



COMPANY UPDATE / ESTIMATE CHANGE

Key Metrics	
NKE - NYSE	(as of 12/29/17) \$62.55
Price Target	N/A
52-Week Range	\$50.35 - \$65.18
Shares Outstanding, basic (mil)	1,627
Market Cap. (\$ mil)	\$101,769
3-Mo. Average Daily Volume	9,990,000
Institutional Ownership	81%
Total Debt/Total Capital (11/17)	29%
ROE (TTM ended 11/17)	32%
Book Value/Share (11/17)	\$7.23
Price/Book Value	8.7x
Annual Dividend & Yield	\$0.80 1.3%
EBITDA Margin (TTM ended 11/17)	16%

EPS FY 5/31 (excludes nonrecurring items)					
	2017	Prior 2018E	Curr. 2018E	Prior 2019E	Curr. 2019E
1Q	\$0.73		\$0.57	A	
2Q	\$0.50		\$0.46	A	
3Q	\$0.68	\$0.69	\$0.52		
4Q	\$0.60	\$0.67	\$0.70		
Year	\$2.51	\$2.33	\$2.25		\$2.60
P/E	24.9x		27.8x		24.1x

Note: Quarterly EPS figures may not add to annual figure due to rounding.  
EPS and revenue figures are from continuing operations.

Revenues (\$mm)					
	2017	Prior 2018E	Curr. 2018E	Prior 2019E	Curr. 2019E
1Q	\$9,061		\$9,070	A	
2Q	\$8,180		\$8,554	A	
3Q	\$8,432	\$8,950	\$8,860		
4Q	\$8,677	\$9,370	\$9,366		
Year	\$34,350	\$35,800	\$35,850		\$38,250

**Company Description:** Nike, Inc. is a global designer, marketer, and distributor of athletic footwear, apparel, equipment, and accessories for a wide variety of sports and fitness activities. In addition to its namesake brand, wholly owned subsidiaries include Converse and Hurley.

**Nike, Inc.**

NKE — NYSE — Neutral-1

**2Q Beat Expectations But Had Some Challenges**

**Investment Highlights**

- **Like the previous quarter, fiscal 2Q earnings were better than expected but below the year ago period.** Positive factors included encouraging international growth, product development activity, growth in the direct-to-consumer (DTC) business, and continued share repurchases. Negative factors included another sales decline in North America, overall lower gross margin, higher operating expenses, and cautionary earnings guidance for the current 3Q period.
- **2Q revenues rose 5% to \$8.554 billion, roughly \$160 million above street consensus.** International revenues rose 14%, more than offsetting a 4.5% decline in North America where competitive pressures were above-average, in our view. Gross margin declined 121 basis points, less than the contraction in 1Q. Total selling & administrative expenses rose 10.5%, a function of higher marketing expenses and investments in the DTC business. The tax rate was about half the year-ago rate due mainly to a tax benefit, while the weighted average share count dropped 2% due to share repurchases. Diluted EPS of \$0.46 was down from \$0.50 a year ago, but better than the street consensus figure of \$0.40. The EPS beat relative to expectations was largely related to sequential improvement in several key international markets and double-digit growth in the DTC business.
- **Our rating remains Neutral.** Despite the EPS beat in 2Q, we have lowered our annual estimate due to several near-term issues. For example, our 3Q EPS estimate reflects a 24% year-over-year decline due to the timing of new product launches, an expected promotional environment, and an expected foreign currency headwind. The 4Q outlook appears more favorable, in our view. Stock valuation remains above our preferred buying level. We will monitor company and industry conditions as we seek a more attractive entry point.

**Note Important Disclosures on Pages 7-8.  
Note Analyst Certification on Page 7.**

**Exhibit 1****Consolidated Statements of Income** (in millions except percentages, basis point figures, and per share data)

