Framework Investing’s

# Nike Valuation Overview

Framework Member Conference Call

Oct 12, 2017

# Agenda

- Nike Overview
- Valuation Framework Review
  - Revenue Growth
  - Profitability
  - Investment Spending
  - Medium-Term Growth
- Interlude: Morningstar Profit Argument
- Q&A

# Nike Overview

What kind of company is Nike?

# NIKE, INC. IS A GROWTH COMPANY.

We create innovative, must-have products. We build deep, personal connections with consumers. And we deliver an integrated marketplace with compelling retail experiences.

# Nike by the Numbers

FRAMEWORK Investing

**Nike (NKE)** Add to Watchlists Create an Alert Notes (0)

**51.50** ▼ -0.02 -0.04% NYSE Oct 10, 12:11 Delayed 2m USD

Quote | Fundamental Chart | Technicals | Key Stats | Financials | Data | Estimates | News | Events | Y-Ratings | Performance | Valuation | Multichart

**NKE Price Chart** View Full Chart


**NKE Key Stats** View All Key Stats

| | | | |
|---|---|---|---|
| **Income Statement** | | **Price and Valuation** | |
| Revenue (TTM) | 34.36B | Market Cap | 84.02B |
| Revenue (Quarterly YoY Growth) | 0.10% | 52 Week High (Daily) | 60.53 |
| EPS Diluted (TTM) | 2.35 | 52 Week Low (Daily) | 49.01 |
| EPS Diluted (Quarterly YoY Growth) | -21.92% | PS Ratio (TTM) | 2.524 |
| Net Income (TTM) | 3.941B | PE Ratio (TTM) | 21.91 |
| **Profitability** | | Price to Book Value | 7.006 |
| Gross Profit Margin (Quarterly) | 43.68% | **Other** | |
| Profit Margin (Quarterly) | 10.47% | Beta (5Y) | 0.6146 |
| **Dividend** | | Debt to Equity Ratio (Quarterly) | 0.318 |
| Dividend Yield (Forward) | 1.40% | Free Cash Flow (Quarterly) | 560.00M |
| Dividend Yield (TTM) | 1.40% | Return on Equity (TTM) | 31.98% |

# Nike by the Numbers

FRAMEWORK Investing

Not lo

Article | Talk | Read | View source | View history

WIKIPEDIA
The Free Encyclopedia

Main page
Contents
Featured content
Current events
Random article
Donate to Wikipedia
Wikipedia store

Interaction

Help

## Nike, Inc.

From Wikipedia, the free encyclopedia

*This article is about the sportswear and apparel company. For other uses of the name "Nike", see Nike (disambiguation).*

**Nike, Inc.** (official, US: /ˈnaɪki/; also, non-US /ˈnaɪk/)[note 1] is an American multinational corporation that is engaged in the design, development, manufacturing, and worldwide marketing and sales of footwear, apparel, equipment, accessories, and services. The company is headquartered near Beaverton, Oregon, in the Portland metropolitan area. It is the world's largest supplier of athletic shoes and apparel[5] and a major manufacturer of sports equipment, with revenue in excess of US$24.1 billion in its fiscal year 2012 (ending May 31, 2012). As of 2012, it employed more than 44,000 people worldwide. In 2014 the brand alone was valued at $19 billion, making it the most valuable brand among sports businesses.[6] As of 2017, the Nike brand is valued at $29.6 billion.[7]

# Nike by the Numbers

| NKE Analyst Coverage | |
|---|---|
| **Consensus Recommendations** | |
| Buy Recommendations | 14 |
| Outperform Recommendations | 8 |
| Hold Recommendations | 14 |
| Underperform Recommendations | 1 |
| Sell Recommendations | 1 |
| Consensus Recommendation | 2.132 |
| **Target Price** | |
| Price | 51.50 |
| Price Target | 58.82 |

Buy : Sell Ratio

18 : 1

# Valuation Framework

FRAMEWORK Investing

| | | Worst Case | Best Case |
|---|---|---|---|
| Short-Term | Revenue Growth | 6% / year | 9% / year |
| | Profit Margin (OCP) | 9% | 11% |
| | Investments % Profit | 24% | |
| Medium-Term | Cash Flow Growth | 8% / year | 10% / year |
| | Intrinsic Value Range | $35 / share | $53 / share |

Average of all Scenarios $43 / share

Recent Market Price $51 / share

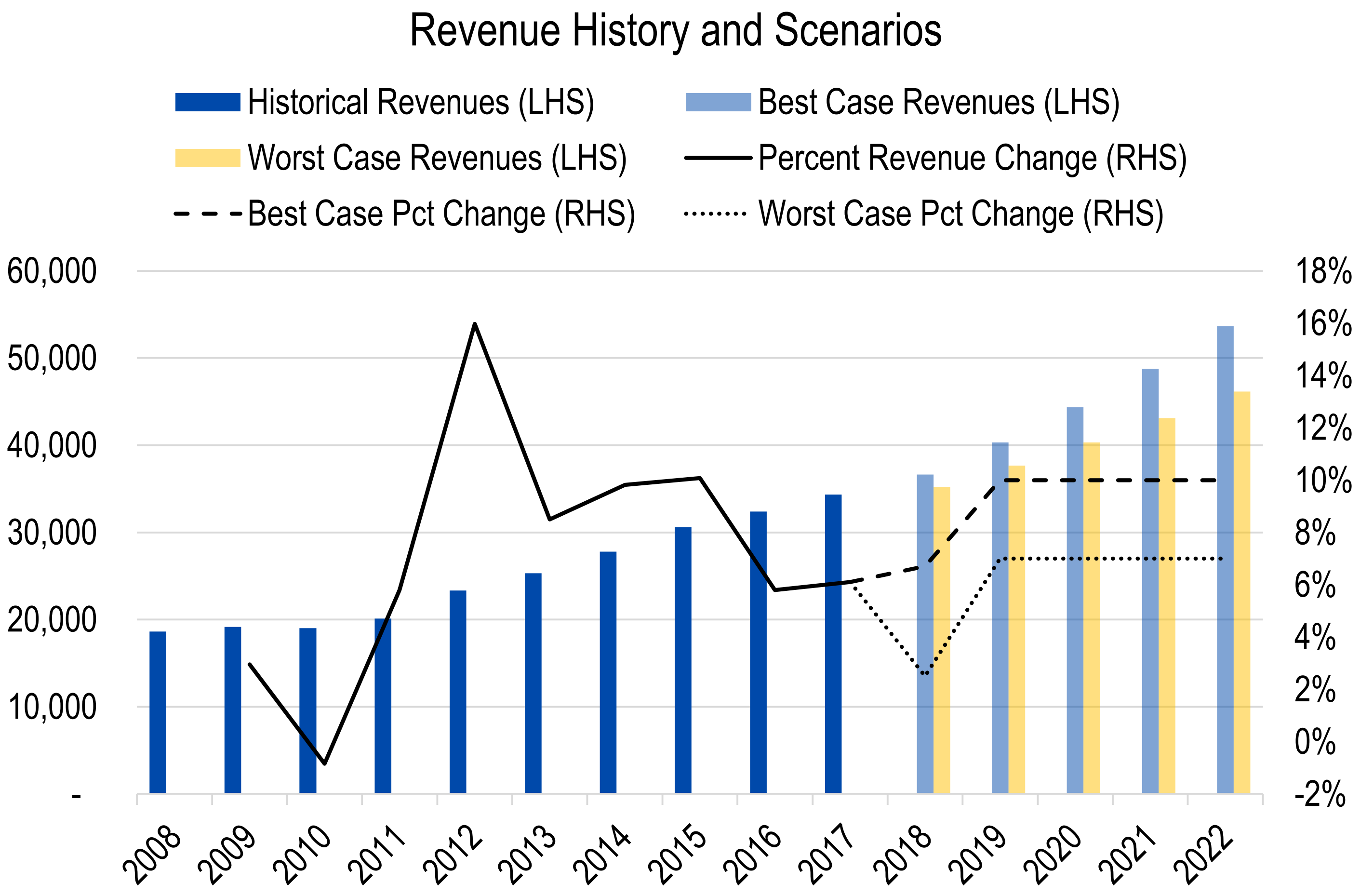
# Revenue Analysis

Roughly 300 million “shoe equivalents” sold in FY 2017

# Valuation Framework

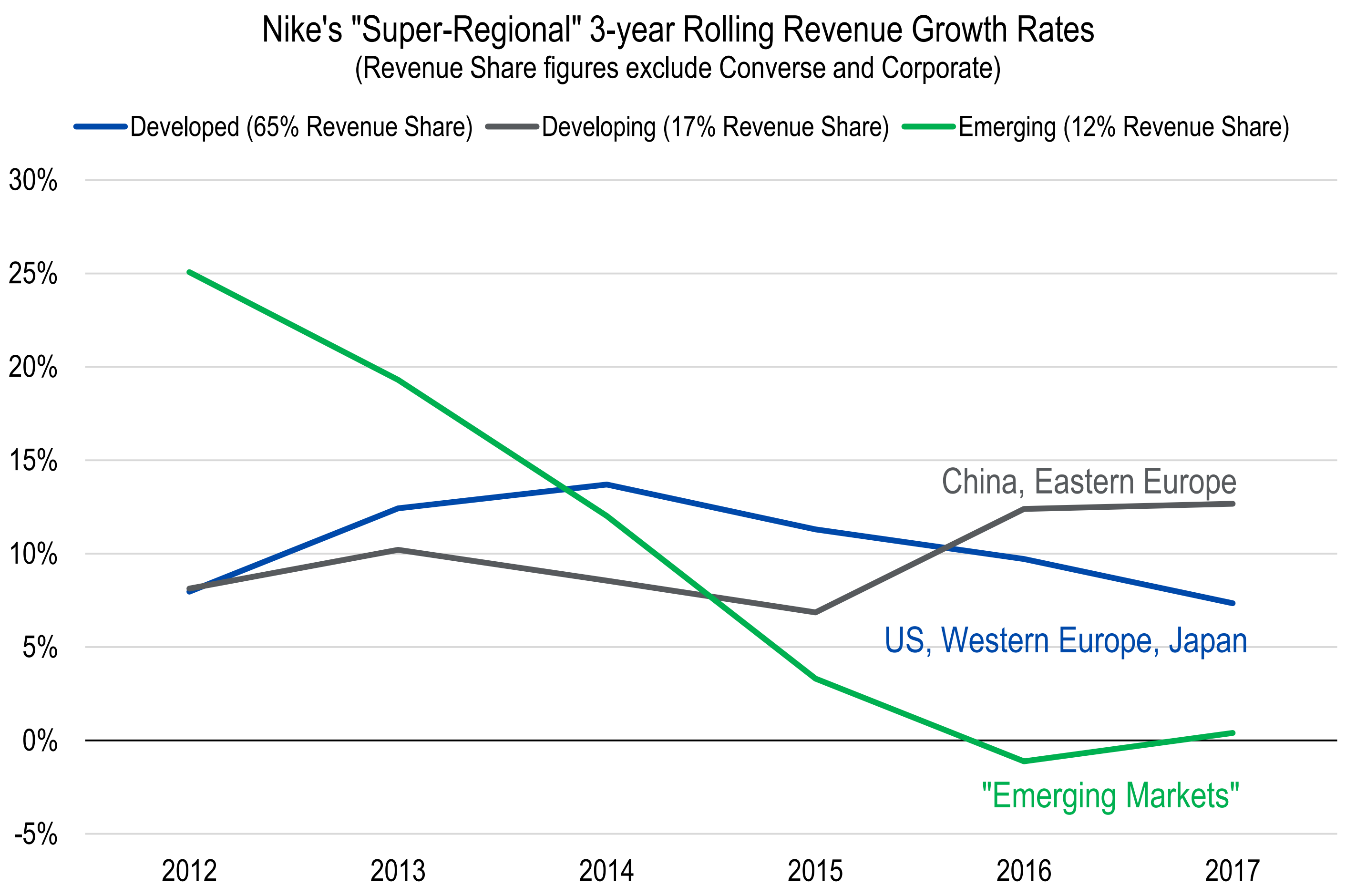
| | | Worst Case | Best Case |
|---|---|---|---|
| Short-Term | Revenue Growth | 6% / year | 9% / year |
| | Profit Margin (OCP) | | |
| | Investments % Profit | | |
| Medium-Term | Cash Flow Growth | | |
| | Intrinsic Value Range | | |

