



# NIKE, INC

## **NKE - BATTLEGROUND ISSUES BEFORE THE PRINT**

September 26, 2016

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# THE SHORT-SELLER'S NARRATIVE

- Sharply decelerating futures trends
- Simply massive acceleration in the Adidas brand,
- Continued growth out of Under Armour,
- Shrinking US distribution,
- NKE already tapped out inside FL (72% of FL sales bear a Swoosh),
- The Olympic Hangover,
- Golf Implosion
- Peak valuation, and
- Hockey Stick Guidance

## TRUE, YOU NEED TO BELIEVE HERE...BUT WE DO

Our sense is that given the pessimism around the name, if you think Nike can

- a) Hit/beat the quarter, and
- b) Deliver on the hockey stick,

And you think that

- a) Gross margins are headed above 50%, and
- b) There's \$5.00+ in EPS power just below the surface with sharply accelerating returns

Then this is probably a stock you want to own.

# HEDGEYE RETAIL IDEA LIST

## BEST LONG IDEAS

		TRADE	TREND	TAIL
<b>RH</b>	Restoration Hardware	✓	✓	✓
<b>NKE</b>	Nike, Inc.	✓	✓	✓

## OTHER ACTIVE LONGS

<b>DKS</b>	Dick's Sporting Goods	✓	✓	-
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## LONG VETTING BENCH

<b>KATE</b>	Kate Spade
<b>RL</b>	Ralph Lauren
<b>VFC</b>	VF Corp
<b>WWW</b>	Wolverine Worldwide
<b>TJX</b>	TJX Companies
<b>AMZN</b>	Amazon.com
<b>ULTA</b>	Ulta Salon

## BEST SHORT IDEAS

		TRADE	TREND	TAIL
<b>HBI</b>	HanesBrands	×	×	×
<b>TGT</b>	Target	-	×	×
<b>KSS</b>	Kohl's	-	×	×
<b>LULU</b>	Lululemon	-	-	×
<b>FL</b>	Foot Locker	×	×	×

## OTHER ACTIVE SHORTS

<b>TIF</b>	Tiffany	×	×	×
<b>W</b>	Wayfair	×	-	×
<b>HIBB</b>	Hibbett Sports	-	×	×
<b>PRTY</b>	Party City	-	×	×
<b>BBBY</b>	Bed, Bath & Beyond	×	×	×
<b>WSM</b>	Williams-Sonoma	×	×	×

## SHORT VETTING BENCH

<b>FRAN</b>	Francesca's
<b>PVH</b>	PVH Corp.
<b>SHOO</b>	Steve Madden
<b>OLLI</b>	Ollie's Bargain Outlets
<b>FINL</b>	Finish Line
<b>GPS</b>	Gap, Inc
<b>JWN</b>	Nordstrom
<b>M</b>	Macy's
<b>JCP</b>	JC Penney
<b>COLM</b>	Columbia Sportswear
<b>ELY</b>	Callaway Golf

Bench = timing is not right, or research is in progress.

# NIKE FINANCIAL SUMMARY

Nike, Inc. (NKE)

\$55.15

FY17 ends May 2017

	1Q17E	2017E	2018E	2019E	2020E
Hedgeye EPS (\$)	0.56	2.39	3.19	4.01	4.78
Consensus (\$)	0.56	2.40	2.77	3.20	3.65
Variance %	0.0%	-0.5%	15.1%	25.5%	30.8%

Sales (\$MM)	35,187	39,998	45,142	50,481
EBIT Margin	14.6%	16.7%	18.2%	18.8%
EBITDA (\$MM)	5,767	7,437	9,110	10,577
FCF Per Share (\$)	1.78	2.43	3.20	3.90
Book Value Per Share (\$)	7.42	8.20	9.37	10.84
Net Debt to Total Capital	-27.0%	-22.0%	-21.9%	-24.1%

P/E	23.1 x	17.3 x	13.7 x	11.5 x
EV/EBITDA	16.1 x	12.3 x	9.9 x	8.3 x
Price/Book	7.4 x	6.7 x	5.9 x	5.1 x
Cash Yield	3.2%	4.4%	5.8%	7.1%

## Targeted Valuation Range

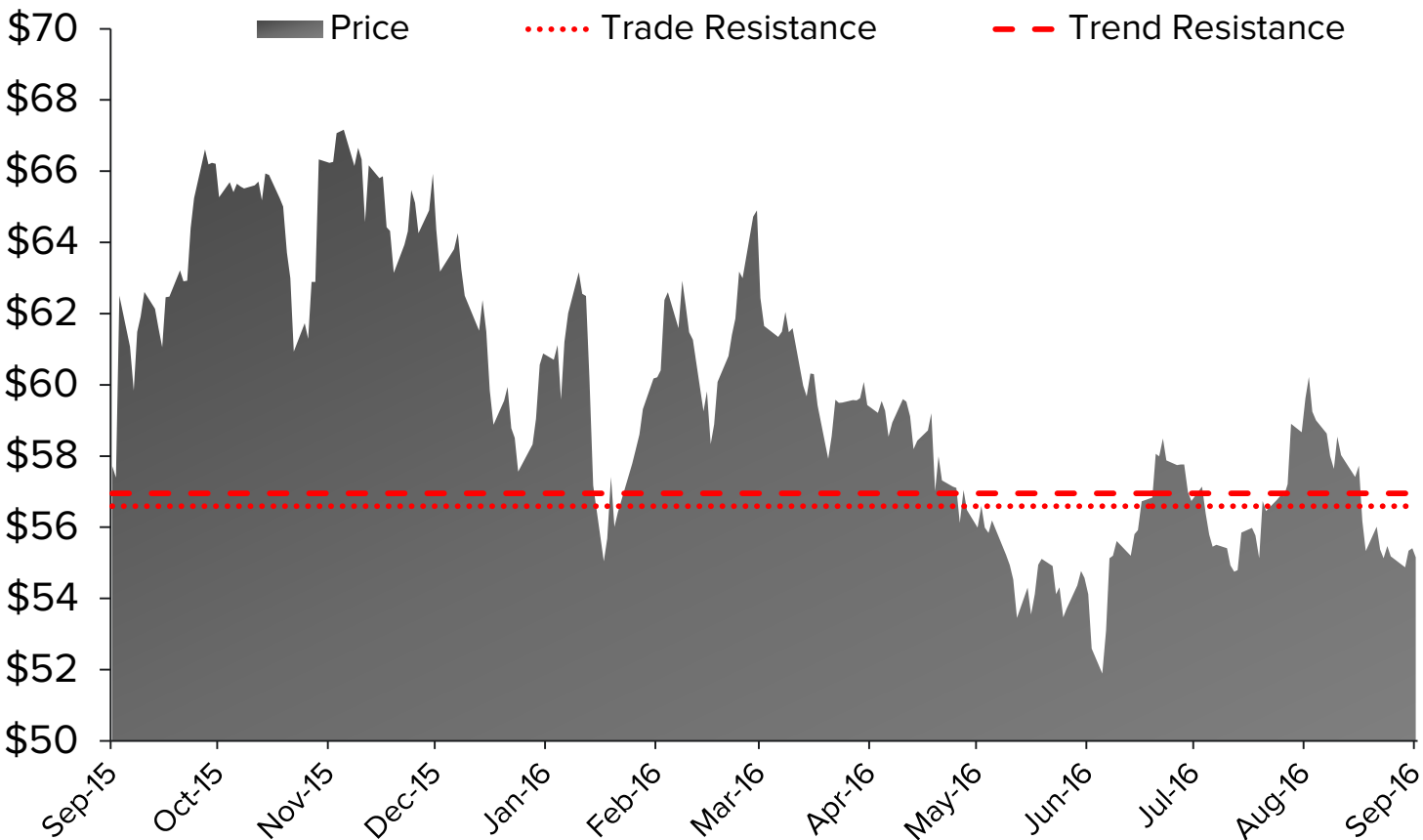
	EPS %	P/E	Price	EV/EBITDA
2017E	10.7%	28.0 x	67	19.6 x
2018E	33.4%	27.0 x	86	19.4 x
2019E	26.0%	26.0 x	104	18.9 x
2020E	19.0%	25.0 x	119	18.2 x

## Investment Thesis Snapshot

1. A lot of bad news in it today. Some issues are true, some are overblown.
2. If you think the quarter is intact, and they can hit the hockey stick, we think you own the stock.
3. The e-comm theme is still very misunderstood - in (positive) magnitude and duration.
4. There's \$5 in earnings power in here, AND we think this management team can unlock it.

# NIKE BEARISH QUANTITATIVE SET-UP

## NKE QUANT LEVELS



NKE is now bearish from both a TRADE and TREND perspective for the 1st time since 2013.



**THE YEEZY FACTOR**



# A RELEVANT SUB BRAND. BUT NOT A BRAND BRAND



## THERE'S A DIFFERENCE BETWEEN A COURT LEGACY AND A KARDASHIAN ONE

Jordan will grow by a greater increment this year than Kanye will generate in total revenue. Entertainers have had their moments in the spotlight in this business – Shakira, Carrie Underwood, Heidi Klum, Lil' Wayne, Rick Ross, Wiz Khalifa, Meek Mill, Teyana Taylor, the Biebs, and yes, Kanye too. All those entertainers were 'caught' ditching the endorser's brand and wearing Nike/Jordan.

# IT MATTERS...BUT NOT REALLY

## YEEZY IN CONTEXT

	2016E Wholesale Rev (mm)	2016E End Retail (mm)
Jordan Brand	\$3,150	\$6,300
Yeezy	\$150	\$300
UA Footwear	\$1,000	\$1,750

Last year Yeezy did ~\$100mm.