	Quarter Ended			Six Months Ended		
	<u>11/30/17</u>	<u>11/30/16</u>	<u>% chg.</u>	<u>11/30/17</u>	<u>11/30/16</u>	<u>% chg.</u>
Revenues	\$8,554	\$8,180	4.6%	\$17,624	\$17,241	2.2%
Cost of Sales	<u>4,876</u>	<u>4,564</u>	6.8%	<u>9,984</u>	<u>9,502</u>	5.1%
Gross Profit	3,678	3,616	1.7%	7,640	7,739	(1.3%)
Demand Creation Exp.	877	762	15.1%	1,732	1,803	(3.9%)
Operating Overhead Exp.	<u>1,891</u>	<u>1,743</u>	8.5%	<u>3,892</u>	<u>3,599</u>	8.1%
Total Selling & Admin. Exp.	2,768	2,505	10.5%	5,624	5,402	4.1%
Operating Income	910	1,111	(18.1%)	2,016	2,337	(13.7%)
Interest Expense (Income)	13	15		29	22	
Other Expense (Income)	<u>18</u>	<u>(18)</u>		<u>36</u>	<u>(80)</u>	
Income Before Taxes	879	1,114	(21.1%)	1,951	2,395	(18.5%)
Income Taxes	<u>112</u>	<u>272</u>	(58.8%)	<u>234</u>	<u>304</u>	(23.0%)
Net Income	<u>\$767</u>	<u>\$842</u>	(8.9%)	<u>\$1,717</u>	<u>\$2,091</u>	(17.9%)
<b>Diluted Earnings Per Share</b>	<b><u>\$0.46</u></b>	<b><u>\$0.50</u></b>	(7.1%)	<b><u>\$1.03</u></b>	<b><u>\$1.23</u></b>	(16.3%)
Avg. # of Dil. Shares Outst.	1,661	1,693	(1.9%)	1,669	1,701	(1.9%)
Dividends Declared	\$0.20	\$0.18	11.1%	\$0.38	\$0.34	11.8%
<b>As a % of Revenues:</b>			<b><u>bp chg.</u></b>			<b><u>bp chg.</u></b>
Gross Profit	43.00%	44.21%	(121)	43.35%	44.89%	(154)
Demand Creation Exp.	10.25%	9.32%	94	9.83%	10.46%	(63)
Operating Overhead Exp.	22.11%	21.31%	80	22.08%	20.87%	121
Income Before Taxes	10.28%	13.62%	(334)	11.07%	13.89%	(282)
Net Income	8.97%	10.29%	(133)	9.74%	12.13%	(239)
Tax Rate	12.74%	24.42%	(1,167)	11.99%	12.69%	(70)
<b>Divisional Revenues (in millions):</b>						
North America Footwear	\$2,070	\$2,219	(6.7%)	\$4,504	\$4,737	(4.9%)
North America Apparel	1,279	1,273	0.5%	2,578	2,590	(0.5%)
North America Equipment	<u>136</u>	<u>158</u>	(13.9%)	<u>327</u>	<u>354</u>	(7.6%)
Total North America	3,485	3,650	(4.5%)	7,409	7,681	(3.5%)
International Footwear	2,956	2,603	13.6%	6,015	5,557	8.2%
International Apparel	1,482	1,262	17.4%	2,835	2,494	13.7%
International Equipment	<u>190</u>	<u>188</u>	1.1%	<u>419</u>	<u>415</u>	1.0%
Total International	4,628	4,053	14.2%	9,269	8,466	9.5%
Global Brand Divisions (licensing)	<u>23</u>	<u>21</u>	9.5%	<u>43</u>	<u>36</u>	19.4%
Total Nike Branded Revenues	8,136	7,724	5.3%	16,721	16,183	3.3%
Converse	408	416	(1.9%)	891	990	(10.0%)
Corporate	<u>10</u>	<u>40</u>	N/A	<u>12</u>	<u>68</u>	N/A
<b>Total Revenues</b>	<b>\$8,554</b>	<b>\$8,180</b>	<b>4.6%</b>	<b>\$17,624</b>	<b>\$17,241</b>	<b>2.2%</b>
<b>Nike Brand Revenue Mix:</b>			<b><u>bp chg.</u></b>			<b><u>bp chg.</u></b>
Footwear	61.77%	62.43%	(65)	62.91%	63.61%	(70)
Apparel	33.94%	32.82%	112	32.37%	31.42%	96
Equipment	4.01%	4.48%	(47)	4.46%	4.75%	(29)
Global Brand Divisions	<u>0.28%</u>	<u>0.27%</u>	1	<u>0.26%</u>	<u>0.22%</u>	3
	100.00%	100.00%		100.00%	100.00%	

Source: Nike, Inc.

