FY 2019 Q1 Earnings Release Conference Call Transcript
September 25, 2018

PRESENTATION

Operator:

Good afternoon, everyone. Welcome to NIKE, Inc.'s Fiscal 2019 First Quarter Conference Call. For those who want to reference today's press release, you'll find it at http://investors.nike.com. Leading today's call is Nitesh Sharan, Vice President, Investor Relations and Treasurer.

Before I turn the call over to Mr. Sharan, let me remind you that participants on 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 the Annual Report filed on Form 10-K. Some forward-looking statements may concern expectations of future revenue growth or gross margin.

In addition, participants may discuss non-GAAP financial measures, including references to constant dollar revenue. References to constant dollar revenue are intended to provide context as to the performance of the business, eliminating foreign exchange fluctuations.

Participants may also make references to other non-public financial and statistical information and non-GAAP financial measures. To the extent non-public financial and statistical information is discussed, presentations of comparable GAAP measures and quantitative reconciliations will be made available at NIKE's website, http://investors.nike.com.

Now, I would like to turn the call over to Nitesh Sharan, Vice President, Investor Relations and Treasurer.

Nitesh Sharan, Vice President, Investor Relations and Treasurer:

Thank you, operator. Hello, everyone, and thank you for joining us today to discuss NIKE, Inc.'s fiscal 2019 first quarter results. As the operator indicated, participants on today's call may discuss non-GAAP financial measures. You'll find the appropriate reconciliations in our press release, which was issued about an hour ago or at our website, investors.nike.com.

Joining us on today's call will be NIKE, Inc. Chairman, President and CEO, Mark Parker; and our Chief Financial Officer, Andy Campion. Following their prepared remarks, we will take your questions. We'd like to allow as many of you to ask questions as possible in our allotted time. So, we would appreciate you limiting your initial questions to two. In the event you have additional questions that are not covered by others, please feel free to re-queue and we will do our best to come back to you. Thanks for your cooperation on this.

I'll now turn the call over to NIKE, Inc. Chairman, President and CEO, Mark Parker.

Mark Parker, Chairman, Chief Executive Officer and President, NIKE, Inc.:

Thanks, Nitesh. And hello, and good afternoon, everyone. Last quarter, we described the growing momentum in our business, and in Q1, that momentum continued at a strong pace. We're capitalizing on the opportunities we see in the near-term and we're diving deeper into the areas that will widen NIKE's advantages over the long-term. Through the Consumer Direct Offense, we're taking a winning formula and executing it across our complete portfolio and it's leading to the balanced growth that you see today.

For the quarter, NIKE, Inc. revenues grew 10% on a reported basis. Specific highlights include double digit growth in our international geographies and 6% growth in North America; NIKE Digital is leading the way for differentiated retail, up 36% for the quarter; and we saw acceleration in both our sportswear and performance businesses. While this quarter's success was broad based, and we're pleased with our momentum, we know we have even more opportunities ahead.

As we've described before, a key focus that will create separation for NIKE over the long-term is our digital transformation. Ultimately, it's about becoming more personal, at scale. And put simply, it's how digital is accelerating each of our Triple Double pillars, and that's how we create through 2X Innovation, how we connect through 2X Direct, and how we serve through 2X Speed.

So, let's look at the quarter through each of these lenses. The success we're seeing today starts with great product. It's ultimately where the consumer casts their vote. Our innovation platforms are building a foundation for growth over many years. As the tastes of the consumer shift faster, strong platforms allow us to continually bring fresh products to market, while extending our storytelling and investments. We're seeing it with NIKE Air and React, consumers are drawn to their comfort and performance and they're asking for more style options.

VaporMax and 270 are both proving there is still vast growth potential in NIKE Air as we develop more comfort innovation in new forms. This spring, we're taking the exaggerated AIR you see in the Air Max 270 and going a step further with the introduction of the Air Max 720. This new platform is engineered for maximum comfort, cradling the entire foot. And the Air Max 720 is distinctly NIKE and we'll deliver it to consumers in early 2019.

NIKE React is a great example of how we've capitalized on the appeal of performance innovation and immediately scaled it into sportswear. The React Element 87 is considered one of the industry's top new designs, and we've applied the comfort of React cushioning to more performance and lifestyle shoes at several price points.

ZoomX continues to power the world's fastest runners, including Eliud Kipchoge during his epic, world record smashing run at the Berlin Marathon this month. This quarter, we took the magic of the Vaporfly 4% and merged it with an iconic running shoe, creating the Peg Turbo. The launch has created incredible energy for the whole Pegasus franchise, and helped lead our overall Running business to solid growth this quarter.

One of our most versatile and ever-advancing platforms is Flyknit. Through digital knitting, we can now place breathability, stretch and support exactly where we need it. In Basketball, for example, the KD 11 and the LeBron 16 each leverage specific yarns and different knit structures to match individual athlete needs. The LeBron 16, with its Battleknit 2.0, has had a great early read with consumers, both men and women.

As part of our broader commitment to scale sustainable platforms, we're expanding NIKE Flyleather through iconic styles like the Air Force 1, Cortez and the Air Max 95. Flyleather is a super material that looks and feels like premium leather, but is lighter, more durable and more sustainable. It uses at least 50% reclaimed leather and helps eliminate waste. And in the coming year, for the first time ever, NIKE will bring digitally-powered adjustable footwear to professional sports.

