



COMPANY UPDATE / ESTIMATE CHANGE

Key Metrics

NKE - NYSE	(as of 10/2/17)	\$51.87
Price Target		N/A
52-Week Range		\$49.01 - \$60.53
Shares Outstanding, basic (mil)		1,639
Market Cap. (\$ mil)		\$85,020
3-Mo. Average Daily Volume		8,590,000
Institutional Ownership		81%
Total Debt/Total Capital (8/17)		22%
ROE (TTM ended 8/17)		33%
Book Value/Share (8/17)		\$7.32
Price/Book Value		7.1x
Annual Dividend & Yield	\$0.72	1.4%
EBITDA Margin (TTM ended 8/17)		15%

EPS FY 5/31 (excludes nonrecurring items)

	2016	2017	Prior 2018E	Curr. 2018E
1Q	\$0.67	\$0.73		\$0.57 A
2Q	\$0.45	\$0.50	\$0.54	\$0.40
3Q	\$0.55	\$0.68	\$0.72	\$0.69
4Q	\$0.49	\$0.60	\$0.68	\$0.67
Year	\$2.16	\$2.51	\$2.44	\$2.33
P/E	24.0x	20.7x		22.3x

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		\$9,070 A
2Q	\$7,686	\$8,180		\$8,410
3Q	\$8,032	\$8,432		\$8,950
4Q	\$8,244	\$8,677		\$9,370
Year	\$32,376	\$34,350	\$36,300	\$35,800

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

1Q EPS Beat Expectations, But Year-Over-Year Decline Reflects Several Challenges

Investment Highlights

- **Fiscal 1Q earnings were better than expected but were well below the year ago period.** Positive factors included pockets of international growth, normalized demand creation expenses, and continued share repurchases. Negative factors included a rare sales decline in North America, overall lower gross margin, higher overhead expenses, and a higher tax rate.
- **1Q revenues were flat at \$9.070 billion, but in line with street expectations.** Gross margin fell 182 basis points. Total selling & administrative expenses declined 1%, but this included an 8% increase in operating overhead. The tax rate increased from an atypical low level a year ago, while the weighted average share count dropped 2% due to share repurchases. Diluted EPS of \$0.57 was down from \$0.73 a year ago, but was better than the street consensus figure of \$0.48. The EPS beat relative to expectations was largely related to an 18% decline in “demand creation” spending.
- **Challenges could be mounting, in our opinion.** Recent quarters included headwinds such as stiffer competition and costs of prioritizing the direct-to-consumer business. We add to this list what could be a cyclical downturn in the domestic athletic footwear/apparel. Recent earnings pressure at key retailers and Nike’s soft 1Q North America sales figures suggest some changes in consumer buying patterns.
- **Our rating on NKE remains Neutral.** Despite the EPS beat in 1Q, we have lowered our annual estimate to reflect expected near-term pressures. In fact, our 2Q EPS estimate moves to a 20% year-over-year decline from our previous expectation of an 8% increase. Given all factors, 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 and per share data)

