here to stay*". See also e.g. "*The digital shift is here to stay, and the industry has to adapt*" - Joe Preston, President and CEO, New Balance, cited in McKinsey, "Sporting Goods: the Next Normal for an Industry in Flux" January 25, 2021 (Annex 118), p. 20. See also p. 51 (McKinsey European consumer survey of September 2020 indicating that 28 percent of respondents say they will reduce their use of physical channels going forward).

146 See transcript of Nike's Q1 FY21 Earnings call (Annex 283), p. 5.

147 See transcript of Nike's Q1 FY21 Earnings call (Annex 283), p. 6. Heidi O'Neill, now president of consumer and marketplace for Nike, explained in an interview from 2017 (available at: https://sgbonline.com/nikes-heidi-oneill-discusses-digital-first-strategy/) "*Overall, Nike members, who have signed up for exclusive deals, early reserves and other benefits, are currently worth three times the value of an anonymous consumers. At the most personalized level that tend to occur with those signed on through its SNKRS program, Nike is starting to see a five-times annual value.*"

customers with a special interest in launches, exclusives and brand narratives about adidas's sneakers. However, adidas's digital activities extend much more broadly into building the brand value and establishing direct connections with consumers, including through the adidas Training by Runtastic app (workout and fitness exercises) and adidas Runtastic Running App (plans for 5k, 10k and marathon training and challenges and virtual races).[148]

73. adidas also operates a Creators Club,[149] which is free to join and enables customers to earn points by buying adidas products or using adidas's training apps. The points can be redeemed to access limited edition products, attend special events, etc. The operation of the Creators Club enables adidas to acquire extensive customer data, including from customers buying from third party retailers. In addition, during the pandemic, adidas emphasised the government's stay at home message and encouraged customers to use their fitness apps to work out at home. The consumer lifetime value of Creators Club members is more than twice as high as non-members.[150]

74. adidas is a major client of Tradebyte (which now owns Anatwine[151]) a SaaS company which "*enable[s] seamless 'direct to consumer' experiences for brands and manufacturers*"[152] and which offers brands the opportunity "*to <u>sell your products directly to the customer through a retailer. As a seller, you decide how, where and at what price the items are offered</u>.*"[153] In particular, adidas has used Tradebyte to sell through Zalando.[154]

75. adidas has invested heavily in its digital offering, including through its purchase of Runtastic (fitness apps) for an enterprise value of €220m in 2015,[155] and an investment of a further €1bn in "*digital transformation*" by 2025.[156]

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148 See adidas Annual Report, 2020 (Annex 190), p. 81.
149 See https://www.adidas.co.uk/creatorsclub?cm_mmc=AdieSEM_Google-_-adidas-Creators_Club-B-Exact-_-creators-club-_-adidas%20creators%20club&cm_mmca1=UK&cm_mmca2=e&ds_kid=43700044772723694&gclid=CjwKCAjw9r-DBhBxEiwA9qYUpXwuKNpP1nMJf3AUXWyGMLitsS-xqeQgFxheCS5VqQRCMsKl5qBRLBoCdc8QAvD_BwE&gclsrc=aw.ds.
150 See adidas Annual Report, 2020 (Annex 190), p. 81.
151 See https://blog.tradebyte.com/en/anatwine-and-tradebyte-join-forces.
152 See https://www.tradebyte.com/en/about-us/.
153 See https://www.tradebyte.com/en/brands/dtc-business/.
154 See https://fashionunited.uk/news/business/zalando-adidas-team-up-to-fulfil-consumer-demand/2015121118705.
155 See https://www.adidas-group.com/en/media/news-archive/press-releases/2015/adidas-group-acquires-runtastic/.
156 See the adidas Growth Strategy release (Annex 189), p. 3.

76. Table 6 shows the growth in global sales of adidas's own digital sales (i.e. excluding those of its wholesale distributors). The impact of the COVID-19 pandemic can be seen most clearly in the jump in rate of change between Q1 and Q2 of FY to 31 December 2020.

Table 6: growth in global digital sales by adidas itself (excluding wholesale partners)

Financial year	Quarters	Digital sales growth (%)
To 31 Dec 2017		+57%[157]
To 31 Dec 2018		+36%[158]
To 31 Dec 2019		+34%[159] to "*slightly below*" €3bn[160]
To 31 Dec 2020		+53% to >€4bn[161]
***… of which*:**	… Q1	+35%[162]
	… Q2	+93%[163]
	… Q3	+51%[164]
	… Q4	+43%[165]
2025 target		"*double*" to €8-9 bn

77. On 27 April 2020, in its Q1FY20 earnings call, Kasper Rorsted, adidas's CEO, attributed the acceleration of the company's digital strategy to the COVID-19 pandemic:

> "*there is no doubt the acceleration we are seeing right now towards a more digital and D2C-led company is getting a huge step forward, compared to a normal set-up.*"[166].

