FY24 Q2 Earnings Release Conference Call Transcript
December 21, 2023

[OPERATOR]

Good afternoon, everyone. Welcome to NIKE, Inc. Fiscal 2024 Second Quarter Conference Call. For those who want to reference today's press release, you'll find it at investors.nike.com. Leading today's call is Paul Trussell, Vice President of Corporate Finance and Treasurer. Now I would like to turn the call over to Paul Trussell.

[PAUL TRUSSELL]

Thank you, operator. Hello, everyone, and thank you for joining us today to discuss NIKE, Inc.'s fiscal 2024 second quarter results. Joining us on today's call will be NIKE, Inc. President and CEO, John Donahoe and our CFO, Matt Friend.

Before we begin, 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 NIKE's reports filed with the SEC. In addition, participants may discuss non-GAAP financial measures and nonpublic financial and statistical information. Please refer to NIKE's earnings press release or NIKE's website, investors.nike.com, for comparable GAAP measures and quantitative reconciliations.

All growth comparisons on the call today are presented on a year-over-year basis and are currency-neutral unless otherwise noted. We will start with prepared remarks and then open up for questions. We would like to allow as many of you to ask questions as possible in our allotted time so we would appreciate you limiting your initial question to one. Thanks for your cooperation on this.

I'll now turn the call over to NIKE Inc. President and CEO, John Donahoe.

[JOHN DONAHOE]

Thank you, Paul, and hello to everyone on today's call. NIKE is the market leader in sport. It's a role we take seriously. We create innovation that pushes human potential. We expand the world of sport, inviting new generations all around the globe into the community of athletes. And we feel the energy and excitement of sport itself, both on a global stage and on the ground in community and cities everywhere.

One thing that distinguishes NIKE more than any other brand in the world is that we get our inspiration from athletes and sport. And it was a great quarter for NIKE and the athletes who inspire us. Here's just a few examples. Kelvin Kiptum broke the Marathon World Record wearing the Alphafly 3, which built on our proprietary system of speed that continues to set the standard. A'ja Wilson earned WNBA Finals MVP after leading the Las Vegas Aces to their second straight title. LeBron James and Anthony Davis led the Lakers to the first-ever NBA in-season tournament championship. Aitana Bonmati won the women's Ballon d'Or. And Sha'Carri Richardson was named USA Track and Field Female Athlete of the Year.

Being inspired by world-class athletes like these keeps us focused on what's redefining what's possible. That's what sets us apart. No one changes the game like NIKE, from our breakthrough innovation for toddlers with the Swoosh 1 shoe to being able to elevate beloved product like Kobe's into an entire franchise to NBA players increasingly choosing to play in the Sabrina 1, a shoe deeply resonating across gender. Again and again, it's NIKE that pushes what's possible to break the status quo.

Now in addition to creating best-in-class innovation, great companies must also focus on strong execution. And that's what we did in Q2, delivering our second $13 billion quarter. This went on top of last year's extraordinary 27% growth. And we drove more than 20% growth in earnings per share this quarter. Simply put, this is the result of relentless execution by our team in an uneven macro backdrop.

Looking at holiday, we outpaced the industry, driving growth of close to 10%. NIKE Digital had its strongest Black Friday week ever, and a record number of consumers shopped in our stores over the long Thanksgiving weekend. And in Greater China, brick-and-mortar grew double digits during National Day holiday, and NIKE once again outperformed the industry during 11.11 as the #1 sport brand on Tmall.

These holiday results, when combined with Q2's earnings growth and our continued healthy inventory showcase how we're executing against our priorities even in the face of a highly promotional environment and increasing macro volatility.

Last quarter, I talked about how we're getting back on our front foot, accelerating the flow of our innovation and executing with excellence across our winning formula of innovative product times distinctive storytelling times differentiated marketplace experiences. Let me give you a few examples of where we've demonstrated progress.

Within our Running business, we're driving deeper connections with the running community. We recently launched our most innovative trail shoe yet, the Ultrafly at the world's Pinnacle Trail Race. We hosted over 1,000 runners for a uniquely NIKE experience, which drove energy and positive feedback from both elite runners and the broader trail running community. And we partnered with top RSG doors for a series of community activations centered on the Ultrafly and other key products like Peg Trail and Wildhorse. All this led to growth of over 20% in our trail running portfolio for the quarter.

In Global Football, we're fueling growth through strategic Only NIKE Athlete storytelling. As you know, we have a 3-silo construct in men's football, having paired Erling Haaland with the Phantom Boot, Jamal Musiala with the Tempo and Kylian Mbappé and Marcus Rashford leading the Mercurial. With the game's greatest showcasing our product superiority and our seamless execution to pull this innovation through the marketplace, all 3 franchises are up strong double digits, even lapping last year's strong performance with the Men's World Cup.

And in Lifestyle, we're driving a women's-led geo-by-geo marketing acceleration behind V2K, a standout shoe in our fast-growing retro running line. It's being fueled by a tongue-in-cheek campaign that's resonated with this consumer and a creator partnership strategy that's delivered head-to-toe style inspiration into her preferred media channels. All this catalyzed the V2K to very strong sell-through in the quarter with exciting potential for this style still to come.