	Quarter Ended		% chg.
	<u>8/31/17</u>	<u>8/31/16</u>	
Revenues	\$9,070	\$9,061	0.1%
Cost of Sales	<u>5,108</u>	<u>4,938</u>	3.4%
Gross Profit	3,962	4,123	(3.9%)
Demand Creation Exp.	855	1,041	(17.9%)
Operating Overhead Exp.	<u>2,001</u>	<u>1,856</u>	7.8%
Total Selling & Admin. Exp.	2,856	2,897	(1.4%)
Operating Income	1,106	1,226	(9.8%)
Interest Expense (Income)	16	7	
Other Expense (Income)	<u>18</u>	<u>(62)</u>	
Income Before Taxes	1,072	1,281	(16.3%)
Income Taxes	<u>122</u>	<u>32</u>	281.3%
Net Income	<u>\$950</u>	<u>\$1,249</u>	(23.9%)
Diluted Earnings Per Share	<u>\$0.57</u>	<u>\$0.73</u>	(22.5%)
Avg. # of Dil. Shares Outst.	1,677	1,709	(1.9%)
Dividends Declared	\$0.18	\$0.16	12.5%
As a % of Revenues:			<u>bp chg.</u>
Gross Profit	43.68%	45.50%	(182)
Demand Creation Exp.	9.43%	11.49%	(206)
Operating Overhead Exp.	22.06%	20.48%	158
Income Before Taxes	11.82%	14.14%	(232)
Net Income	10.47%	13.78%	(331)
Tax Rate	11.38%	2.50%	888
Divisional Revenues (in millions):			
North America Footwear	\$2,434	\$2,518	(3.3%)
North America Apparel	1,299	1,317	(1.4%)
North America Equipment	<u>191</u>	<u>196</u>	(2.6%)
Total North America	3,924	4,031	(2.7%)
International Footwear	3,059	2,954	3.6%
International Apparel	1,353	1,232	9.8%
International Equipment	<u>229</u>	<u>227</u>	0.9%
Total International	4,641	4,413	5.2%
Global Brand Divisions (licensing)	<u>20</u>	<u>15</u>	33.3%
Total Nike Branded Revenues	8,585	8,459	1.5%
Converse	483	574	(15.9%)
Corporate	<u>2</u>	<u>28</u>	N/A
Total Revenues	\$9,070	\$9,061	0.1%
Nike Brand Revenue Mix:			<u>bp chg.</u>
Footwear	63.98%	64.69%	(70)
Apparel	30.89%	30.13%	76
Equipment	4.89%	5.00%	(11)
Global Brand Divisions	<u>0.23%</u>	<u>0.18%</u>	6
	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		% chg.
	<u>8/31/17</u>	<u>8/31/16</u>	
<u>Revenues</u>			
North America	\$3,924	\$4,031	(2.7%)
EMEA	2,344	2,262	3.6%
Greater China	1,108	1,020	8.6%
Asia Pacific/Latin America	1,189	1,131	5.1%
Global Brand Divisions*	<u>20</u>	<u>15</u>	33.3%
Total Nike Brand	8,585	8,459	1.5%
Converse	483	574	(15.9%)
Corporate ~	<u>2</u>	<u>28</u>	N/A
Total Revenues	\$9,070	\$9,061	0.1%
<u>EBIT</u>			
North America	\$1,002	\$1,004	(0.2%)
EMEA	451	485	(7.0%)
Greater China	394	371	6.2%
Asia Pacific/Latin America	260	209	24.4%
Global Brand Divisions*	<u>(675)</u>	<u>(771)</u>	(12.5%)
Total Nike Brand	1,432	1,298	10.3%
Converse	89	153	(41.8%)
Corporate ~	<u>(433)</u>	<u>(163)</u>	165.6%
Total EBIT	\$1,088	\$1,288	(15.5%)
<u>EBIT Margins</u>			
North America	25.54%	24.91%	63
EMEA	19.24%	21.44%	(220)
Greater China	35.56%	36.37%	(81)
Asia Pacific/Latin America	21.87%	18.48%	339
Nike Brand Total	16.68%	15.34%	134
Total Company	12.00%	14.21%	(222)

* 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 fiscal 1Q. Total 1Q revenues met the street consensus figure. International growth offset a rare drop in North America and a notable decline for the Converse brand. Gross margin was down 182 basis points compared to management's original guide of a 150-180 basis point decline. The contraction related to foreign currency exchange rates and a higher mix of off-price sales. Selling & administrative expenses declined 1%. This reflected an 18% drop in demand creation expenses from an event-heavy quarter a year ago, and an 8% increase in operating overhead as the company incurred realignment costs stemming from a recent workforce reduction and ongoing costs related to direct-to-consumer initiatives. The tax rate normalized a bit versus the prior year period, while the weighted average share count dropped nearly 2%, which helped the EPS calculation a bit.

The company revised its reporting structure, moving to a four-segment geographical breakdown from the previous six-segment format. Prior year period figures, as noted in Exhibit 2, have been re-stated to conform to the new format.

In North America, Nike-branded sales were down approximately 3% with declines in all three product categories—footwear, apparel, and equipment. EBIT (earnings before interest and taxes) was about flat, benefiting from lower demand creation expenses. EMEA (Europe, Middle East, and Africa) posted a sales gain but an EBIT decline due to foreign exchange headwinds on gross margin. Greater China and the Asia Pacific & Latin America segments had decent gains, in our view. As for non-Nike branded business, Converse was a disappointment with double-digit declines in sales and profits. Total company EBIT dropped about 15% with a 222 basis point contraction in margin.

Our primary concern regarding the quarter (acknowledging past concerns of stiffer competition and costs of growing the direct-to-consumer business) is a potential cyclical downturn in demand for athletic merchandise, at least in North America. Several domestic retailers in the athletic footwear/apparel space have reported recent soft results, including lighter store traffic. While this could reflect some shifts in consumer buying preferences (greater online/digital experiences), it could also reflect potential contraction (or growth deceleration) in the industry or greater consumer interest in non-athletic categories. We will be closely watching trends among the key retailers and product suppliers such as Nike. On the aforementioned past concerns, we believe Adidas has become a stronger competitor this year, while digital initiatives represent long-term opportunities that require near-term spending (integrating new delivery, distribution, and marketing efforts).

Financial condition. We believe the company is in good financial shape. At August 31, 2017, cash and short-term investments were \$5.519 billion, \$532 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 quarter end were up 6%, above recent and projected near-term sales gains. The current ratio was 2.7-to-1. Total debt was \$3.479 billion, or 22% of total capitalization. Shareholders' equity at the end of the period was \$11.993 billion.

Share repurchases and dividends. During the fiscal 1Q period, Nike repurchased 15.3 million shares for \$849 million, representing an average cost of roughly \$55 per share. The company has nearly \$7 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.

