FY 2009 Q1 Preliminary Call Transcript
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Operator:

Good afternoon, everyone. Welcome to Nike's fiscal 2009 first quarter conference call. For those who need to reference today's press release you'll find it at www.Nikebiz.com. Leading today's call is Pamela Catlett, Vice President, Investor Relations. Before I turn the call over to Ms. Catlett, let me remind you that participants of this call will make forward-looking statements based on current expectations and those statements are subject to certain risks and uncertainties that could cause actual results to differ materially. These risks and uncertainties are detailed in the reports filed with the SEC including forms 8-K, 10-K, and 10-Q.

Some forward-looking statements concern future orders that are not necessarily indicative of changes in total revenues for subsequent periods due to mix of futures and at-once orders, exchange rate fluctuations, order cancellations, and discounts which may vary significantly from quarter-to-quarter. In addition, it is important to remember a significant portion of NIKE, Inc.'s business including equipment; most of Nike Retail, NIKE Golf, Cole Haan, Converse, Hurley, and Umbro are not included in these futures numbers. Finally, participants may discuss non-GAAP financial measures. The presentation of comparable GAAP measures and quantitative reconciliations are found at Nike's Web site. This call might also include discussion of non-public financial and statistical information, which is also publicly available on that site www.nikebiz.com.

Now I would like to turn the call over to Pamela Catlett, Vice President, Investor Relations.

Pamela M. Catlett, Vice President of Investor Relations

Thank you and good afternoon, everyone. Thank you for joining us today to discuss Nike's fiscal 2009 first quarter results. As the operator indicated, participants on today's call may discuss non-GAAP financial measures – a comparative presentation of reconciliations between GAAP and non-GAAP reported items can be found in our press release which was issued about an hour ago, and can be found at www.nikebiz.com.

Joining us on today's call will be NIKE, Inc. CEO Mark Parker, followed by Charlie Denson, President of the NIKE Brand, and finally you will hear from our Chief Financial Officer Don Blair who will give you and in depth review of our financial results.

Following their prepared remarks, we will take your questions. And as many of you know, for questions we'd like to allow as many of you to ask questions as possible in our allotted time. So we'd appreciate you focusing your initial questions to two and in the event you have additional questions that are not covered by others, please do feel free to re-queue and we will do our best to come back to you. Thank you very much for your cooperation on this. And now it is my pleasure to introduce NIKE, Inc. CEO Mark Parker.

Mark Parker, President and CEO

Thanks, Pam… and welcome everybody to our first-quarter earnings call for fiscal year 2009.

Q1 again demonstrated the strength of our brands and our business. We continue to gain share in key markets and deliver growth in revenue and profitability. That said we're not stopping to celebrate and we're not complacent… AND we're clear on what's needed to deliver our goals through fiscal year '09 and beyond. Let's go to the numbers first:

- Nike, Inc. revenue is up 17% to $5.4 billion… that's 28 consecutive quarters of year-over-year growth.
- Gross margins are up 240 basis points.
- Reported Global Futures are up 10%, which marks 31 consecutive quarters of futures increases
- And diluted EPS was down 8% from Q108 – influenced by a one-time tax benefit that contributed $0.20 per diluted share last year.

As I've said in the past, Nike will continue to invest in growth opportunities that offer the greatest potential for return. These Q1 results are in line with our ability to leverage those investments, our brands, and our resources across the portfolio.

You can't talk about results or opportunity without considering the broader environment. While there is financial uncertainty in some sectors, our results continue to warrant confidence in the power and flexibility of our businesses. We recognize the impact from prices, inflation, and currency fluctuations, and we realize that no one is immune…all of which reinforces my commitment to our simple and consistent strategy – manage for continued growth by leveraging the competitive advantages that we control: innovation, focus, and consumer relevance.

Innovative product is at the core of Nike… and practically speaking it's where consumers cast their vote on your brand.

- We landed in Beijing with new footwear and apparel for all 28 Olympic sports.
- We launched Flywire technology in the HyperDunk and Zoom Victory Spike.
- We launched LunarLite cushioning in the LunaRacer.
- We launched new Swift apparel.