Note: May fiscal year

**Exhibit 2****Contribution by Geographic Segment** (in millions except percentages and basis point figures)

	Quarter Ended			Six Months Ended		
	<u>11/30/17</u>	<u>11/30/16</u>	<u>% chg.</u>	<u>11/30/17</u>	<u>11/30/16</u>	<u>% chg.</u>
<b>Revenues</b>						
North America	\$3,485	\$3,650	(4.5%)	\$7,409	\$7,681	(3.5%)
EMEA	2,133	1,792	19.0%	4,477	4,054	10.4%
Greater China	1,222	1,055	15.8%	2,330	2,075	12.3%
Asia Pacific/Latin America	1,273	1,206	5.6%	2,462	2,337	5.3%
Global Brand Divisions*	23	21	9.5%	43	36	19.4%
Total Nike Brand	8,136	7,724	5.3%	16,721	16,183	3.3%
Converse	408	416	(1.9%)	891	990	(10.0%)
Corporate ~	10	40		12	68	
Total Revenues	\$8,554	\$8,180	4.6%	\$17,624	\$17,241	2.2%
<b>EBIT</b>						
North America	\$783	\$912	(14.1%)	\$1,785	\$1,916	(6.8%)
EMEA	337	313	7.7%	788	798	(1.3%)
Greater China	378	375	0.8%	772	746	3.5%
Asia Pacific/Latin America	291	266	9.4%	551	475	16.0%
Global Brand Divisions*	(602)	(619)	(2.7%)	(1,277)	(1,390)	(8.1%)
Total Nike Brand	1,187	1,247	(4.8%)	2,619	2,545	2.9%
Converse	48	78	(38.5%)	137	231	(40.7%)
Corporate ~	(343)	(196)	75.0%	(776)	(359)	116.2%
Total EBIT	\$892	\$1,129	(21.0%)	\$1,980	\$2,417	(18.1%)
<b>EBIT Margins</b>						
			<b>bp chg.</b>			<b>bp chg.</b>
North America	22.47%	24.99%	(252)	24.09%	24.94%	(85)
EMEA	15.80%	17.47%	(167)	17.60%	19.68%	(208)
Greater China	30.93%	35.55%	(461)	33.13%	35.95%	(282)
Asia Pacific/Latin America	22.86%	22.06%	80	22.38%	20.33%	205
Total Nike Brand	14.59%	16.14%	(156)	15.66%	15.73%	(6)
Total Company	10.43%	13.80%	(337)	11.23%	14.02%	(278)

\* Note: Global Brand Divisions represent licensing businesses not part of a geographic operating segment and include centrally managed expenses for the Nike brand.

~ Corporate segment consists of unallocated general and administrative expenses and other items.

EBIT = Earnings before interest and taxes

Source: Nike, Inc.

Note: May fiscal year

**Additional comments on fiscal 2Q.** Total 2Q revenues exceeded our estimate and the street consensus figure. Just as in Nike's 1Q, international growth offset a decline in North America and a large profit drop for the Converse brand. Overall gross margin was down 121 basis points compared to management's original guide of an approximate 180 basis point decline. The contraction related to foreign currency exchange rates and higher product costs per unit. Total selling & administrative expenses rose more than we anticipated as demand creation costs and operating overhead both grew more rapidly than sales. The tax rate was well below the year ago level due to a tax benefit related to stock-based compensation expense and an increase in the mix of earnings from outside the U.S., where tax rates are generally lower. Finally, the weighted average share count dropped nearly 2%, which also helped the EPS calculation.

In the competitive North America region, Nike-branded sales were down 4.5%, including a near 7% decline in footwear. EBIT (earnings before interest and taxes) dropped 14%, as investments in operations and expenses associated with a new partnership with the NBA had an impact.

We consider the EMEA (Europe, Middle East, and Africa) region the star of the quarter as it posted gains in sales and EBIT, improving on decent currency-neutral 1Q results. Fiscal 2Q results benefited from double-digit growth in footwear and apparel, solid demand with the DTC business, and an encouraging performance from Nike-owned stores.

Greater China and the Asia Pacific & Latin America segments also had gains in sales and EBIT. As for non-Nike branded business, Converse remained a disappointment with a slight sales decline but a pronounced drop in EBIT. Nike's total company EBIT in 2Q dropped 21% with a 337 basis point contraction in margin.