All 3 of these examples offer an early indication of the growth we aspire to. We have real opportunity to drive progress across many dimensions of our business, and that's our priority moving forward.

At NIKE, we like to say we're on the offense always. When we see something that needs solving, we don't wait around. We solve it. And so as we look to the future, we know where we must focus.

Three areas will always drive our distinction and competitive separation: product innovation, storytelling that connects and marketplace execution. When NIKE is at its best, we create impact on a scale that can't be matched, grounded in sport, centered in youth culture, inviting consumers around the world into our brands.

The second half of fiscal '24 represents the start of a multiyear product innovation cycle that will introduce new franchises, concepts and platforms, elevating our full portfolio. And while there'll be some key moments in the second half, this new innovation cycle will take some time to fully ramp up, given our size and scale.

Now we know we have an outsized opportunity to drive long-term profitable growth and with areas of significant growth potential like Women's, Jordan Brand and Running, each of which requires focused investment to reach full potential.

We also must get deeper traction on our key speed initiatives. Today, we know we must be faster, increasing the pace of innovation, increasing the pace of market to consumer and increasing our agility and responsiveness. To drive this, we'll embrace a significant savings plan to create investment capacity to fuel profitable growth at speed and scale. Areas of potential savings include simplifying our product portfolio, increasing automation and the use of technology, streamlining our organization and leveraging our scale to drive greater efficiency.

Let me just acknowledge that this work will be led with respect and thoughtfulness as we move to improve the ways in which we work and build a leaner and stronger company for the future.

Matt will provide more detail on this later in the call.

Now we've made some progress as we look to accelerate growth in our business. And I want to walk through 2 key areas today where we're investing for future and further growth, our Women's business and Jordan Brand. Both Women's and Jordan are opportunities that are grounded in performance and the ability to drive culture and lifestyle, with the latter providing even greater scale and growth opportunities.

First, let's discuss Women's, which is already a roughly $9 billion business, and that's just a NIKE brand, excluding Jordan and Converse. Our Women's business has grown high single digits on average over the past 3 years. And while we're encouraged by this progress, we now have line of sight into what we believe is the best plan we've ever had to accelerate growth in Women's. Our plan makes us even more confident in serving her through sport and style.

Today, about 40% of our members are women consumers. They make up a bigger proportion of new members, and their demand per member is growing faster. We see great opportunity to better serve this consumer by responding to her needs across the spectrum of performance and lifestyle.

Let me first touch on performance, where we're focused on innovating for her to create new opportunities we did not previously serve. We've now built a collection of bras and leggings across different price points. This includes our statement leggings, Zenvy, Go, and Universa, all of which are above $100, a price point we were not previously in. These leggings serve her with a whole new approach to fit and comfort, thanks to new material innovation. And we're holistically elevating our retail, presentation and storytelling to help her find the right product for her exact needs. More and more women are joining our brand by purchasing these leggings. In fact, all told, statement leggings fueled our fitness apparel growth in Women's for the quarter.

And in footwear, we're seeing very strong sell-through for the Motiva, a shoe with a comfortable and distinctive design that shows how we've dimensionalized performance into walking. And Free Metcon is also performing very well, serving her need for versatility by expanding a fitness shoe into comfortable everyday wear. And at the same time, when we look at women's lifestyle, we've established our leadership position in women's sportswear through a focus on style and comfort with iconic franchises like Air Force 1, Dunk, Court and Fleece, all of which drive continued momentum with new energy and design.

And we're also fueling the rapidly growing retro running trend with our portfolio styles like the Vomero 5, V2K and P-6000. In fact, even with us sequentially increasing the supply, demand for this entire line is so strong, there remains tremendous opportunity to grow further. We're excited to scale these styles over the next few seasons. And so today, we're taking the right steps to serve our women consumer with energy and sharpness. And we're fully aligned in accelerating our offense to raise our game with an eye to the immense opportunity we see going forward.

Now let's discuss Jordan Brand, which is on a clear path to become the #2 footwear brand in North America, the biggest brand not named NIKE. We're fueling the strong momentum in Jordan by growing a Monday to Friday business with a more diverse product portfolio on top of our very successful launch business. Over the past few years, we've driven strong growth in the Jordan business by bringing more dimensions into the brand. We're proving that Jordan can be more than retro, more than footwear, more than men's and more than North

America. An approach to growth will continue to bring life and growth over the coming years.

And this is just the beginning for Jordan Brand as we see even greater growth potential through our plan for deeper investment, which for Jordan will come in areas like merchandising, marketing and marketplace. For instance, today, Jordan Brand performance product is outpacing overall growth with Jordan reigniting its Encore presence in basketball with the strongest signature portfolio ever as Tatum, Luka and Zion push the brand to new heights, both on and off the court.

Jordan is also expanding beyond basketball into, for example, Golf, Global Football and American Football. And Jordan Women's and Kids continues to lead the brand's overall growth. Women's and Kids business share within Jordan have increased 7 points over the past 3 years. And Jordan Apparel is now a roughly $1 billion business, averaging almost 20% growth over the past 3 years. We're also building new dimensions in the iconic AJ1 franchise across high, mid and low as well as through women's-led dimensions such as the ELEVATE and the Brooklyn Boot.

