



## COMPANY UPDATE / ESTIMATE CHANGE

### Key Metrics

NKE - NYSE (as of 6/30/17)	\$59.00
Price Target	N/A
52-Week Range	\$49.01 - \$60.33
Shares Outstanding, basic (mil)	1,647
Market Cap. (\$ mil)	\$97,167
3-Mo. Average Daily Volume	10,042,055
Institutional Ownership	82%
Total Debt/Total Capital (5/17)	23%
ROE (TTM ended 5/17)	34%
Book Value/Share (5/17)	\$7.53
Price/Book Value	7.8x
Annual Dividend & Yield	\$0.72 1.2%
EBITDA Margin (TTM ended 5/17)	14%

### EPS FY 5/31 (excludes nonrecurring items)

	2016	2017	Prior 2018E	Curr. 2018E
1Q	\$0.67	\$0.73		\$0.50
2Q	\$0.45	\$0.50		\$0.54
3Q	\$0.55	\$0.68		\$0.72
4Q	\$0.49	\$0.60		\$0.68
Year	\$2.16	\$2.51	\$2.55	\$2.44
P/E	27.3x	23.5x		24.2x

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

### Revenues (\$mm)

	2016	2017	Prior 2018E	Curr. 2018E
1Q	\$8,414	\$9,061		
2Q	\$7,686	\$8,180		
3Q	\$8,032	\$8,432		
4Q	\$8,244	\$8,677		
Year	\$32,376	\$34,350	\$36,500	\$36,300

**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

### 4Q EPS Beat Expectations, But Challenges Exist

#### Investment Highlights

- Fiscal 4Q results were better than we expected.** Positive factors included tight cost controls, a lower tax rate, and continued share repurchases. Negative factors were the same as in recent quarters—lower gross margin, foreign currency headwinds, and “futures” that included a weak figure for North America. Still, NKE shares jumped 11% on 6/30/17 in reaction to the earnings release and management’s commentary.
- 4Q revenues rose just 5% to \$8.677 billion, in line with our and street consensus estimates.** On a currency-neutral basis, revenues were up 7%. Gross margin fell 187 basis points, more than management originally anticipated. Combined, demand creation expenses and operating overhead declined 4%, more than we anticipated. A lower tax rate and a 3% drop in the share count helped lead to diluted EPS of \$0.60 compared to the year ago figure of \$0.49. We projected EPS of \$0.52, while street consensus was \$0.50.
- Nike’s “futures” figures were soft.** Worldwide orders for Nike-branded footwear and apparel scheduled for delivery from June 2017 through November 2017 were down 2% from the year ago level, or flat excluding the impact of currency changes. This included a 10% decline in the key North America market, a further sign of heightened competition, in our view. The reported North American futures decline was 9% one quarter ago and 4% two quarters ago.
- Our rating on NKE remains Neutral.** While recent EPS figures have been solid, we believe a shift to more direct-to-consumer business models, foreign currency headwinds, and stiffer competition are factors to watch. We have slightly lowered our FY18 financial estimates. We will continue to closely monitor key factors, the related impact on Nike’s financials, and stock valuation (currently 24x our FY18 EPS estimate) as we seek a more attractive entry point.