Jordan did \$5.5bn

## PAIRS MADE



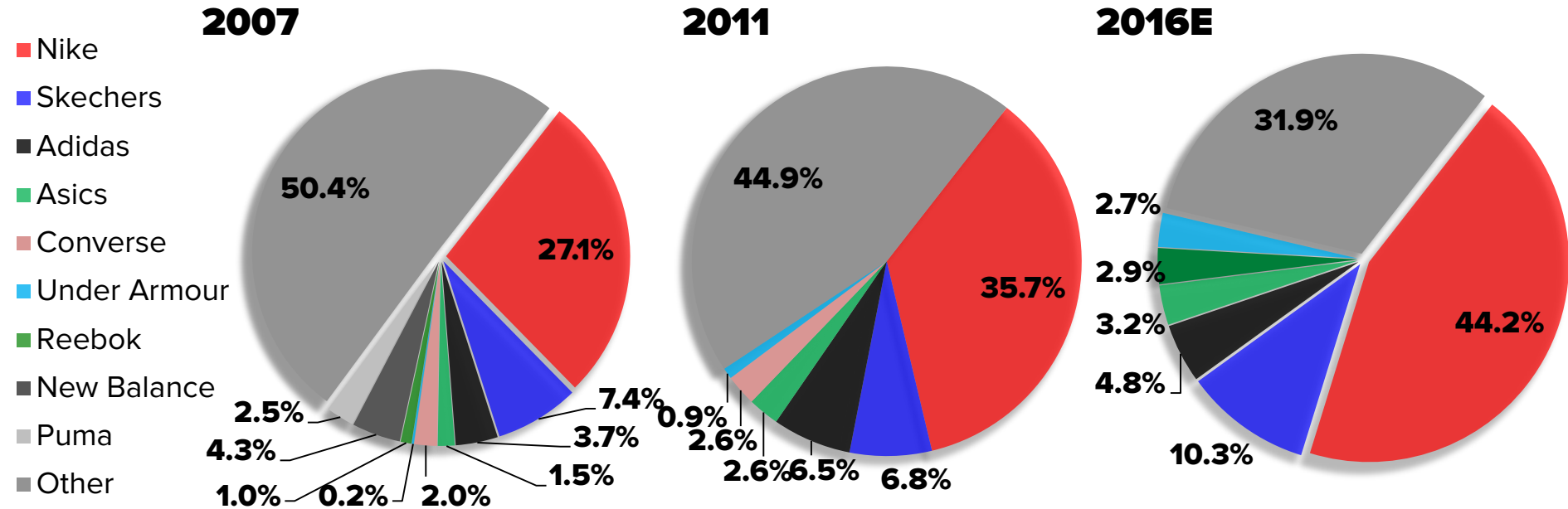
Yeezy seems on track to triple in 2016 – and yet it would only be ~70bps of US market share...

Typical Units Per Launch	
Jordan Brand	300,000
Yeezy	40,000

# YEEZY VS JORDAN IS LIKE MALAWI INVADING THE US



# ADIDAS BRAND MATTERS MORE IN THE US

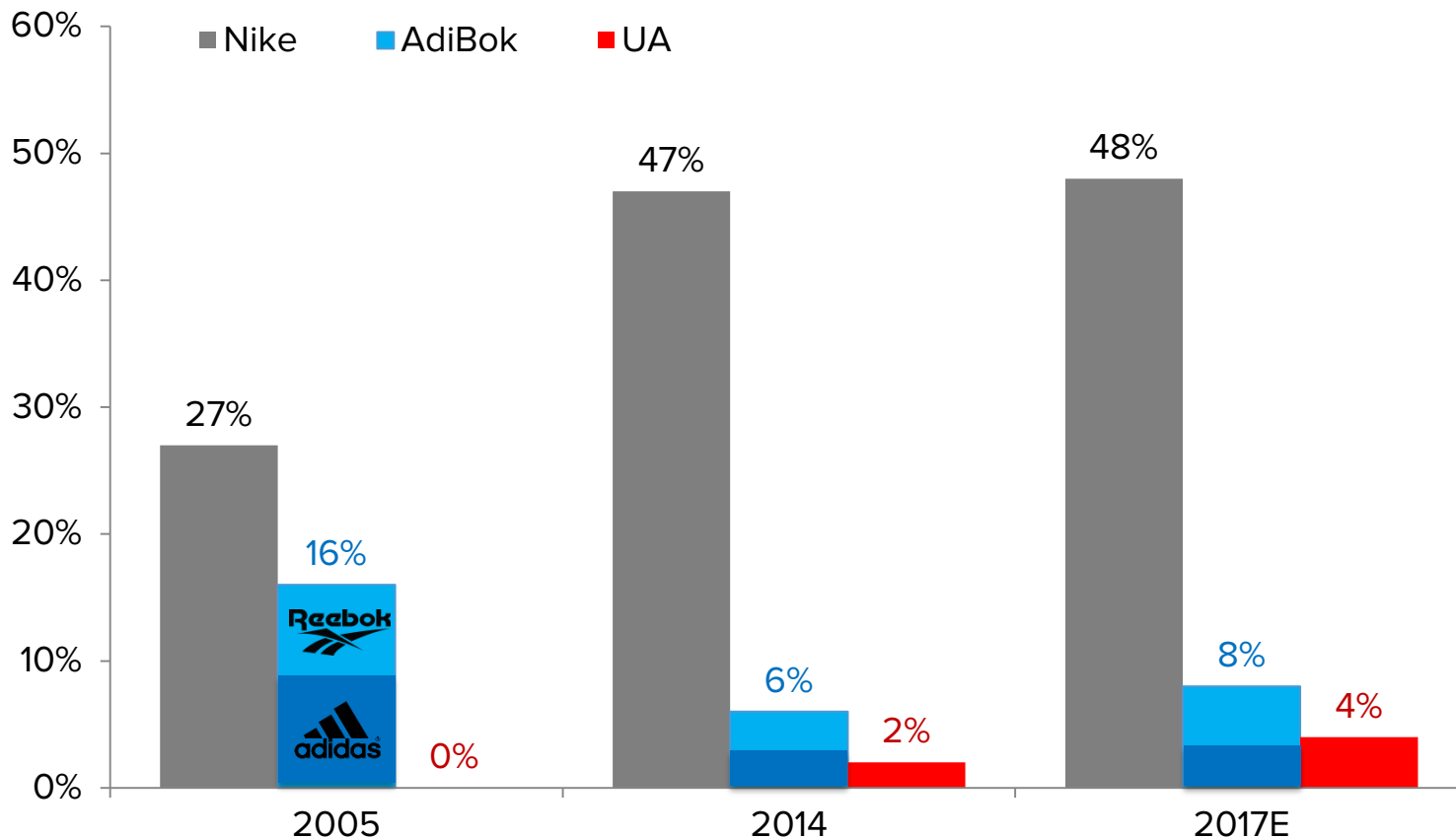


## 10 YEAR USA SPORTS FOOTWEAR MARKET SHARE

The footwear landscape has changed dramatically over the last decade.

# REMEMBER THE BASE ADIBOK IS COMING FROM

## US MARKET SHARE

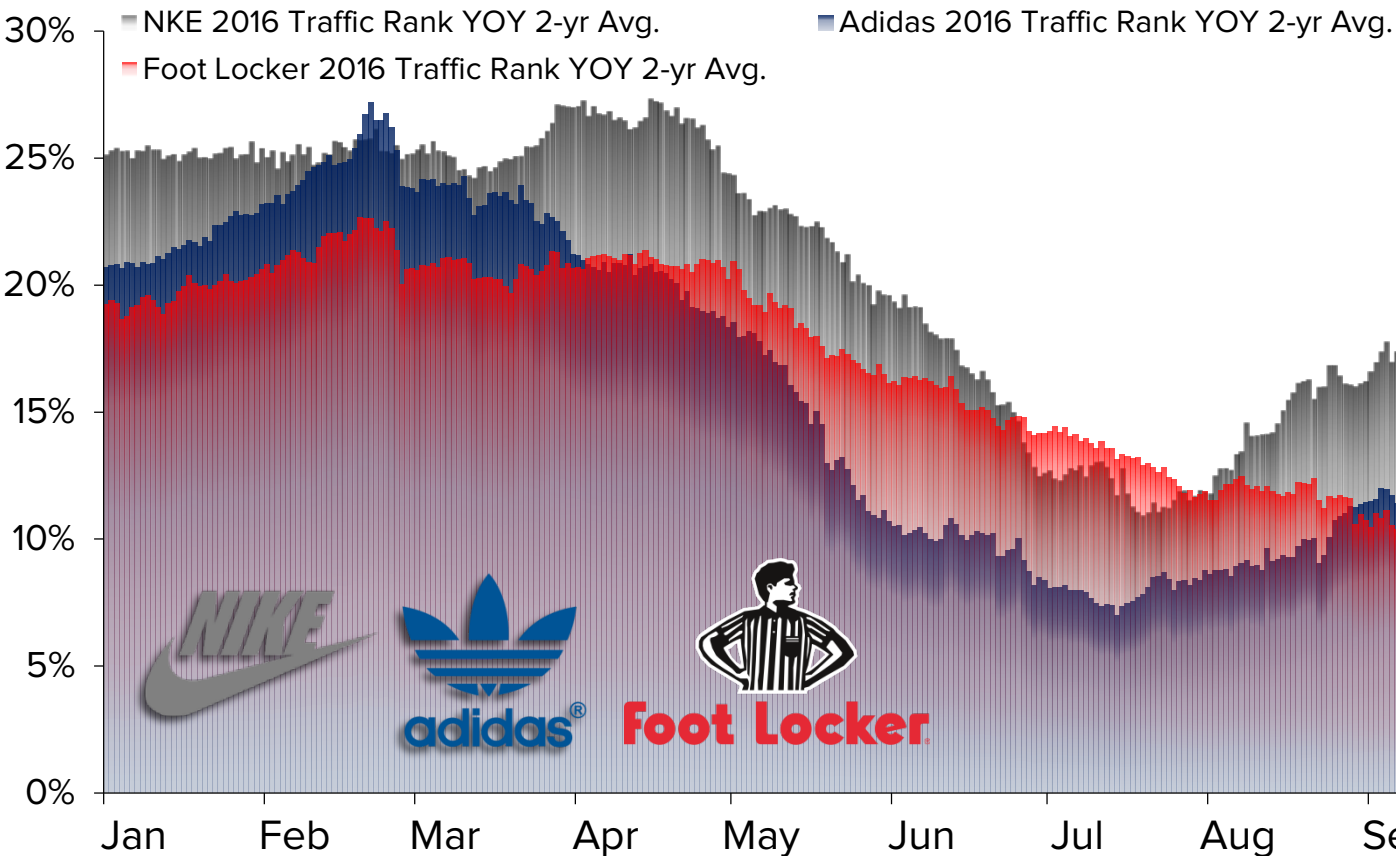


At the merger, Nike and Adibok were about 10 pts from each other. At the peak around 2014, that spread expanded to 37 pts.