And I'd also like to spotlight Jordan's strategic approach and success with our Remix footwear line, which, again, has already surpassed the $1 billion annual revenue mark with high double-digit growth. Led by styles like the Max Aura and the Stadium 90, Remix has increased Jordan's accessibility through more affordable price points and an expanded distribution with key partners.

And last but not least, Jordan's share from international markets continues to expand as we bring the brand to global cities in an authentic way. This has shown up as we pilot the Jordan Destination Tab in the NIKE commerce app in EMEA with strong early results. And the Jordan World of Flight doors in Milan, Tokyo and Seoul have emerged as the Company's most productive retail concepts. The sky is the limit for Jordan as we continue to invest and explore what's possible for one of the world's leading brands.

In the end, we are moving with confidence against the opportunities we see. And looking ahead to the next calendar year, we remain single-minded in our focus to compete and win. I wouldn't trade our position with anyone. And with that, I'll turn the call over to Matt.

[MATT FRIEND]

Thanks, John, and hello to everyone on the call. NIKE's second quarter financial performance reflected our proactive marketplace management and disciplined execution with tremendous delivery by our teams in a dynamic environment. Revenue was up slightly versus the prior year, growing 1% on a reported basis as we compare to 17% reported and 27% currency-neutral revenue growth 1 year ago. Gross margins expanded despite a highly promotional marketplace, and combined with disciplined SG&A management, earnings per share and free cash flow accelerated.

As I said last quarter, we believe we are turning the corner in driving more profitable and sustainable growth. At the same time, there were a number of puts and takes in the quarter. So before I walk through our financial results, let me share some perspective on our performance in light of current macro and consumer trends as well as additional insight into our business direction.

Now as you recall, we moved proactively in the prior year to liquidate excess inventory and reduce wholesale sell-in for the first half of fiscal '24. And while this dampened our reported revenue growth through Q2, total retail sales in the quarter grew across the marketplace on top of double-digit growth in the prior year. ASPs were up across both footwear and apparel and AURs grew across channels.

Average order values among NIKE members increased versus the prior year. Our higher-priced products, in particular, have been resilient with our $100-plus footwear models driving strong growth in units sold across the marketplace. And overall, we have maintained lower markdown rates than many of our competitors.

In the most impactful consumer shopping moments, NIKE's brand strength created even greater separation. We delivered market-leading results in Greater China in 11.11. And over the Black Friday and Cyber Week period, NIKE Direct grew approximately 10% across North America, EMEA and APLA. In Q2, NIKE Direct once again led our growth and wholesale shipments exceeded our expectations. Having said that, we are seeing indications of more cautious consumer behavior around the world in an uneven macro environment.

Total retail sales across the marketplace fell short of our expectations with softer demand outside of the key consumer moments. While NIKE's store traffic continued to grow, we saw softness in digital traffic and higher levels of promotional activity across the marketplace. As a result, we are adjusting our channel growth plans for the remainder of the year.

Looking to our product portfolio, our top franchises continue to drive strong full price sales, but we intentionally manage the life cycle of these models across the marketplace for long-term value. Given the promotional environment and the cautious consumer behavior that we are seeing, we are stepping up our plans to reduce marketplace supply of our key franchises.

Our goal is to focus NIKE's brand heat and energy on what is new as we accelerate our product innovation cycle. We have seen encouraging signs from recent consumer activations around some of NIKE's latest innovations and newness, and we intend to accelerate our pace through the Paris Olympics and beyond. While this will initially take some time, we are confident in our pipeline and the product journeys, stories and consumer energy to come.

Now as you heard from John, our priority is to drive sustainable and profitable long-term growth while building a faster, more efficient NIKE. Since fiscal '19, our investments in accelerating NIKE's Consumer Direct vision have created new operating capabilities, added tens of millions of new members to our member base and delivered a return of more than $12 billion of incremental revenue. However, we have also added complexity and inefficiency. In this competitive environment, we need to accelerate our pace of innovation, elevate our marketplace experiences, maximize the impact of our storytelling and increase our speed and responsiveness, all in service of the consumer.

To do this, we are creating investment capacity to fuel NIKE's next phase of innovation, growth and profitability. We are identifying opportunities across the company to deliver up to $2 billion in cumulative cost savings over the next 3 years, both up and down our P&L and across our value chain. Some examples include simplifying our product assortment, improving supply chain efficiency, leveraging our scale to lower the marginal cost of operations, increasing automation and speed from data and technology, streamlining our organizational structure, reducing management layers and enhancing our procurement capabilities.

And as we look to drive greater efficiency and productivity, we will reallocate and invest the majority of these savings to deliver the greatest consumer impact on our largest growth opportunities. Ultimately, we believe that building a faster and more efficient NIKE will accelerate future growth and innovation and deliver long-term profitability, creating value for years to come. We will continue sharing updates over the coming quarters.