**Note Important Disclosures on Pages 8-9.**  
**Note Analyst Certification on Page 8.**

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

	<b>Quarter Ended</b>			<b>Fiscal Year Ended</b>		
	<b><u>5/31/17</u></b>	<b><u>5/31/16</u></b>	<b><u>% chg.</u></b>	<b><u>5/31/17</u></b>	<b><u>5/31/16</u></b>	<b><u>% chg.</u></b>
Revenues	\$8,677	\$8,244	5.3%	\$34,350	\$32,376	6.1%
Cost of Sales	4,854	4,458	8.9%	19,038	17,405	9.4%
Gross Profit	3,823	3,786	1.0%	15,312	14,971	2.3%
Demand Creation Exp.	789	873	(9.6%)	3,341	3,278	1.9%
Operating Overhead Exp.	1,876	1,893	(0.9%)	7,222	7,191	0.4%
Total Selling & Admin. Exp.	2,665	2,766	(3.7%)	10,563	10,469	0.9%
Operating Income	1,158	1,020	13.5%	4,749	4,502	5.5%
Interest Expense (Income)	18	5	NMF	59	19	NMF
Other Expense (Income)	(28)	(58)	(51.7%)	(196)	(140)	40.0%
Income Before Taxes	1,168	1,073	8.9%	4,886	4,623	5.7%
Income Taxes	160	227	(29.5%)	646	863	(25.1%)
Net Income	<u>\$1,008</u>	<u>\$846</u>	19.1%	<u>\$4,240</u>	<u>\$3,760</u>	12.8%
<b>Diluted Earnings Per Share</b>	<b><u>\$0.60</u></b>	<b><u>\$0.49</u></b>	22.3%	<b><u>\$2.51</u></b>	<b><u>\$2.16</u></b>	16.1%
Avg. # of Dil. Shares Outst.	1,679	1,723	(2.6%)	1,692	1,743	(2.9%)
Dividends Declared	\$0.18	\$0.16	12.5%	\$0.70	\$0.62	12.9%
<b>As a % of Revenues:</b>			<b><u>bp chg.</u></b>			<b><u>bp chg.</u></b>
Gross Profit	44.06%	45.92%	(187)	44.58%	46.24%	(166)
Demand Creation Exp.	9.09%	10.59%	(150)	9.73%	10.12%	(40)
Operating Overhead Exp.	21.62%	22.96%	(134)	21.02%	22.21%	(119)
Income Before Taxes	13.46%	13.02%	45	14.22%	14.28%	(5)
Net Income	11.62%	10.26%	135	12.34%	11.61%	73
Tax Rate	13.70%	21.16%	(746)	13.22%	18.67%	(545)
<b>Divisional Revenues (in millions):</b>						
North America Footwear	\$2,457	\$2,367	3.8%	\$9,684	\$9,299	4.1%
North America Apparel	1,142	1,163	(1.8%)	4,886	4,746	2.9%
North America Equipment	154	205	(24.9%)	646	719	(10.2%)
Total North America	3,753	3,735	0.5%	15,216	14,764	3.1%
International Footwear	3,016	2,715	11.1%	11,397	10,572	7.8%
International Apparel	1,159	1,077	7.6%	4,768	4,321	10.3%
International Equipment	181	186	(2.7%)	779	777	0.3%
Total International	4,356	3,978	9.5%	16,944	15,670	8.1%
Global Brand Divisions (licensing)	18	12	50.0%	73	73	0.0%
Total Nike Branded Revenues	8,127	7,725	5.2%	32,233	30,507	5.7%
Converse	554	513	8.0%	2,042	1,955	4.5%
Corporate	(4)	6	N/A	75	(86)	N/A
<b>Total Revenues</b>	<b>\$8,677</b>	<b>\$8,244</b>	<b>5.3%</b>	<b>\$34,350</b>	<b>\$32,376</b>	<b>6.1%</b>
<b>Nike Brand Revenue Mix:</b>			<b><u>bp chg.</u></b>			<b><u>bp chg.</u></b>
Footwear	67.34%	65.79%	156	65.40%	65.14%	27
Apparel	28.31%	29.00%	(68)	29.95%	29.72%	23
Equipment	4.12%	5.06%	(94)	4.42%	4.90%	(48)
Global Brand Divisions	0.22%	0.16%	7	0.23%	0.24%	(1)
	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)