# Framework's Forecasts



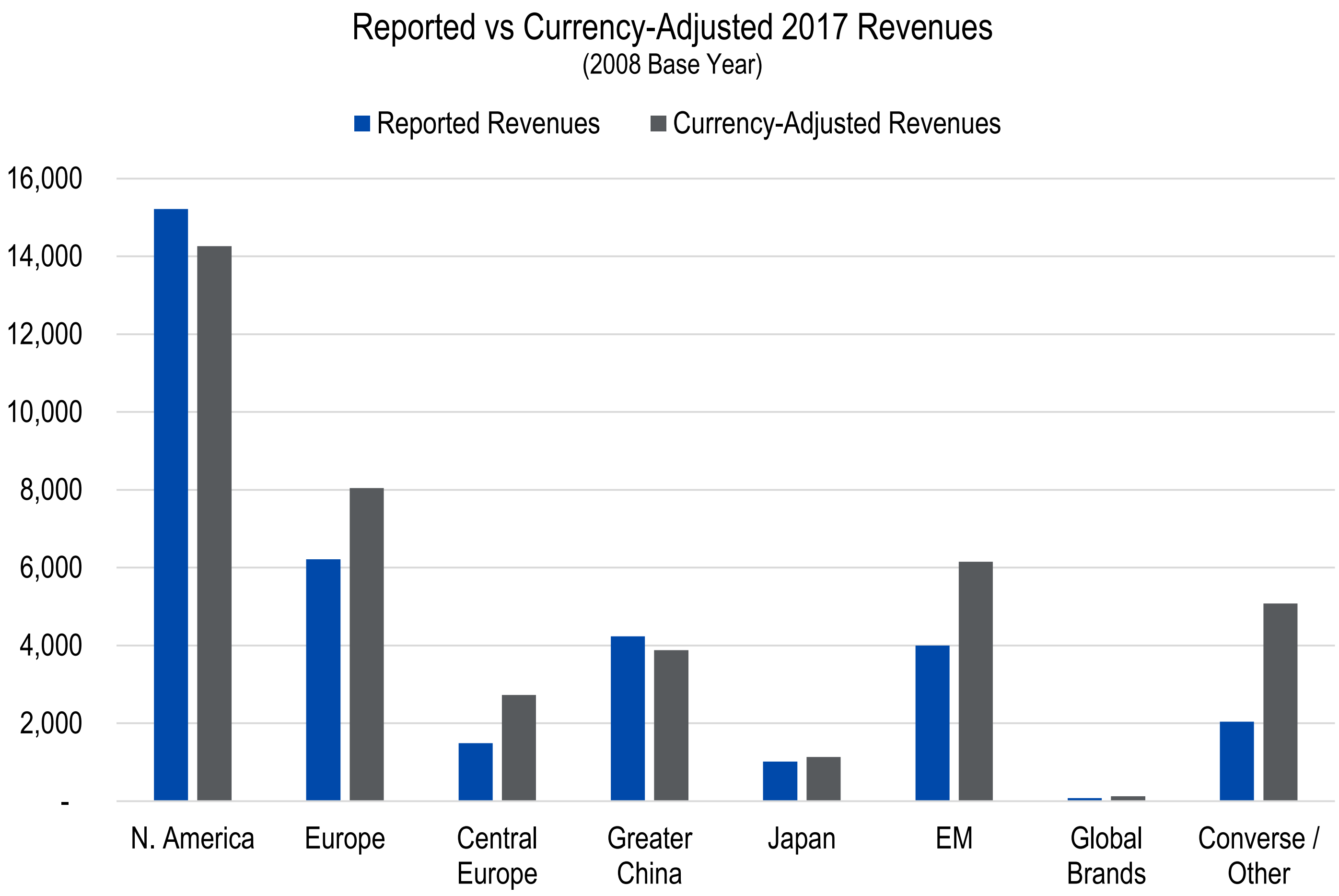

- Best-Case CAGR: 9.3%
- Worst-Case CAGR: 6.1%
- Used analyst estimates for current fiscal year, then 10% and 7% going forward.
- Global sportswear and equipment market growing at 4% per year.
- Currency Adjustments made a big difference in 2016-2017.

# Framework's Forecasts



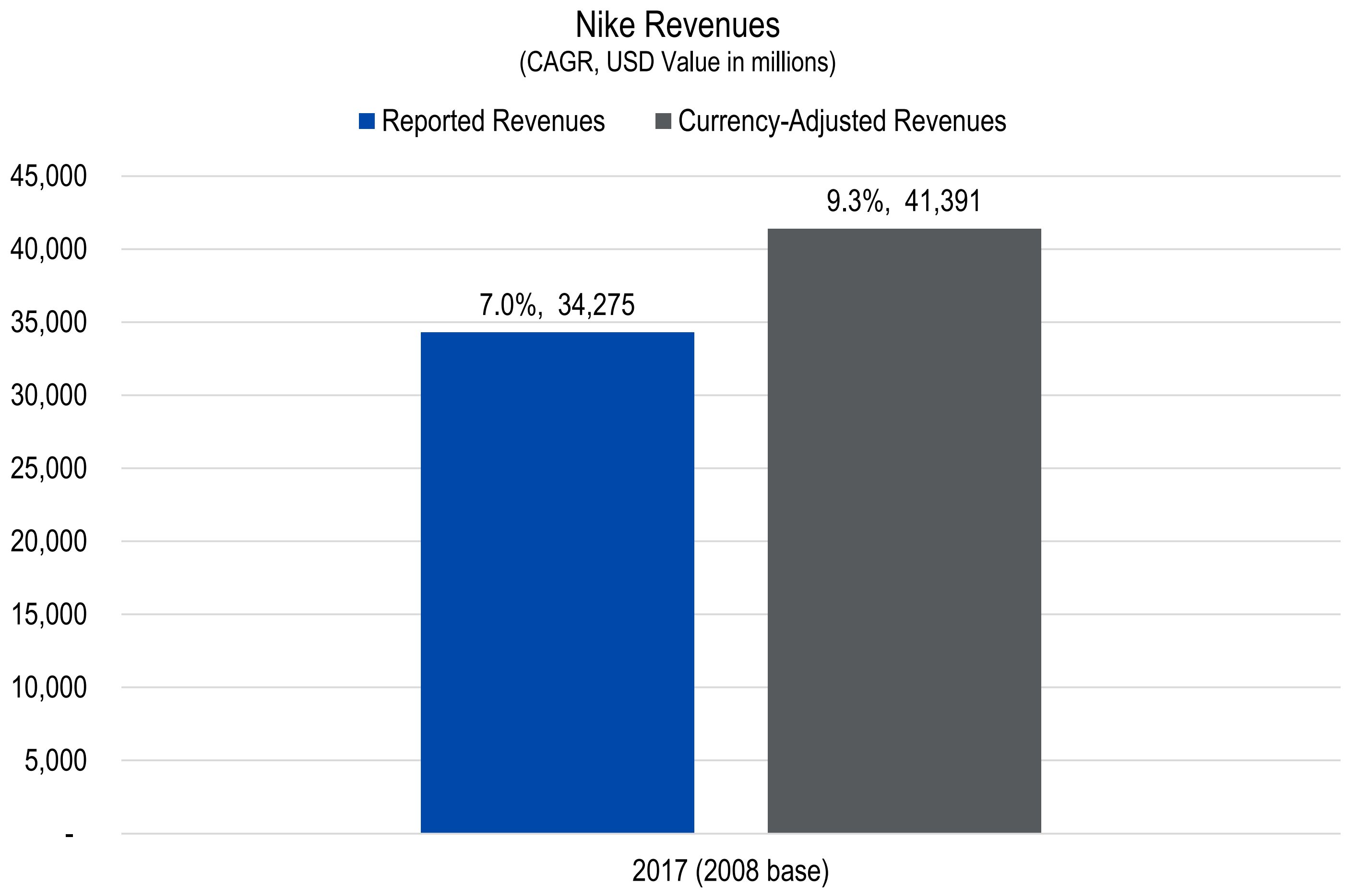

- Best-Case CAGR: 9.3%
- Worst-Case CAGR: 6.1%
- Used analyst estimates for current fiscal year, then 10% and 7% going forward.
- Global sportswear and equipment market growing at 4% per year.
- Currency Adjustments made a big difference in 2016-2017.

# Currency Adjustments




- Use 2008 reported revenues as base.
- Increase base each year by currency-adjusted percentage.
- Compare reported 2017 revenues to theoretical currency adjusted 2017 revenues.

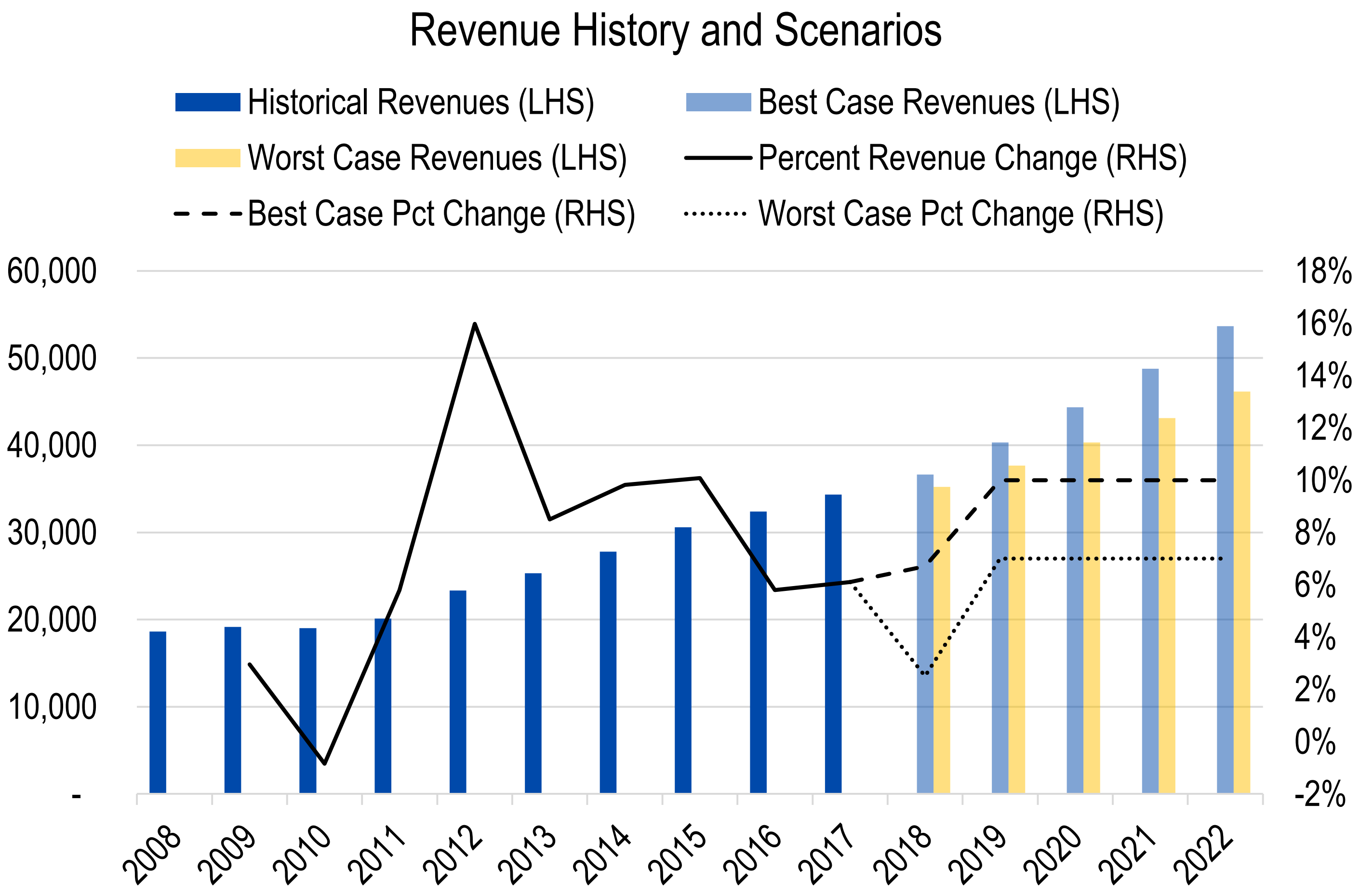
# Currency Adjustments




- Use 2008 reported revenues as base.
- Increase base each year by currency-adjusted percentage.
- Compare reported 2017 revenues to theoretical currency adjusted 2017 revenues.