78. On 6 August 2020, in its Q2FY20 earnings call, Kasper Rorsted, adidas's CEO, said:

> "*Digital is and will continue to be our most important commercial and brand driver… A customer we know is a more valuable customer… We've already defined building blocks and investments for the future. Focusing on Creators Club members as the anchor of the digital experience, shifting marketing investments towards digital and achieving consistent storytelling, leveraging*

157 See adidas' FY 2018 results, 13 March 2019 (available at: https://www.adidas-group.com/media/filer_public/cc/84/cc84ca30-2990-4091-a00c-c2492bb2881d/q4_2018_ir_final.pdf), slide 15.
158 See adidas' 2018 annual report (available at: https://www.adidas-group.com/media/filer_public/e9/ba/e9bad34f-ca11-44f6-977f-364d0650feaf/annual_report_gb-2018-en_secured.pdf), p. 20.
159 See adidas' 2019 annual report (available at: https://www.adidas-group.com/media/filer_public/a8/5c/a85c9b8e-865b-4237-8def-8574be243577/annual_report_gb-2019_en.pdf), p. 53.
160 See transcript of adidas' Q2FY20 earnings call of 6 August 2020 (Annex 195), p. 21.
161 See adidas' 2020 annual report (Annex 190), p. 10.
162 See adidas' Q1 2020 Fact Sheet (available at: https://www.adidas-group.com/media/filer_public/6e/6a/6e6a09d6-adb0-4050-82f5-a050277822c5/fact_sheet_q1_2020_en.pdf), p.11.
163 See adidas' Q2 2020 Fact Sheet (available at: https://www.adidas-group.com/media/filer_public/69/3b/693bb0fb-0baf-461e-8a62-bae64d7b0f60/fact_sheet_q2_2020_en.pdf,) p.11.
164 See adidas' January-September 2020 Fact Sheet (available at: https://www.adidas-group.com/media/filer_public/a1/8a/a18ab840-79fe-462d-bdba-b21d08e24666/fact_sheet_9m2020_en.pdf), p. 9.
165 See adidas' press release, 10 March 2021 (Annex 182), p. 1.
166 See transcript of Q1FY20 earnings call of 27 April 2020 from Seeking Alpha, "adidas AG ADR (ADDYY) CEO Kasper Rorsted on Q1 2020 Results - Earnings Call Transcript", 27 April 2020 (Annex 194), p. 4.

> *consumer insights along the value chain and scaling data-driven creation and strengthening operational backbone with additional logistic capacity.*"[167]
>
> "*there is no doubt that the consumers that have moved online will continue to be online and will continue to, where they're getting a good experience, shop at that space.*"[168]
>
> "*the transition to e-com will require us to invest more in dedicated distribution facility so we can ensure that we can distribute to our customers because we took a 2- to 3- year step forward*"[169] as a result of the COVID-19 pandemic. "*[W]e also understand the requirement for fairly large investments moving forward.*"[170]

79. On 10 March 2021, adidas presented its growth strategy to 2025, "Own the Game".[171] It forecast that its e-commerce business would "*double from currently*" by 2025 to €8 to €9bn and proposed to invest more than €1bn to support the digital transformation, including by expanding its data and technology expertise internally and expanding its membership program (seeking to triple the number of members from more than 150m currently to around 500m by 2025).[172]

(iii) Evidence from the Parties' internal documents

80. JD Sports' internal documents describe the accelerating shift to digital:

    (a) **[✂]**[173] **[✂]**:

    [✂] ". [174]

    (b) **[✂]**[175] **[✂]**[176] **[✂]**.

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167 See transcript of Q2FY20 earnings call of 6 August 2020 from Seeking Alpha, "Adidas AG (ADDYY) CEO Kasper Rorsted on Q2 2020 Results - Earnings Call Transcript", 06 August 2020 (Annex 195), pp. 11 and 12.

168 See transcript of Q2FY20 earnings call of 6 August 2020 from Seeking Alpha, "Adidas AG (ADDYY) CEO Kasper Rorsted on Q2 2020 Results - Earnings Call Transcript", 06 August 2020 (Annex 195), p. 17.

169 See transcript of Q2FY20 earnings call of 6 August 2020 from Seeking Alpha, "Adidas AG (ADDYY) CEO Kasper Rorsted on Q2 2020 Results - Earnings Call Transcript", 06 August 2020 (Annex 195), p. 18.