Building on the auto-lacing platform from HyperAdapt, this breakthrough creates a custom-fit. We had a group of elite athletes on campus this summer for an intense wear test and their feedback was that they'd never felt more secure or more in control of their movements. This next generation, adaptable innovation will set the standard for optimal fit and we'll offer it at more accessible price points and in greater quantities.

In addition to platforms, we're executing the fundamentals across our categories at a high level right now. We know that it's newness and freshness that wins with the consumer today. So, with our edit-to-amplify approach, we're providing deeper assortments and greater options of our top-sellers. Our footwear power franchises, for example consistently outperform our overall footwear sell-through.

Apparel, too, continued its momentum with 11% growth, driven by fleece tops and bottoms, jackets and pants. We delivered a number of Sportswear apparel collections over the last 90 days like the City Ready and the Metallic Sheen collections in women's and NIKE Sport and Tech Packs and ACG. We'll continue on this path, and extend into performance, because collections give consumers more complete looks and allow for better merchandising and storytelling.

Overall, with apparel in our categories, we saw consistent sell-through of our football national team collections, drafting off the energy we created from the World Cup where we had our first all NIKE men's final. The growth in our women's apparel business was led by sportswear and sports bras, where our strategy to blend style and comfort is working. And in NIKE basketball apparel, we're capturing the excitement for LeBron's move to the Lakers. As you'll see in just a few weeks, we're bringing more creative designs with the NBA City jerseys this year.

When we look across our complete portfolio of product, we still see areas with significant upside. We've talked before about the opportunity in Women's, in Young Athletes and Jordan. Delivering innovation and fresh product in these areas bring balance to our portfolio.

A strong roster of core footwear at entry price points is equally important to NIKE's overall growth potential. We're not yet where we want to be in core footwear, particularly in North America, but two priorities for the business are to develop innovation specifically for the core consumer and to better leverage pinnacle performance platforms, like NIKE Air, in this zone.

Another product strategy that's driving incredible energy is our ability to create unique intersections between sport and style across our brands. A few example, over this past quarter include the on-and-off-court collaboration between Serena and Virgil Abloh for the U.S. Open, Converse's limited-edition Chuck Taylors and One Stars with creative partners in fashion and music and our first Jordan Brand football kit with PSG.

As I've said before, it's not lifestyle versus performance or fashion versus sport. The consumer continues to be inspired by seeing those worlds come together. Overall, 2X Innovation is at the heart of our continued momentum right now. We have versatile platforms, we're mixing sport and style in unexpected ways and we have a deep lineup across our product portfolio that's creating value across all dimensions of our business.

And while our product innovation is fueling demand, our 2X Direct strategy is driving new ways to connect with our consumers. It's building confidence in our vision for smart retail where we remove friction and personalize experiences through the intersection of digital and physical environments. 2X Direct is in the early stages and it's already creating an impact, resulting in strong growth and margin expansion for our NIKE Direct channels.

We continue to see unprecedented demand for our highest-heat product through our SNKRS app, which has become the world's number one footwear shopping app. And we'll continue to expand the reach of SNKRS, launching in Mexico, Brazil and Southeast Asia next quarter.

The NIKE Live retail concept we unveiled with our Melrose store in LA was incredibly successful this quarter. The premise behind the concept is to create a live and ever-changing experience. We're testing a number of new features, including product assortments that update frequently based on what's trending with the local consumer, a service that allows consumers to reserve an item on our apps and then pick it up curbside or in the store from a personal smart locker, and through Swoosh text, our store athletes can now provide expert advice for consumers after they've left the store.

And what we're learning in Melrose, we're bringing to two new flagship stores in our two most important key cities, New York and Shanghai, this next quarter. Both will be the culmination of all we've learned about personalized and experiential shopping over the last several years. They will be incredible showcases for the NIKE Brand.

Our obsession with the store experience is also paying off with top strategic partners. While retail consolidation has not finished its course in North America, our growing NIKE Consumer Experiences with Footlocker, Nordstrom, and other key partners are already driving higher growth rates as compared to non-differentiated doors.

We're equally energized by the momentum we're building with new digital commerce partners. We just moved from a pilot stage to a fully operational program with Flipkart in India. And two weeks ago, we announced a new partnership with Jet.com to sell selected assortments of both NIKE and Converse in key cities in North America. With Jet, we're partnering to develop consumer insights and create a better branded experience on their platform.

We're doing the same with our key partners in China. This quarter, we made it possible to combine NIKEPlus member accounts to Tmall accounts. We're seeing an impressive increase in new members in China as a result. And last week, we launched a partnership with WeChat, making 1 billion monthly active users just one click away from becoming a NIKEPlus member.

Ultimately, companies will be judged on their ability to be more personal with their consumers at scale. And NIKE is taking the lead on this promise, leveraging more insights from all over the world and reshaping the shopping experience through smart retail. To make that a reality, we're unlocking opportunities to quickly and seamlessly design, manufacture and deliver our products to consumers through 2X Speed. We are sharpening our sensing capabilities and developing fully-responsive product manufacturing. We're actively building a portfolio of innovation and automation that impacts the entire spectrum of our process.