Now let me turn to our NIKE, Inc. second quarter results. In Q2, NIKE, Inc. revenue was up 1% on a reported basis and down 1% on a currency-neutral basis, following our strong top line growth 1 year ago. NIKE Direct grew 4% with NIKE stores up 9% and NIKE Digital up 1% while wholesale declined 3%. Gross margins expanded 170 basis points to 44.6% on a reported basis, driven by strategic pricing actions, lower ocean freight rates, improved supply chain efficiency and modest markdown improvements, partially offset by higher product input costs. This included impact from approximately 60 basis points of unfavorable changes in net foreign currency exchange rates.

SG&A grew 1% on a reported basis, favorable to our expectations through disciplined expense management and some shifts in timing of spending. Our effective tax rate for the quarter was 17.9% compared to 19.3% for the same period last year. Diluted earnings per share was $1.03, up 21% year- over-year. NIKE inventory dollars are down 14% versus the prior year and down high single digits versus the prior quarter. In total, NIKE inventory dollars are down over $1.5 billion from the peak at the end of Q1 in the prior year with days in inventory continuing to improve. Total footwear and apparel inventory units across the marketplace are down double digits versus the prior year.

Now let me turn to our operating segments. In North America, Q2 revenue declined 3% with wholesale down 9% versus the prior year. NIKE Direct grew 3% with NIKE stores up 4% and NIKE Digital up 2%. EBIT grew 2% on a reported basis. This follows extraordinary growth in Q2 of fiscal '23 with North America revenue up 31%, NIKE Direct up 23%, NIKE Digital up 31% and wholesale up 37%. This quarter, we saw mid-single-digit retail sales growth with key partners, including DICK'S Sporting Goods, JD Finish Line and Hibbett.

Jordan and Women's led our momentum in the marketplace. With Jordan, Remix footwear grew double digits, and the AJ11 Gratitude release delivered the brand's largest shock drop ever. Within Women's, Dunk, Free Metcon and our $100-plus statement leggings delivered strong growth. In addition, Structure 25 and Vomero 17, our latest updates for everyday runners, drove positive response from consumers and running specialty partners.

In EMEA, Q2 revenue declined 3% with wholesale down 8%. NIKE Direct was up 7% as NIKE stores grew 8% and NIKE Digital grew 7%. EBIT declined 6% on a reported basis. As a reminder, this also compares to tremendous growth in Q2 of fiscal '23, with EMEA revenue up 33%, NIKE Direct up 44%, NIKE Digital up 62% and wholesale up 28%. Against the backdrop of increased macro headwinds, we saw strong consumer response to newness and premium innovation. Our winterized running products drove positive sell-through, along with strong growth from Invincible, Vaporfly and Ultrafly. Mercurial and Phantom and Tiempo grew double digits, and our retro running styles, including V2K, P-6000 and Shox continue to energize the marketplace.

In Greater China, Q2 revenue grew 8% and wholesale grew 19%. NIKE Direct declined 4% with NIKE stores growing 16% and NIKE Digital declining 22%. EBIT grew 1% on a reported basis with multiple points of impact from foreign exchange. On the whole, we are seeing a highly promotional marketplace with increased macro headwinds, especially on Digital. That said, Q2 was another strong quarter in brick- and-mortar, with continued improvement in full-price sales and sales in NIKE-owned and partner doors growing mid-teens versus the prior year.

We also continue to see strong momentum with key strategic partners, including Top Sports and Pou Sheng. And NIKE continues to strengthen its lead as Chinese consumers' #1 cool and favorite brand.

Turning to our product portfolio. Performance outpaced lifestyle this quarter with innovation and hyperlocal storytelling resonating with consumers. We saw strong momentum in Basketball, Fitness, retro running footwear and winterized apparel. Locally inspired express lane collections, including our Street Dance Inspired Dunk and Hyperlocal Pegasus releases were top choices for consumers. And overall, our inventory remains healthy with units down and improved markdown rates versus the prior year.

Looking ahead, we continue to closely monitor the operating environment. However, we remain confident in NIKE's brand strength, our deep consumer connections and our foundation for long-term growth in China.

In APLA, Q2 revenue grew 10% and wholesale grew 7%. NIKE Direct grew 15% as NIKE stores grew 17% and NIKE Digital grew 14%. EBIT grew 7% on a reported basis. Southeast Asia and India, Korea and Mexico grew double digits, leading a record quarter for the geography. Our Flipkart and Myntra platforms drove strong growth in India. Korea led record member day sales in the geography, and Mexico accelerated its digital momentum over the Buen Fin shopping holiday.

We saw strong momentum across our portfolio, led by Jordan Kids. Jordan Brand delivered strong growth in Remix footwear, AJ1 Essentials and Signature Basketball. In kid's lifestyle and Global Football grew double digits with positive momentum from All Kids Fleece, Court Borough and the Mercurial.

All told, our team executed with tremendous focus and agility to deliver our Q2 results while managing through volatility. Last quarter, as I provided guidance, I highlighted a number of risks in our operating environment, including the effects of a stronger U.S. dollar on foreign currency translation, consumer demand over the holiday season and our second half wholesale order books. Looking forward, the impact of these risks is becoming clearer. And as a result, we are adjusting our full year financial outlook.