And we're seeing consumers all over the world embrace these innovations and others. By any objective analysis, we lead in product innovation in our industry, and we'll keep that front and center going forward… always!

Seeing that innovation become reality – a profitable reality – requires focus . . . today more than ever. Focus on maximizing the potential for growth. Focus on leveraging our SG&A and other resources. And focus on creating value for shareholders.

We're just coming off a summer that created tremendous global excitement in sports, and we're moving into the season of championships in team sports. That puts Nike in a good position to move through the year capitalizing on that energy.

We're also focused on leveraging our resources across the portfolio. Our Supply Chain is one of Nike's greatest competitive advantages. Lean manufacturing, materials sourcing, digital efficiencies – it all helps us get the right products, to the right places, at the right time, at the right price – and that's good for our consumers, our retailers, and our gross margins.

Of course we focus on deploying capital thoughtfully and returning cash to shareholders. Over the last 10 years we have repurchased $5.5 billion of stock. As we complete our current $3 billion program, we will begin a new $5 billion repurchase program over the next four years.

I can assure you that this management team is focused on leveraging the entire Nike portfolio to meet our goal of $23 billion in revenue by the end of fiscal year 2011.

We are relevant with consumers because we understand each other. They know we create innovative products and experiences. They value that performance and authenticity. That's why we continue to gain marketshare…that's why we've reclaimed our rightful spot atop the running category.

When I look at China and the Beijing Olympics I see a great example of how Nike leverages our innovation, focus and consumer relevance. I spent a lot of time in China before and during the Olympics.

I've never been more impressed with our ability to execute on all levels. Our products were the most compelling and advanced. Our stories and messages were inspiring. And our Nike stores did more than set sales records – they were destinations for hundreds of thousands of Chinese consumers.

By every measure the Olympic Games achieved its promise for China, for sport, and for Nike. We were the clear winner in Beijing and the choice of China's consumers. Most importantly, now that the torch has been extinguished, the deep consumer connections and experiences we've built set the stage for strong, sustained long-term growth in China.

And what's happening in China right now is happening in every emerging market for Nike around the world, including Brazil, India, Turkey, and Russia – people are embracing Nike as the authentic leader in sports.

But it's not all about the Nike brand at the Olympics. Our Affiliate businesses also delivered a strong first quarter as they continue to grow and become a larger part of the Nike, Inc. portfolio.

Converse continues to deliver exceptional results:

- Revenue is up 32%.
- Our ONE STAR product in Target is performing beyond our expectations.
- And inventory is lean, and the business is executing extremely well.

Hurley is gaining some serious top- and bottom-line momentum.

- Revenue is up 38%... the biggest quarter ever for Hurley.
- The brand really showed its strength at the recent Action Sports Retailer show in San Diego. Action Sports, as you know, is one of the fastest growing segments in our industry, and the Nike portfolio…specifically Hurley, Converse and the NIKE Brand… is well positioned to go after that growth.

In total our ongoing affiliate businesses posted overall revenue growth of 20% and pre-tax income growth of 19%.

So, growing revenue, market share, and gross margins… growing futures, growing brands… I think this shows the power of leadership and a sound strategy in our industry.

I know what Nike needs to do to grow. It's the same thing our industry needs to do, and that is – obsess on the consumer. They give us the insights we need to drive innovation in everything we do – product creation, assortment planning, merchandising – all the way through the retail experience. Everything is always sharper when we stay connected to the consumer.

And we connect with consumers through our category offense – a strategy Nike got out in front of early and is now accelerating. It's the key to the innovation, focus and relevance I mentioned earlier. And it's driving the work we're doing with our retail partners – segmenting and differentiating our brand and their stores in the marketplace.

I believe the future of our industry is based on a more intimate relationship with this category-based consumer, and Nike, Inc. is able to create and realize that future better than any other company.

We have never been more sharply focused and as deeply aligned as we are right now. Our ability to leverage our assets and core competencies across our portfolio of brands gives us the flexibility to continue to invest in new opportunities, whether it's a new technology, a new category, or a new brand.