Earnings outlook. We have updated our financial outlook based on 1Q results and our view of the coming quarters. We estimate FY18 revenues of \$35.8 billion, down \$500 million from our previous figure. We now assume gross margin contraction of 75 basis points rather than our previous estimate of a 42 basis point drop. Our projection of total SG&A expenses, in dollars, is unchanged. We project EPS to decline 7% to \$2.33, down \$0.11 from our previous estimate of \$2.44.

In FY19, we believe a more normalized competitive environment and more favorable foreign currency translation could contribute to reported revenue growth of 7% and EPS growth in the 12-15% range 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 23x 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 21x. As for relative valuation, the stock's forward price/earnings multiple versus the S&P 500 forward multiple is currently 1.12x, slightly below the ten-year historical median.

In our view, NKE's current valuation (a premium to the ten year median) reflects solid company fundamentals, strong brand equity, and above-average long-term earnings growth potential. In addition, an upward bias exists due to the valuation being based on a challenging year expected to produce an EPS decline. Recent multiple contraction may reflect near-term challenges such as competitive issues, expected margin pressure, spending needs, and cyclical industry factors.

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)

	FY18E	FY17	FY16	FY15	FY14
Revenues	\$35,800	\$34,350	\$32,376	\$30,601	\$27,799
Cost of Sales	20,110	19,038	17,405	16,534	15,353
Gross Profit	15,690	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)	60	59	19	28	33
Other Expense (Income)	(80)	(196)	(140)	(58)	103
Income Before Taxes	4,560	4,886	4,623	4,205	3,544
Income Taxes	730	646	863	932	851
Net Income	<u>\$3,830</u>	<u>\$4,240</u>	<u>\$3,760</u>	<u>\$3,273</u>	<u>\$2,693</u>
Diluted Earnings Per Share	<u>\$2.33</u>	<u>\$2.51</u>	<u>\$2.16</u>	<u>\$1.85</u>	<u>\$1.49</u>
Avg. # of Dil. Shares Outst.	1,645	1,692	1,743	1,769	1,812
Year Over Year % chg.					
Revenues	4.22%	6.10%	5.80%	10.08%	9.82%
Gross Profit	2.47%	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	(6.67%)	5.69%	9.94%	18.65%	8.31%
Net Income	(9.66%)	12.77%	14.88%	21.54%	9.29%
As a % of Revenues:					
Gross Profit	43.83%	44.58%	46.24%	45.97%	44.77%
Total Selling & Admin. Exp.	31.15%	30.75%	32.34%	32.33%	31.53%
Income Before Taxes	12.74%	14.22%	14.28%	13.74%	12.75%
Net Income	10.70%	12.34%	11.61%	10.70%	9.69%
Tax Rate	16.00%	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 - \$115.31

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

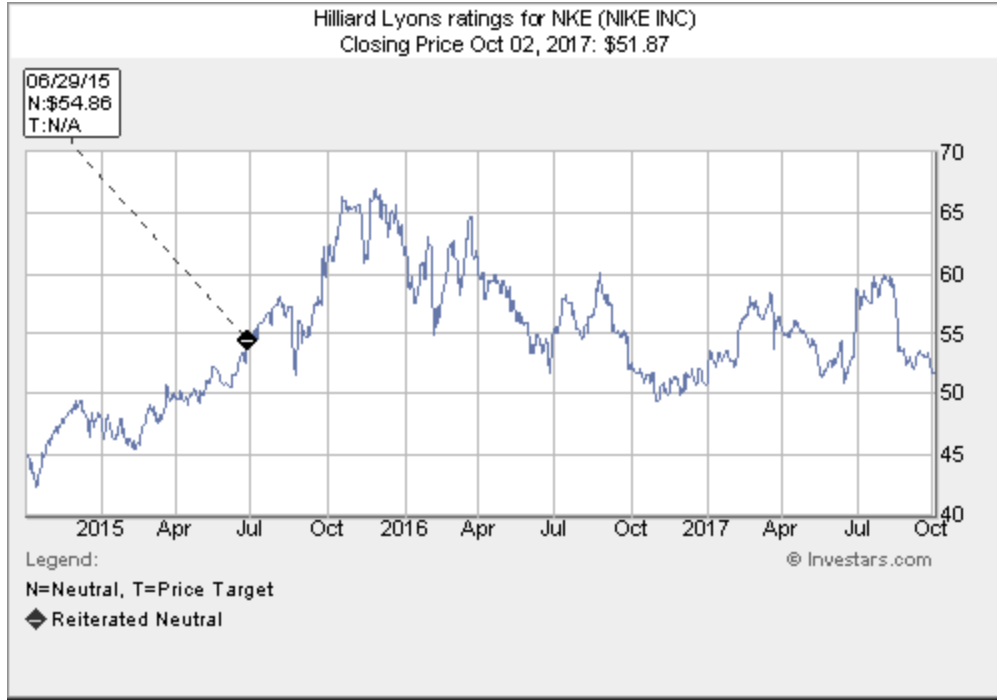
2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks

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

Rating	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	40	32%	10%	90%
Hold/Neutral	77	62%	8%	92%
Sell	8	6%	0%	100%

As of 6 September 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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