Our goals are ambitious, and we have high standards. Our vision is to leverage automation to deliver amazing, innovative products, faster and more responsively, while being more sustainable and cost efficient. And we've had some great success.

For example, we invented a flat assembly process for uppers in our Advanced Product Creation Center at our World Headquarters, using 30% fewer steps and 50% less labor. We tested this process with our partners, including Flex, and in our Asia source base as well. Transforming traditional footwear manufacturing is a significant undertaking.

We've learned a lot and are building new high-impact capabilities, yet we continue to face specific challenges together with our partners, including Flex, where the goal has been to deliver responsive, automated, close to market manufacturing of high-quality product at scale. This is a dynamic process and we're continually assessing and refining the best path forward, leveraging our breakthroughs in areas like rapid prototyping, 3D and digital printing and new methods of make, all in service of cutting the overall product creation cycle in half.

Another key initiative accelerating us towards that goal is the Express Lane, which continues to be the engine that's creating the most agility in our supply chain right now. We're driving double-digit growth in many of our key cities through the Express Lane as we capitalize on the local energy for key icons like the Cortez and sports moments like the World Cup.

With this end-to-end view, our entire value chain, we're delivering the right product, to the right consumer in the right moment. And across product lines, throughout geos and with our partners around the world, we're relentlessly driving speed at a scale that is creating impact for our business.

We're off to a great start in Q1, managing the dynamic environment. More importantly, we're setting a new foundation for long-term sustainable growth for years to come. Thanks, and now here's Andy.

Andy Campion, Executive Vice President & Chief Financial Officer:

Thank you, Mark, and good afternoon to everyone on the call. We are extremely pleased with the quality of the growth that we delivered in the first quarter.

On a currency-neutral basis, we are delivering stronger, more broad-based momentum around the world than the expectations we set entering the fiscal year. We have continued strong growth in international markets, led by Greater China growing at 20%, and our international growth is now being amplified by very strong sustainable growth in North America.

As for the quality of our growth, our momentum continues to be directly tied to execution of the Consumer Direct

Offense and more specifically the Triple Double. First, take for example our 2X Direct initiative. 2X Direct is about connecting the NIKE Brand more directly to our consumers. And today, the most direct connection to the consumer is through the mobile device in the palm of their hand. In Q1, we continued to enhance and expand our NIKE Digital ecosystem, leading with mobile, and the result was 36% NIKE Digital growth. NIKE Digital was once again, our fastest-growing channel in each and every geography. While NIKE Digital is leading the way, we believe physical retail will also play an important role in doubling our direct connection to consumers. We see growth in the physical environment being driven by smarter retail, experiences that leverage digital technology to better serve consumers.

In Q1, our vision for physical retail became more tangible. We continued to roll out what we're calling the NIKE App at Retail, starting with our own in-line stores, and we also launched a new concept called NIKE Live. The NIKE Live concept came to life in Q1 through the opening of NIKE by Melrose in Los Angeles.

NIKE Live leverages our NikePlus membership platform and other digitally-enabled services to provide a truly differentiated consumer experience at retail. The results to date have been phenomenal. For example, at NIKE by Melrose, the conversion of in-store shoppers into digital NIKEPlus members is six times higher than in the rest of our fleet, as consumers seek to gain the full benefit associated with being more directly connected to NIKE.

Our approach has been to test, learn and then scale new concepts such as these. Accordingly, we're now in the process of scaling these new concepts across our fleet of owned stores, and these tangible proof points are also accelerating new concept development with our strategic wholesale partners.

2X Innovation is another key pillar within the Consumer Direct Offense that is fueling our broad-based momentum. Suffice it to say that our recently launched innovation platforms, VaporMax, Air Max 270, React, and ZoomX have already generated, in aggregate, over $2 billion in revenue at retail.

Further, these platforms are driving brand distinction and catalyzing growth across our broader product portfolio in both performance and sportswear. For example, as Mark noted, the new innovation we are bringing to the NIKE Air franchise has ignited double digit growth across our multi-billion-dollar family of NIKE Air products. Newness and innovation are also favorably impacting our gross margin as our full-price sell-through is significantly outpacing off-price sales. Our current inventory levels are also tight in relation to the strong demand that we are creating.

Underlying our strategic momentum is the digital transformation of NIKE that Mark mentioned. A year ago, we aligned our teams around the world on our new strategy, the Consumer Direct Offense. Over the past year, we've been ramping up investment in the new digital capabilities that will reshape how we operate at NIKE for the long-term.

Our investments in new digital capabilities are coming in the form of both organic development and acquisition. As we closed fiscal year 2018, we announced the acquisitions of Zodiac and Invertex, both of which are already having a profound impact on how we better serve consumers. Another acquisition that we made back in fiscal year 2017 was Virgin Mega. That team has now become known as Studio 23, a digital hub in New York that's driving the explosive growth of the SNKRS app.

Within fiscal year 2019, we're also investing significantly in the organic development of new capabilities, including digital demand sensing, consumer data and analytics, connected inventory, digital product design and creation, a digital content engine, and a new enterprise resource platform that will help unlock speed and flexibility in our supply chain.

As our long-term financial model implies, we believe that NIKE's unrivaled scale and resources afford us the ability to over index on investment in these differentiating capabilities, while still delivering expanding profitability over the five-year horizon. Execution of the Consumer Direct Offense is clearly beginning to transform NIKE's business model and how we will create value for shareholders over the long-term.