I see tremendous potential throughout our industry. As the leader, we are clear and confident in how to turn that potential into real growth and value for our shareholders… and will continue to do so.

Now here's Charlie for some news on the Nike brand.

Charlie Denson, President, NIKE Brand

Thanks Mark.

The Nike brand is off to a solid start for FY 09. It's been an amazing summer – our summer of sport:

- We started with the NBA Finals, where Paul Pierce led the Boston Celtics to their first title in 22 years.
- We watched Tiger's amazing Monday playoff win at the U.S. Open.
- Cesc Fabregas and Fernando Torres led Spain to their first Euro title in 44 years.
- Rafael Nadal and Roger Federer put on the greatest show ever at Wimbledon. It put tennis back on the front page and took Rafa to the number-one ranking in the world, only to be followed by Roger's U.S. Open title – his 13th grand slam victory and just one short of tying Pete Sampras.
- And of course, the biggest show on earth, the Beijing Olympics.

We had a heckuva summer for ourselves as well. On the quarter:

- The Nike Brand generated record revenue of $4.8 billion – up 18 percent.

- Every region increased revenue.
- Global footwear was up 19 percent.
- Global apparel was up 18 percent.
- All six categories saw revenue increases year over year.

So, a really solid performance by the Nike brand in the first quarter.

I'm very confident in our ability to build on the success of Q1, and I'll give you three reasons why:

First, our category offense. As Mark said, it's at the center of our growth strategy for the brand, and we're just beginning to see the depth of its true potential. Take Running. 18 months ago, Nike held a number 2 or 3 spot with the core competitive runner – respectable for most, but unacceptable for Nike.

By diving deep and focusing exclusively on the performance-minded runner:

- We generated strong revenue increases across all product platforms in all regions.
- Revenue from the Running Experience in NikeTown New York is up 45 percent.
- And we held a 'little' 10K run called the Human Race. Over 800,000 people showed up. It was the biggest running event in history and something only Nike could do.

We've created some real energy in running, and we did it by connecting completely with the athlete. It was all enabled by Nike+, which starts to give you a sense of the importance of social networking as part of our brand experience. That's the category offense at work, and we're applying that same intensity to all six of our key categories.

OK, confidence builder #2 is retail…

We're getting a really clear view of how to change the game in retail, and we're seeing results in stores right now.

- Retail revenues are up 18 percent, and in the U.S. we saw a 6 percent increase in comp store sales for in-line stores.
- I just mentioned the Running Experience, but you'd also have to add the Boot Room in NikeTown London where revenues are up 40 percent.
- And on the digital side, e-commerce and customization continue to grow.
- There's more on retail, but I'll come back to that in a minute.

Finally, let me tell you about Beijing…

This was by far our most successful single event ever, on multiple fronts:

- The presence and messaging of the Nike brand was the best I've ever seen. Chinese consumers really connected with what Nike is all about – innovation, authenticity, individuality, a passion for sports –they really get that.
- And we set sales records in stores all over China. In fact, I was in our store on Wan Fu Jing Road in Beijing, and it was so crowded you couldn't see the floor.
- These Olympic Games were the most watched Olympics in history. And so our investment in Beijing is paying off not just in China but it's impacting our business all over the world.

One last thing on Beijing… I mentioned about 8 months ago that this Olympics had the potential to re-ignite basketball around the world. I think that's exactly what happened.

- We saw the best basketball tournament ever played. A global tournament with global stars… great for the game and great for Nike.
- It was a microcosm of what is going on with basketball worldwide. And by the way, 8 out of every 10 players on each team, men's and women's, were wearing Nike shoes.
- I can confidently say that we now have two global team sports – football and basketball – and we lead in both.