Looking to the balance of the year, we expect Q3 reported revenue to be slightly negative as we again compare to double-digit growth in the prior year and Q4 reported revenue to be up low single digits, with full year reported revenue now growing approximately 1%. This new outlook reflects increased macro headwinds, particularly in Greater China and EMEA. adjusted digital growth plans based on recent digital traffic softness and higher marketplace promotions, life cycle management of key product franchises and a stronger U.S. dollar that has negatively impacted second half reported revenue versus 90 days ago.

I will also remind you that there are approximately 400 basis points of headwinds from supply disruptions and accelerated liquidation in the prior year. We expect increased gross margin expansion in our second half, with Q3 margins expanding 160 to 180 basis points and Q4 margins expanding 225 to 250 basis points. We continue to expect full year gross margins to expand 140 to 160 basis points. This reflects benefits from strategic price increases, improved ocean freight rates and supply chain efficiency, partially offset by higher product input costs and approximately 60 basis points of impact from foreign exchange headwinds.

We expect full year SG&A growth to improve to low single digits, excluding restructuring charges as we continue to tightly manage expenses and improve productivity and efficiency. Specifically, we expect SG&A dollars in both Q3 and Q4 to be modestly above our first half run rate, excluding the charge. We anticipate a restructuring charge of $400 million to $450 million in our second half, primarily related to severance costs, which will be recognized largely in the third quarter. We expect full year SG&A, including the restructuring charge, to grow mid-single digits.

We now expect other income and expense including net interest income to be $275 million to $325 million for the full year. We continue to expect our full year effective tax rate to be in the high teens range. Taken all together, strong gross margin execution and disciplined cost controls are enabling us to offset softer second half revenue and drive earnings growth. Excluding restructuring charges, we expect to deliver on our prior full year earnings outlook.

While we expect the operating environment to remain dynamic, we have been here before, and we know that moments like this are when NIKE operates and executes at its best. We will stay on the offense, manage risk, optimize opportunity and leverage our strengths to create even further competitive separation. As we move forward, our focus is building a faster, more efficient NIKE and embracing the opportunities in front of us to accelerate sustainable and more profitable growth.

And so with that, let's open up the call for questions.

[OPERATOR]

Your first question comes from the line of Matthew Boss from JPMorgan.

[MATTHEW BOSS]

So, a 2-part question. John, could you maybe elaborate on the structural changes that you cited that maybe in the pivot to the front foot on innovation, just the structural changes that you see supporting that and what that means for the product pipeline as we think to next year.

And then Matt, maybe putting that portion of the press release relative to the commentary around the second half, just how best to foot this? And could you help break down the change in your second quarter revenue or your second half revenue outlook between retail and wholesale?

[MATT FRIEND]

Yes. Let me go ahead and start. Matt, talking a bit about the environment that we're operating in right now and what's changed and what we're seeing. We obviously delivered a strong quarter and delivered revenue in line with the guidance we gave 90 days ago and are incredibly pleased with the disciplined execution and management of the marketplace, including our inventory being down 14% and NIKE plus partner inventory being down double digits versus the prior year.

But what we saw in the quarter was a bifurcation of performance. And specifically, what I mean is that we saw incredibly strong performance for the NIKE brand over the largest consumer moments if you bookend from back-to-school in the prior quarter through Black Friday and Cyber Monday this quarter. But in the periods in between, we saw softer performance in the marketplace. And as a result of that, total retail sales in the quarter were below the expectations that we set for ourselves 90 days ago.

As a result of that and specifically considering the promotional activity we see in the marketplace and some of the softness in digital, we've lowered our guidance for the balance of this year and provided a little bit of sharpness for you on Q3 and Q4 in particular. Q3 really is reflective of the comparisons to the prior year, much like we anniversaried this quarter. But overall, we've taken a more prudent approach to our planning for the balance of the year, given the increased macro headwinds we're seeing in China and EMEA in particular and the way that we've adjusted our digital growth downward based on the traffic softness that we've seen and the higher marketplace promotions.

And so connected to what John will talk about in a second, our focus is on newness and innovation, particularly because in an environment like this where the consumer is cautious and we're seeing higher levels of promotional activity, it's newness and innovation which really creates brand distinction in this environment. And we're even seeing it in the context of recent releases and recent product introductions that we've had over the last 60 to 90 days.

[JOHN DONAHOE]

And Matt, to the first part of your question regarding the structural changes, as you know, 6 months ago, we realigned our entire organization under Heidi O'Neill and Craig Williams as our co-Presidents. And it is making a huge difference in our focus and ability to execute. And as you know, we're single-mindedly focused on aligning our entire team to drive what NIKE does best, innovative product combined with distinctive storytelling combined with unique marketplace experiences.

And as Matt just said, we have a real focus, Heidi, Craig and team, a real focus on newness and driving our next product innovation cycle, which will elevate our entire portfolio, right? This is what NIKE does best. And we're doing it with consistency and scale where we want to break through. That's our focus. And so you're seeing some -- I'll maybe pick one example where you're seeing some early results.