	<b>Quarter Ended</b>			<b>Fiscal Year Ended</b>		
	<b>5/31/17</b>	<b>5/31/16</b>	<b>% chg.</b>	<b>5/31/17</b>	<b>5/31/16</b>	<b>% chg.</b>
<b>Revenues</b>						
North America	\$3,753	\$3,735	0.5%	\$15,216	\$14,764	3.1%
Western Europe	1,564	1,502	4.1%	6,211	5,884	5.6%
Central & Eastern Europe	357	345	3.5%	1,487	1,431	3.9%
Greater China	1,087	979	11.0%	4,237	3,785	11.9%
Japan	295	280	5.4%	1,014	869	16.7%
Emerging Markets	1,053	872	20.8%	3,995	3,701	7.9%
Global Brand Divisions*	18	12	50.0%	73	73	0.0%
Total Nike Brand	8,127	7,725	5.2%	32,233	30,507	5.7%
Converse	554	513	8.0%	2,042	1,955	4.5%
Corporate ~	(4)	6	N/A	75	(86)	N/A
Total Revenues	\$8,677	\$8,244	5.3%	\$34,350	\$32,376	6.1%
<b>EBIT</b>						
North America	\$979	\$936	4.6%	\$3,875	\$3,763	3.0%
Western Europe	285	308	(7.5%)	1,203	1,434	(16.1%)
Central & Eastern Europe	48	46	4.3%	244	289	(15.6%)
Greater China	380	357	6.4%	1,507	1,372	9.8%
Japan	77	55	40.0%	224	174	28.7%
Emerging Markets	215	191	12.6%	816	892	(8.5%)
Global Brand Divisions*	(689)	(722)	(4.6%)	(2,677)	(2,596)	3.1%
Total Nike Brand	1,295	1,171	10.6%	5,192	5,328	(2.6%)
Converse	137	128	7.0%	477	487	(2.1%)
Corporate ~	(246)	(221)	11.3%	(724)	(1,173)	(38.3%)
Total EBIT	\$1,186	\$1,078	10.0%	\$4,945	\$4,642	6.5%
<b>EBIT Margins</b>						
			<b>bp chg.</b>			<b>bp chg.</b>
North America	26.09%	25.06%	103	25.47%	25.49%	(2)
Western Europe	18.22%	20.51%	(228)	19.37%	24.37%	(500)
Central & Eastern Europe	13.45%	13.33%	11	16.41%	20.20%	(379)
Greater China	34.96%	36.47%	(151)	35.57%	36.25%	(68)
Japan	26.10%	19.64%	646	22.09%	20.02%	207
Emerging Markets	20.42%	21.90%	(149)	20.43%	24.10%	(368)
Nike Brand Total	15.93%	15.16%	78	16.11%	17.46%	(136)
Total Company	13.67%	13.08%	59	14.40%	14.34%	6

\* Note: Global Brand Divisions represent licensing businesses not part of a geographic operating segment and include centrally managed general & administrative 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 4Q.** Nike's fiscal 4Q revenues were in line with our and street expectations, but the bottom line was better than expected due to several factors. Gross margin was down a bit more than the company suggested in its previous guidance. However, selling & administrative expenses declined nearly 4% as management was perhaps more aggressive in cost containment efforts in the quarter. In the previous quarter (fiscal 3Q), total S&A expenses declined about 3% from the year ago level. Also helping the 4Q bottom line was a tax rate decline of 746 basis points due to an increase in the mix of earnings from non-U.S. territories. Lastly, the weighted average share count dropped nearly 3%, which also helped the EPS calculation.

The global futures figure (down 2%, or flat on a currency neutral basis) was weaker than we anticipated, with a 10% decline in North America of particular note. We believe competitors—primarily Adidas—have generally stepped up their games, which could spur Nike to spend more on demand creation or perhaps become more promotional with pricing, either of which could impact margins.