Now its holding steady as UA is gaining share.

# CONTENT WINNING, DISTRIBUTION LOSING

## NIKE.COM VS ADIDAS.COM DAILY TRAFFIC RANK GROWTH

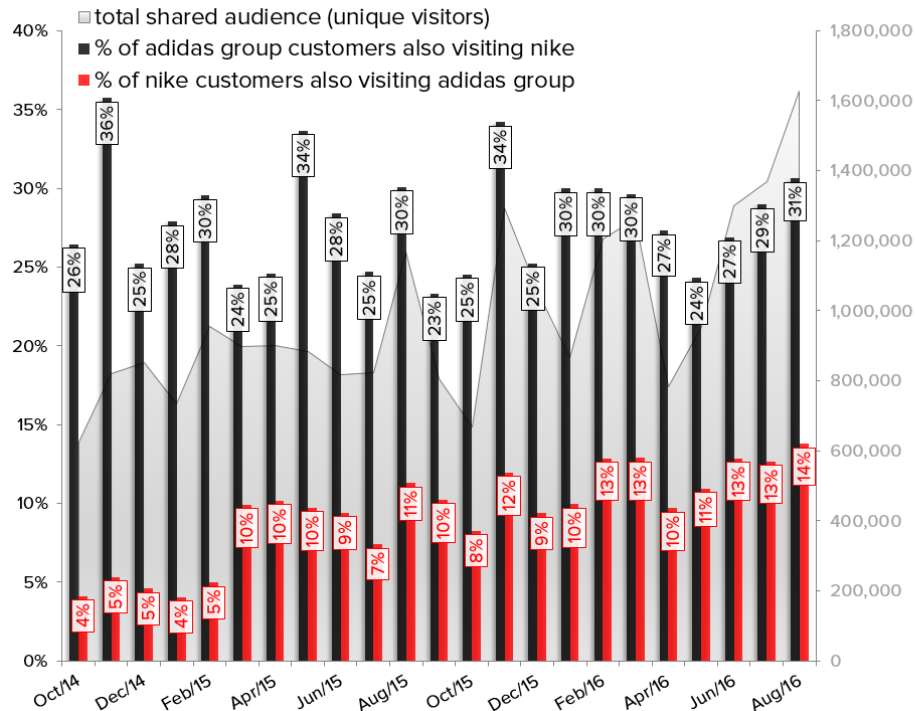


Adidas is ripping, but Nike ain't doing too bad either.

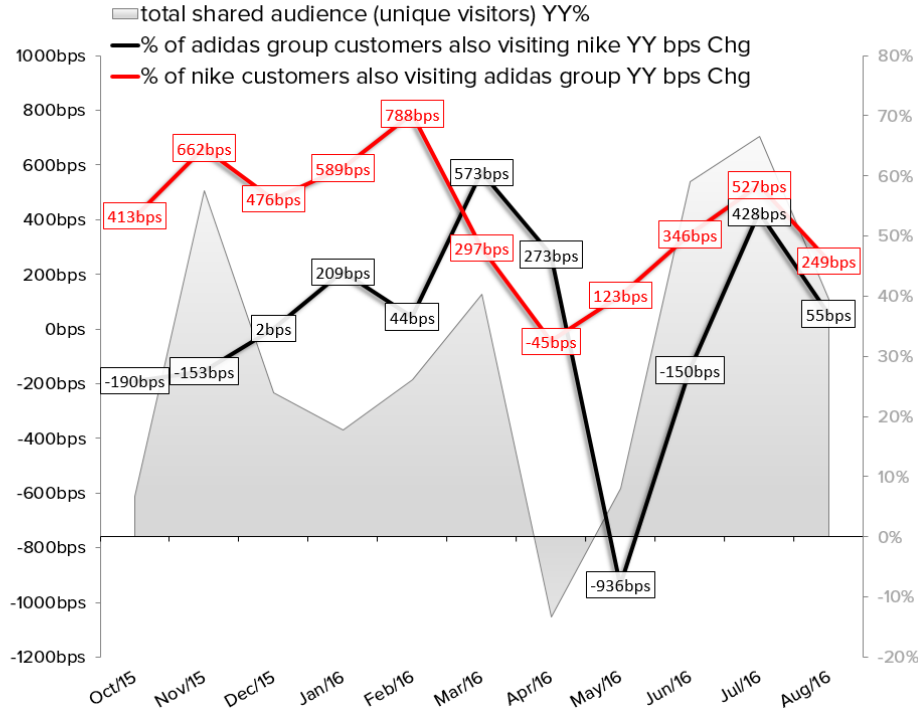
FL = bad

# NO SUDDEN MOVEMENTS IN NKE/ADI ONLINE OVERLAP

## ADIDAS GROUP VS NIKE CUSTOMER OVERLAP



## ADIDAS GROUP VS NIKE CUSTOMER OVERLAP YOY%



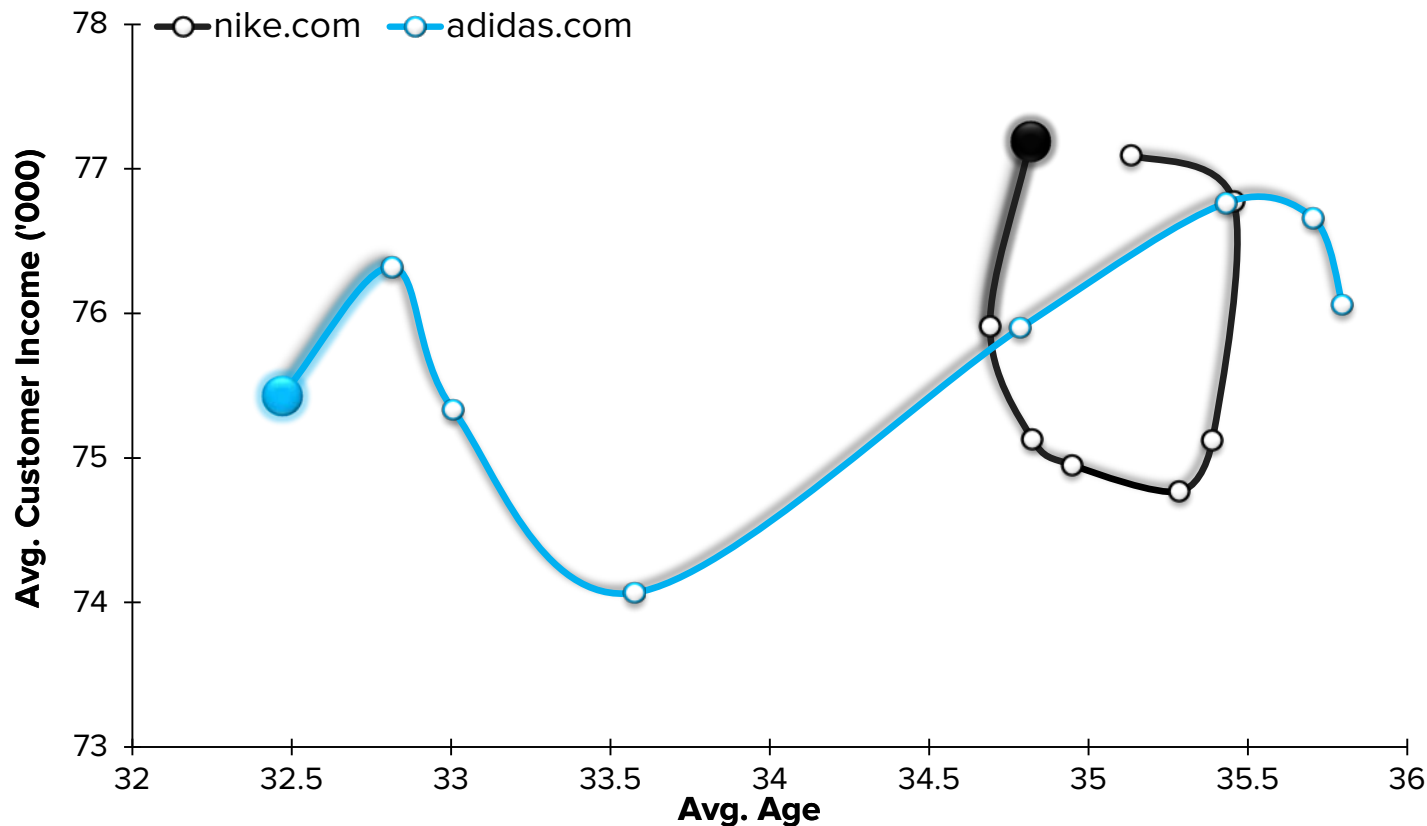
**ADIDAS IS RIPPING, BUT NIKE AIN'T DOING TOO BAD EITHER.**

The % of Nike customers that also visit Adidas sites is steadily rising.

# THE CHART NIKE WON'T WANT YOU TO SEE

## MONTHLY AVERAGE CUSTOMER AGE VS. INCOME

Avg. Adidas customer getting younger.