Look at what's happening in basketball right now, right? We are bringing fresh innovative product at scale. So the past 6 months, we've launched Sabrina 1, LeBron 21, Tatum 1, Luka 2, the Ja 1. You saw Ja come back 2 nights ago, the Ja 1 on Christmas Day. And so that's creating huge momentum in basketball with great innovation. And in the next 3 months, we add to that GT Cut, which is one of our most innovative shoes to date, the Book 1, which we think has great appeal on and off the court. And of course, Kobe, which we think has huge potential on an ongoing basis.

And so this is driving momentum both on the court through performance, like NIKE does, innovation and performance and off the court. And that translates into lifestyle. You may have seen LeBron was wearing the Lunar Roam walking into his game the other night, and Lunar Roam sold out on SNKRS the day we launched it 2 days ago. And so what you're seeing is when we focus our guns on driving performance innovation, translating that into lifestyle, we can cut through and drive scale and consistency like no one else can.

So, as we look ahead, we're excited about tenth anniversary of Air Max Day that's coming up in March. The Air Max DN is our best Air Max product in years. You'll see us really get behind it. That will be, I think, both a successful shoe but more importantly, can help lift the Air Max portfolio. With Running, we'll be focusing on calendar '24 be the year of Pegasus for us with the Peg 41 and the Peg family refresh. And then we're getting excited and gearing up for the Olympics, right, in Paris this summer. That's when NIKE shines its best. You'll see us really using Air as a source of innovation, both in performance and in lifestyle. And so our the you called it a pivot. I just think it's an acceleration, an alignment and an acceleration of speed and focus is distinct, and we feel it.

[OPERATOR]

Your next question comes from the line of Michael Binetti from Evercore ISI.

[MICHAEL BINETTI]

Thanks for all the detail today, particularly around some of the longer-term thinking in the business. Some of the longer-term commentary is pretty helpful. I'm just wondering if we can help true-up the margin story for the next few years. I guess, would you -- is the $2 billion in cost savings, we said the majority will be reinvested is if I try to think back to the longer-term target of getting the business to the high- teens margins, this should go a long way.

Is your feeling that the net amount of these efficiencies takes us to that multiyear target? And then considering, Matt, the commentary on the second half revenues here, a lot of it sounds like it's macro and China. Maybe some help thinking about as we look past '24. Do you have visibility yet to say, "Hey, we've got the controllable to help us offset some of the macro pressures that we see to make '25 an algorithm revenue year?

[MATT FRIEND]

Sure, Michael. Well, let me start with the margins. I think that this quarter was really a strong proof point with strong gross margin expansion and operating margin expansion. And the team's execution and gross margin in particular was really strong. When we look at the drivers of it, it's a combination of recovery of the transitory headwinds, which we've been talking about for a couple of years now, but also structural drivers like price increases, which we've been able to sustain in this environment, and supply chain efficiencies, specifically meaning that we're improving our cost per unit as we deliver product into the marketplace.

And so the underlying drivers that were behind our long-term margin goals are still there, and this quarter is a great proof point as we're on that trajectory. The way to connect it to the Safe To Invest plan is to think a little bit about the opportunities for us to be -- to drive more profitable growth as we look forward. And I've been talking for a couple of quarters now about lowering our marginal cost of growth. And when I look back on some of the long-term targets that we've given like SG&A as a percentage of revenue being below pre-pandemic levels, we've largely done it.

But when we look at our resources today, we see greater opportunity for efficiency and effectiveness and reinvesting some of those resources for higher return opportunities, like John mentioned. And so that's really what we're focused on. I will remind you what I said on the call, which is that it's -- this isn't just SG&A. The $2 billion Save To Invest plan is up and down the P&L, and it's across our value chain. And so we will see benefits in SG&A but we really are looking at the business holistically.

And our focus as we look forward is to drive more profitable growth over the next several years. We remain confident in the long-term margin goals that we've been talking about. And so as we approach '25, we know that we're due to provide an update on those long-term goals, but we still remain confident on that endpoint.

As it relates to the revenue, just hit it quickly. Yes, we are largely seeing adjustments based on increased macro headwinds in China and in Europe. The element that we can control in this is the commentary I made around managing our franchises. We have incredibly strong franchises. In fact, we build dimension to franchises. It's what we do to drive growth in our business. And we continue to see those largest franchises driving year-over-year growth and selling at levels of full price realization that's above the goals that we've set for the business.

But we know in an environment like this when the consumer is under pressure and the promotional activity is higher, that it's newness and it's innovation which causes the consumer to act. And John just referenced a number of products and product launches in the last 45 to 60 days where we're seeing an incredible amount of consumer energy in response to newness and new stories. And we've seen either full sellouts or incredibly high levels of full-price selling. And I won't rename all the products, but what it demonstrates is what we already know, which is that in this type of an environment, what we control is accelerating our pace of innovation and newness in order to give the consumer something to want to continue to invest in this category.

And we think that we can do it like nobody else. And so, what you're hearing from us is a controllable effort to accelerate that pace, managing some of the larger franchises and really accelerating as we go forward. That will start with many of the items we've been talking about in our portfolio through the balance of this year and then the acceleration you're going to see and feel, especially as we focus our brand heat on this newness will carry us into '25.