OK, real quick, let's look at the regions, starting with the U.S:

- The U.S. region performed extremely well in a very tough retail environment.
- Futures are up. Our total revenue is up 8 percent.
- Our retail revenues increased 16 percent.
- We saw very strong performances in Running, Action Sports and Basketball.
- Apparel revenue increased 9 percent, with strong advances in Training apparel and double-digit growth in Running and Basketball apparel.
- Sportswear apparel remains a work in progress. We're excited about the response to our new Mercer Street store in New York City – it's a great example of sportswear as a brand extension to our authentic category positioning.
- We see a lot of momentum and a rising average selling price. Consumers are embracing our new technologies and the benefits they provide.

Overall there's a lot of visible growth opportunity in the U.S… consumers are a bit cautious, but they are passionate about those products and brands that deliver exceptional performance… we continue to be the brand of choice.

In EMEA:

- We're off to a strong start, with football and running leading the way into the future.
- On a constant dollar basis, Revenue is up 5 percent as we continue to grow in key countries.
- In Germany and the Alpine countries revenues are up 11 percent, which speaks well to our strategy at the European Championships.
- Turkey and Russia are up over 30 percent.
- And in the U.K. revenues climbed 5 percent.
- We're seeing some tough economic conditions in Spain, Italy and France, where we're staying focused on connecting with those consumers and managing our distribution and inventories.

In the AMERICAS region:

- First-quarter revenues grew by 19% and futures are up 24%.
- Football, running, women's training and sportswear all had strong double-digit growth.
- In Brazil, after taking over the previously licensed apparel business, our football apparel business is up over 60%.
- And Sportswear continues to sell well.
- Lots of momentum building in the Americas.

In ASIA:

- Revenue is up 26 percent, including growth in every major country in the region.
- Japan continues to trend up with revenue growth of 2 percent and futures up 4 percent.
- In China, revenue increased over 50 percent.
- I already talked about the Olympics, but just in case I haven't convinced you yet of our success and staying power in China, I'll say just one more thing… our future orders are up nearly 50 percent.

Alright, so back to retail:

Our strategy here is based on one thing: Nike at retail is a mirror of the Nike brand. But it's not about doors, it's about experiences.

- The Nike brand always leads with innovative product, and that pipeline has the best product we've ever seen. Flywire technology alone is going to reset the standard of performance in multiple categories. That's a compelling story.
- The Nike brand is all about category focus. Any retail execution we do will be driven through the lens of core consumers in our six key categories.
- And the Nike brand creates a sense of community. You heard Mark talk about consumer relevance. Community is a big part of that.

Put these together and you get the Running Experience in NikeTown New York. You get the Boot Room in London. You get a category focus that drives the entire consumer experience all the way through retail.

These are the advantages we bring to our retail destinations and to our wholesale partners. This is how we refine and scale new concepts. And we'll continue to invest in the people, the processes and structures necessary to create distinction and separation for the Nike brand.

So, Q1 is in the books. We exceeded expectations because we put more innovative product into the market… and we got that product to more people in the world… than ever before. Our brand is strong. And we're laser-focused on leveraging resources and managing our business well to deliver long-term sustainable growth.

These are the reasons we feel confident that we can continue to deliver results in these interesting times.

Now here's Don to give you the details on our financial performance.

<u>Don Blair, VP & Chief Financial Officer</u>

Thanks Charlie.

As you've heard from my colleagues, we think Q1 was a great start to fiscal 2009. All of our brands posted higher revenues for the quarter and our gross margin grew 240 basis points. While first quarter earnings per share declined as a result of planned SG&A investments and the comparison to last year's one time tax benefit, we're right where we expected to be at this point in the year. On balance, we're very happy with the strength of our brands and the performance of our businesses.

Over the past several years, you've often heard me talk about our commitment to investing for the future while also delivering growth in revenue, earnings and cash flow. In the dynamic global environment in which we compete, our focus on managing all of the levers of the Nike, Inc. P&L and Balance Sheet has allowed us to achieve that goal and is a strength we believe distinguishes our company.

To paraphrase Mark, today's results reflect our ability to leverage our investments.

We've invested in our brands to drive top line growth – and we posted double-digit revenue growth on a constant currency basis.

We've invested in emerging markets – and China grew over 50 percent, Russia grew over 40% and Brazil grew 30%.