170 See transcript of Q2FY20 earnings call of 6 August 2020 from Seeking Alpha, "Adidas AG (ADDYY) CEO Kasper Rorsted on Q2 2020 Results - Earnings Call Transcript", 06 August 2020 (Annex 195), p. 18.

171 See the adidas Growth Strategy release (Annex 189).

172 See also adidas's Annual Report, 2020 (Annex 190), p. 71.

173 **[✂]**

174 **[✂]**

175 **[✂]**

176 **[✂]**

(c) **[✂]**[177].[178]

(d) **[✂]**:

> "**[✂]** ".[179]

(e) **[✂]** ".[180]

(d) **[✂]**[181] **[✂]**[182] **[✂]**".[183]

(iv) Evidence from competitors

81. Competitors also (i) anticipate an ongoing shift to digital and (ii) are investing considerable sums to meet that shift, sums that greatly exceed those available to an independent Footasylum.

(a) **Next** issued its preliminary results on 1 April 2021 for the year to January 2021.[184] Next's management are highly regarded for their astute analysis of UK retailing. In their prelims, Next stated:

> "*We expect the shift in consumer behaviour towards Online sales to continue for some time and one of our priorities during the year has been to continue the development of our Online platform. We accelerated part of our planned capital expenditure in the Online business, spending £121m on warehousing and systems.*"

> "*Retail stores were, and will remain, at a fundamental and irreversible disadvantage to online competition. This is not being driven by price or even home delivery, but by the scale of the choice websites can offer relative to any physical store. The annual decline in Retail like-for-like sales has become the new normal, and looks set to remain that way for many years.*"

> "*Unlike physical stores, the internet is unconstrained by limited display space. In addition, items can be made available online with minimal stock investment, whereas making an item available across 500 stores, in several sizes, requires thousands of units.*"

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177 **[✂].**

178 **[✂].**

179 **[✂].**

180 **[✂].**

181 **[✂].**

182 **[✂].**

183 **[✂].**

184 See Next's Results for the Year Ending January 2021, 1 April 2021 (Annex 236).

> "*It is impossible to say with certainty how many customers, who shopped Online as a result of the pandemic, will remain shopping Online once stores reopen. Our instinct is that retention rates for customers acquired in 2020 are likely to be similar to those gained in more normal times, though we recognise that might be optimistic. One thing appears to be certain, the longer the pandemic encourages online shopping, the more likely it is that customers will keep shopping that way. What might start as an experiment or lockdown necessity, over time, becomes increasingly normal and convenient.*"

> "*The pandemic has served to accelerate a pre-existing social trend - the move to more online shopping. History has been given a shove and, having moved forward, seems unlikely to reverse.*"

> "*We continue to develop new business ideas within the Group, chief amongst these being our ... Total Platform businesses... Total Platform aims to leverage NEXT's Online infrastructure and provide partners with a comprehensive solution to trading online - website, call centres, warehousing, distribution, returns and retail services all handled by NEXT.*" (Total Platform is therefore similar in structure to Zalando.)

(b) In **Frasers Group's** Annual Report (issued on 20 August 2020) for the 52 weeks to 26 April 2020, Frasers stated that it "*intends to invest in excess of £100m in its digital elevation strategy… This commitment will support the Group's wider ongoing elevation strategy.*"[185] On announcements of 23 February and 9 April 2021, Frasers Group plc stated[186] that it anticipated taking a further impairment charge which could exceed £200m for its freehold and leasehold (IFRS 16 right of use) properties and property, plant and equipment in particular because of "*potential systemic changes to consumer behaviour*". This appears to be a reference to a potential significant shift from shopping in store to shopping online.

(c) **Shop Direct / the Very Group** Limited, which owns the online department store very.co.uk and stocks a wide range of desirable Nike and adidas SKUs, reported growth in the six months to 31 December 2020 in sales of sportswear of 10.4%.[187]

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185 See outlook statement in Frasers Group Annual Report (Annex 322), p.2. See also p. 7: "*To achieve our objectives with the elevation strategy we will rely heavily on our third party brand partnerships, particularly Nike and adidas.*"

186 See: https://www.investegate.co.uk/frasers-group-plc--fras-/rns/covid-potential-accounting-impact-on-asset-values/202102230700039626P/ and https://www.investegate.co.uk/frasers-group-plc--fras-/rns/covid-potential-accounting-impact-on-asset-values/202104090700039054U/.

187 See https://theverygroup.com/wp-content/uploads/2021/02/The-Very-Group-Ltd-Interim-Financial-Statements-Q2-YTD-2020-21.pdf, p. 1.