We know it's going to take time because you got to scale this newness and the innovation, and that's what we're focused on doing. So our guidance for the second half from a controllable perspective is also reflecting on the proactive actions we're taking to manage our product portfolio as we look forward.

[OPERATOR]

Your next question comes from the line of Gabriella Carbone from Deutsche Bank.

[GABRIELLA CARBONE]

I wanted to dig in a little bit more on the running category. Particularly how has your approach to this category maybe changed over the past year? And then I know you mentioned trail running. Are there any other products in this category? You mentioned scaling moving ahead, but have you been seeing good customer response that you're excited about?

[JOHN DONAHOE]

Yes, Gabrielle, we've made running a key priority. We talk about 3 areas we're really getting behind where we see huge growth opportunity, that being Women's, Jordan and Running. And as you said, in Running, we tend to break it into 3 categories. And for us, it starts with road racing. That's the pinnacle, that's the peak.

And as you know, in the past 3 to 6 months, we are dominating it through the Alphafly 3 which debuted in Chicago Marathon. Kelvin Kiptum, as I mentioned in my remarks, set a world record. It's dominating the podiums for both men and women. And that will actually be launching available to the public in Q3. And as we see people going into racing into the Olympics, both marathon and otherwise, our performance running for racing is unmatched.

And then as Trail, as you mentioned, that's the fastest-growing segment, grew 20% for us. And we do what we do. Innovation is driving it. So the Ultrafly Trail, which is the first trail shoe with a carbon fiber plate, that's again, very NIKE, very classic NIKE, innovation, performance innovation, along with Peg Trail and Zegama, trail is growing fast, partly because trail running is growing, but increasingly, trail shoes are becoming lifestyle shoes. They are being worn on the streets, particularly in EMEA and in Europe but also around the world. So, we'll continue to invest in great product there as well, as I said in my remarks, our ground game.

And then in the road running or everyday running category, this is the area where we have the most work. And so we have good product. We had some nice wins in the quarter, the Structure

25 and the Vomero 17, which were our latest updates for everyday runner, they had positive response from consumers and specialty runners. But we're very focused on building out our ground game with everyday runners, and that means getting into the RSGs, back into the RSGs and being present where runners are, whether it's not just at the marathons where the elite runners are, but the everyday races in the key cities around the world and the running communities. And you'll see us, we are steadily investing in that and building our presence there.

And as we look forward, in terms of driving scale in everyday running, as I mentioned earlier, we're focused on Pegasus. That's our largest franchise, one of the largest franchises in running history, period. And we're very excited about Peg 41 and updates across the Peg family, which are coming in calendar '24. So a lot of focus, and we'll report in road everyday running, it's going to be quarter-by-quarter, steady progress, steady progress, steady progress toward our goal.

[MATT FRIEND]

I'd just add, too, that we're excited about the product portfolio we have below $100. And that product offering that's coming to market in the coming quarters will also enable us to get back on our front foot at an important price point in both across in multiple markets across the world.

[OPERATOR]

Your next question comes from the line of Lorraine Hutchinson from Bank of America.

[LORRAINE HUTCHINSON]

I wanted to focus on the China margins for a minute. And I was just curious, outside of the FX hit that you're facing, do you see an opportunity to drive margins in China back towards pre-COVID levels? Or has something changed that makes that market less profitable?

[JOHN DONAHOE]

Well, Lorraine, let me first just step back and look at how we see China for a minute, and then we'll talk about margin because if you don't have a great business, it's hard to have great margins. And the fact is we feel very good about our position in China and our ability to compete, and that has not changed from 90 days ago. And China sport is back, the China consumer's back out on the street with a real focus on active and healthy lifestyles. You see the government encouraging sport and healthy lifestyles. And Gen Z is the most active generation ever so that's a tailwind for our industry.

And so even in the face of macro uncertainty, our brand is continuing to resonate. And we're doing what NIKE does so well which is taking global products, global innovations, global brand, global athletes and powerfully combining them and connecting them to local culture and local sport and local consumer moments. And a wonderful example last quarter is Eliud Kipchoge, the world's best marathoner, did a tour through China right before the China the Shanghai Marathon. As you know, we sponsored the Shanghai Marathon. And sure enough, we dominated shoe counts in the top 100. We swept the women's podium, and that's bringing energy and running and the lifestyle of running. And it's growing the market. I mean, I think we're we grew 8%. We yes, there's some macro headwinds but we feel very good about our position and our ability to compete.

[MATT FRIEND]

Yes. And on the profitability side, what I'd say, Lorraine, is that this quarter, if we exclude the impact of FX, our EBIT grew faster than revenue in Greater China. And so, I think it's a great proof point that we can start to expand margins and move back towards where we were prior to the pandemic.

I did mention that the marketplace is highly promotional, and we're seeing that especially on Digital. And so, in the near term, the promotional nature of the marketplace is holding us back. But what I would tell you is that our inventories -- our inventory units are down versus the prior year. Our full-price realization is continuing to improve in our stores and our partner stores. And as we look at the environment that we're in right now, we're not going to race to the bottom on Digital. We're going to focus on prioritizing brand health and brand strength. And right now, the digital marketplace in particular is at the highest of promotional activity.