So, let's recap our Q1 results in a bit more detail, with a focus on how strategic execution is the driving force behind our current financial performance. NIKE, Inc. Q1 revenue increased 10%, up 9% on a currency-neutral basis. Our stronger than projected currency-neutral growth was driven by acceleration in North America and continued strong momentum in international markets, albeit slightly offset by FX dynamics within the quarter. Our growth across geographies was led by NIKE Direct, with NIKE Direct growing 12%, and NIKE Digital growing 34% on a currency-neutral basis.

The impact of innovation, NIKE Digital growth outpacing all other channels, and our tighter supply and demand management also fueled roughly 50 basis points of NIKE, Inc. gross margin expansion in Q1. Demand creation grew 13% in the first quarter, primarily driven by sports marketing investments as well as brand campaigns that amplified key moments in sport such as the World Cup.

Operating overhead increased 5%, driven by investments in digital capabilities as well as in our supply chain and enterprise technology platforms. Our effective tax rate for the quarter was 14%, which reflects the implementation of U.S. tax reform. First quarter diluted earnings per share increased 18% to $0.67.

Finally, as of August 31, inventories were flat to prior year, primarily driven by a strong pull market across all geographies coupled with the efforts we've taken over the past year to right-size supply.

So now, let's turn to the financial performance for our reported operating segments. In North America, we have returned to strong sustainable growth. Q1 revenue grew 6% on a reported and currency-neutral basis, led by accelerating growth across both footwear and apparel, driven by new innovation platforms as well as strong owned and partner digital growth.

Wholesale has also returned to growth, yet we see even greater opportunity to drive differentiation across the wholesale marketplace going forward, in part by leveraging our learnings from the NIKE App at Retail and NIKE by Melrose.

Another growth opportunity we see ahead of us in North America relates to the Jordan Brand. In the second half of fiscal year 2018, we tightened supply. We also reset our approach to Jordan Retro, creating more current stories and collaborations with respect to Jordan's most iconic styles. We're now bringing those icons to life in more compelling ways for the new generation of Jordan consumers, and as a result, the Jordan Brand is back to a pull market.

We are also beginning to add greater dimension to the Jordan Brand. For example, for women, we are extending sizes in the icons we know they already love and also creating silhouettes and new collaborations made specifically, for her. Apparel and performance basketball also represent significant growth opportunities going forward.

As the football and basketball seasons ramp up, our brand momentum will continue to build in North America. At the same time, we're not taking that momentum for granted. We continue to identify and attack opportunities to elevate our game and drive strong, sustainable growth in this important geography.

So, now, let's turn to EMEA. In EMEA, Q1 revenue grew 9% on a currency-neutral basis, driven by strong growth in Sportswear and healthy growth in Running and Jordan. NIKE Digital led all dimensions of the marketplace, growing at a strong double-digit rate.

One of the underlying drivers of our sustained growth in EMEA is the strength of our brand across this diverse geography. EMEA is home to five of our 12 key global cities. And in all five of those key cities in EMEA, NIKE is rated number one by consumers and our growth is over-indexing the broader market.

By connecting more deeply with consumers in key influential cities and by amplifying the biggest moments in sport, NIKE is creating increasingly greater distinction as a brand in Europe. One of those sport moments was the incredibly exciting World Cup, in which both of the finalists were NIKE teams.

And soon after the World Cup Final, we launched our Awaken the Phantom campaign generating over 50 million views in the first two weeks and driving strong sell-through on the launch of our newest global football franchise, the Phantom. And finally, after celebrating the French national team's World Cup victory, we continued to bring energy to global football with the launch of a Jordan branded Paris Saint-Germain team kit and collection of apparel. That launch has been phenomenal, with the key styles selling out immediately.

While NIKE has become the leading brand in EMEA, we are far from having achieved our full potential. We see the opportunity to both grow the market for athletic footwear and apparel across Europe, and also create even greater separation from the competition as a brand. That is why we believe we can sustain this strong growth in EMEA over the long-term.

Next, let's turn to Greater China, another geography in which the NIKE Brand continues to lead and sustain strong growth. We've now delivered 17 consecutive quarters of double-digit revenue growth in Greater China. In Q1, Greater China's growth was 20% on a currency-neutral basis, fueled by Sportswear, Jordan, Basketball, and across Women's and Young Athletes. Growth was also strong and balanced across both footwear and apparel.

We are winning with the Chinese consumer first and foremost through the key cities of Shanghai and Beijing. We're also continually innovating in this large, digitally-native marketplace. NIKE Digital growth remains strong and actually, accelerated in Q1. We're also driving growth through our partnerships with China's leading digital platforms like Tmall and WeChat.

And finally, we're beginning to leverage digital in the largely NIKE-branded physical retail environment in China. Take for example our partner Belle, which was acquired last year by Hillhouse, a leading firm in technology and consumer services. Belle has already rolled out connected inventory that enables a more direct NIKE Consumer Experience with a faster and easier way to fulfill consumer demand, fully leveraging their roughly 2,500 touch points.