(d) **THG (The Hut Group)**, the consumer brands company which listed recently in the UK and has a market capitalisation of over £6bn, announced on 15 April 2021[188] that its THG Ingenuity division, which provides an end-to-end direct-to-consumer e-commerce solution for consumer brand owners, had signed up Pentland Brands Limited. THG Ingenuity will manage the digital e-commerce experience for Pentland's portfolio of sports, outdoor and lifestyle brands, such as Berghaus and Speedo. This deal provides THG – which has a heritage in health & beauty and nutrition – with credibility in product categories that are close to those of the Parties.

(e) **Amazon** continues to invest significantly in improving its digital infrastructure. In July 2020, Amazon reported strong second quarter results with operating cash flow, free cash flow, net sales, operating income all around 40% higher in the year prior than in the year prior to Q2 2019.[189] As industry commentators have noted, the prevalence of Amazon and its push to offer next and same-day delivery means that customers expect a similar offering from all retailers, including those listed above. This in turn means that all retailers need to continually invest in their digital infrastructure to meet customers' expectations.[190]

82. The JP Morgan Cazenove note analysed the offerings of "*brands and retailers in the UK*" and reviewed 10 suppliers.[191] In addition to four brands (Nike, adidas, Puma and Under Armour), the analysts discussed five retailers (other than JD Sports): Foot Locker, ASOS, Zalando, Zara and H&M. All five are investing heavily:

(a) On 17 February 2021, **Foot Locker**, which has very close relations with Nike,[192]

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188 See https://www.investegate.co.uk/thg-plc--thg-/rns/fy20-preliminary-results-and-q12021-trading-update/202104150700035637V/.

189 See https://press.aboutamazon.com/news-releases/news-release-details/amazoncom-announces-second-quarter-results.

190 See for example, The Guardian, 'How Amazon became a pandemic giant – and why that could be a threat to us all', 18 November 2020, https://www.theguardian.com/technology/2020/nov/18/how-amazon-became-a-pandemic-giant-and-why-that-could-be-a-threat-to-us-all.

191 See the JP Morgan Cazenove note (Annex 275), pp. 20-21.

192 See, e.g., their pilot drop-ship program in the US enabling Foot Locker to activate inventory that they do not hold in their stores or websites as noted in the transcript of their Q4FY20 earnings call (Annex 235), pp. 4 and 18 and their collaboration on the Washington Heights concept store, reported in FN, "Nike & Foot Locker Just Collaborated on a Store Concept That Shows Where the Future of Sneaker Retail Is Headed", 9 August 2020, and FN, "Why Foot Locker's Coronavirus Recovery Depends a Lot on Nike", 22 May 2020.

announced plans[193] for <u>$275m of capital expenditure</u> in 2021, emphasising: "*<u>A meaningful portion of funds</u> will be invested into its digital capabilities and infrastructure, enhancement of the digital customer experience*".

(b) In its Annual Report for FY to 31 August 2020, **ASOS**, the pure-play online retailer which has a "*strategic focus*" on sportswear[194] – where it "*see[s] clear opportunity to continue increasing our share*"[195] – and a close relationship with adidas,[196] reported capex of £115.6m on technology platforms and warehouse infrastructure and forecast capex of £170-180m in FY21, including on a fourth fulfilment centre.[197] ASOS is investing in developing a "*partner fulfilment*" DTC service and intends to launch at the end of the calendar year 2021, pursuant to its strategic objective to "*enhance our flexible and multi-brand platform; partnering with brands to expand high potential categories, implementing flexible fulfilment capabilities to expand customer choice.*"[198] ASOS's partner fulfilment DTC service is very similar to Zalando's, that has proven popular with Nike and, especially, adidas.

(c) In its Capital Markets Day 2021 presentation, **Zalando**,[199] Europe's biggest online-only fashion retailer,[200] reported a "*Step change in online penetration in 2020 that is <u>expected to continue to increase from its higher base</u>*"[201] and noted "*The COVID-19 pandemic has accelerated change in the fashion industry that has long been in progress and <u>blurred the boundaries between offline and online</u>*".[202]

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193 See transcript of Foot Locker's Q4 2020 Earnings call (Annex 235), pp.9-10 and <u>https://investors.footlocker-inc.com/news-releases/news-release-details/foot-locker-inc-announces-2021-capital-allocation-plans</u>.

194 See ASOS' interim results for the six months to 28 February 2021 (Annex 156), p.5.

195 See ASOS' "2020 in Review" (Annex 162), p. 6.

196 See ASOS' 2020 Annual Report (Annex 161) , p. 15:"*In January, we dropped Beyoncé's long-awaited adidas X IVY PARK collaboration… Working closely with adidas on the launch of this collection …. The initial product range sold out within a few hours*".