And so, an element of us revising our guidance for the balance of this year is an acknowledgment that we don't want to chase that. That's not who NIKE is. We're going to focus on innovation and newness and building a strong business in the marketplace on things like the basketball products that John referenced. We're super excited about bringing Kobe to market in Greater China. The Jordan business continues to have tremendous resonance there. And that's how we're going to grow and continue to compete in that market.

[OPERATOR]

Your next question comes from the line of John Kernan from TD Cowen.

[JOHN KERNAN]

Happy holidays. Matt, how should we think about operating overhead and demand creation going forward as we think about the overall SG&A piece of the business? There's obviously some restructuring and some cost savings. But is this the time you need to reinvest, given the changes in the competitive environment and the need to reinvigorate the product cycle and the marketing? Curious how we should think about the SG&A algorithm going forward.

[MATT FRIEND]

Yes. I mean, John, when we think about the Safe To Invest plan and the value it will create and the capacity it will create for us to be able to invest, Invest is the biggest growth opportunities we see. We don't envision that as being people. We envision that as being consumer-facing investment, bringing product innovation to market and having maximum impact with the consumer. And so our goal here is to see a reallocation of resources through this program so that more of our dollars are going towards consumer-facing activities that can have the kind of impact that you referenced.

And we believe when we look at the size of the market and our position against some of the categories that John referenced and/or the way the consumer is continuing to encourage us to bring them new and interesting things from a Jordan perspective, we see opportunity to continue to grow our business and that's where our focus is.

So I think we're going to -- we're focused on driving more profitable growth. That should mean that there's some leverage in SG&A, but you should also expect to see us reinvesting some of the resources that we're taking out of the business back in things that are consumer-facing that have an impact on sport and that continues to enable us to maximize the impact of the stories that we want to tell.

[JOHN DONAHOE]

That's exactly why we're doing it because we want to double down on our investments to capitalize on growth.

[OPERATOR]

Your next question comes from the line of Ike Boruchow from Wells Fargo.

[IKE BORUCHOW]

Matt, maybe for you. Just on the North American market, can you just comment more broadly or specifically on the current state of the inventory situation, maybe both yours and just competitively what you're seeing out there in holiday? And then just time line on when you think that the inventory dynamics and at least North America might be more cleaned up or more healthy for the brand to start to see better price realization and growth.

[MATT FRIEND]

Sure. Well, so in the quarter, we did see growth in retail sales in North America versus the prior year. Remember, it wasn't a lot of growth because we were comping some very significant growth rates in the prior year. The actions that we've taken on inventory are significant, and our inventory units are down strong double digits in North America. That's the biggest market where we've seen the biggest movement in our inventory.

When we look at the level of inventory in our partners relative to their current level of retail sales, we feel good about the weeks of supply that we have there. And what I would tell you in the large majority of our partners, we also are seeing the highest mix of current season inventory that we've seen in many, many seasons. And so we feel great that our partners are positioned to put our newest and most relevant product in front of the consumer.

We are watching the marketplace closely because my comments around the big consumer moments and the in-between periods apply to North America as well. And so we are watching cautious consumer behavior there. But at this point, we feel great about our inventory. And that's why we're so focused on newness and innovation because that's what's going to pull us through a promotional marketplace like we have. And so there's definitely a lot of inventory in the market across brands, but we feel great about where we are. And newness and innovation is what will enable us to earn open to buy in our partners and will enable us to reaccelerate the top line.

[OPERATOR]

Our last question comes from the line of Paul Lejuez from Citi.

[PAUL LEJUEZ]

I'm curious if you could talk about and quantify the cumulative freight drag that you've seen over the past few years and the timing of how you will recapture that freight drag in F '24 versus F '25 just based on your recent freight contracts. And what are the offsets as we think about potential puts and takes on the gross margin line '24, '25?

[MATT FRIEND]

Well, sure. We've been talking about 200 basis points of impact from ocean freight cumulatively over the past 2 years. And we started to see those transitory benefits begin to recapture here in the second quarter. Some of our upside in the quarter versus our guidance was it came a little bit earlier than we had anticipated. Our rates for this year walked. And so, we expect to continue to see that, the recovery of that, in Q3 and Q4.

One of the other transitory impacts that we're watching closely was markdowns. And right now, we're only planning for a very modest amount of markdown recovery relative to the markdowns that we incurred in the prior year, and that's just given where the marketplace is. We've decided to take a more prudent approach to our margin guidance for the balance of the year, given some of the uncertainties that are out there.

So, when we look to the balance of this year, we're encouraged by the second half expansion being higher than the first half expansion. And one of the other things that we're starting to get visibility into when we look at our margins in the fourth quarter is product costs, product input costs are starting to flip to a tailwind. And so, when we think about the long-term margin goals that we have, the teams are executing well, and we continue to be encouraged with what we're seeing through this year.

[OPERATOR]

This concludes today's conference call. Thank you for your participation, and you may now disconnect.