Now, let's turn from China to another fast growing and fast developing geography, APLA. In Q1, APLA revenue grew 14% on a currency-neutral basis, fueled by balanced double-digit growth across footwear and apparel, and led by Japan, Mexico and Korea. Two areas of increasing focus for us in APLA have been our women's business and digital. Women's growth continues to accelerate, driven by distinctive brand marketing campaigns such as the Come Out In Force and Rally Cry campaigns focused on inspiring and empowering women through sport.

NIKE Digital is also accelerating in APLA, with revenue growing over 70% in Q1, the highest rate of growth across all of our geographies as we continue expanding our digital ecosystem across this region. We will continue to sustain strong growth as we roll out the NIKE SNKRS app in markets such as Mexico and Brazil, and bring the NIKE Live retail concept to Tokyo later this fiscal year.

Beyond NIKE Direct, we're also expanding our digital connectivity to consumers across this region through entrepreneurial commerce partnerships such as those with Flipkart, Zozotown and several others. We see continued momentum in APLA over the course of fiscal year 2019 and we will continue to invest in this fast growing diverse geography as we move even closer to the Tokyo Olympics in 2020.

And, finally, at Converse, revenue increased 7% on a currency-neutral basis. Growth was fueled by double-digit revenue growth in Greater China and strong double-digit growth digitally. That said, Converse also experienced declines in undifferentiated wholesale primarily in the U.S. and the UK. As we move through fiscal year 2019, we will be expanding Converse's product portfolio, while also elevating the Converse-branded digital ecosystem.

We are off to an even stronger start to the fiscal year than we initially expected. Our currency-neutral growth and profitability is exceeding our expectations. At the same time, global trade uncertainty and geopolitical dynamics have resulted in the dollar strengthening and foreign exchange shifting to a slight headwind over the past 90 days.

Taking into account all of these dynamics, we are maintaining our full year guidance for fiscal year 2019. Specifically, we expect revenue growth in the high-single digits, albeit at the lower end of that range as operational upside will likely be somewhat offset by FX headwinds. We expect gross margin to expand 50 basis points or slightly greater, SG&A to grow in the high-single digits, and our Effective Tax Rate to be in the mid-teens. Other Expense, net of interest Expense is now projected to be an expense of $100 million to $125 million.

Based on the FX volatility of late, let me briefly explain more specifically how FX impacts NIKE's financials in the short-term. First, it is important to note that the revenue line item in our P&L is essentially unhedged. Therefore, our reported real dollar revenue growth reflects nearly all currency movements real time.

We do have a robust hedging program that delays the impact of FX on our profitability for 12 to as much as 24 months, most notably with respect to developed market currencies, for example the euro. However, it is not economical to hedge FX risk in many emerging markets, such as Turkey, Argentina and Brazil. And as for China, we are able to partially, but not fully hedge our net exposure.

Our focus is on sustaining strong currency-neutral operating momentum over the full year and even more importantly over the longer term, but I'll provide a bit of context on Q2. For Q2, we expect strong currency-neutral revenue growth in line with the 9% currency-neutral revenue growth we delivered in Q1. That said, taking into account real time, FX dynamics reported real dollar revenue growth for Q2 is likely to be 2 points to 3 points lower than our currency-neutral revenue growth.

For gross margin, we expect Q2 expansion approaching the same level of expansion that we delivered in Q1. As a reminder, we expect less gross margin expansion in the first half of the year as compared to the second half of the year.

In Q2, we expect SG&A growth in the low-teens, driven by the timing of our investments in sports marketing, including the kick-off of the NBA and NFL seasons and the timing of strategic investment in new digital capabilities. For other expense, net of interest expense, we expect expense in Q2 to be in the $30 million to $40 million range.

Our execution of the Consumer Direct Offense is creating brand distinction with consumers around the world and driving strong financial performance. At the same time, we see ourselves as being in the early stages of this transformation. There is no finish line for NIKE, particularly as it relates to digital. So, we will continue to invest in the capabilities that will differentiate and create competitive advantage for NIKE long-term.

Those capabilities include product innovation, brand marketing, digital and speed within our supply chain. We are thrilled with our momentum out of the gate in fiscal year 2019. And nonetheless, we remain on the offense identifying and attacking opportunities to elevate our game, build on our momentum with consumers, and ensure that we deliver sustainable, profitable, capital-efficient growth over the long-term.

With that, we'll now open up the call for questions.

QUESTION AND ANSWER SECTION

[Operator Instructions]

Operator:

Your first question comes from the line of Kate McShane with Citi. Your line is open.

<Q – Kate McShane >: Hi. Good afternoon. Thanks for taking my question. When looking at the 6% North America growth that you saw this quarter, I wondered if you could help us understand how much is being driven by ASP growth versus unit growth and how much of a drag is the undifferentiated retail?

<A – Andy>: Hi, Kate. It's Andy. I'll take that one. In North America, we're actually seeing expansion in average selling prices as well as units. Our growth is relatively well balanced as you saw in our reporting across footwear and apparel. So, it's very strong and balanced growth, and we see that strong and balanced growth continuing over the balance of the year.

<Q – Kate McShane >: Okay. Thank you for that.