We've invested in our multi-brand portfolio – and revenues from our continuing Other businesses are up almost 20%.

We've invested in our supply chain to optimize our efficiency – and our gross margins grew strongly despite Asian cost pressures.

And we've invested in Nike Brand retail – which grew 14%, highlighted by a 6% increase in comp store sales for in-line stores.

In short, revenue is up, futures are up, gross margins are strong and consumers continue to seek the Nike brand experience around the world.

In today's environment, managing our business to invest for the future and deliver growth today means we remain relentlessly focused on healthy top line growth, keeping our inventories tight, and driving a more rigorous focus on cost management throughout the organization. We think we've made the right investments and we will continue to leverage them to fuel our growth.
We do not know where every macro-economic variable will land, but we do know that if we stay focused on the levers we can control, we'll put ourselves in the best possible position to deliver our financial goals for this year and into the future.

Now on to the quarter:

- In Q1, Nike, Inc. Revenue grew 17% to over $5.4 billion; currency changes contributed about 7 points of that growth. Excluding currency changes, Nike Brand revenues grew 11%.

- On a currency neutral basis, Nike Brand footwear and apparel Futures orders scheduled for delivery from September 2008 through January 2009 grew 9%, up from 8% growth on our last call and driven by accelerated growth in orders for US Footwear.

- Diluted Earnings Per Share for the quarter declined 8% to $1.03, reflecting SG&A investments this year and comparison against last year's one-time tax benefit. Adjusted for the prior year tax item, EPS would have increased 12%.

- Gross Margin for the quarter grew 240 basis points to 47.2%, somewhat higher than we had expected. We anticipated many of the factors that drove the year-on-year improvement: better exchange rates, effective sourcing cost initiatives, retail expansion, selective footwear price increases and a shift in mix to higher margin styles. The upside came primarily as a result of higher margins in our Other businesses and less rapid cost inflation in Asia.

- SG&A for the quarter grew 29%, including 5 points from currency changes. On a currency neutral basis, Demand Creation grew 39% due primarily to investments in the European Football Championships and Beijing Olympics. Operating Overhead grew 14% on a constant currency basis, driven by investments in infrastructure to support key growth drivers such as owned retail, emerging markets and our Other businesses. On-the-ground activities around the summer sporting events and increased stock-based compensation expenses also contributed to operating overhead growth.

- Net Interest Income in the first quarter was $10M, $14M below last year due primarily to lower interest rates.

- Our Effective Tax Rate for the first quarter was 28.5 percent, 13.5 points higher than Q1 last year, when we benefited from the one-time utilization of past foreign losses.

The strength of our balance sheet continues to be a true point of difference for Nike, particularly in the current financial climate.

For the quarter, we generated $249M of Free Cash Flow from Operations, up 10% year-on-year. A key driver was working capital, which reflected a six day improvement in the Cash Conversion Cycle.

While we continued to invest in our business, we also returned a significant amount of cash to our shareholders. During the quarter, we repurchased $430M of stock and paid out $113M in dividends. We expect to complete our current share repurchase program later this year, about 18 months early. Earlier this week, our Board authorized a new four-year, $5B share repurchase program to begin as soon as our current program is completed. This step reaffirms our confidence in the strength of our cash flow and our long term growth potential.

Our Return on Invested Capital for the 12 months ended August 31 was 23.2%, 70 basis points below the prior 12 month period primarily due to the positive impact of the one-time tax benefit on the year-ago figure.

With that recap of our first-quarter performance, let me now give you some additional perspective on results across our operating units, starting with the U.S.

Our U.S. Region posted excellent results, as revenue grew 8% to $1.8B and gross margins improved strongly over the prior year. Pretax income increased only 1% as increased demand creation spending partially offset the growth in revenues and margins. The strength of the Nike brand in the U.S. is evident by the continued strength of our top retail destinations. Seven out of our 10 largest wholesale partners delivered year-over-year revenue growth, with renewed energy from athletic specialty accounts.

Revenues at Nike-owned retail stores grew 16% for the quarter, while comp store sales at Nike in-line stores increased 8%; our e-commerce business grew more than 30%.

