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BJORKLUND FUND

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Nike, Inc.: NKE

Joseph Carey

Sector: Consumer Discretionary
Industry: Clothing and Footwear
Current Price: $60.42
Target Price: $63.84

Company Description: Nike produces and sells athletic apparel, shoes and accessories all over the globe. The focus of the business is offering the highest quality clothing, as well as unmatched innovation through their subsidiaries. Products are distributed to the market through retail accounts, online and brick and mortar locations. The company is experiencing the highest growth in China at a 3-year average of 14.9% growth, and they are increasing their percentage of revenue from that location about a percent per annum.

Limit-Buy

Current Price:	$60.42
Suggested Limit	$55.03
Target Price:	$63.84
Market Cap:	98.576B
Average Volume:	12.113m
WACC:	9.2%
ROIC:	25.11%
EBITA Margin:	14.17%

Thesis:

This upcoming year Nike is well-positioned to execute on their new long term growth plan. Considering the industry conditions and global uncertainty, the stock price does not reflect the certainty of success in the growth strategy.

Catalysts:

- **Short Term (within the year):** Industry growth in Americas, the largest segment
- **Mid Term (1-2 years):** Effectiveness of the Consumer Direct Offense strategy and consolidating retailer chain
- **Long Term (3+):** Ability to expand margins and outperform Adidas

Competition:

Nike faces extremely high competition both domestically and internationally. The strongest competitors offer similar products in terms of styles, price and quality. The company lists the main competitors as follows; Adidas, ASICS, Li Ning, Lululemon Athletica, Puma and Under Armor. They all compete in multiple facets of the business models they currently employ. For UA and Adidas specifically, each company desires to create demand and brand loyalty through sponsorship of professional athletes and sports. Each company tries to attract and pay substantial compensation to these athletes they sign to promote the brand, yet there is only a limited number of standout athletes capable of delivering the brand promotion desired by top tier management. Nike has been able to capitalize on the opportunity and has signed some of the biggest names in Basketball, football, and many other sports as well. In the sense getting a positive return on investment, even with significant compensation, Nike has been continually growing their cash based ROIC year over year for the past 6 years. In terms of other facets of the business that they compete in includes market share for apparel and footwear. The consumer's social standards have shifted, creating opportunity for demand to shift as well. People all over the world are becoming more conscious of healthier lifestyles and the importance of exercise. This inherently makes the market that these 7 main competitors currently compete in, larger. Through this opportunity, Nike has held the largest percentage of the sports footwear industry but has lost momentum due to Adidas's ability to create higher demand within their product line. The last facet that they compete in is for retail space currently. Retail space includes shelving in wholesale and direct distributers stores as well as prime real estate for company owned store locations. Companies such as Adidas and Nike both set standards for target real estate with terms of ideal square-footage, foot traffic and demographics. However, as direct competitors they compete for obtaining leases on the same or similar properties at times because of such mirrored guidelines. In terms of shelving, partnering with stores that offer large e-commerce platforms and brick-and-mortar locations helps companies in the industry get further awareness and unmatched customer support in terms of handling inconveniences from sizing or dissatisfaction. Nike faces significant pressure from all facets mentioned, yet has maintained their image and market share.

Growth Strategy:

Nike management seems to understand the market conditions around them, which is allowing them to change their overall vision to strive for continual growth in an unfavorable market. Mid-summer this past year, Nike released a new growth plan to provide customers with unmatched personalization at large scale. The plan is labeled the "Consumer Direct Offense" and will be implemented and developed in the next few years. Part of the plan includes Nike planning to target 12 key cities, 10 of which are overseas. Projections estimate roughly 80% of revenue growth will be tied to these target markets. On top of targeting growth markets, Nike plans to leverage data analytics to deliver higher demanded products to the market faster as well as be ahead of competitors in trends. The products in Nike's focus include men's sportswear, running and the Jordan brand. For the woman's segment, products in focus include sportswear and running as well. These are the key drivers listed in achieving revenue growth targets. Another build off the plan includes the Triple Double strategy to provide double the innovation, double the speed and double the direct connections with consumers. The idea

of the platform is to innovate products that are already staples of the business, reducing the total amount of styles offered by 25%, bringing them to the market in half the time. This will likely help reduce accumulating inventory due to changing trends and products going out of style. The 2x direct strategy is the most interesting as it is Nike's way of creating a personalized experience for every customer, building the essential feeling of the brand in everyday life. Also, the use of mobile applications to support the plan create a membership feel to Nike and offer direct personalized marketing by style, geography, and flash updates. This is a very valid strategy to lower SG&A in the following few years by reducing the costs of demand creation. Investors are highly anticipating this strategy's efficiency in delivering growth and brand revival for Nike.

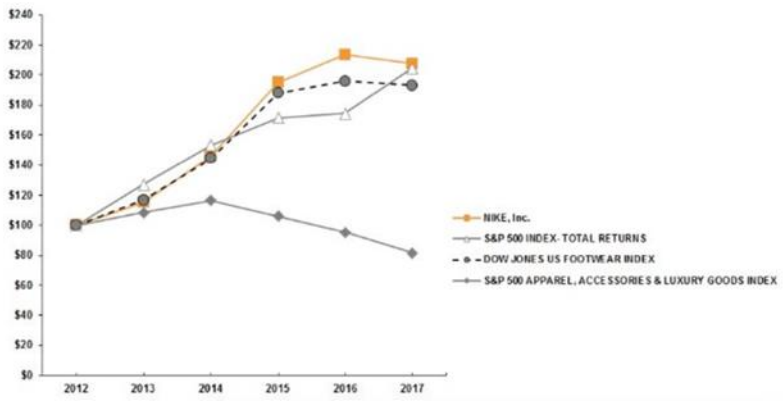
The financial impact of the strategy is a multifaceted expansion of revenue growth and margin expansion. The plan is also expected to lead to a Nike global workforce reduction of roughly 2%. Nike forecasts an average high-single digit growth in revenue, margin expansion and mid-teens growth in EPS over the next five years. Market sentiment is mixed as management is projecting upward growth in a period of a market contraction and uncertainty. However, management has a historically proven track record of implementing customer focused strategies that have spiked long-term growth in the past.