**Financial condition.** We believe Nike remains in good financial shape. At November 30, 2017, cash and short-term investments were \$6.389 billion. Inventories at quarter end were up 6%, in line with recent quarters and projected sales gains. The current ratio was 2.5-to-1. Total debt was \$4.711 billion, or 29% of total capitalization. Shareholders' equity at the end of the period was \$11.758 billion.

**Share repurchases and dividends.** During the fiscal 2Q period, Nike repurchased 16.7 million shares for \$902 million, representing an average cost of roughly \$54 per share. The company has nearly \$6 billion remaining on an existing repurchase authorization that went into effect in November 2015. We expect buybacks to remain a common use of cash flow.

In November 2017, Nike announced an 11% increase to its quarterly dividend, taking the rate to \$0.20 per share from the previous rate of \$0.18 per share. The first dividend at this rate was payable January 2, 2018. This marks the 16<sup>th</sup> consecutive year of dividend increases. With a current payout ratio of about 35% based on trailing EPS, we believe the streak of annual rate increases is likely to continue in future years.

**Earnings outlook.** Our primary concerns of late have been the challenges of stiffer competition (primarily Adidas), a promotional environment in North America, and near-term costs of growing the direct-to-consumer business. We are also still cautious regarding a potential cyclical downturn in demand for athletic merchandise, at least in North America, yet our concerns have diminished a bit recently. We will be closely watching trends among the key retailers and product suppliers such as Nike.

We have updated our financial outlook based on 2Q results and our view of the coming quarters. This includes the aforementioned 3Q challenges but some expected alleviation in 4Q. We now estimate FY18 revenues of \$35.850 billion, up \$50 million from our previous figure. We assume gross margin contraction of 80 basis points. Our projection of total SG&A expenses, in dollars, has increased a bit. We project EPS to decline 7% from last year to \$2.25, down \$0.08 from our previous estimate.

In FY19, we believe a more normalized competitive environment and more favorable foreign currency translation could contribute to reported revenue growth of nearly 7% and EPS growth of roughly 15% from a challenged FY18.

**Longer term.** Longer-term, we believe a reasonable revenue growth target is mid to upper single-digits with EPS growth in the low double-digit range. Our longer term outlook for Nike remains relatively bright. We like the global growth opportunities, seasoned management team, and strong financial condition.

We believe growth opportunities exist in all geographic markets and product categories, including deeper penetration in developed markets and aggressive expansion in developing markets. Also, continued investments in the growing and higher margin direct-to-consumer business could be a long-term source of growth. A strong financial condition, the recent capital raise, and a penchant to remain in a growth mode could lead to acquisitions, in our view. However, we have assumed none in our financial projections and investment thesis.

**Valuation.** NKE shares are currently trading at roughly 26x our estimate of forward twelve-month earnings. This is down from recent levels (including a peak figure of 31x less than two years ago), but above a ten-year historical median of 19x. As for relative valuation, the stock's forward price/earnings multiple versus the S&P 500 forward multiple is currently 1.3x, similar to the ten-year historical median.

In our view, NKE's current valuation (a notable premium to the ten year median) reflects solid company fundamentals, powerful brand equity, strong cash flow generation, and above-average long-term earnings growth potential. In addition, an upward bias exists with the current valuation due to the impact on earnings from some challenging factors at hand.

We believe revenues, earnings, cash flow, and dividends are likely to increase each year, with EPS in the current fiscal year being an exception. Given all factors, we prefer a valuation lower than the current level or a favorable fundamental development for consideration of a purchase recommendation. We view Nike as a high quality, well-managed company with global growth opportunities. We will continue to monitor the stock and business conditions closely, with a particular focus on the risk/reward profile.

## SUITABILITY AND RISKS

**Suitability.** Our Suitability rating on NKE is 1 on a 1-to-4 scale (1=most conservative, 4=most aggressive). This view is based on factors such as the company's favorable earnings history, large market capitalization, and strong financial condition. We also consider the company's global market share positions and growth opportunities. As such, we believe NKE shares could be suitable for a wide variety of investors and risk tolerance levels.

**Risks & considerations.** Our positive long-term view of the company is based on factors such as growth opportunities in key markets, enviable market share positions, and product innovation. Also, we like the company's considerable free-cash flow generation and its excellent balance sheet. This is weighed against risk factors such as worldwide economic concerns, inflationary effects, and cyclical factors. Other risks to owning NKE include potential disruptions with key retail accounts, changes with distribution channels, rising cost of sales due to higher input costs, currency fluctuations, ongoing fashion and brand preference risk, and the competitive environment.