# Framework's Forecasts

FRAMEWORK Investing




- Best-Case CAGR: 9.3%
- Worst-Case CAGR: 6.1%
- Used analyst estimates for current fiscal year, then 10% and 7% going forward.
- Currency Adjustments made a big difference in 2016-2017.
- Global sportswear and equipment market growing at 4% per year.

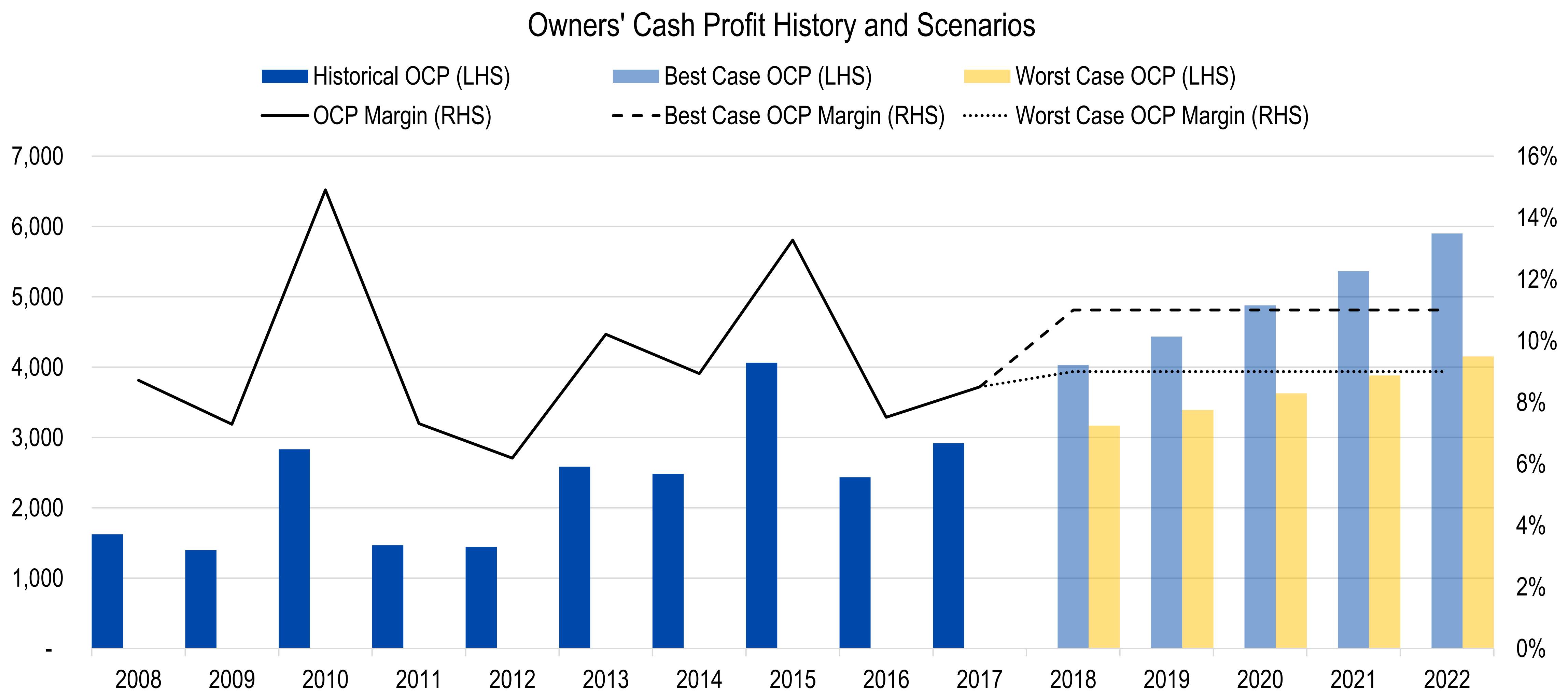
# Profit Analysis

Deceptively steady

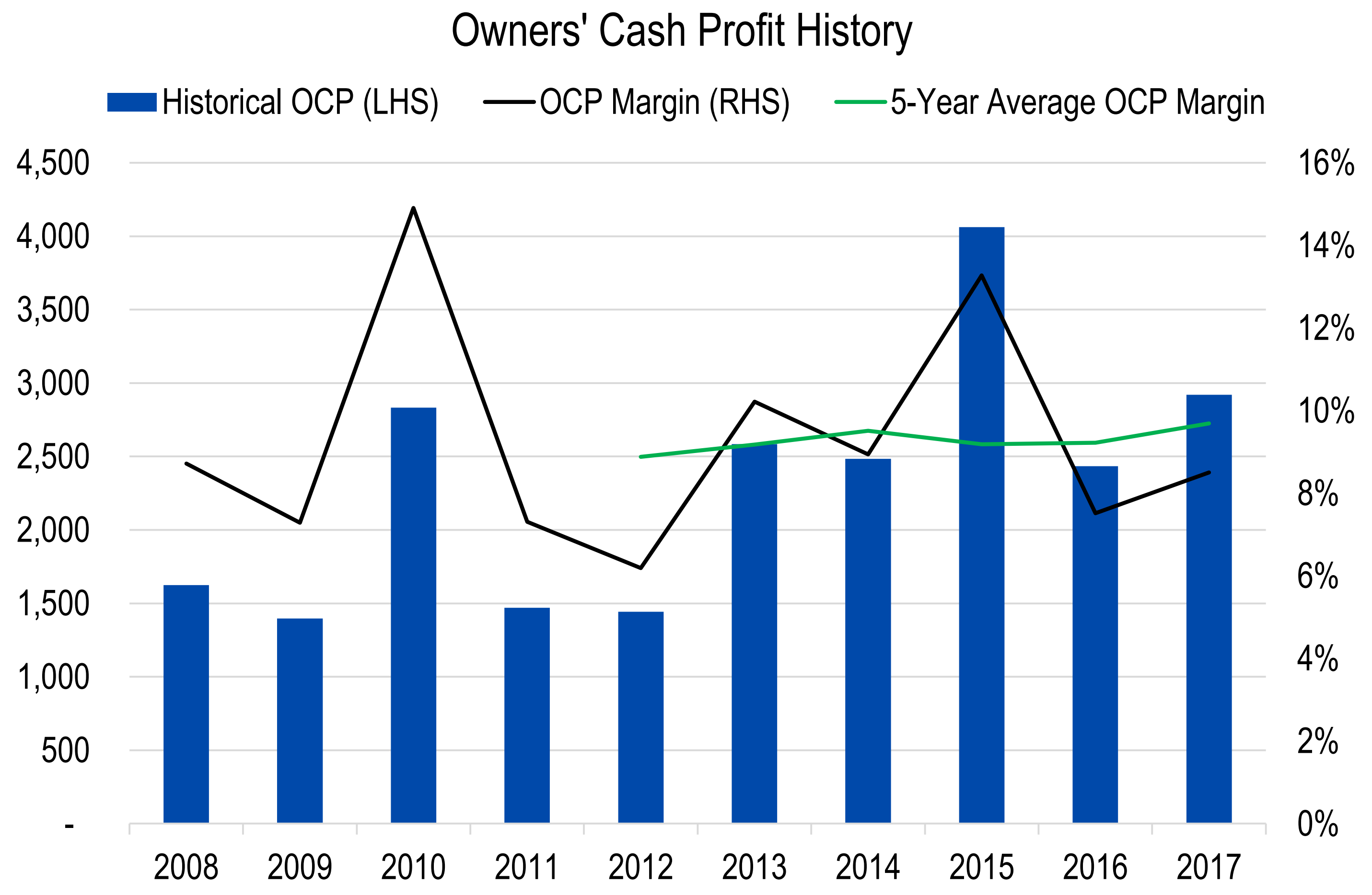
# Valuation Framework

| | | Worst Case | Best Case |
|---|---|---|---|
| Short-Term | Revenue Growth | 6% / year | 9% / year |
| | Profit Margin (OCP) | 9% | 11% |
| | Investments % Profit | | |
| Medium-Term | Cash Flow Growth | | |
| | Intrinsic Value Range | | |

# Framework's Forecasts



# Profit Dynamics




- Five-year average margin is very stable between 9%-10%.
- Two notable spikes in 2010 and 2015.

# Profit Dynamics

## NIKE, Inc. Consolidated Statements of Cash Flows

| (In millions) | Year Ended May 31, 2016 | 2015 | 2014 |
|---|---|---|---|
| **Cash provided by operations:** | | | |
| Net income | $ 3,760 | $ 3,273 | $ 2,693 |
| Income charges (credits) not affecting cash: | | | |
| Depreciation | 649 | 606 | 518 |
| Deferred income taxes | (80) | (113) | (11) |
| Stock-based compensation | 236 | 191 | 177 |
| Amortization and other | 13 | 43 | 68 |
| Net foreign currency adjustments | 98 | 424 | 56 |
| Changes in certain working capital components and other assets and liabilities: | | | |
| Decrease (increase) in accounts receivable | 60 | (216) | (298) |
| (Increase) in inventories | (590) | (621) | (505) |
| (Increase) in prepaid expenses and other current assets | (161) | (144) | (210) |
| (Decrease) increase in accounts payable, accrued liabilities and income taxes payable | (889) | 1,237 | 525 |
| Cash provided by operations | 3,096 | 4,680 | 3,013 |

- Five-year average margin is very stable between 9%-10%.
- Two notable spikes in 2010 and 2015.

# Profit Dynamics

NIKE, INC.