Among the 4Q highlights:

- The company is successfully pursuing growth from its direct-to-consumer businesses, such as online commerce and its Nike retail stores. In the just completed FY17 year, direct-to-consumer sales of Nike branded merchandise grew 16% and represented 28% of total sales.
- North America—by far the company’s largest region—posted a 0.5% gain in revenues and a 5% increase in EBIT (earnings before interest and taxes). Results reflected strength in sportswear, the Jordan brand, gross margin expansion, and improving inventory levels.
- Western Europe posted a 4% revenue gain on a reported basis, or 12% on a currency-neutral basis. Foreign currency headwinds and higher product costs contributed to a 7.5% drop in reported EBIT, however.
- Central & Eastern Europe posted a 3.5% revenue increase on an as-reported basis and a 6% gain on a currency-neutral basis. Factoring foreign currency translation, EBIT increased 4%.
- Greater China had an 11% increase in reported revenues, a 16% increase in revenues on a currency-neutral basis, and a 6% gain in reported EBIT.
- Japan produced a 5% gain in reported and currency-neutral revenues and a 40% gain in EBIT, though based on relatively small figures.
- The Emerging Markets segment posted a 21% increase in reported revenues, an 18% increase in currency-neutral revenues, and a 13% increase in EBIT.
- Converse revenues were up 8% for the quarter, with profits up 7%.
- Total company EBIT rose 10% with a 59 basis point improvement, mostly due to the operating margin gain that came from lower demand creation expenses compared to one year ago.

**Futures.** The company no longer includes “futures” figures in its earnings releases due to the declining correlation between these statistics and overall reported sales. Factors include shipment timing, changes in levels of futures vs. at-once orders, and a growing portion of the company’s business that is not reflected in the futures figures at all (such as close-out orders, equipment sales, direct-to-consumer and online sales, and all sales from the Converse, Nike Golf and Hurley brands).

Still, reported futures were below our expectation. While currency-adjusted figures were mostly solid in international markets, the 10% drop for North America was concerning. We believe a key contributing factor here is the battle for market share, including a seemingly strong presence from rival Adidas. Global markets reported more encouraging futures figures, in our view. The company’s second-largest segment—Western Europe—had a 3% constant dollar gain. Greater China and Emerging Markets segments both had 12% increases, while Japan rose 3%. The only negative currency-neutral futures figure was from Central & Eastern Europe, which was down 1%.

**Financial condition.** At May 30, 2017, cash and short-term investments were \$6.179 billion, \$722 million above the year ago figure due in part to a \$1.5 billion capital raise in October 2016. Cash uses from the issue of long-term notes have thus far included share repurchases, dividend payments, and investments in infrastructure and working capital, among other uses.

Inventories at 4Q end were up a modest 4%, to our liking. The current ratio was 2.9-to-1. Total debt was \$3.802 billion, or 23% of total capitalization. Shareholders’ equity at the end of the period was \$12.407 billion.

**Share repurchases and dividends.** During the 4Q period, Nike repurchased 14.9 million shares for \$820 million, representing an average cost of roughly \$55 per share. The company has about \$7.6 billion remaining on an existing repurchase authorization that went into effect in November 2015. We expect buybacks to remain a use of cash flow each year.

**New relationship with Amazon.** Nike and Amazon.com Inc. recently agreed to a pilot program whereby Nike will offer some of its athletic shoes on the amazon.com website. Some limited amount of Nike footwear is already available on the website of Amazon subsidiary Zappos, but not directly through Amazon's eponymous site. A primary benefit to Nike would be a significant step toward greater distribution with the world's largest and most powerful online retailer, while another benefit could be a resulting decline in counterfeit Nike products that are believed to commonly exist online. Stock prices of traditional retailers who sell Nike products saw share price weakness upon the news, but Nike management has often stated its support and differentiation plans (product assortment, presentation, customer connection, etc.) for retailers.

## OUTLOOK

Management discussed its outlook for the current FY18 year, which leads to our updated estimates. A major factor is evolution of distribution methods including continued growth in direct-to-consumer business models. Also, management seemed enthused about the product pipeline, innovation and technology, and the speed of the process that takes products from manufacturing stages to end-user delivery. Challenging factors include continued foreign currency headwinds (leading to gross margin contraction), navigating changing trends in distribution (including Nike's direct-to-consumer businesses, online partners such as Amazon, and traditional retailers), and the competitive environment (particularly in North America).