**Exhibit 3****Consolidated Statements of Income** (figures in millions except percentages and per share data)

	<b><u>FY19E</u></b>	<b><u>FY18E</u></b>	<b><u>FY17</u></b>	<b><u>FY16</u></b>	<b><u>FY15</u></b>	<b><u>FY14</u></b>
Revenues	\$38,250	\$35,850	\$34,350	\$32,376	\$30,601	\$27,799
Cost of Sales	<u>21,255</u>	<u>20,155</u>	<u>19,038</u>	<u>17,405</u>	<u>16,534</u>	<u>15,353</u>
Gross Profit	16,995	15,695	15,312	14,971	14,067	12,446
Total Selling & Admin. Exp.	11,815	11,170	10,563	10,469	9,892	8,766
Interest Expense (Income)	62	61	59	19	28	33
Other Expense (Income)	<u>40</u>	<u>63</u>	<u>(196)</u>	<u>(140)</u>	<u>(58)</u>	<u>103</u>
Income Before Taxes	5,078	4,401	4,886	4,623	4,205	3,544
Income Taxes	<u>812</u>	<u>660</u>	<u>646</u>	<u>863</u>	<u>932</u>	<u>851</u>
Net Income	<u>\$4,266</u>	<u>\$3,741</u>	<u>\$4,240</u>	<u>\$3,760</u>	<u>\$3,273</u>	<u>\$2,693</u>
<b>Diluted Earnings Per Share</b>	<b><u>\$2.60</u></b>	<b><u>\$2.25</u></b>	<b><u>\$2.51</u></b>	<b><u>\$2.16</u></b>	<b><u>\$1.85</u></b>	<b><u>\$1.49</u></b>
Avg. # of Dil. Shares Outst.	1,640	1,660	1,692	1,743	1,769	1,812
<b>Year Over Year % chg.</b>						
Revenues	6.69%	4.37%	6.10%	5.80%	10.08%	9.82%
Gross Profit	8.28%	2.50%	2.28%	6.43%	13.02%	12.80%
Total Selling & Admin. Exp.	5.77%	5.75%	0.90%	5.83%	12.85%	12.67%
Income Before Taxes	15.38%	(9.93%)	5.69%	9.94%	18.65%	8.31%
Net Income	14.03%	(11.77%)	12.77%	14.88%	21.54%	9.29%
<b>As a % of Revenues:</b>						
Gross Profit	44.43%	43.78%	44.58%	46.24%	45.97%	44.77%
Total Selling & Admin. Exp.	30.89%	31.16%	30.75%	32.34%	32.33%	31.53%
Income Before Taxes	13.28%	12.28%	14.22%	14.28%	13.74%	12.75%
Net Income	11.15%	10.43%	12.34%	11.61%	10.70%	9.69%
Tax Rate	16.00%	15.00%	13.22%	18.67%	22.16%	24.01%

Note: Income statement figures exclude nonrecurring items such as restructuring charges, impairment charges, and one-time tax benefits.

Source: Nike, Inc. and Hilliard Lyons estimates

Note: May fiscal year

*Additional information is available upon request.*

Prices of stocks mentioned: Adidas AG - ADDYY - \$99.82

### Analyst Certification

I, Jeffrey S. Thomison, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

### Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

### Investment Ratings

**Buy** - We believe the stock has significant total return potential in the coming 12 months.

**Long-term Buy** - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2–3 years.

**Neutral** - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.

**Underperform** - We believe the stock is vulnerable to a price set back in the next 12 months.

### Suitability Ratings

**1** - A large cap, core holding with a solid history

**2** - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks

**3** - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage

**4** - Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base

<b>Rating</b>	<b>Hilliard Lyons Recommended Issues</b>		<b>Investment Banking Provided in Past 12 Mo.</b>	
	<b># of Stocks Covered</b>	<b>% of Stocks Covered</b>	<b>Banking</b>	<b>No Banking</b>
<b>Buy</b>	31	28%	13%	87%
<b>Hold/Neutral</b>	74	66%	9%	91%
<b>Sell</b>	7	6%	0%	100%

*As of 6 December 2017*



Note: Price targets accompanying Buy ratings reflect a one year time period while price targets accompanying Long-term Buy ratings reflect a two to three year time period.

### Other Disclosures

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