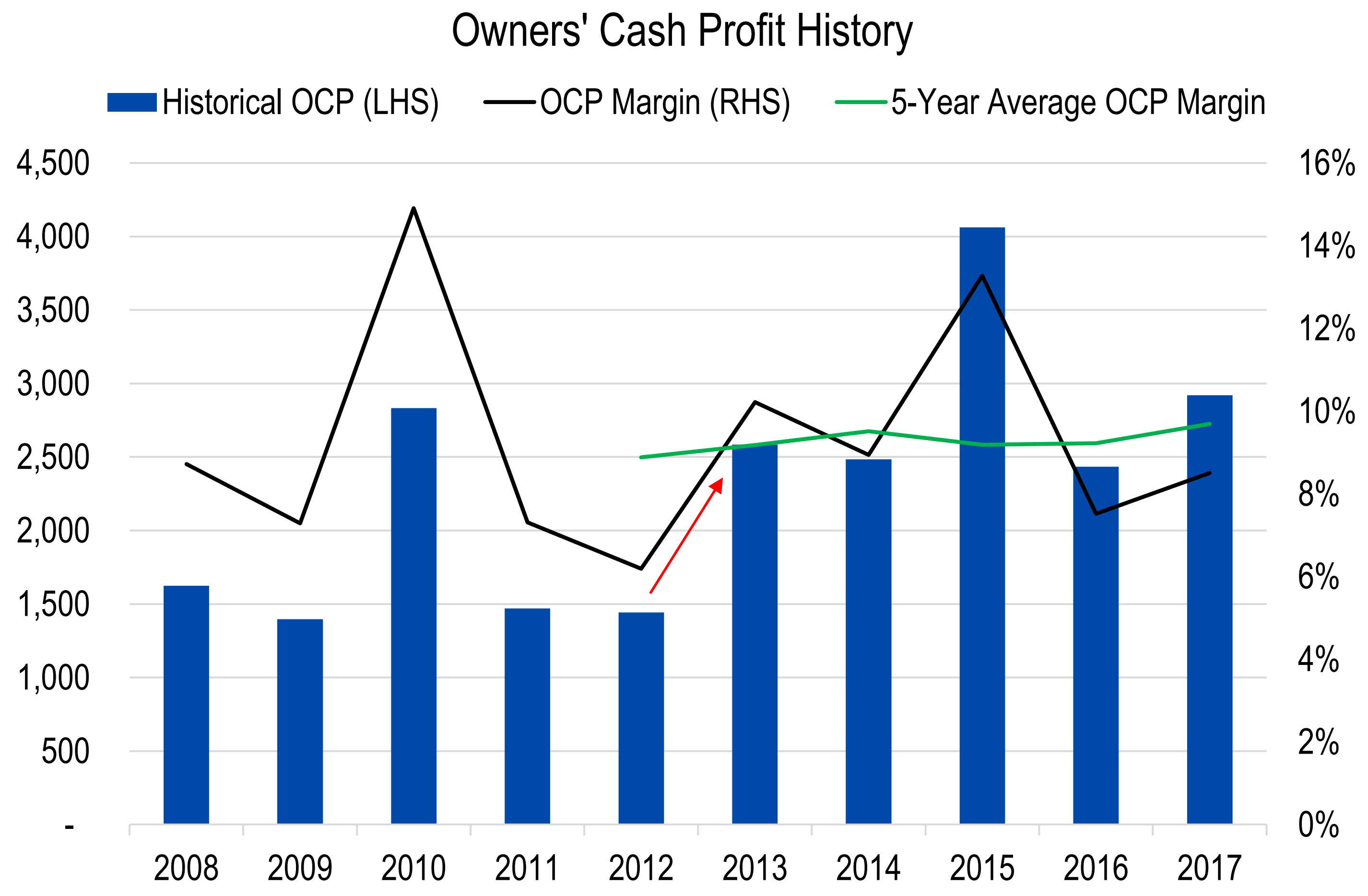
CONSOLIDATED STATEMENTS OF CASH FLOWS

Depressed by restructuring charges

| | Year Ended May 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| | | (In millions) | |
| **Cash provided by operations:** | | | |
| Net income | $ 2,133 | $ 1,907 | $ 1,487 |
| Income charges (credits) not affecting cash: | | | |
| Depreciation | 335 | 324 | 335 |
| Deferred income taxes | (76) | 8 | (294) |
| Stock-based compensation (Note 11) | 105 | 159 | 171 |
| Impairment of goodwill, intangibles and other assets (Note 4) | — | — | 401 |
| Amortization and other | 23 | 72 | 48 |
| Changes in certain working capital components and other assets and liabilities excluding the impact of acquisition and divestitures: | | | |
| (Increase) decrease in accounts receivable | (273) | 182 | (238) |
| (Increase) decrease in inventories | (551) | 285 | 32 |
| (Increase) decrease in prepaid expenses and other current assets | (35) | (70) | 14 |
| Increase (decrease) in accounts payable, accrued liabilities and income taxes payable | 151 | 297 | (220) |
| Cash provided by operations | 1,812 | 3,164 | 1,736 |

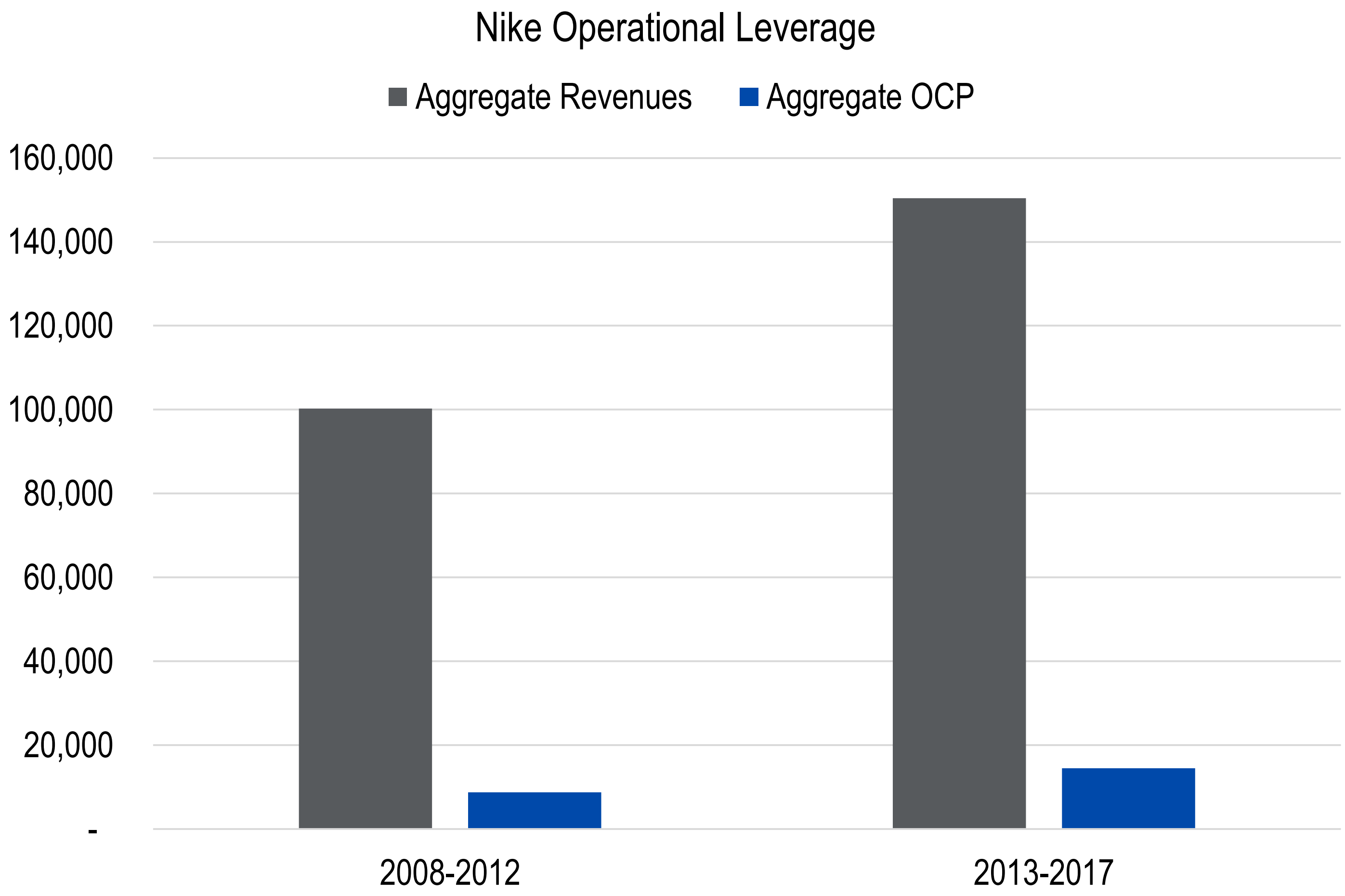
- Five-year average margin is very stable between 9%-10%.
- Two notable spikes in 2010 and 2015.

# Profit Dynamics




- Five-year average margin is very stable between 9%-10%.
- Two notable spikes in 2010 and 2015.
- Profits show a step-function up in 2013

# Profit Dynamics




- Five-year average margin is very stable between 9%-10%.
- Two notable spikes in 2010 and 2015.
- Profits show a step-function up in 2013
  - Aggregate revenues grew 50%
  - Aggregate profits grew 65%

# Profit Dynamics

**NIKE, Inc. Consolidated Statements of Cash Flows**

| *(In millions)* | Year Ended May 31, 2013 | 2012 | 2011 |
|---|---|---|---|
| **Cash provided by operations:** | | | |
| Net income | $ 2,485 | $ 2,223 | $ 2,133 |
| Income charges (credits) not affecting cash: | | | |
| Depreciation | 438 | 373 | 335 |
| Deferred income taxes | 21 | (60) | (76) |
| Stock-based compensation (Note 11) | 174 | 130 | 105 |
| Amortization and other | 75 | 32 | 23 |
| Net gain on divestitures | (124) | — | — |
| Changes in certain working capital components and other assets and liabilities: | | | |
| Decrease (increase) in accounts receivable | 142 | (323) | (273) |
| (Increase) in inventories | (197) | (805) | (551) |
| (Increase) in prepaid expenses and other current assets | (28) | (141) | (35) |
| Increase in accounts payable, accrued liabilities and income taxes payable | 41 | 470 | 151 |
| Cash provided by operations | 3,027 | 1,899 | 1,812 |

*Improved working capital management??*

- Five-year average margin is very stable between 9%-10%.
- Two notable spikes in 2010 and 2015.
- Profits show a step-function up in 2013
  - Aggregate revenues grew 50%
  - Aggregate profits grew 65%

# Profit Dynamics

MAY 31, 2012

## NIKE, INC. TO DIVEST OF COLE HAAN AND UMBRO

NIKE, Inc. to focus on accelerating growth through Nike and complementary sport brands.

“Divesting of Umbro and Cole Haan will allow us to focus our resources on the highest-potential opportunities for NIKE, Inc. to continue to drive sustainable, profitable growth for our shareholders.”*

Cole Haan, which specializes in casual and dress leather footwear and bags, was acquired by NIKE, Inc. in 1988. The company is based in New York. Umbro is a football (soccer) specialist brand based in Manchester, UK, acquired by NIKE, Inc. in 2008. The process of divesting of these two businesses will begin immediately, and is expected to be complete by the end of NIKE, Inc.’s fiscal 2013 (May 31, 2013).

- Five-year average margin is very stable between 9%-10%.
- Two notable spikes in 2010 and 2015.
- Profits show a step-function up in 2013
  - Aggregate revenues grew 50%
  - Aggregate profits grew 65%

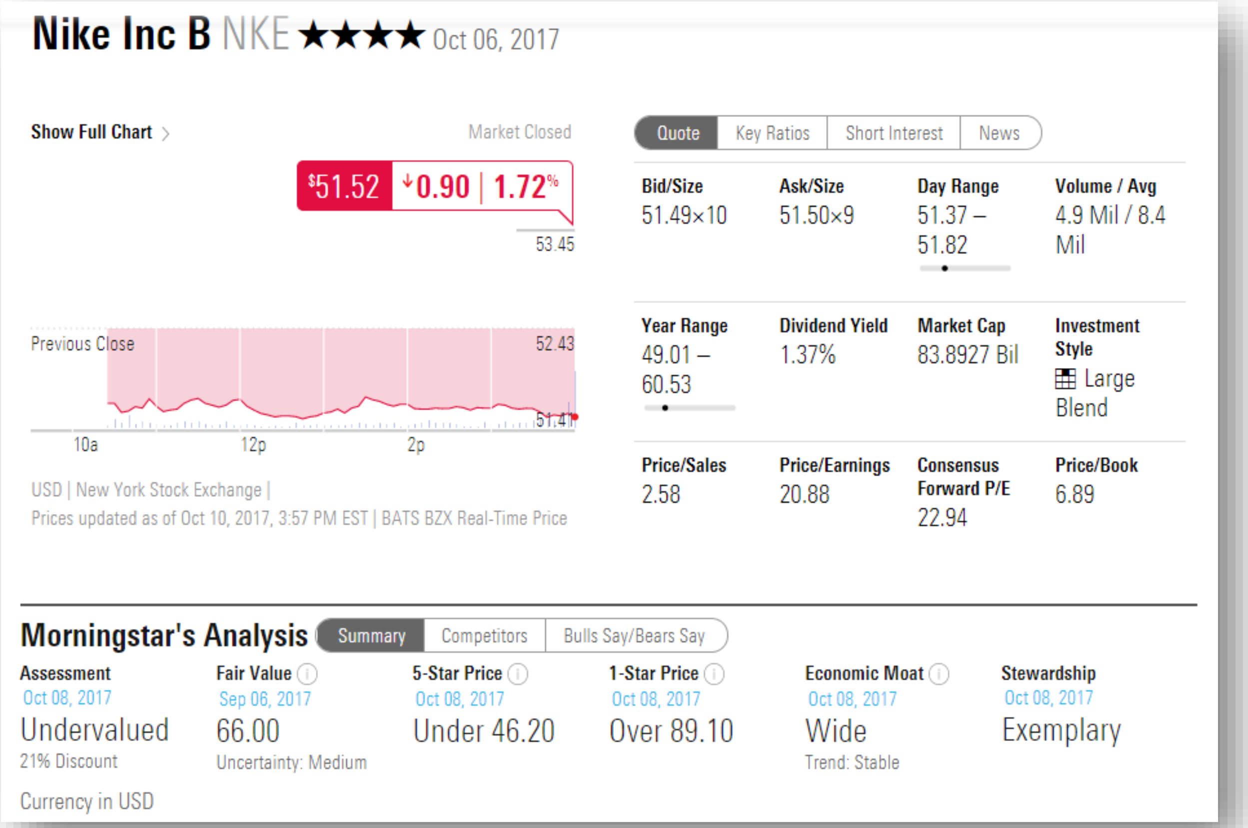
*We think the OCP increases mainly have to do with Nike jettisoning these non-core brands in FY 2013*

# Morningstar’s Profit Argument

Is Nike on the verge of an enormous margin expansion?