# FL GROWTH HEADWIND FROM NIKE DISTRIBUTION SHIFT

	NKE-FY10	NKE-FY11	NKE-FY12	NKE-FY13	NKE-FY14	NKE-FY15	NKE-FY16	NKE-FY17(E)
FL Sales (adjusted for NKE)	4919	5220	5749	6242	6735	7199	7483	7839
NA %	70.6%	70.7%	70.4%	72.7%	70.2%	69.6%	71.6%	72.6%
NA \$	\$3,471	\$3,689	\$4,048	\$4,539	\$4,728	\$5,009	\$5,356	\$5,689
NKE %	68%	63%	61%	65%	68%	73%	72%	70%
US % NKE inflator	4%	4%	4%	4%	4%	4%	4%	4%
NKE US %	72%	67%	65%	69%	72%	77%	76%	73.9%
NKE US FL Sales	\$2,499	\$2,472	\$2,631	\$3,132	\$3,405	\$3,857	\$4,070	\$4,202
Incremental Nike		(\$27)	\$159	\$501	\$273	\$453	\$213	\$132
NKE points to FL growth		-0.8%	4.3%	12.4%	6.0%	9.6%	4.3%	2.5%
NKE Wholesale Sales (NA)		\$5,801	\$6,720	\$8,571	\$9,296	\$10,243	\$10,674	\$10,931
Retail Equivalent		1.80x	1.78x	1.75x	1.71x	1.71x	1.71x	1.71x
NKE Wholesale Retail Equivalent		\$10,440	\$11,944	\$14,971	\$15,869	\$17,509	\$18,246	\$18,685
NKE DTC Sales (NA)		\$1,778	\$2,119	\$2,587	\$3,003	\$3,497	\$4,090	\$4,908
YY % NKE DTC NA Growth			19.2%	22.1%	16.1%	16.5%	17.0%	20.0%
Incremental NKE US Wholesale (Retail Eqv.)			\$1,504	\$3,027	\$898	\$1,640	\$737	\$440
% captured by FL			10.6%	16.5%	30.4%	27.6%	28.9%	30.0%
NKE NA Sales (reported)		\$7,579	\$8,839	\$11,158	\$12,299	\$13,740	\$14,764	\$15,839

		% of growth wholesale								
		30.0%	40.0%	50.0%	60.0%	70.0%				
UA NA FW Sales	\$1,008	20%	\$24	\$32	\$40	\$48	\$56	0%	AdiBok NA FW Sales	\$2,001
% UA Growth		30%	\$48	\$64	\$80	\$97	\$113	5%	% AdiBok growth	
		40%	\$72	\$97	\$121	\$145	\$169	10%		
		50%	\$96	\$129	\$161	\$193	\$225	15%		
		60%	\$121	\$161	\$201	\$241	\$281	20%		
		70%	\$145	\$193	\$241	\$289	\$338	25%		
		80%	\$169	\$225	\$281	\$338	\$394	30%		


In this analysis, in order for FL to meet street expectations, UA would need to grow FW 60% and AdiBok 20%, with 50% of that growth coming from wholesale in order for those brands to fill the Nike void, assuming FL captures 40% of the incremental share from each of the brands.

# FL GROWTH HEADWIND FROM NIKE DISTRIBUTION SHIFT

To Hit Street Estimates:



=

 **+ 100%**

or

 **+ 50%**

**NA Footwear Brand Growth**

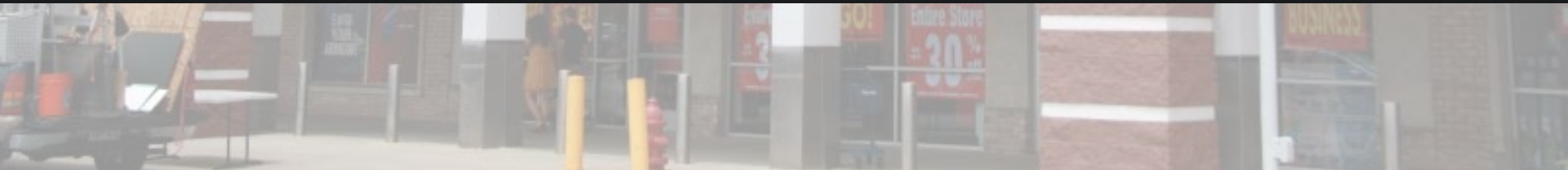
FL would need an incremental \$200mm from UA and/or Adidas.

If only one brand filled the void...

- UA would have to grow NA footwear by ~100%
- Or adidas NA would have to grow about 50%



**CHANNEL ISSUES**



# 2015 NIKE US REVENUE HEAT MAP

Retail Value (\$mm) 21,520

Athletic Specialty	10,621	49.4%
FL	4,216	19.6%
FINL	1,389	6.5%
DKS	1,425	6.6%
HIBB	533	2.5%
Academy	939	4.4%
Sports Authority	1,063	4.9%
Sport Chalet	64	0.3%
BGFV	147	0.7%
DTLR	105	0.5%
Modells	245	1.1%
Dunhams Sports	113	0.5%
Schells	98	0.5%
MC Sports	34	0.2%
Olympia Sports	69	0.3%
Fleet Feet	53	0.2%
Shiekh Shoes	96	0.4%
Road Runner Sports	33	0.2%

NKE DTC	3,583	16.6%
NKE Retail	2,866	13.3%
NKE e-comm	717	3.3%

Dept Stores	3,198	14.9%
M	563	2.6%
KSS	825	3.8%
JWN	350	1.6%
JCP	550	2.6%
DDS	222	1.0%
BLKIA	22	0.1%
WMT	329	1.5%
TGT	103	0.5%
SHLD	236	1.1%

Family/Other	767	3.6%
SCVL	273	1.3%
Famous Footwear	75	0.3%
DSW	198	0.9%
TLYS	17	0.1%
SSI	64	0.3%
GCO	30	0.1%
TJX	55	0.3%
ZUMZ	57	0.3%

Online	515	2.4%
Zappos	203	0.9%
AMZN	312	1.5%

## NIKE US SALES DISTRIBUTION BY CHANNEL

Here's our estimate for sales by channel and by retailer after triangulating current and historical disclosure by Nike and the companies noted above. 5% of US distribution went away this year. That's a 2% consolidated revenue hit all else equal.

# LATEST CHANNEL DEVELOPMENTS



NKE now accounts for 72% of assortment at Foot Locker; expressed concerns about Nike's price/value relationship



TSA files Chapter 11, closes 460 doors



Sports Chalet closes over 50 doors



Hibbett making push to get involved in the dot.com business; has been member of the Nike Affiliate Program. Bad for HIBB and HIBB/NKE



Macy's expanding sports brand assortment, more Nike, Adidas, Under Armour in stores



Maxed out in Bob's Stores?



SCVL opening Nike 'Shop in Shops', expects to have 47 by end of year.

# NIKE FADING OUT GOLF EQUIPMENT

Phil Knight: “There are probably 2 or 3 too many golf manufacturers in the business... We didn’t do it profitably. It was an easy financial decision, but a hard personal “decision.”

## Closing Impact

**Revenue: ~350mm (1%)**

**GM%: +10-20bps**

**EPS: \$0.00-\$0.01**

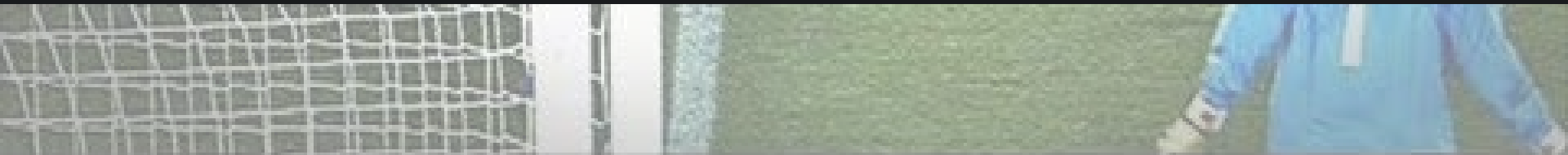


## NIKE GOLF EQUIPMENT CLOSING IMPACT

Negative revenue impact – slightly positive GM/EPS.



# **“IMPOSSIBLE” E-COMM GOALS**



# NIKE'S STATED GOALS ARE DOABLE

## DTC & ECOMMERCE GOALS VS ACTUAL

### 2010 Meeting

**2015 DTC Target**

\$5.0

**2015 DTC Actual**

\$6.6

### 2013 Meeting

**2017 DTC Target**

\$8.0

**2016 DTC Actual**

\$7.9

**2017 Ecommerce Target**

\$2.0

**2016 Ecommerce Actual**

\$1.7

### 2015 Meeting

**2020 DTC Target**

\$16.0

**2020 Ecommerce Target**

\$7.0

Nike beat it's publicly-stated e-commerce target twice so far, and there's likely to be a third.

Target = incremental \$5bn in e-comm, or 30% CAGR.  
#doable

40% CAGR = \$8.5bn  
50% CAGR = \$12.5bn



# ECOMMERCE TARGETS ARE DOABLE

## ECOM TARGETS BREAKDOWN

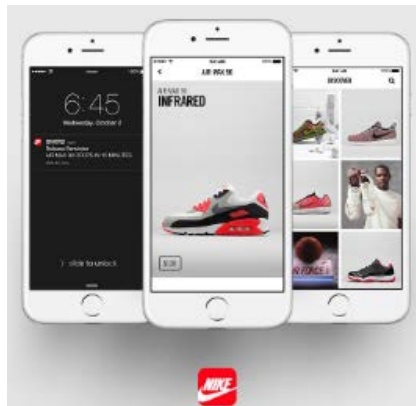
**External Target: \$7bn**

**Internal Target: \$8-9bn**

**OUR Targets \$9-11bn**

2015 NIKE, INC. INVESTOR MEETING

[View the Agenda](#)



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Target = incremental \$5bn in e-comm, or 30% CAGR.