197 See ASOS' 2020 Annual Report (Annex 161), p. 7.

198 See ASOS's interim results to 28 February 2021 (Annex 156), p.4. ASOS said on its 14 October 2020 earnings call that it was in discussions with "*2 very large global brands*" about its platform / flex fulfilment functionality (Annex 160), p. 35.

199 Zalando benchmarks itself against H&M, Inditex, ASOS, adidas and Nike: see Annex 356, slide 9.

200 See Reuters article "Zalando to deliver orders for adidas French website", 19 August 2019 (https://www.reuters.com/article/us-zalando-adidas-logistics-idUKKCN1V90JM).

201 See Zalando's Strategy Update 2021 (Annex 356), slide 10.

202 See Zalando's Strategy Update 2021 (Annex 356), slide 27.

(d) **Inditex** (which owns brands including **Zara**) is investing over €1bn in digital capital expenditure over 2020-22.[203]

(e) **H&M's** FY2020 Annual Report states:

> "*Customers are looking for a smooth, simple and inspiring experience in which stores and online interact and enhance each other, and in recent years the H&M group has therefore made substantial investments to provide this.*"[204]

E. IMPACT OF THE THREE CHANGES ON THE PARTIES

(i) Impact of the three changes on JD Sports

83. JD Sports has traded well through the COVID-19 pandemic, successfully transitioning to online sales during periods when stores were closed. In its interim results for the 26 weeks to 1 August 2020,[205] JD Sports stated:

> "*The majority of our physical store estate was closed for periods of up to three months. However, demand remained resilient with consumers readily switching to online channels reflecting the benefits of an agile omni-channel approach which has been developed over a number of years. Across the countries where we had to temporarily close stores, approximately 60% of the combined store and online revenues from the prior year were retained through the closure period.*"

84. In its trading statement of 11 January 2021,[206] JD Sports said that revenues for the 22 weeks to 2 January 2021 in the Group's like for like businesses were more than 5% ahead of the prior year "*as consumers readily switched between physical and digital channels*".

85. On 13 April 2021,[207] JD Sports announced its preliminary results for the 52 weeks ending 30 January 2021,[208] reporting profit before tax of £324m after exceptional items that included a writedown of £55.6m (to zero) in the balance sheet value of the goodwill and

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[203] See Inditex's 2020 results presentation available at https://www.inditex.com/documents/10279/648175/2020_Results_v2.pdf/270b31a8-def3-c53e-73a9-91200087e0d2, slide 15.

[204] See H&M's FY2020 Annual Report (available at https://hmgroup.com/wp-content/uploads/2021/04/HM-Annual-Report-2020.pdf), p. 38.

[205] See JD Sports' interim results for the 26 weeks to 1 August 2020 (Annex 121), p.3.

[206] See JD Sports' Trading Update of 11 January 2021 (Annex 120), p.1.

[207] Also on 13 April 2021, JD Sports and Clipper Logistics plc announced that they had signed a letter of intent for Clipper to provide JD Sports with e-fulfilment services from its distribution centre in Sherburn, near Leeds: see https://www.investegate.co.uk/clipper-logstcs-plc--clg-/rns/jd-sports-and-clipper-announce-letter-of-intent/20210413070004 2100V/. Clipper Logistics is a leading provider of value-added logistics solutions, e-fulfilment and returns management services to the retail sector. **[✂]**

[208] See JD Sports' Results for the 52 weeks ended 30 January 2021 (Annex 122), pp. 3, 1, 4.

fascia name from its acquisition of Footasylum. JD Sports attributed its successful trading in material part to its strong omni-channel offering and its relationship with the brands, stating:

> "*We have* *a market leading multichannel proposition* *which continues to enhance its relevance to consumers and has the necessary agility to progress in an environment where the retailing of international brands may see permanent global structural change.*"
>
> "*Our teams have* *risen to the challenges associated with the frequent shift in demand between channels* *resulting in a strong retention of sales across our various markets, but particularly in the UK and United States. We also* *continue to invest in data analytics* *to further enhance our insight of the consumer.*"[209]
>
> "*JD is* *highly regarded by the brands*: *JD has a positive relationship and is of increasing relevance to a significant number of international brands who recognise that we share their vision of an elevated marketplace and that we look to nurture collaborative affiliations over the long term. They also acknowledge that we actively seek to enhance the equity of a brand through a compelling and differentiated proposition in stores and online which gives a rich experience consistent with the premium nature of the product mix. These brands particularly value the fact that we have a unique relationship with our customer base that helps give immediate credibility to new styles and ranges.*"

86. JD Sports provided a positive outlook statement, guiding for headline profit before tax[210] for the full year to 29 January 2022 in the range of £475 million to £500 million.