# Morningstar is Bullish

FRAMEWORK Investing




- FVE = $66 / share
- “Buy” rating now, “Strong Buy” at $46
- Wide “Moat”
- “Exemplary” Stewardship

# Morningstar is Bullish

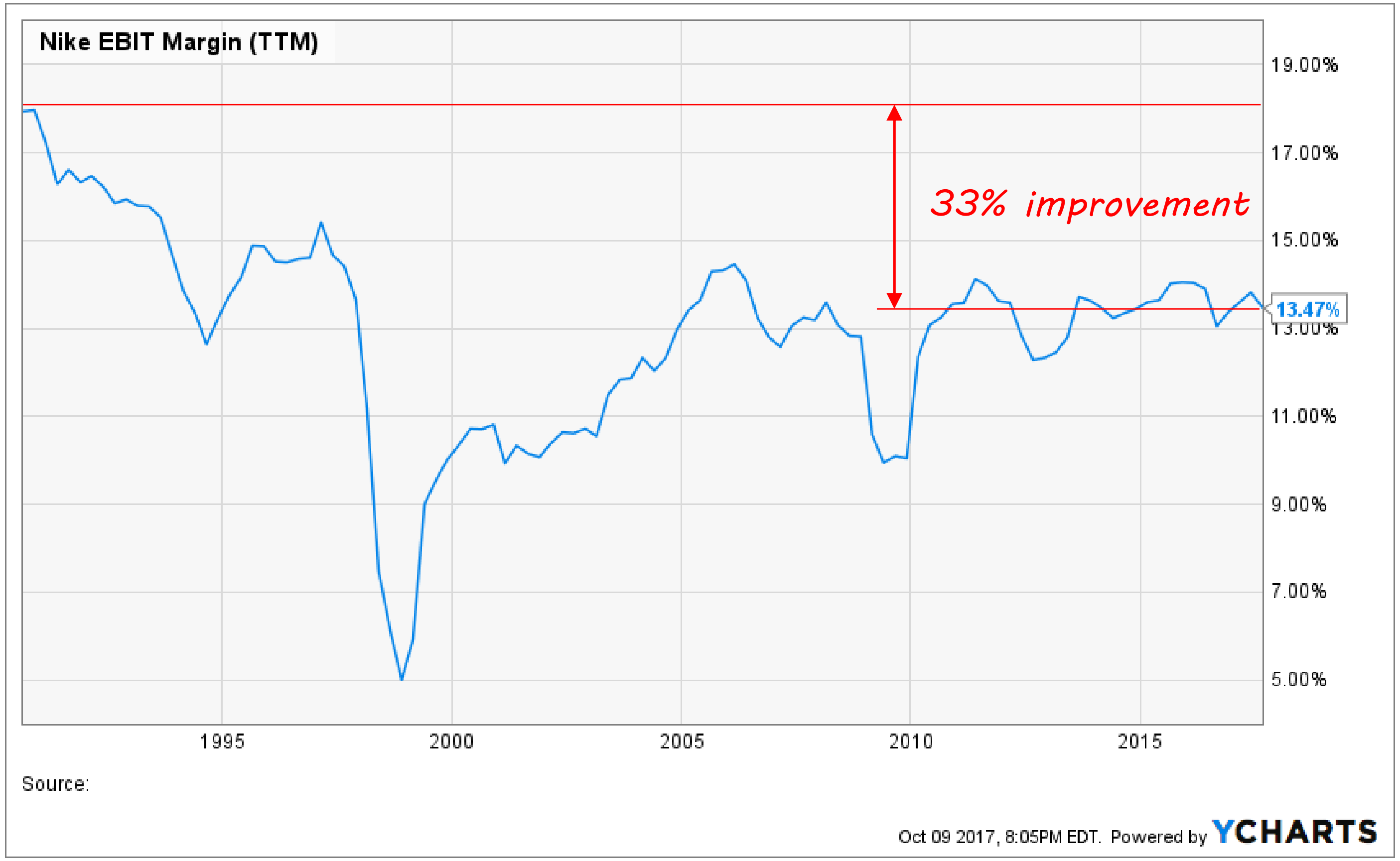
**Valuation** by Michael Wong Updated Sep 27, 2017

After reviewing fiscal 2018 first-quarter results, we are maintaining our $66 fair value estimate, as the time value of money offsets slightly revised near-term assumptions (we lowered our fiscal 2018 gross margin forecast 20 basis points to 44.0% to incorporate North American promotions). Despite near-term pressures, we expect profitability improvement resulting from the firm's efforts to build out its direct-to-consumer network will lead to operating margins to 18% by fiscal 2027, up from less than 14% in fiscal 2017. Our fair value estimate implies a forward fiscal 2018 price/earnings ratio of 28 and an enterprise value/EBITDA ratio of 19 times.

*Bullish valuation based upon the firm's ability to expand operating margins by 453 basis points versus the trailing twelve-month value*

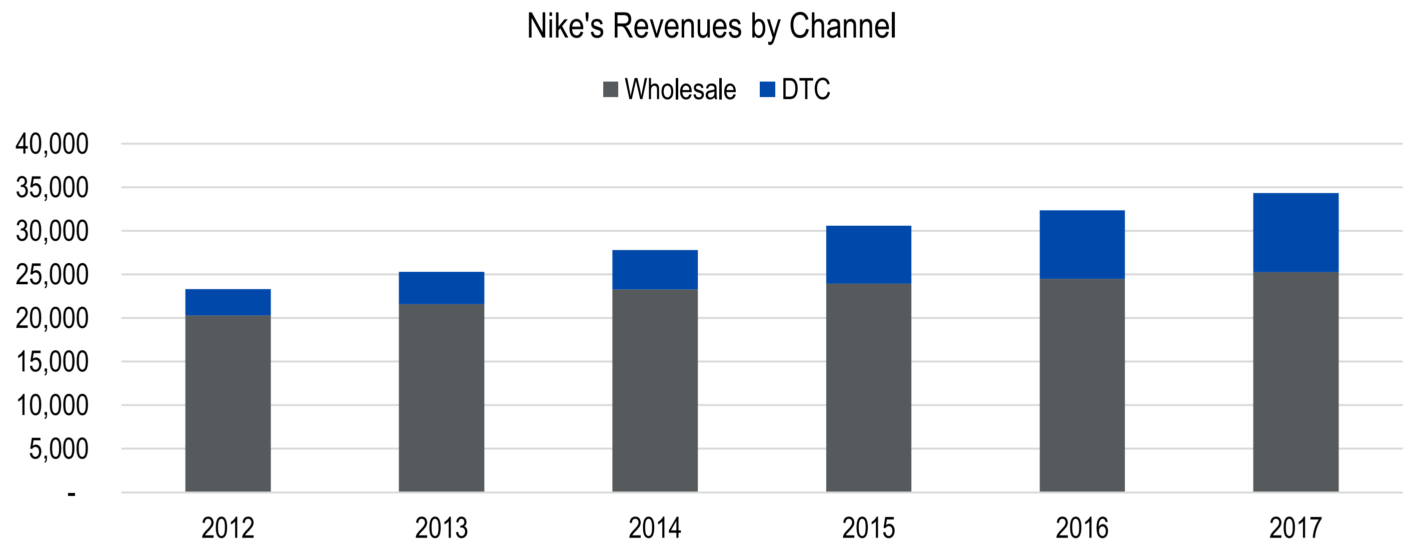
- FVE = $66 / share
- "Buy" rating now, "Strong Buy" at $46
- Wide "Moat"
- "Exemplary" Stewardship

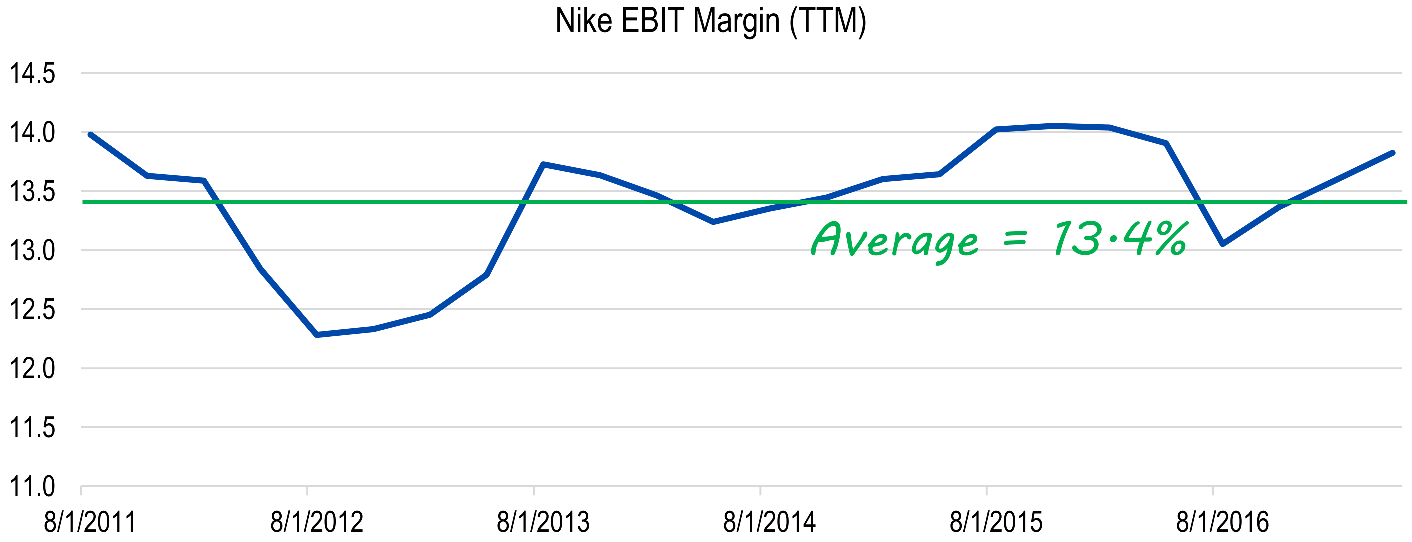
# Nike's Historical EBIT Margin




- If we look back at Nike's profit historically, the only time the firm has been able to achieve 18% margins is in 1990
- This profit increase would imply a 33% improvement over the trailing twelve-month period
- This might be possible, but as a base-case assumption, it seems… aggressive
- Morningstar's analyst believes this is possible as Nike's Direct-to-Consumer (DTC) business increases revenue share