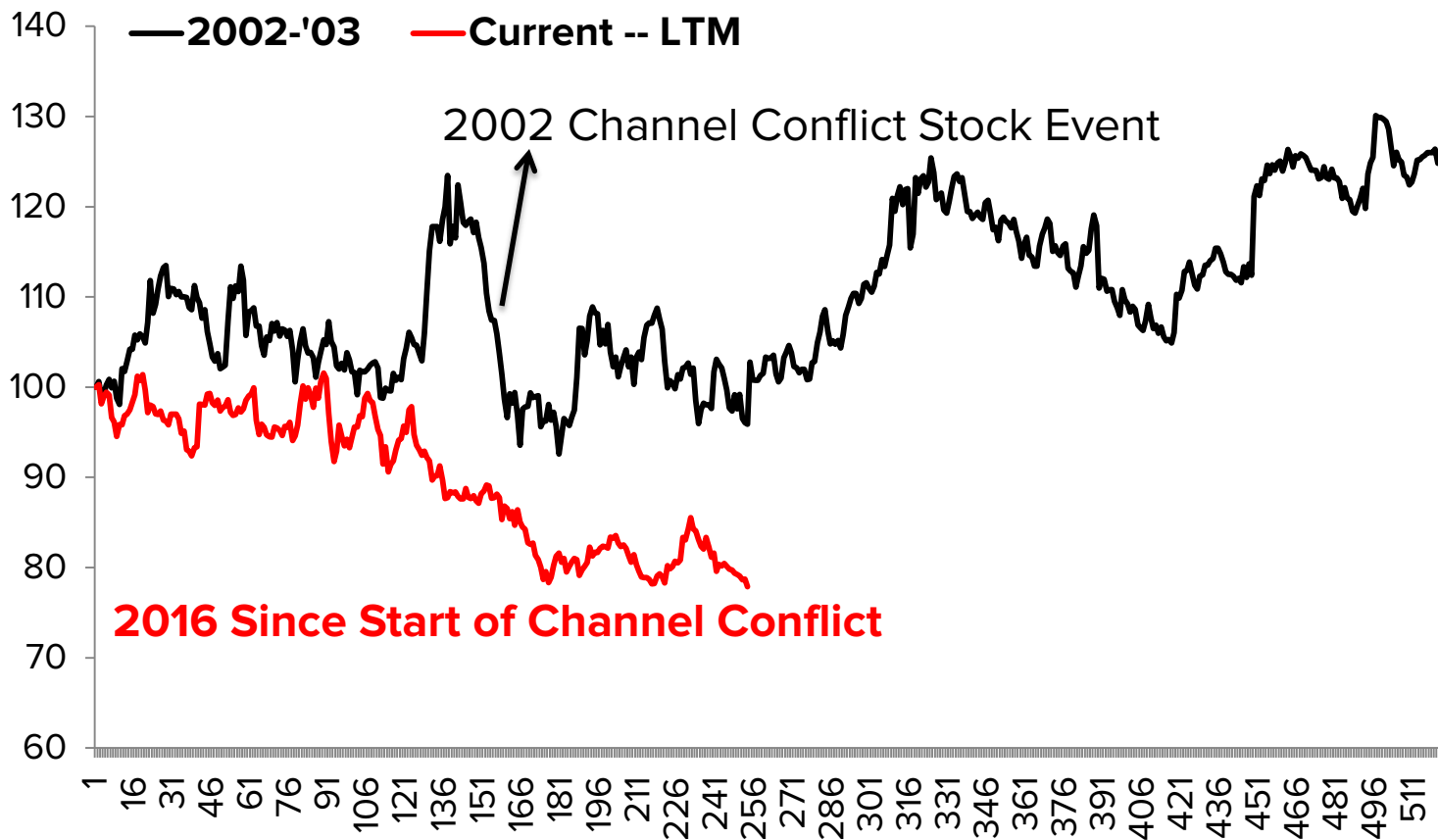
#doable

40% CAGR = \$8.5bn

50% CAGR = \$12.5bn

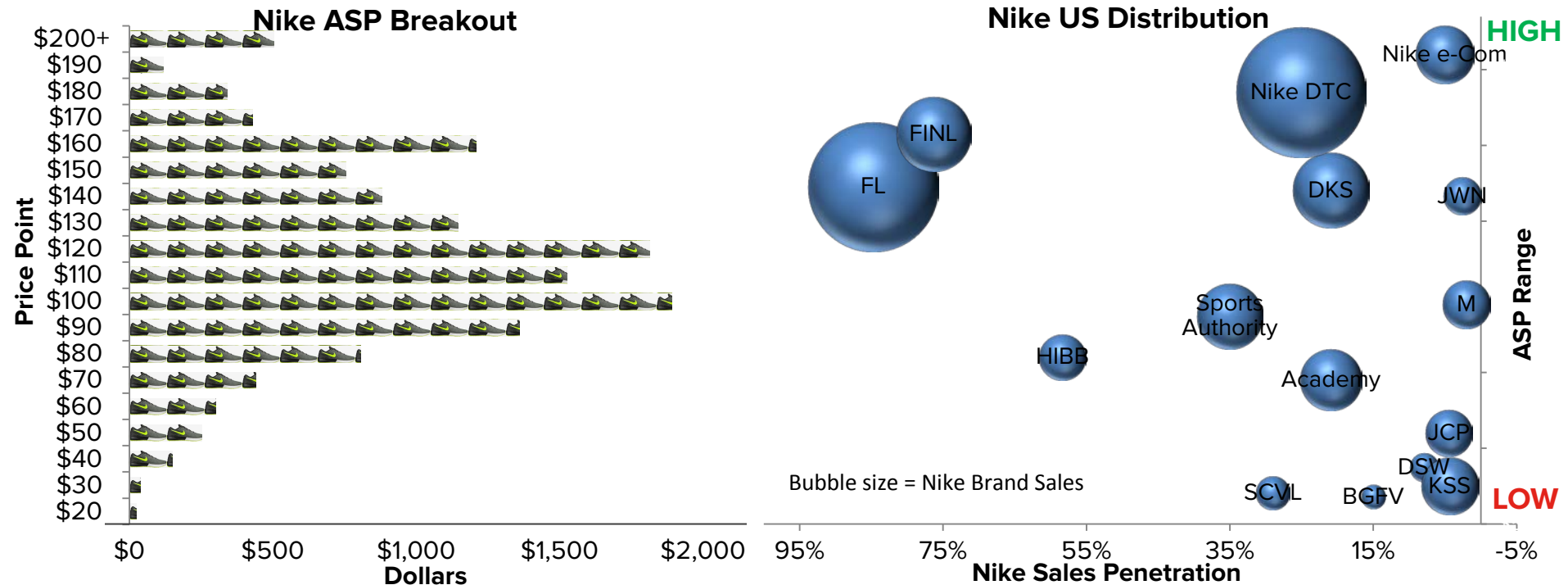
# PRICING IN A CONFLICT ALREADY?

## NKE PRICE: LAST CHANNEL CONFLICT VS 2016 CONFLICT



YTD stock price has already baked in much of the downside from channel issues.

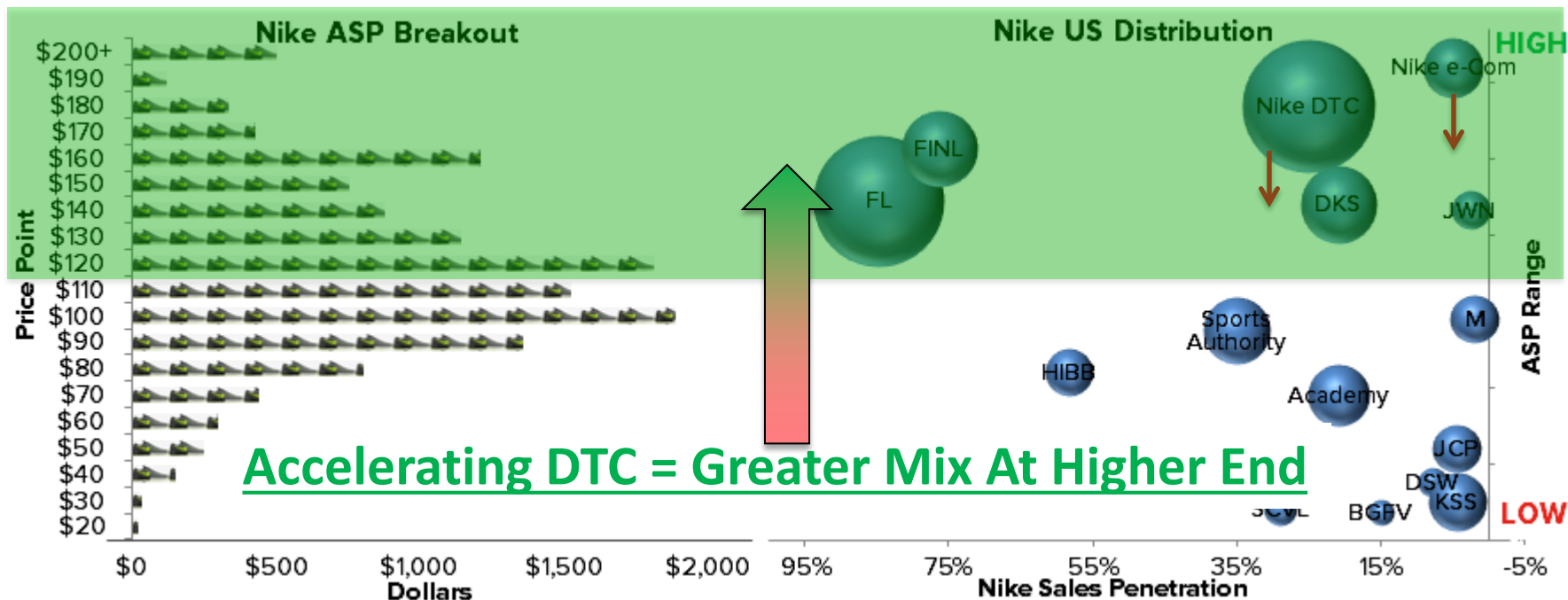
# NIKE US UNIT DISTRIBUTION



## NIKE IS LOCKED AND LOADED BETWEEN \$90-\$160/PAIR

Nike has a solid distribution of units by price point. The \$90-\$160 zone can definitely grow, but it's not the path of least resistance. If Nike sells more at a lower price (KSS) that's bad. Higher price point (\$200) accrues to Nike.