87. JD Sports' internal document, "**[✂]**" reported (in the initial months of the first lockdown):

> "**[✂]**"[211]

88. JD Sports is expected by analysts and investors to continue to trade well in the medium term. The JP Morgan Cazenove note states "*JD Sports is increasingly standing out as one of the few real differentiated partners for the brands*"[212] and it therefore remains a significant partner for the brands with low risks of disintermediation in the medium term.[213] This upbeat assessment of JD Sports' medium term prospects is supported by its share price, which reached all-time highs following publication of its preliminary

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209 JD Sports capitalised £19.1m of expenditure on software development in its sports fashion business during the year (prior year: £23.2m): see note 2. The capital expenditure by JD Sports on digital dwarfs Footasylum's profit before tax of £1.7m (see note 5).

210 The headline figure excludes exceptional charges.

211 **[✂].**

212 See the JP Morgan Cazenove note (Annex 275), p. 22.

213 See also Investors Chronicle article, 25 March 2021, "Can JD Sports survive the threat of direct-to-consumer shopping?".

results on 13 April 2021, implying that investors regard the company's medium term prospects positively. **[✂]**

89. **[✂]**[214] **[✂]**".[215]

90. **[✂]**[216] **[✂]**[217] **[✂]**[218] **[✂]**[219] **[✂]**.[220]

(ii) Impact of the three changes on Footasylum

91. Footasylum also traded well, particularly through the initial phases of the COVID-19 pandemic. It benefited from the extensive governmental support offered to retailers, including the furlough scheme, business rates relief and VAT deferral. It has successfully transitioned to online sales as it has a functioning website and fulfilment capabilities. JD Sports' preliminary results reported that, in the 52 week period ended 1 February 2020, Footasylum generated revenue of £215.9m and made profit before tax of £1.7m.[221]

92. **[✂]**[222] **[✂]**[223] **[✂]**[224] **[✂]**[225]

93. However, since that **[✂]** November 2020, the prospects for Footasylum as an independent **[✂].**

94. First, as described in section B above, Nike and adidas are growing DTC rapidly and are aiming to increase their DTC sales considerably. This growth by the DTC providers will divert business away from retailers including Footasylum.[226]

214 See JD Sports' response to CMA s.109 dated 6 April 2021, question 4.
215 **[✂]**
216 **[✂]**
217 **[✂]**
218 See https://www.investegate.co.uk/clipper-logstcs-plc--clg-/rns/jd-sports-and-clipper-announce-letter-of-intent/202104130700042100V/.
219 See https://www.retailgazette.co.uk/blog/2021/04/boohoo-signs-lease-to-open-4th-warehouse/.
220 See:https://otp.tools.investis.com/clients/uk/jdsports3/rns/regulatory-story.aspx?cid=222&newsid=1468564&culture=en-GB&val=637545528399534488 https://www.investegate.co.uk/clipper-logstcs-plc--clg-/rns/jd-sports-and-clipper-announce-letter-of-intent/202104130700042100V/.
221 See JD Sports' Results for the 52 weeks ended 30 January 2021 (Annex 122) , p.23.
222 **[✂]**.
223 **[✂]**.
224 **[✂]**.
225 **[✂]**.
226 **[✂]**

95. Secondly, as described in section C above, Footasylum is vulnerable to progressive disintermediation: the brands' clearly stated policies are to reduce the number of retailers, by cutting out those "*middlemen*"[227] who provide least value to the brands. As Jonathan Pritchard of brokers Peel Hunt explains, DTC "*is a massive threat to retailers that don't have strong relationships with Nike and Adidas*" and "*It's the lesser retailers that are going to find their allocations potentially struggling over time*."[228] Whilst JD Sports is benefiting from Nike and adidas seeking to consolidate around a smaller number of preferred retailers, **[✂]**

96. **[✂]**

97. **[✂]**[229] **[✂]**[230] **[✂]**

98. **[✂]**.[231] These were described in paragraphs 52-59 above.

99. **[✂]**.