<A – Andy>: And sorry, Kate, as for undifferentiated retail, as I mentioned, we're seeing growth across all dimensions of the marketplace. We have had relatively strong growth with our strategic wholesale partners being Footlocker, Finish Line, Dick's and others. That's being driven by the elevation of the consumer experience with those partners and also by the extraordinary impact of the new innovation and newness that we're bringing to our product portfolio. We're in the early stages of some of the more truly transformational change, but what we're really encouraged by is that the learnings that we're having particularly with the NIKE App at Retail and NIKE by Melrose, in other words the NIKE Live concept, those conversations are really picking up steam in terms of new concept development that we see a great opportunity for across that bricks-and-mortar fleet in wholesale.

<A – Mark>: Yeah. I'll add that the demand that we're seeing in North America is actually quite balanced across the portfolio. And on top of that, the inventory situation is actually quite clean as that demand has been increasing. So, we're in a good position here.

<Q – Kate McShane >: Okay. Thank you very much.

Nitesh Sharan>: Thanks, Kate. Operator, we'll take the next question, please.

Operator:

The next question comes from Bob Drbul with Guggenheim. Your line is open.

<Q – Bob Drbul>: Hey, guys. Good afternoon. I guess the question that I have is more of a bigger picture question for you. I was wondering if you could address your demand creation advertising, marketing approach. There's been a little bit of news the last couple of weeks and some controversy around it, and I was just wondering if you could maybe address how you approach these type of situations, the concerns that you have, but the benefits that you see around certain campaigns.

<A – Mark>: Yeah. Well, just generally, we're motivated to inspire our consumer, to connect, to engage and inspire. We feel actually very good and very proud of the work that we're doing with Just Do It, introducing Just Do It to the new generation of consumers on the 30th anniversary of the campaign when it first debuted. We know it's resonated actually quite strongly with consumers obviously here in North America, but also around the world. It's really transcended the North America market to touch, I think, people around the world.

We have an incredible line-up of athletes in that spot. When you look at the Just Do It campaign and the list of athletes we have there, it's actually quite impressive, including Serena, Odell, Colin, Shaquem Griffin, Lacey Baker. These are actually very inspiring athletes and, again, we feel like that campaign has delivered on that message in a way that's really connected with people around the world.

Like any campaign, it's – not any campaign, but many campaigns, it's driving a real uptick, I think, in traffic and engagement, both socially as well as commercially. We've seen record engagement with the brand as part of the campaign. And our brand strength, as you well know, is a key dimension that contributes to the ongoing momentum that we're building across the NIKE portfolio. So – and that's really how we look at it is how do we connect and engage in a way that's relevant and inspiring to the consumers that we're here to serve.

<Q – Bob Drbul>: Great. Thanks. And I guess the second question I have is, after this weekend's golf results, I was wondering if you had any perspective on how Phil Mickelson feels ahead of the match play event in November with Tiger.

<A – Mark>: Yeah, he's probably feeling a little more pressure I would imagine. It's great to see Tiger back and the reaction to his performance on Sunday was pretty inspiring, so, yeah, I think Phil might be feeling a little bit of that pressure.

Nitesh Sharan>: Thanks, Bob. Operator, we'll take the next question, please.

<u>Operator:</u>

Next question comes from Lauren Cassel with Morgan Stanley. Your line is open.

<Q – Lauren Cassel >: Great. Thanks so much, and congrats on a great quarter. First, is there any color you can share on North America DTC growth specifically during the quarter? And then just bigger picture, there's been some caution or nervousness in the market about potential slowdown in the Chinese economy and consumer spending there. Obviously, you guys delivered some really nice growth there this quarter. But are there any signs or signals that you're seeing that would suggest a slowdown there? Thanks so much.

<A – Andy>: Sure. I will take North America NIKE Direct or DTC, as you put it, growth. I'll hit on all three dimensions. We had extremely strong double-digit growth in Digital and acceleration in that regard. We have taken a number of actions to remove friction, enhance the consumer experience, allocate product to that channel where we know consumers – or demand is robust, and we're actually using data and demand sensing to better line-up supply with demand digitally, so incredibly strong growth digitally.

In our in-line stores, we're actually seeing strong comps as well. We've seen traffic up and even more notably conversion, and conversion in the in-line stores we're seeing is a direct result of two things: one, the brand distinction that Mark mentioned in response to the last question as well as the product that we're bringing to market. We're seeing incredibly strong full-price sell-through on our line right now, our closeout mix is down in inventory and our off-price sales are down as a percent of total.

In our factory stores, our factory stores continue to be a very profitable dimension of the business. And frankly, the only challenge I would really highlight in our factory stores is that its full-price sell-through is so strong in inline and digitally, it leaves some gaps in terms of the assortment that we bring to market in the short-term in our factory stores, but we've identified opportunities in that regard and are looking at supply to fill those gaps. So, again, it's a nice problem to have.

<A – Mark>: Yeah. And let me touch on China. I mean, as Andy had mentioned in his remarks, we've seen 17 consecutive quarters of double-digit growth and really strong underlying fundamentals within the market, things – factors like the growth of the middle class, the sports participation, obviously a very digitally savvy consumer and we're well positioned in that regard in the marketplace in terms of the NIKE Brand and its position.

We have a very strong connection with the Chinese consumer. We have – for a long time, we're leading the market in digital, growing 40% in Q1. We've had great relationships with our digital partners there. I mentioned

Tmall, WeChat is starting up with tremendous potential there. So, there's great momentum in the marketplace in across multiple categories, Sportswear, Running, Basketball. The Jordan Brand is incredibly strong in China.