## ASP IMPACT TO ACCRUE TO NIKE NOT WHOLESAL



## CHANNEL / ASP BIFURCATION

# NIKE WHOLESALE VS RETAIL CONVERSION MATH

Wholesale Margin Math		On-Line Margin Math	
Price at Retail	100.0	Online Direct Price	100.0
		Apparel Attachment Rate	30%
'At Once' Cost	50.0	Net Revenue	130.0
- Futures Discount	5.0		
Retailer's Cost	45.0	Online Servicing Cost	6.0
		Incr Mktg/Cust Acquisition	4.5
		Cost of Goods	26.0
		Shipping	2.6
Nike Revenue	45.0	Nike Revenue	130.0
Cost of Goods	22.0	Total Costs	39.1
Nike Margin	23.0	Nike Margin	90.9
GM %	51%	GM %	70%

## ITS ALL ABOUT THE \$\$\$

20 points is not an extra \$20 dollars on a \$100 shoe.  
It's about 4x as much. THAT's what matters to Nike.

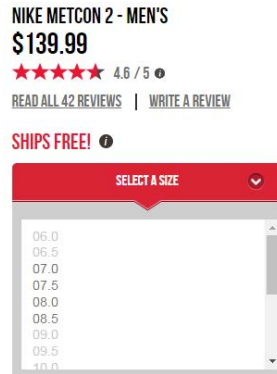
# ASP IMPACT TO ACCRUE TO NIKE NOT WHOLESALE

## Shoe sold at Foot Locker

- Price \$140
- Nike Inc. consolidates \$63



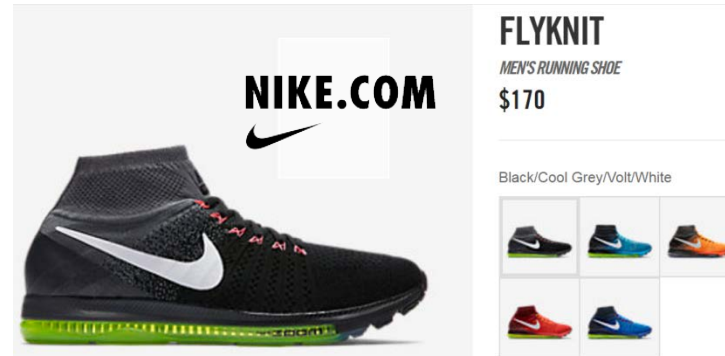
**NKE Gross Profit \$32**



Unit Channel Shift  
0% Share Gain

## Shoe sold on Nike.com

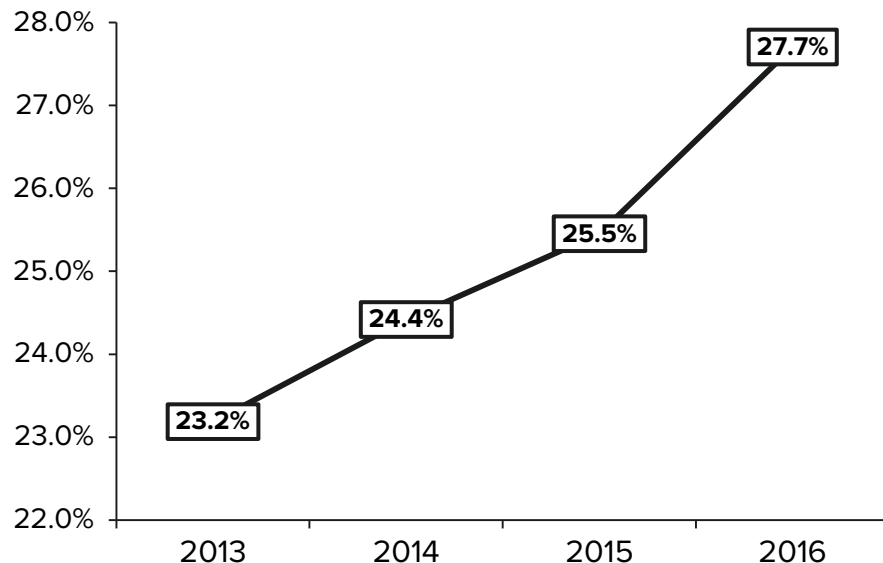
- Price \$170
- Nike Inc. consolidates \$170



**NKE Gross Profit \$119 +270%**

# DTC MIX SHIFT THE NA \$ BUFFER

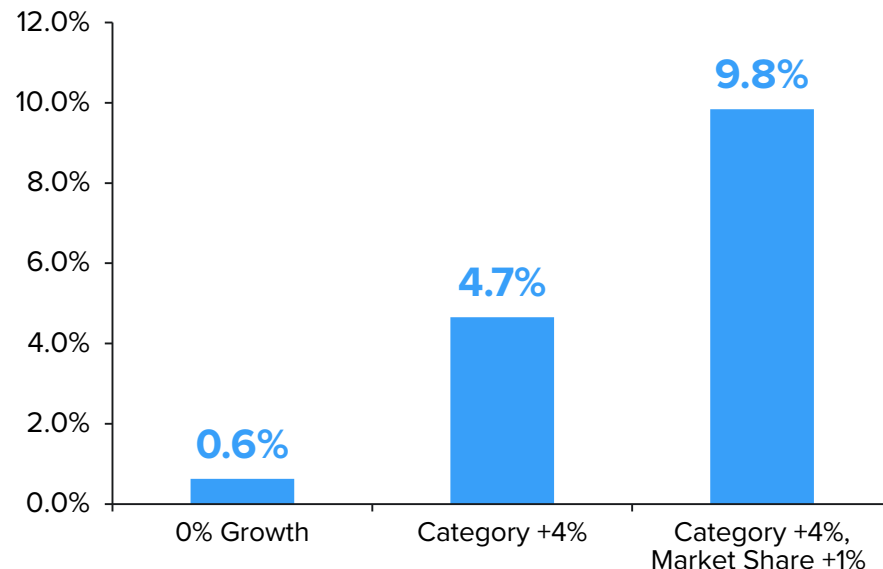
## NKE NA DTC % OF TOTAL



## NA DTC ACCELERATING OFF BIGGER BASE

NA DTC penetration up 500bps on P&L in 3yrs. Now 18% of end NKE retail dollars.

## CHANNEL SHIFT \$ BUFFER



## CHANNEL SHIFT BTW 0BPS-180BPS OF GROWTH

For every 1% change in sales mix at end retail, gives NKE 60bps of growth assuming no growth in category and flat market share.