100. Thirdly, as described in section D above, whilst Footasylum has a functioning website and fulfilment capabilities, it is not able to invest at the level of Nike's most important partners.[232]

    (a) Footasylum's competitors (including the brands) are investing heavily in digital (including "*ability to use AI and machine learning, digital demand sensing, insight gathering, digital marketing, membership personalisation, even inventory optimization*"[233]) and Footasylum would have less ability to invest in a manner that would keep pace with Nike's most important partners. **[✂]**[234] . This is a small sum when compared with the recent and planned capital expenditure of the brands (e.g., Nike's investment of over $1bn on data and

227 See Investors Chronicle article, 25 March 2021, "Can JD Sports survive the threat of direct-to-consumer shopping?".

228 See Investors Chronicle article, 25 March 2021, "Can JD Sports survive the threat of direct-to-consumer shopping?".

229 **[✂]**

230 **[✂]**

231 **[✂]**

232 Or, for that matter, in extensive store refurbishments.

233 See comments of John Donahoe, CEO of Nike, on Q1FY21 earnings call (Annex 283) of 22 September 2020, p. 19-20.

234 **[✂]**

analytics capabilities in 2019[235]), and other retailers noted above (e.g., Foot Locker's plans for <u>$275m of capital expenditure</u> in 2021;[236] and Next's planned capital expenditure in its online business of £121 million on warehousing and systems).[237]

(b) Digital sales through independent retailers are obviously less attractive to brands than sales through their own digital offerings, but are also less attractive than sales through partners such as Zalando, Next – and potentially ASOS – who provide the brands with much greater control over "*how, where and at what price the items are offered*" (see paragraph 36).

101. Moreover, the brands have been explicit that the shift to digital involves their obtaining data about consumers shopping in third party stores, which leaves retailers vulnerable to the brands using that data to increase their own (more profitable) DTC sales. Indeed, Nike talks directly about "*<u>owned</u> digital market share*" as a key measure of success[238] (assumedly in contrast to digital market share held by retailers).

F. <u>IMPACT OF THE THREE CHANGES ON THE COMPETITIVE ASSESSMENT</u>

102. The three changes identified in sections B to D significantly alter the competition analysis of the transaction. In this section the Parties discuss the constraint posed by Footasylum on JD Sports and then the constraint posed by JD Sports on Footasylum.

<u>(i) Footasylum as a constraint on JD Sports</u>

103. First, the actual and expected growth in DTC means that Nike and adidas are now stronger and closer competitors to JD Sports than in the pre-pandemic period up to early Q1 2020, and will become stronger and closer competitors of JD Sports' sales of those brands' own products for so long as that continues. Several suppliers have highlighted the fluidity that now exists between physical and digital sales.[239] The convergence

235 See Business of Fashion article, "Inside Nike's Radical Direct-to-Consumer Strategy", December 2020, p. 9.
236 See transcript of Foot Locker's Q4 2020 Earnings call (Annex 235), p.9.
237 See Next's Results for the Year Ending January 2021, 1 April 2021 (Annex 236), p. 2.
238 See Nike's Earnings call transcript for Q1 FY21 (Annex 283), p. 9.
239 See Nike's Earnings call transcript for Q3 FY21 (Annex 262), p. 12, states: *"We start in every case with the consumer, and the consumer is really clear that they want to get what they want when they want it, how they want it and they want a seamless, premium, digital and physical experience. In fact, in many*

implies that the multi-channel constraint from Nike and adidas on JD's multi-channel proposition, not least its physical store estate, has increased considerably, a trend that is likely to continue. This growing competitive threat holds true even if one were to assume the constraint from Footasylum on JD were constant, i.e. the same now as it was in 2017, 2018 or 2019.

104. Secondly, however, in addition to the greater DTC constraint, Footasylum is **[✄]**.

105. Thirdly, Footasylum lacks the resources to invest as heavily in digital and elevate its proposition as far and as fast as the brands themselves, and their most important retail partners. Consequently, the strategic competitive constraints on JD Sports for the next several years will be the aggregate of Nike, adidas, Foot Locker, Sports Direct's elevated stores, Zalando and the leading fashion retailers, ASOS, Next, H&M, Inditex, very.co.uk, etc. Each of these constraints has its own reasons for its success that do not transpose to Footasylum, whether:

- the dual nature of the brands as suppliers and DTC competitors;
- the pure-play online destination success of ASOS, Zalando very.co.uk or Amazon; or
- the scale, resources and footprint of Next, Foot Locker, Frasers Group, H&M, Inditex/Zara, et al.

106. Drawing these strands together, any incentive that a static GUPPI calculation might imply for JD Sports to weaken its offering and recoup sales through Footasylum's comparatively very small store estate and online business would be overwhelmed by the incentives to compete on account of the dynamic sources of competition outlined above.