So, our fundamentals in China are actually quite sound and strong. We're not seeing any push back from consumers. On the contrary, our relationship and connection to consumers is as strong as it can possibly be. We feel confident in our ability to continue to grow, and that's reflected in our outlook for China over this next year, and we feel like there's great momentum in that we're in a good position for that to continue.

Now, that said, we're mindful of the dynamics, but we are focused on serving that Chinese consumer, strengthening our position there. And I'll just, I guess, close by saying we are amongst the most popular brands with the Chinese consumer.

<Q – Lauren Cassel >: Okay. Thanks so much.

Nitesh Sharan>: Thank you, Lauren. Operator, we'll take the next question, please.

<u>Operator:</u>

Your next question comes from Jim Duffy with Stifel. Your line is open.

<Q – Jim Duffy>: Thank you. Good afternoon, everyone. Good balance in the quarter. A lot of good indicators, the inventory looks well-managed and you're seeing strong results in DTC and also spoke about improving margin from DTC. I'm wondering can you speak about some of the elements of cost inflation that are offsetting the mix benefits in the gross margin. And Andy, can you detail the FX impact considered in the gross margin outlook for the year?

<A– Andy Campion >: Sure. I'll hit both dynamics, cost and FX; but let me first give you a little bit of overall context on our margins. We're seeing strong structural improvement in our margins and that's being driven by the innovation we're bringing to market and in turn the strong full-price versus off-price mix. Second, it's being driven by the over indexing growth in our NIKE Digital business and it's also being amplified by the initiatives that we have around product cost management.

In the first half of the year, there's one element of material, so to speak, that is a bit of a headwind and that's in the chemical space, namely rubber. That will ease in the second half of the year.

As we look at FX as well, FX is much more of a tailwind in the margin line item of our P&L in the second half of the year as compared to the first half of the year. So, if I refer back to the guidance that we gave as we entered the year and we reiterated today, we have strong gross margin expansion forecast for the entire fiscal year. At the same time, we see slightly less margin expansion in the first half and more margin expansion in the second half.

<Q – Jim Duffy>: Very good. And then, Mark, one for you. Last nine months, particularly strong period for new product introductions and bringing new innovations to the marketplace. Can you talk about how to think about the cadence from here? Will there be a gap or is there a predictable launch cycle you expect to work with as we look out over the next couple of years?

<A – Mark>: Yeah, our 2X Innovation initiative is really all about a steady flow of innovation. I feel very positive, very confident with what's in the innovation pipeline and what's coming. I mentioned a couple of things earlier. The new iterations of our AIR cushioning platform with the 720, a very exciting product that's building on the VaporMax and the 270, so that's exciting.

I also mentioned the adaptable, adaptive footwear technology coming into performance sport, you'll see that on professional athletes very soon. We have an incredible line-up coming, I think, throughout the fiscal year of product. We're actually focusing on bringing innovation into the core price points as well. So, we have a balanced portfolio of innovation across both footwear and apparel.

And then we have opportunity to further dimensionalize the incredible platforms that we've got. I mean, I mentioned AIR, React, Zoom, there's ZoomX, there's still a tremendous amount of potential to leverage those both in performance across categories and then also across sportswear.

And then I have to tell you, I can't really shed too much light on this at this stage, but my excitement around what's coming as we, believe it or not, ramp up our portfolio around the Tokyo Olympics. NIKE is – that's always the time where we showcase our innovation and the build-up to the Olympics is an incredibly exciting time for NIKE and the innovation that we deliver. So, I guarantee you, we won't disappoint with some of the things that we have coming up and you'll start to see some of that ramp up over the next 12 to 18 months.

<Q – Jim Duffy>: Very good. Thank you.

Nitesh Sharan>: Thank you, Jim. Operator, we'll take two more questions, please.

Operator:

Your next question comes from Paul Trussell with Deutsche Bank. Your line is open.

<Q – Paul Trussell >: Good afternoon. Solid results. Just on North America, given the acceleration that we saw throughout the first quarter, is it fair to assume that the exit rate was more in the high-single digit range? And while I know overall global revenue outlook has not changed, has your thought process on what is achievable in North America maybe been upped a little bit?

<A – Andy>: Sure. Thanks for the compliments, Paul. I'll take that one. We – our goals for North America are long-term focused. It's a large important geography. And as you may recall at our Investor Day in October we said we were targeting mid-single digit revenue growth over the next five years as we innovate within the marketplace from a digital perspective and transform the broader retail landscape.

On that note, we said there might be some disruption in the short-term as well. So, to some extent, we hedged a little bit with respect to fiscal year 2019. To be clear, we've returned to strong growth in North America even faster than we had expected. We have demand that is outstripping supply. You saw our inventory in North America was flat. And so, what we're focused on and we're always focused on, you can rest assured, is capitalizing on every opportunity that we see to serve demand in the North America marketplace.

We're not providing specific guidance from a geo perspective, but I will tell you that the brand is incredibly strong. Our products resonating. Sell-through is strong. And even beyond what's working and what you can see in our numbers, we see opportunity to go beyond that and potentially even more importantly drive that sustainable growth over that five-year horizon and those opportunities fall under the overall umbrella of what Mark often refers to as our Complete Offense.