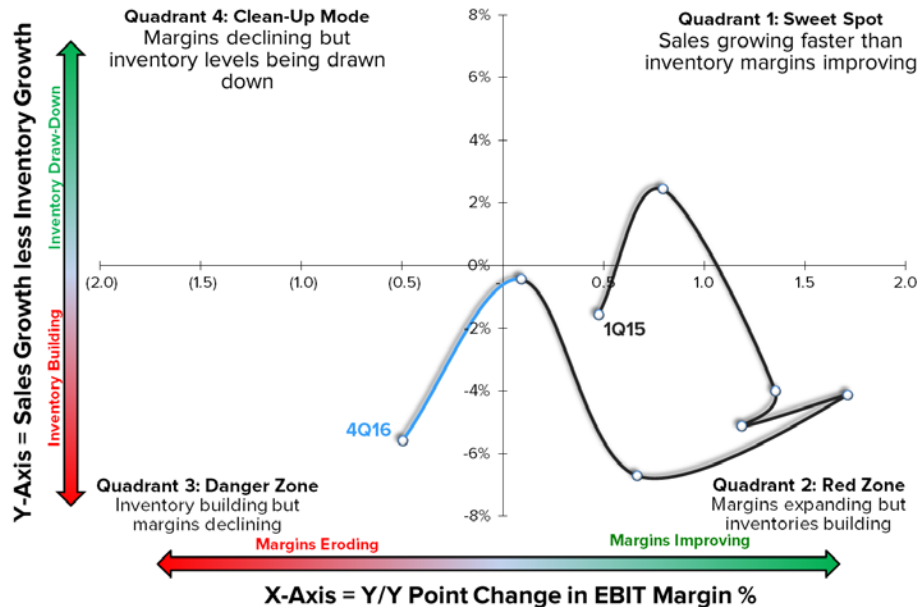
# INVENTORY CONCERNS





# HIGH INVENTORIES + UNUSUAL DISCOUNTING

## NKE SIGMA



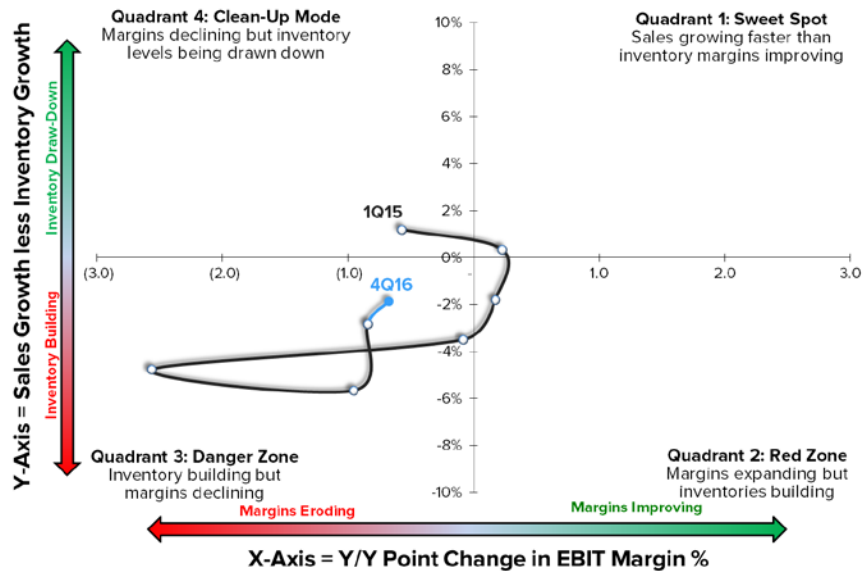
DATA SOURCE: HEDGEYE & COMPANY REPORTS

## UNUSUAL DISCOUNTING



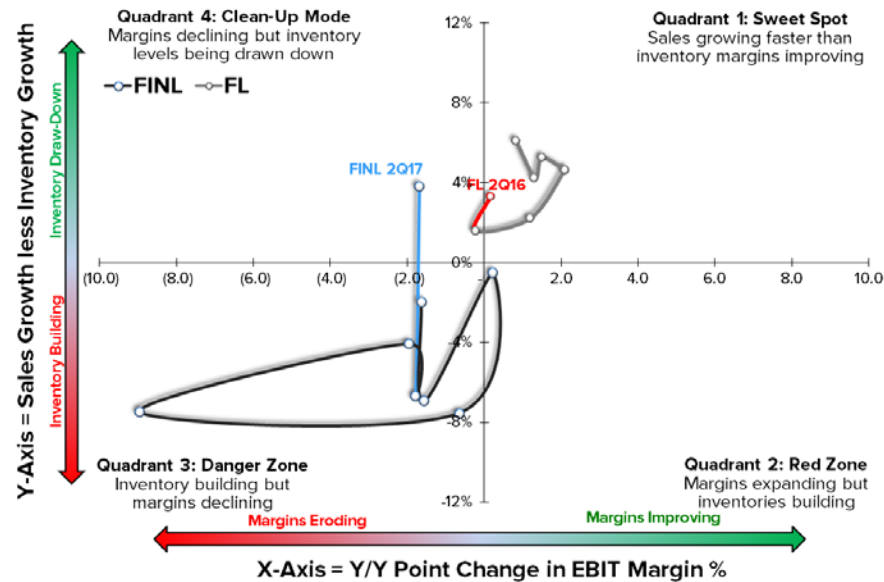
# MIXED DATAPPOINTS

## SPECIALTY ATHLETIC SIGMA



The channel is getting cleaner.

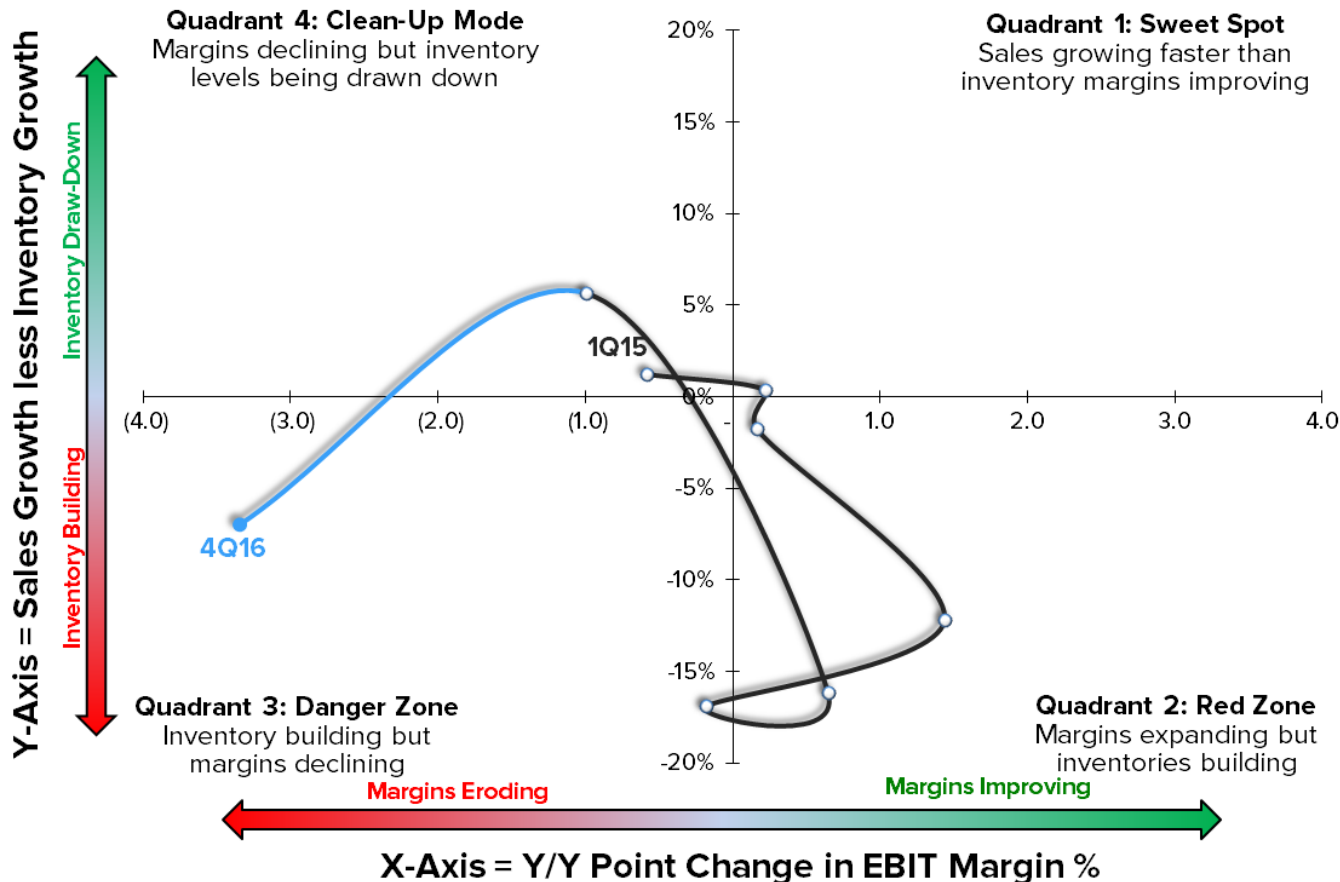
## FINL VS FL SIGMA



Same for FL and FINL.