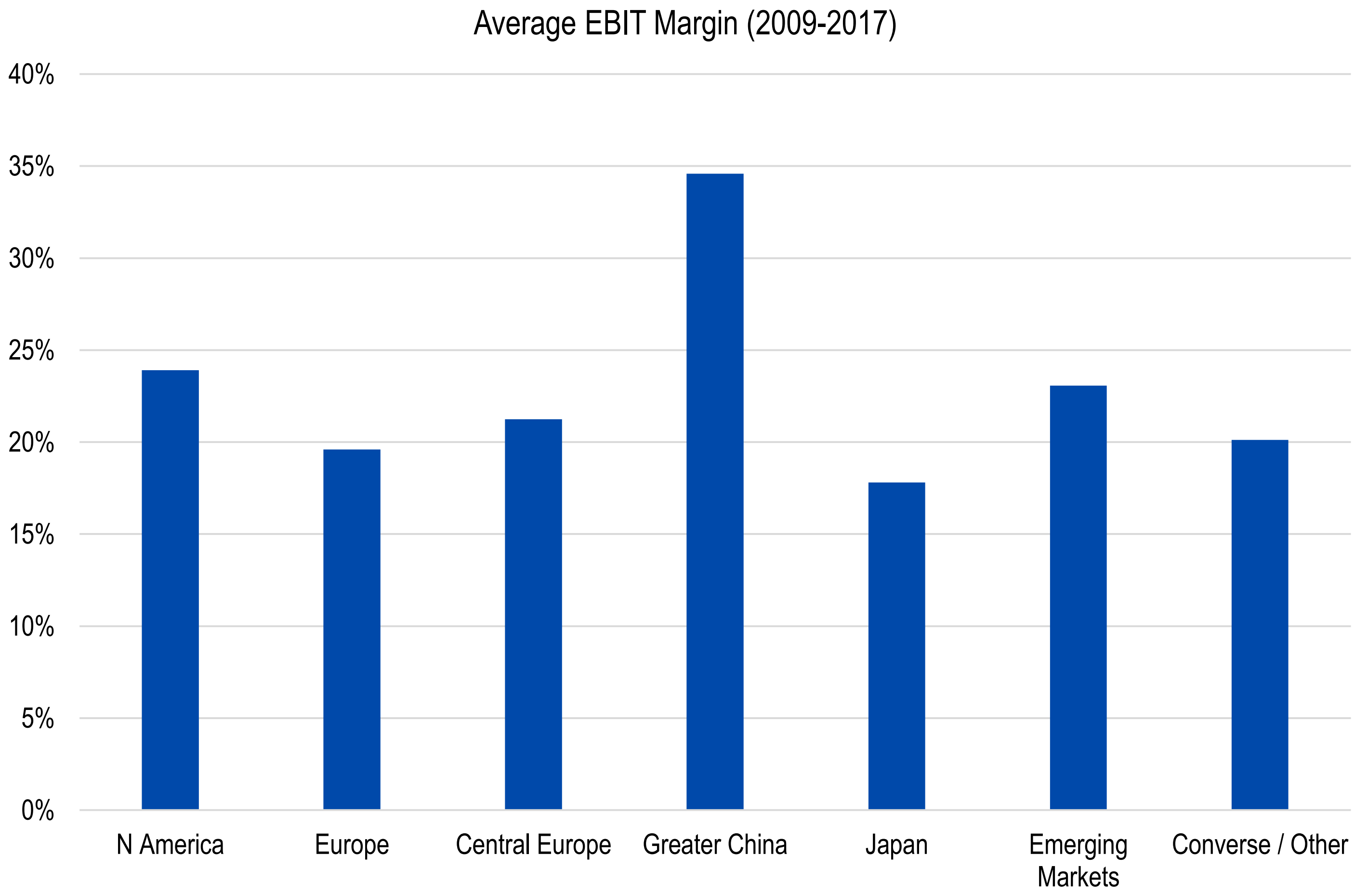
# Nike's DTC Channel




- Nike splits out DTC and Wholesale revenues starting in 2012
- During this time, DTC revenues triple while Wholesale revenues increase by 25%
- What do margins do?
- It's hard to find structural improvement in the EBIT margin graph

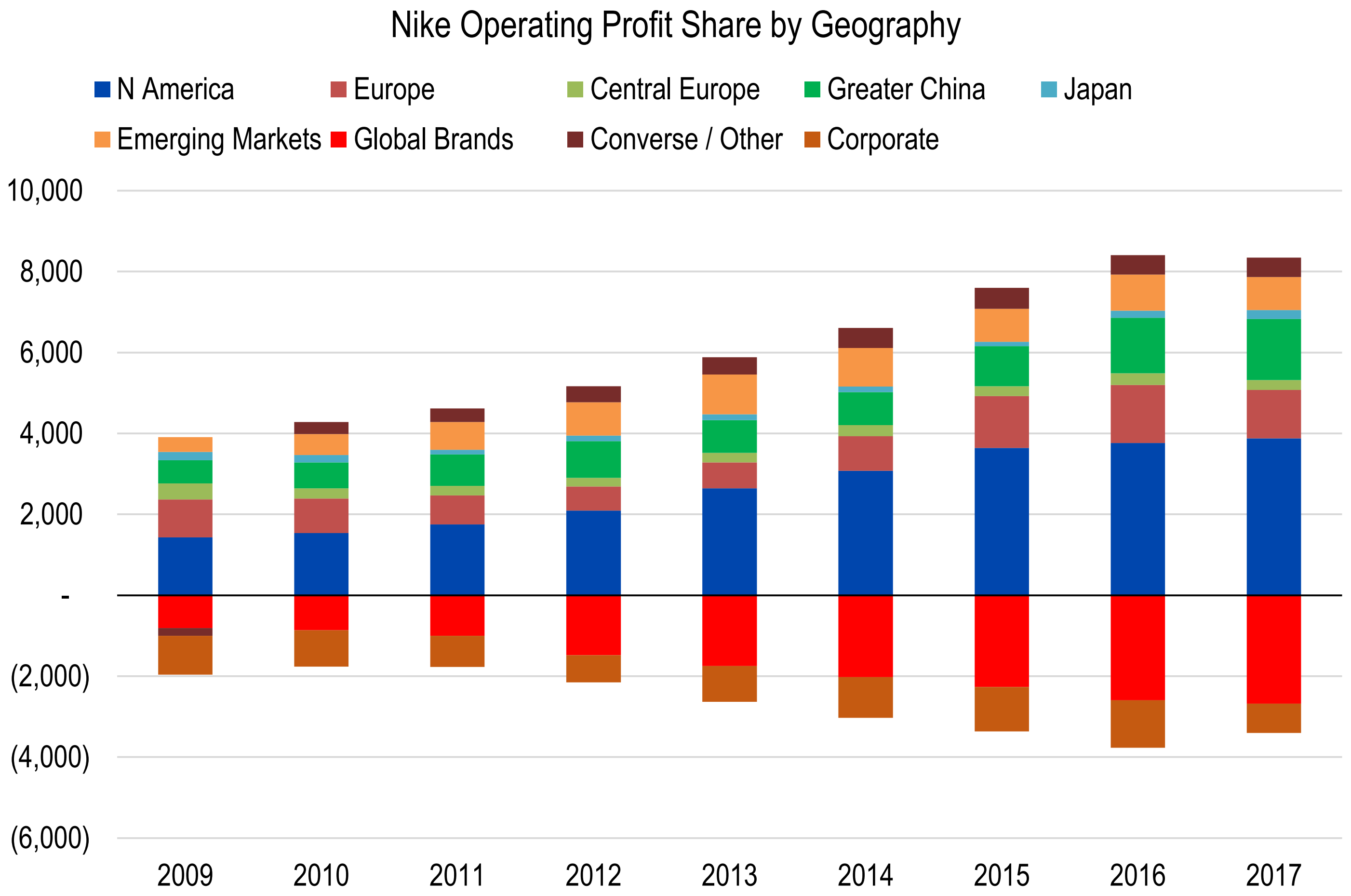
# Chinese Influence




- Chinese operating profit margins are MUCH higher than the firm average
- China's average annual revenue growth rate of 12% is about 20% brisker than North America's
- If China continues to grow quickly and convert revenues to profits as efficiently as it has, Nike's profit margin will rise naturally