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cases, they don't see a difference between digital and physical". The same report states, *"[We'll] work with a smaller number of strategic partners that see the same future we do, and that want to and are willing to share membership data so that we can, together, deliver a very seamless experience, a very personalized experience for our consumers."* Similarly, adidas's 2020 annual report (Annex 190), p. 183, states, *"a changing retail industry… is experiencing rapid substitution of physical retail stores by digital commerce platforms as well as increasing connectivity between physical and digital retail"*.

(ii) JD Sports as a constraint on Footasylum[240]

107. First, the actual and expected growth in DTC means that Nike and adidas are now stronger and closer competitors to Footasylum and will become stronger and closer over the foreseeable future.

108. Secondly, as to the disintermediation described in section C above, Footasylum is seeking to hold on to its allocations from Nike (and adidas). In considering whether, at JD Sports group level, to weaken Footasylum's offering (in order to benefit from any diversion of customers from its Footasylum fascia to its JD Sports fascia), the merged group would need to consider the likely responses of the brands.

109. The brands' recent statements show that they do not consider themselves dependent on retailers such as Footasylum, whose position in the brands' retailer hierarchy is increasingly vulnerable. The economic consequences of weakening the Footasylum offering, at a time when the brands are reducing, or ceasing supplies to many retailers, would likely be severe. Therefore, brands' push to disintermediate retailers further disincentives JD Sports from weakening Footasylum's offering.

G. CONCLUSION

110. The Parties request the CMA to consider the evidence set out above as part of its remittal process.

111. Consistent with the points made in this submission, on 13 April 2021, JD Sports announced in its preliminary results that its accountants have required it to write down by £55.6m the balance sheet value of the goodwill and fascia name from its £90m acquisition of Footasylum. The write down reduced the value of the assets to zero and reduced JD Sports' profits by the same sum.[241]

240 When one merging party is much smaller than the other, it is often the case that a GUPPI or diversion analysis suggests a greater risk of the loss of a particularly important constraint on the smaller player from the larger one than vice versa. This has been a concern in three leading cases at Phase 1, (*Heinz/HP* (2005), *Waterstone's/Ottakars* (2005), and *AG Barr/Britvic* (2013)), but not, in those cases, at Phase 2. As the CMA is aware, the Phase 2 test is an expectation of SLC in a market or markets in the UK, and not just the fraction of the market accounted for by a player with a small single-digit share. In assessing the likelihood of an SLC in relation to Footasylum, its small size is relevant. The assessment of adverse effects depends not only on the loss of the constraint of JD Sports on Footasylum, but also the ease and likelihood that Footasylum can be replaced by the brands through increased DTC, expansion of the brands' important partners via progressive disintermediation, or expansion of other retailers well-placed to take advantage of digital growth.

241 See JD Sports' preliminary results for the 52 weeks ending 30 January 2021 (Annex 122), p.5: "*The continuation of the temporary store closures into the new financial year together with the reduction in the support available for local authority rates have inevitably had a negative impact on the expectations*

112. Nevertheless, JD Sports remains committed to its acquisition of Footasylum for three reasons.[242]

(a) JD Sports will be able to put Footasylum on a firmer financial footing and invest in Footasylum to enable it to meet the brands' ever-increasing demands. Crucially, JD Sports, being one of the most important global partners of Nike and adidas, described in detail above, will be much better placed than an independent Footasylum to persuade Nike and adidas to allocate more desirable products to Footasylum.

(b) Footasylum will also benefit operationally from JD Sports' recognised strength and expertise in merchandising, marketing and best in class store / digital technology. JD Sports also expects efficiencies to result by way of synergies arising from the consolidation of certain central functions and potential economies of scale across the two companies.

(c) The acquisition of Footasylum's range of in-house/own brand labels will assist JD Sports to advance its' strategic aim of diversifying its existing brand portfolio, whilst simultaneously enabling Footasylum to develop its international reach (see paragraph 33(e)(i) – **[✂]**).

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for the performance of Footasylum in the year to 29 January 2022. Furthermore, there is inevitably considerable uncertainty as to whether levels of footfall into the Footasylum stores, which attract an older demographic than JD, will recover to historic levels which could adversely impact the longer term viability of certain stores. As a consequence, the financial projections no longer support the carrying value of the fascia name and goodwill which arose on the acquisition with a charge of £55.6 million recognised in relation to the impairment of these assets."

242 See JD Sports' preliminary results for the 52 weeks ending 30 January 2021 (Annex 122), p.22: "*The Board believes that Footasylum is a well-established business with a strong reputation for lifestyle fashion and, with its offering targeted at a slightly older consumer to JD's existing offering, it is complementary to JD. The Board also believes that there will be significant operational and strategic benefits from a combination of the two businesses.*"