At any given time, even when we have extraordinary momentum, there are areas underneath that umbrella where we see greater opportunity than we're capitalizing on. Specifically, in North America, I touched on Jordan. We see acceleration in Jordan over the coming months and certainly out of this fiscal year and into next year.
Women's is growing strong. Women's was a very strong dimension of growth for us as a company, but we see even more opportunity. It's not so much about the rate of growth, it's how much more opportunity is out there in the women's business especially around athletic footwear and apparel.

And then finally, another dimension of huge opportunity in North America is our Young Athlete's business. It may surprise some people to know that it's one of our largest categories. At the same time, we see the opportunity to bring new materials, colors, prints and even designs directly targeted at young athletes. We have a silhouette called Future Series, which is actually an innovation that's made specifically for kids. So, we do see a tremendous amount of opportunity in North America. Suffice it to say, we're really pleased with the momentum we have and we're bullish on being able to sustain growth in North America in fiscal year 2019 and beyond.

And then you also asked about global growth. You made a comment that said it's pretty consistent. I just want to be clear. On a currency-neutral basis, our momentum on the top line from a revenue perspective is stronger globally than we expected when we came into the year.

While we maintained our high-single digit reported revenue growth guidance, that takes into account that over the last 90 days since we last spoke to you, FX has been pretty volatile. And as I touched on, that line item in our P&L is essentially unhedged. So, while we protect the profitability through hedging, we see those impacts real time and that's also why I gave you a little more color on Q2 guidance. Thank you, Paul.

<Q – Paul Trussell >: Thanks for the color on that.

Nitesh Sharan>: Operator, we'll take...

Operator:

Your last question comes from Jamie Merriman with Bernstein. Your line is open.

<Q – Jamie Merriman>: Thanks very much. Andy, you touched on how you're using data a little bit earlier, but I was wondering if you could just talk a little bit more about… is it inventory allocation by channel, by geography, is some of that data starting to help drive your product creation efforts and are there other ways that it's being deployed at this point? And then just a follow-up. You talked about the Jet.com partnership. Can you just talk about how that compares to the Amazon partnership? Thank you.

<A – Andy>: Sure. I'll start with data and analytics. It is truly an end-to-end initiative at NIKE. It starts with consumer data and analysis around consumer data, and I'd say that is manifesting itself right now already and most importantly, in terms of digital demand sensing. Us continuing to leverage the intuition that we have but amplifying that intuition with real data as to what consumers' preferences are and one of the best examples is NIKE by Melrose. That store, that NIKE Live store in Los Angeles, the entire assortment is based on data that we're analyzing around what consumers in those zip codes have purchased and are interested in and some of the key themes.

You move from digital demand sensing to digital product creation, so taking that insight and designing and creating product leveraging digital technology that allows us to bring that insight to life in a product faster, and then absolutely we're using data in our supply chain to tighten our demand and supply management and you see that already beginning to impact our full-price versus off-price sell-through.

On the very front-end, of course from a consumer perspective, data and analytics help us personalize the consumer experience on the NIKE app as well as the SNKRS app, and even in our physical retail environment as we use things like the NIKE App at Retail. And in that regard, one of the most notable successes or pilots early on has been connected inventory, so using RFID and using data and analytics in terms of where inventory is and where our consumers are looking to buy to get them the product they want more seamlessly.

And then as for your second question, you asked about Jet.com and how that might compare to some of our other partnerships... and I'll say that Mark will probably want to add something here. We're excited about this partnership with Jet because it is a partnership that is really about creating a compelling consumer experience around the NIKE Brand, leveraging NIKE membership to help better serve consumers in that channel, helping ensure that there's a clean assortment of product that's presented to that consumer across the marketplace. So, there are several aspects of it that we view as distinctive in terms of the offering that we'll make to consumers. At the same time, it's one of several initiatives across a range of digital commerce platforms.

<A – Mark>: Yeah, and I'll just add on Jet, we're starting off with a more focused pilot as we look at offering a select amount of product in key cities across North America. It's an assortment that's tailored to those consumers, what we would call a brand-friendly shopping experience. We're looking at our digital partners to help co-create elevated Consumer Experiences and how they partner with NIKE and so we can work together on advancing our connection to consumers through digital commerce.

We are looking at how we partner with these digital platforms to advance the consumer connection in terms of product selection, in terms of personal service, in terms of how the brand is presented online, and we're optimistic and feel very strong that the relationship with Jet.com is going to offer us those opportunities. So, we're excited about that. Amazon, our business with Amazon is performing well. Not a huge update here other than we've seen really good sell-through on a limited selection of products that we've offered. We've said before that we want to work together to elevate the consumer experience and that's important in any digital partnership that we enter into.

We get the most out of our relationship when we work together to elevate that brand presentation. And one of the things we're going to continue to focus on is how we share data with our digital partners to advance that consumer experience, but we feel like the partnership with Amazon is working – moving toward a mutually beneficial space. So, we're actually feeling good about where we are and it's important that we stay focused and continue to look for those opportunities together.

<Q – Jamie Merriman>: Thanks very much.

Nitesh Sharan>: Thank you, Jamie. All right, well, that's all the time we have for today. Thank you, everyone, for joining us. We look forward to speaking with you next quarter. Take care.

Operator

This concludes today's conference call. You may now disconnect.