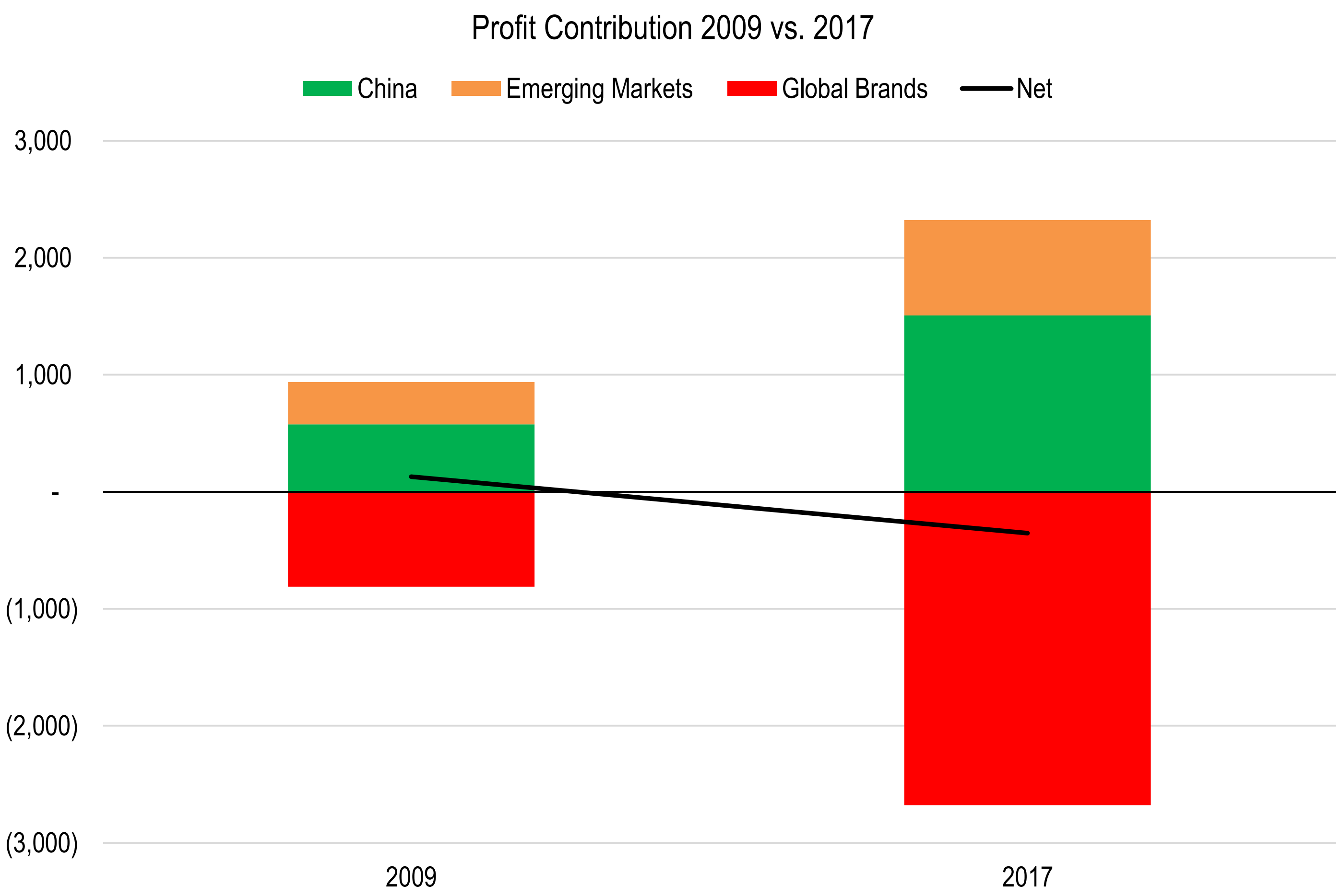
# Chinese Influence

FRAMEWORK Investing



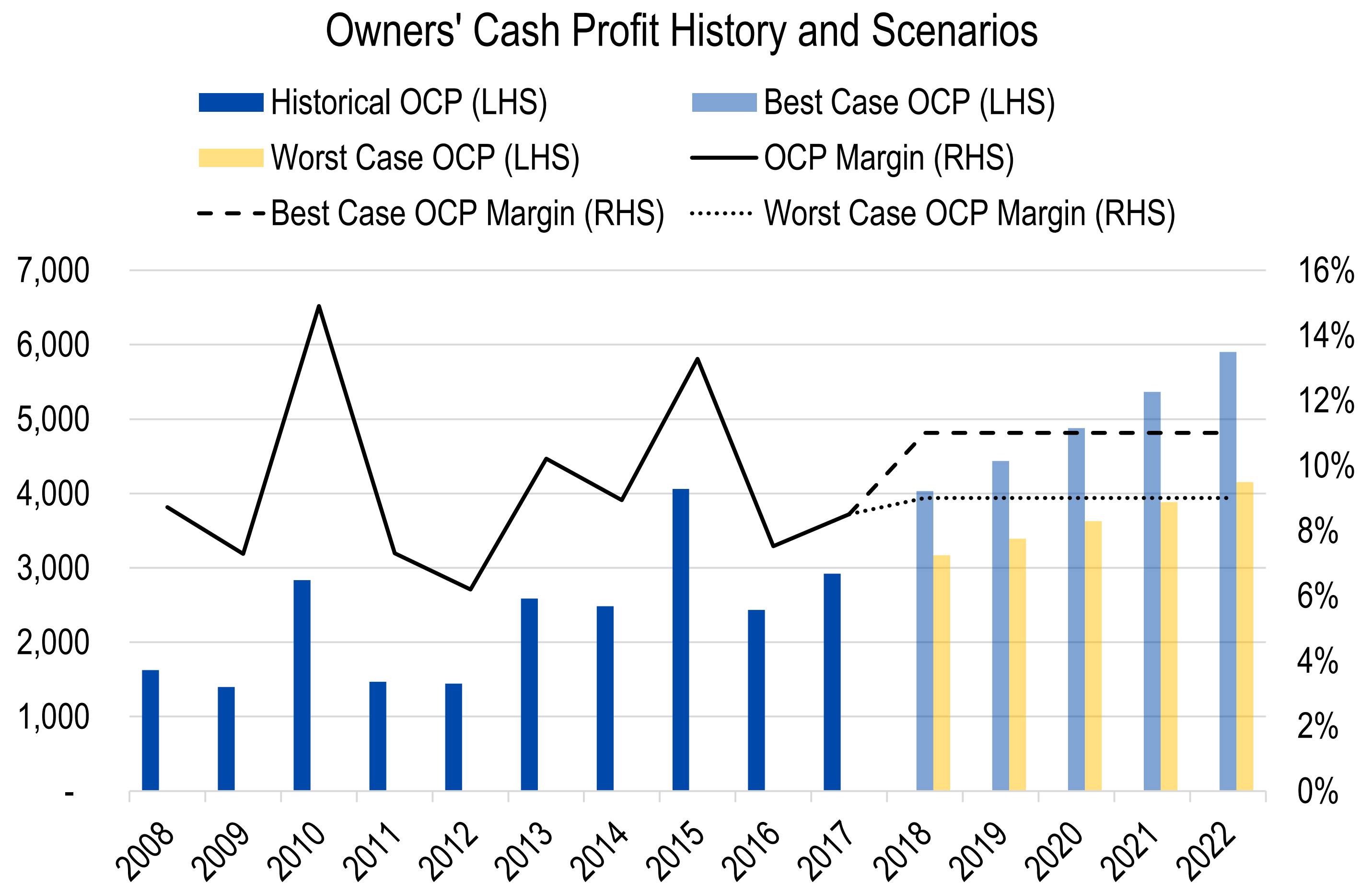

- (Apologies for the graph…)
- "Global Brands" is Nike's centralized marketing segment
- China (green) and Emerging Markets (light orange) are growing quickly, but much of this growth is offset by increasingly large expenditures for Global Brands (red)

# Chinese Influence




- Splitting out only China, Emerging Markets, and Global Brands, we see the enormous growth in all three
- While we cannot ascribe the entire increase of Global Brands' costs to China and EM, it's notable that the net of these three segments went from +$128mm to -$354mm from 2009 to 2017
- Moral of the Story: "Brand value" doesn't come cheap

# Framework's Forecasts




- Best-Case Margin: 11%
- Worst-Case Margin: 9%
- Increasing margin from DTC channel argument looks tenuous
- Nike's Chinese business is profitable, but does this really contribute to significant margin expansion?
- Our model builds in 250 basis points of margin expansion from 2017 and >100 basis points greater than historical

# Investment Spending

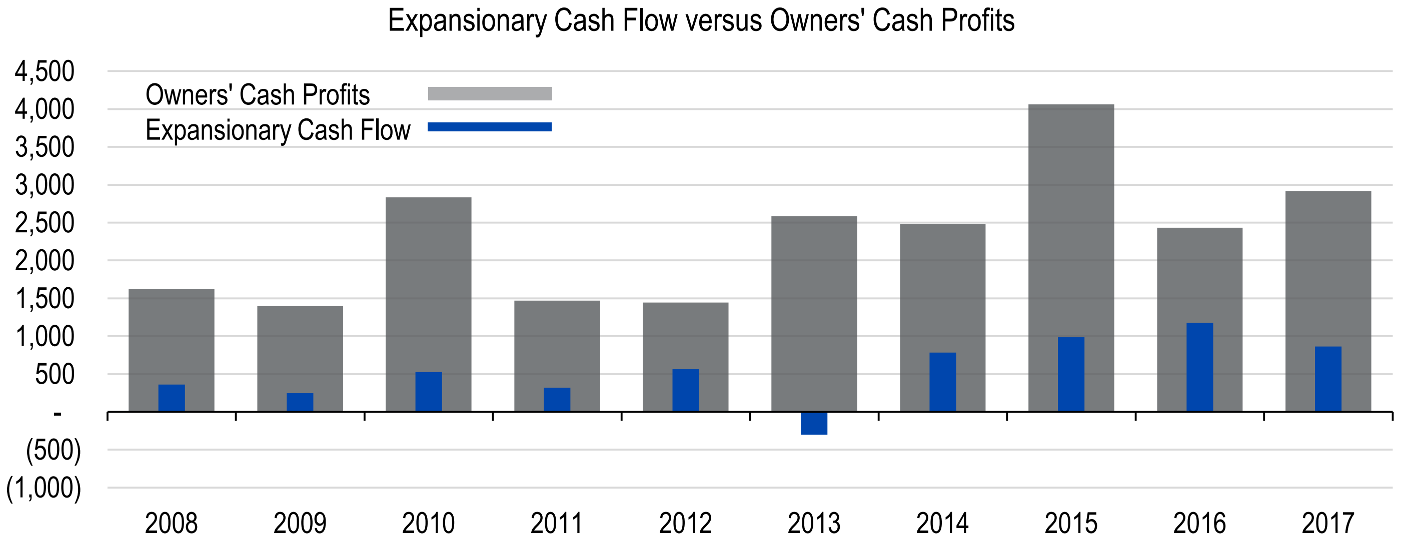
Not much to say about this

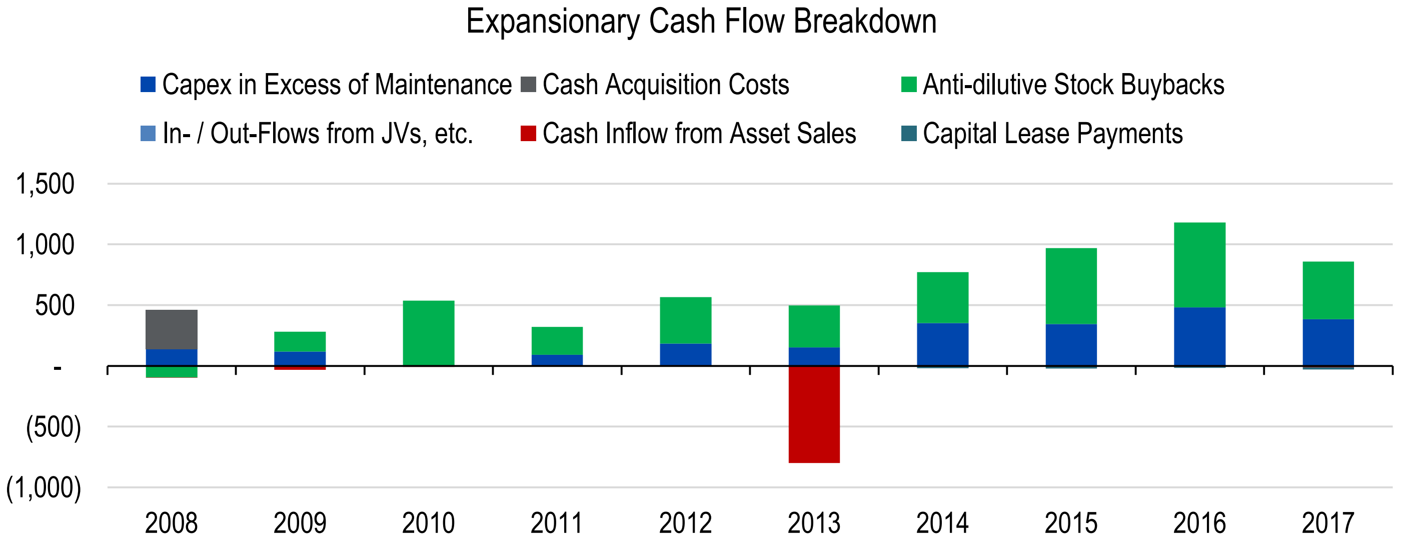
# Valuation Framework

FRAMEWORK Investing

| | | Worst Case | Best Case |
|---|---|---|---|
| Short-Term | Revenue Growth | 6% / year | 9% / year |
| | Profit Margin (OCP) | 9% | 11% |
| | Investments % Profit | 24% | |
| Medium-Term | Cash Flow Growth | | |
| | Intrinsic Value Range | | |

# Framework's Forecasts




- Over the last 10 years, the company has spent 24% of its profits on investments – no reason to think this will change
- Note the importance of Anti-dilutive stock buybacks (lower graph, green sections)
- Note also the pick up in capex in excess of maintenance as the DTC business expands