We estimate FY18 revenue growth of 5.7%, down from our previous figure of 6.2%. We now assume gross margin contraction of 42 basis points rather than our previous estimate of flat gross margin. Despite some expected expenses related to the pursuit of greater distribution, our projection of total SG&A expenses has come down due mainly to overall cost containment efforts. We project EPS to decline 2.8% to \$2.44, down \$0.11 from our previous estimate of \$2.55. The main reason for our outlook moving to a forecasted EPS decline in FY18 versus our previous estimate of a gain is the revised gross margin outlook (which include foreign currency headwinds and some competitive impact), with a secondary reason being expenses related to planned investments in the direct-to-consumer business.

In FY19, we believe a more normalized competitive environment and more favorable foreign currency translation could contribute to reported revenue growth of 7-8% and EPS growth in the 15-18% range from a challenged FY18.

**Longer term.** Longer-term, we believe a reasonable revenue target is mid to upper single-digits with EPS growth in the low double-digit percentages. 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, Nike plans to continue investing in its growing and higher margin direct-to-consumer business. The recently expanded relationship with Amazon.com Inc. calls for close monitoring, as that could have a variety of outcomes and impacts, in our view.

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 & OPINION**

NKE shares are currently trading at 24x our new FY18 EPS estimate. This is down from levels in the past few years (included a peak figure of 31x), but above a recent historical median. NKE's median forward multiple over the past ten years is 20x. As for relative valuation, the stock's forward price/earnings multiple versus the S&P 500 forward multiple is currently 1.25x, equal to the ten-year historical median figure.

In our view, NKE's current valuation reflects solid company fundamentals, competitive advantages, and above-average long-term earnings growth, but also reflects near-term challenges such as expected margin pressure, foreign exchange headwinds, and competitive issues.

We believe revenues, earnings, cash flow, and dividends are apt to increase each year. Although we do not require a P/E multiple at the historical mean level, we do prefer a valuation lower than the current level or a favorable company development for a purchase recommendation. We consider Nike 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)

	<u>FY18E</u>	<u>FY17</u>	<u>FY16</u>	<u>FY15</u>	<u>FY14</u>
Revenues	\$36,300	\$34,350	\$32,376	\$30,601	\$27,799
Cost of Sales	<u>20,270</u>	<u>19,038</u>	<u>17,405</u>	<u>16,534</u>	<u>15,353</u>
Gross Profit	16,030	15,312	14,971	14,067	12,446
Total Selling & Admin. Exp.	11,150	10,563	10,469	9,892	8,766
Interest Expense (Income)	70	59	19	28	33
Other Expense (Income)	<u>(25)</u>	<u>(196)</u>	<u>(140)</u>	<u>(58)</u>	<u>103</u>
Income Before Taxes	4,835	4,886	4,623	4,205	3,544
Income Taxes	<u>822</u>	<u>646</u>	<u>863</u>	<u>932</u>	<u>851</u>
Net Income	<u>\$4,013</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>\$2.44</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.	1,645	1,692	1,743	1,769	1,812
<b>Year Over Year % chg.</b>					
Revenues	5.68%	6.10%	5.80%	10.08%	9.82%
Gross Profit	4.69%	2.28%	6.43%	13.02%	12.80%
Total Selling & Admin. Exp.	5.56%	0.90%	5.83%	12.85%	12.67%
Income Before Taxes	(1.04%)	5.69%	9.94%	18.65%	8.31%
Net Income	(5.35%)	12.77%	14.88%	21.54%	9.29%
<b>As a % of Revenues:</b>					
Gross Profit	44.16%	44.58%	46.24%	45.97%	44.77%
Total Selling & Admin. Exp.	30.72%	30.75%	32.34%	32.33%	31.53%
Income Before Taxes	13.32%	14.22%	14.28%	13.74%	12.75%
Net Income	11.06%	12.34%	11.61%	10.70%	9.69%
Tax Rate	17.00%	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 - \$95.97  
Amazon.com Inc. - AMZN - \$968.00

### 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>	34	27%	12%	88%
<b>Hold/Neutral</b>	80	65%	8%	93%
<b>Sell</b>	10	8%	0%	100%

*As of 7 June 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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