U.S. Footwear revenues increased 9% for the quarter, significantly outpacing the market. The growth was driven by the running, soccer, and women's training categories within the Nike Brand, and Brand Jordan, which expanded its position as the #2 footwear brand in the US.

U.S. Apparel revenues grew 9% for the quarter driven by double-digit growth in performance products, partially offset by continued weakness in Sportswear.

Total U.S. Futures grew 3% versus the prior year powered by strong growth in footwear, partially offset by lower apparel futures, primarily Sportswear.

In our European Region, which includes the Middle East and Africa, first-quarter revenues grew 20%, including 15 points of growth from currency. On a currency-neutral basis, most countries in the region posted higher sales with footwear and equipment delivering year-on-year growth. The emerging markets in the region drove the majority of the growth, partially offset by weakness in Southern Europe.

For the first quarter, pretax income for Europe grew 17%, reflecting revenue growth, gross margin improvement and stronger European currencies. Pretax income growth was tempered by large demand creation investments around the EuroChamps and Olympics.

The Asia Pacific Region reported revenue growth of 36% in the first quarter, including 10 points of growth from currency. On a currency-neutral basis, every product type and most countries in the region grew. Revenues in China expanded more than 50 percent, fueled by retail expansion and highly integrated product, brand and retail execution around the Olympics.

For the quarter, pretax income for the region grew 15% to $186M as revenue growth and higher gross margins more than offset investments in demand creation and China infrastructure.

In the Americas Region, first quarter revenues grew 26%, with currency changes accounting for approximately 7 points of growth. On a currency-neutral basis, growth was balanced across all product lines and countries. For the quarter, pretax income grew 18% to $69M, driven by higher revenues, improved gross margins, and overhead leverage.

First-quarter revenues from the businesses reported as Other grew 7% and pretax income declined by 9%. These reported growth rates reflect the sale of the Bauer and Starter businesses and the acquisition of Umbro. For our continuing businesses - Converse, Cole Haan, Hurley and Nike Golf – revenue grew 20% and pretax income grew 19%. In its first full quarter as part of the Nike portfolio, Umbro broke-even.

As we consider the outlook for the balance of the year, we remain confident in our ability to manage our business through times of economic uncertainty. At this point our financial outlook for fiscal 2009 remains largely unchanged.

- For the second and third quarters, we continue to expect high single digit Revenue growth. Revenue growth in the fourth quarter will likely be lower, reflecting comparisons against strong sales at the end of last year as we ramped up to the Olympics and EuroChamps. For the full year, we expect high single-digit revenue growth, within our long term target range.

- We began the year expecting modest growth in Gross Margins; needless to say, we're very pleased by our strong results for the first quarter and now believe gross margins for the full year could be 100 basis points above the prior year. We expect balance of year growth to be lower than first quarter levels due to changes in product mix and comparisons against strong margins last year. In addition, while the most grim forecasts of oil prices, labor costs and exchange rates have not yet been realized, we remain somewhat cautious in our gross margin outlook for the year.

- We expect the growth in SG&A to decelerate significantly over the balance of year, as we return to more normalized levels following planned investments in the Olympics and Eurochamps over the past two quarters. For the full year, we expect low double digit growth in SG&A, reflecting low- to mid-teens growth in the second and third quarters offset by a year-on-year decline for the fourth quarter. SG&A growth for the year will be driven by higher demand creation spending and infrastructure investments in emerging markets, retail and our Other businesses. As we've indicated earlier, we're continuing to focus on tightening and leveraging our core operating overhead expenses.

- We anticipate Interest Income to continue to track below prior year levels, reflecting the decline in short-term interest rates, while Other Income for the year should improve driven by smaller hedge losses.

- At this point, we estimate our fiscal 2009 Effective Tax Rate will be at or slightly below 28.5%.

In summary, we're very pleased that we delivered another excellent quarter of profitable growth and we're committed to continuing to do so the rest of fiscal 2009 and beyond.

Now I'll turn the call back to the operator so we can take your questions.