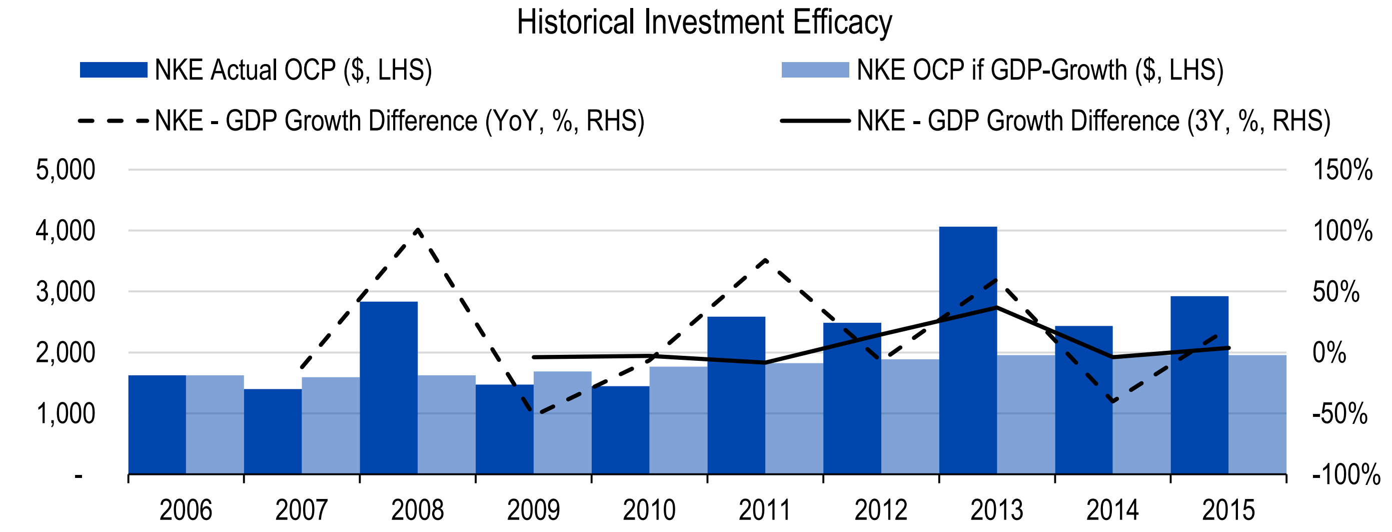
# Medium-Term Cash Flow Growth

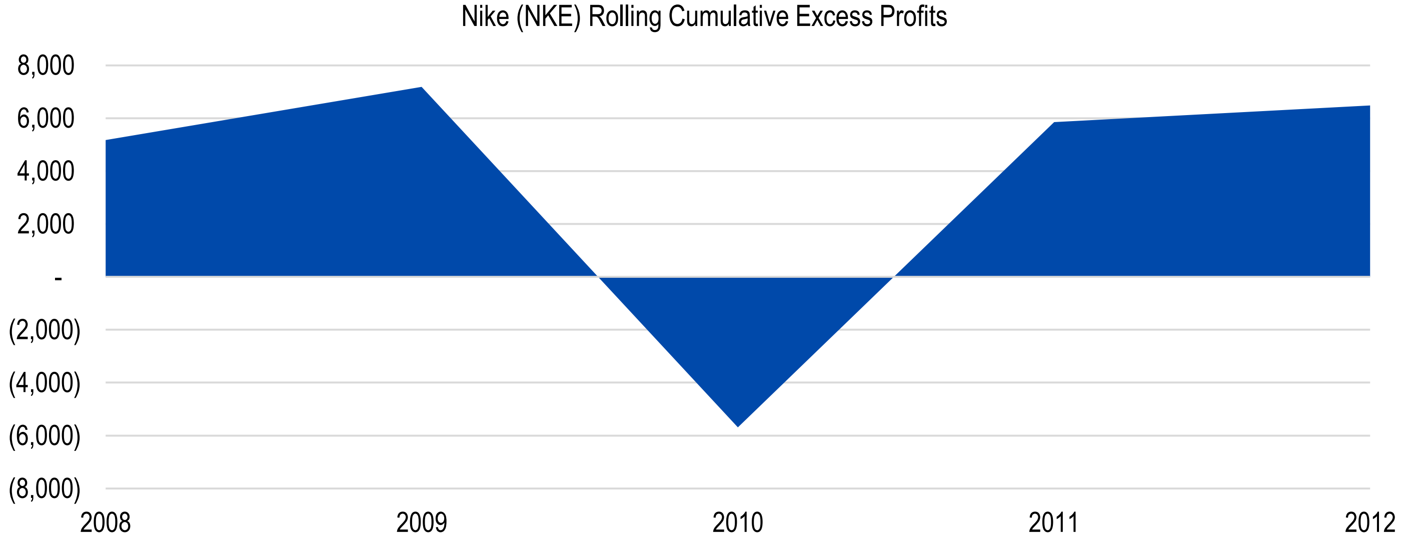
Remember, Nike is a “growth company.”

# Valuation Framework

| | | Worst Case | Best Case |
|---|---|---|---|
| Short-Term | Revenue Growth | 6% / year | 9% / year |
| | Profit Margin (OCP) | 9% | 11% |
| | Investments % Profit | 24% | |
| Medium-Term | Cash Flow Growth | 8% / year | 10% / year |
| | Intrinsic Value Range | | |

# Historical Assessment




- Clearly, Nike has consistently created a lot of value for owners
- 2009-2010 highlights Nike’s sensitivity to consumer discretionary spending
- We want to give Nike the benefit of the doubt
- At the same time, it is a large company in a competitive field that is driven by celebrity and fashion
- Our 8% / 10% forecast is mathematically possible and suggests some margin expansion

# Valuation

Pulling the cash flow pieces together and discounting at a 10% rate.

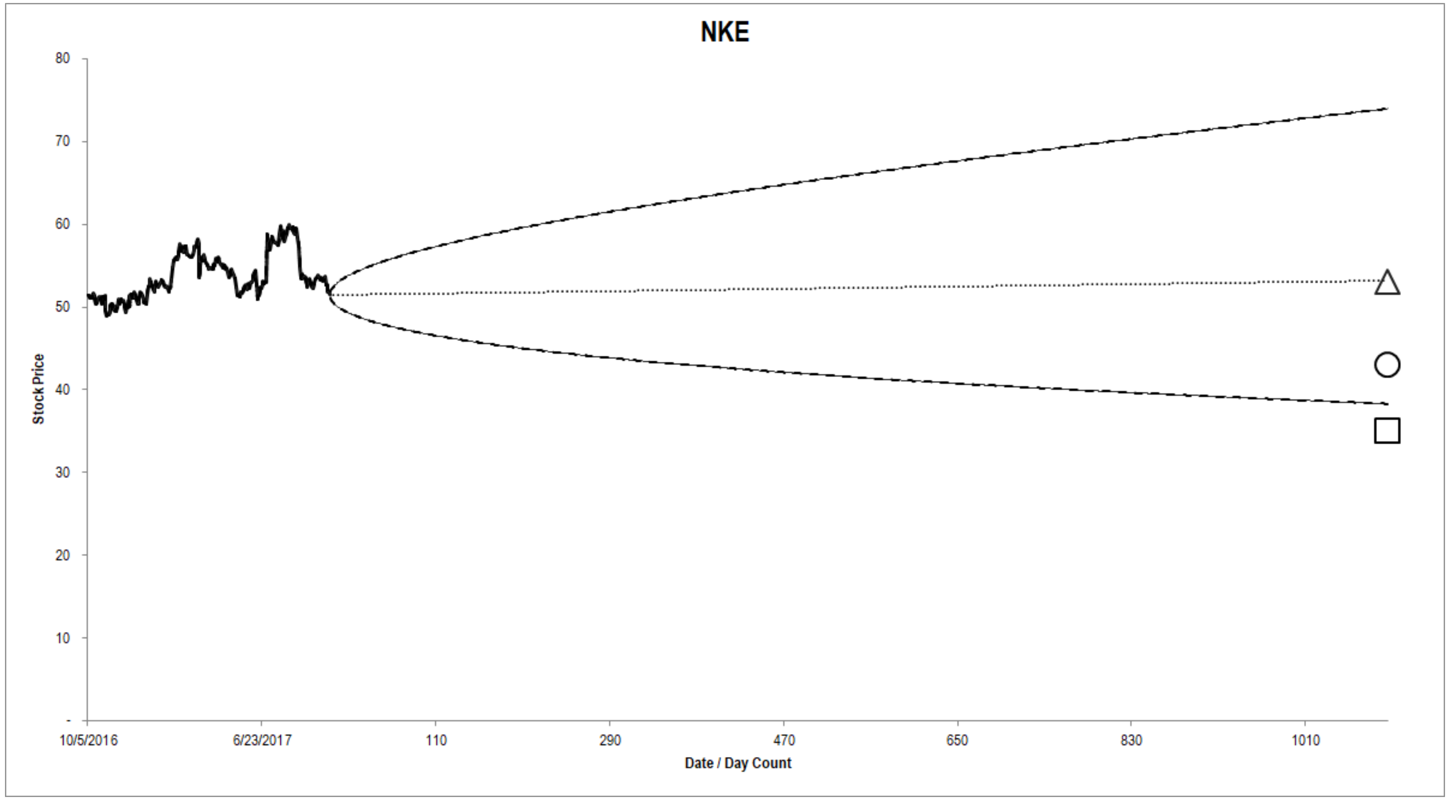
# Valuation Framework

FRAMEWORK Investing

| | | Worst Case | Best Case |
|---|---|---|---|
| Short-Term | Revenue Growth | 6% / year | 9% / year |
| | Profit Margin (OCP) | 9% | 11% |
| | Investments % Profit | 24% | |
| Medium-Term | Cash Flow Growth | 8% / year | 10% / year |
| | Intrinsic Value Range | $35 / share | $53 / share |

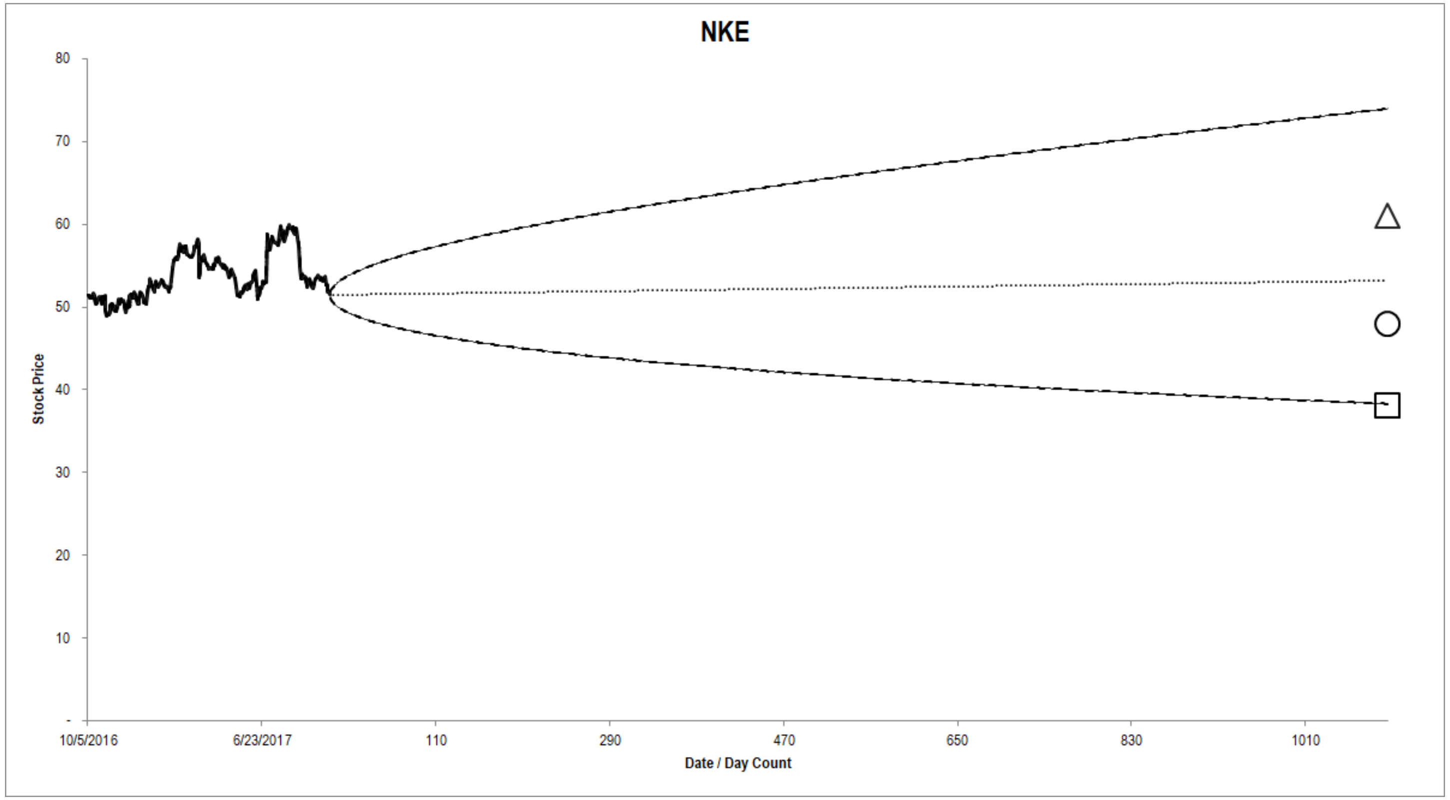
| | |
|---|---|
| Average of all Scenarios | $43 / share |
| Recent Market Price | $51 / share |

# Visual Valuation




- The firm looks overvalued, or at least priced for perfection now

# Visual Valuation




- The firm looks overvalued, or at least priced for perfection now
- Even assuming the medium-term cash flow growth period will last for 10, rather than 5 years, the stock still looks "toppy"

# Thank You

Q&A Session