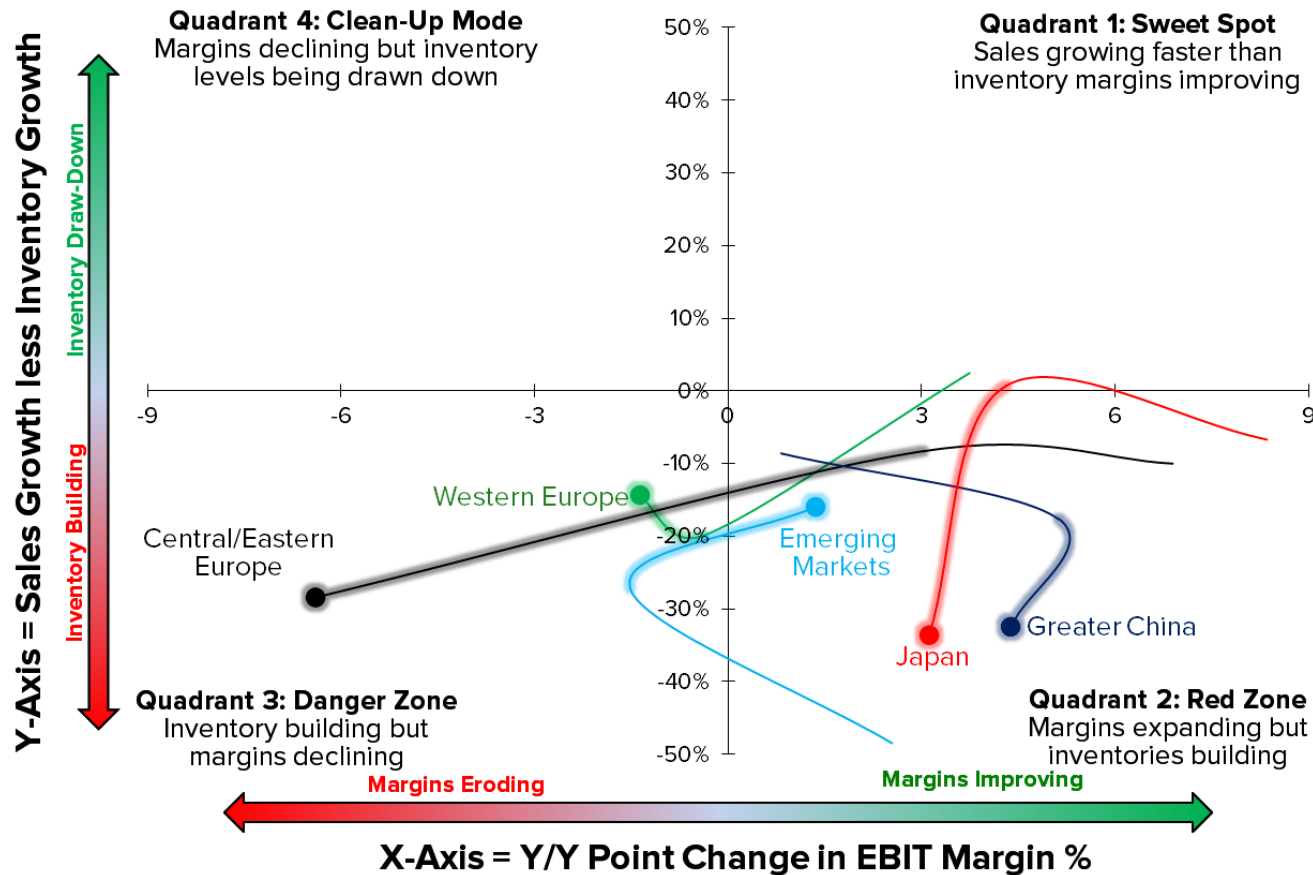
# NKE NORTH AMERICA SIGMA

## NKE NORTH AMERICA 4Q16 SIGMA



# INVENTORY ISSUES ARE GLOBAL

## NKE INTERNATIONAL 4Q16 SIGMA

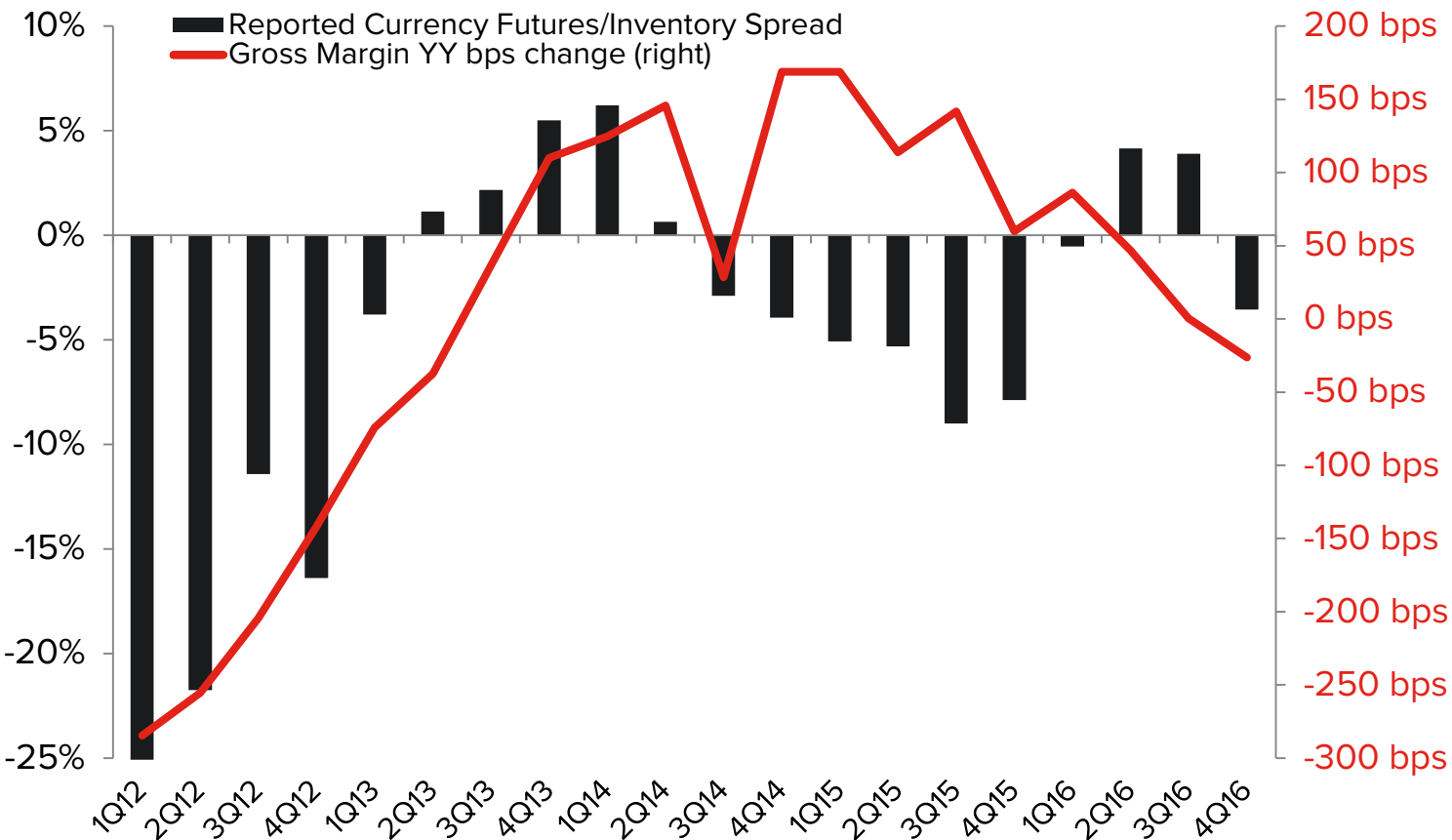


More likely than not, these will get incrementally better than worse.

Keep in mind DTC impact on Inventory as well as Revs.

# FUTURES, INVENTORY, GROSS MARGIN TRIANGULATION

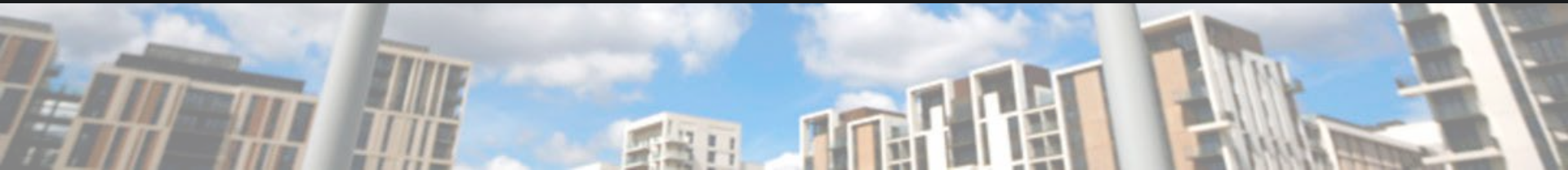
## FUTURES VS. INVENTORY GROWTH VS. GM



Here's the most important chart to watch.



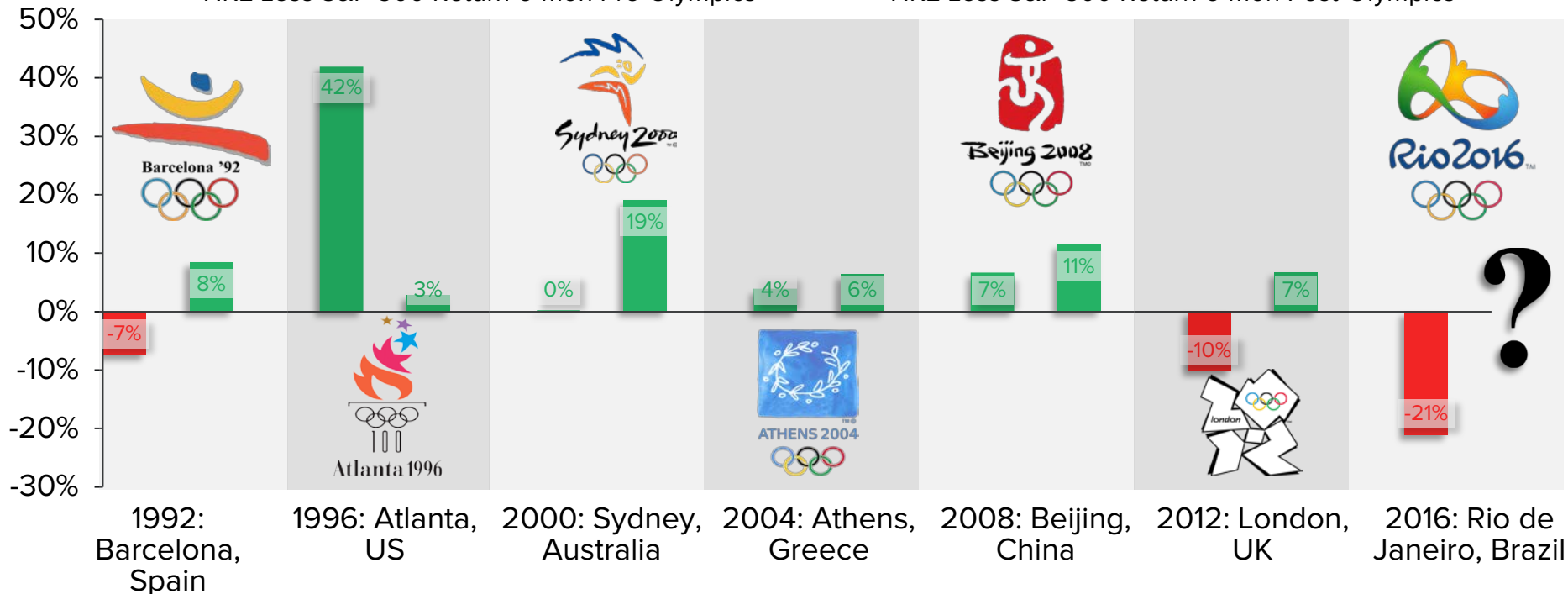
# **THE OLYMPIC TRADE**



# THE OLYMPIC TRADE

■ NKE Less S&P 500 Return 6-mon Pre-Olympics

■ NKE Less S&P 500 Return 6-mon Post-Olympics



## OLYMPIC TRADE – BUY BEFORE SELL AFTER???

The reality is that an Olympic Trade does not exist. Never really did. If anything it does better AFTER the Olympics, not before. Why? Because the lead-up to the event hurts financials. The 'hangover' helps the numbers.





**FUTURES MEETS ACCOUNTING**





# NIKE QUIETLY CHANGED 10-Q DISCLOSURE

2Q16 10-Q Jan 2016

1

**“Moreover, a portion of our revenue is not derived from futures orders, including sales of at-once and closeout NIKE Brand footwear and apparel, sales of NIKE Brand equipment, sales from our DTC operations and sales from Converse, NIKE Golf and Hurley.”**



2

**3Q16 CC Mar 2016 - Q/A answer when asked about futures variance with revenue growth...**

**“One (point) is the lag between the futures order date for our DTC business, and the timing of sell-through to DTC end consumers, and that is a dynamic as we have a fast growing DTC business, particularly led by NIKE.com.”**



3

**3Q16 10-Q Apr 2016**

**“Consistent with prior periods, NIKE Brand reported futures include (1) orders from external wholesale customers and (2) internal orders from our DTC in-line stores and e-commerce operations which are reflected at prices that are comparable to prices charged to external wholesale customers.”**

PLEASE SUBMIT QUESTIONS\* TO

**QA@HEDGEYE.COM**

*\*ANSWERED AT THE END OF THE CALL*

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