Multiples Valuation:

Currently Nike is trading at roughly 23.5x their LTM earnings. The 5-year average for P/E shows that this is a reasonable price to get into the stock. This however is inflated I believe because of a one-off tax benefit that led to favorable EPS growth, while hiding struggling internal conditions and the struggling external environment. The adjusted EPS should be around $2.39, which would mean the company is currently trading at 24.7x earnings. This is more in the higher spectrum for current P/E multiples that the company has had in the past three years. In terms of price to book, the company is again trading at a very high level, making this a poor entry time for the stock. Current price-to-book is 7.31x, matching the 5-year normalized P/B. Multiples valuation is inherently poor in nature due to the lack of analysis that justifies the future price estimation for the stock. It is worth noting for using as a quick measure to justify an entry price even if fundamental analysis doesn't match the multiple valuation.

Profitability Margins:

Nike is best in class financially in most instances, compared to their closest competitors, Under Armor and Adidas. In terms of Revenue growth, Nike has underperformed the market this past fiscal year due to delayed new product releases and overall hype behind the brand has fallen. Adidas, the closest competitor to Nike, experienced over two times revenue growth and two times the share price appreciation. Prior to this past year, Nike has been growing close to the double-digit mark while consistently having EBITDA and Net Income grow at faster rates then revenue growth based on three year CAGRs. Nike operates with the largest EBITDA margin in the industry historically, and based on guidance, will continue to expand margins into the future. While most investors see this as an opportunity for value creation, I argue that margin expansion is highly doubtful as they already produce goods at the



industry best margins. It is not likely economically feasible for the required CAPEX to generate further margin expansion. They have historically fluctuated in a 2% range, but anything beyond that is too aggressive in assumptions. Another key financial metric that is worthy of mentioning is the ROIC. Nike for the past 6 years has been creating a higher ROIC every fiscal year, creating more value to be returned to the shareholders in both dividends in share price appreciation. Guidance suggests continued expansion here as they work to continually create higher demand from less invested capital.

	Name (BICS Best Fit)	Ticker	Mkt Cap	Rev - 1 Yr Gr:Y	T12M EBITDA Mrgn LF	FCF/Sh Gr:Y	ROIC LF	ROIC/WACC Ratio
	Median		5.20B	6.10%	12.23%	31.20%	14.25%	1.35
100)	NIKE INC -CL B	NKE US	93.37B	6.10%	15.54%	32.94%	25.45%	2.81
101)	SKECHERS USA INC-CL A	SKX US	5.20B	13.22%	10.95%	110.46%	15.70%	1.35
102)	ADIDAS AG	ADS GR	45.59B	14.05%	11.41%	22.37%	17.91%	2.09
103)	PUMA SE	PUM GR	6.80B	7.06%	--	--	--	1.58
104)	COLUMBIA SPORTSWEAR CO	COLM US	4.56B	2.19%	13.05%	800.14%	13.06%	1.14
105)	UNDER ARMOUR INC-CLA...	UAA US	5.28B	21.75%	8.07%	52.63%	5.34%	-0.18
106)	TOD'S SPA	TOD IM	2.14B	-3.18%	17.49%	77.49%	6.89%	0.63
107)	REGINA MIRACLE INTERN...	2199 HK	1.16B	-7.97%	7.86%	1.34%	2.93%	0.29
108)	STEVEN MADDEN LTD	SHOO US	2.30B	-0.40%	13.08%	23.42%	15.45%	1.49

Concerns with Inventory Management:

Nike has been growing their inventory on the balance sheet for seven straight years, showing a problem with demand creation across their entire product line. In 5 of the 7 years, the inventory growth has outpaced the revenue growth. The inventory problem is also shown in a decreasing turnover, lowering towards the industry average of 3.26x. This is a valid reason for concern, especially considering the specific identification methods used to value inventory. The current inventory growth can be linked to expansion in product offering too large rather than focusing on the best sellers. Also, trends heavily influence the buying patterns of customers. The only way to liquidate the unwanted and outdated inventory that Nike is currently sitting on is to sell at large discounts to wholesalers or through factory outlet stores. The inventory problem extends to more than just a loss from mark downs. It brings out concern in management's ability to truly innovate and deliver products that consumers can't get enough of. Currently, Nike understands the inventory problem, implied through the new growth strategy. It is entirely about innovating deeply, focusing on key products for revenue growth, and reducing addition to inventory through DTC practices. The DTC will hopefully combat the inventory issue in the future. Currently, ability to execute on the strategy is too soon to tell, so the only uncertainty on the process and thus share price movement is based on news of the strategies effectiveness.

Industry Analysis:

The global retail industry is in different stages based on economic development and cultural affluences. In the North American region, there is a significant shock in the retail market leading to store closures and bankruptcies. This means the direct store distributors in terms of wholesale are shrinking from under the top manufacturers feet. With this, there is a shift to e-commerce and more personalized buying experiences in order to retain a customer base. The focus and demands from consumers has shifted to now expect the highest levels in all respects of the products demanded. Inventory management and trend setting practices are shaping the industry and pushing those out if they are incapable of meeting those practices. With the shrinking retail industry domestically and demand not being recaptured through e-commerce currently, estimates suggest mature levels of growth in the footwear and sports apparel industry. In Europe, the market

for athletic apparel and footwear is also nearing a mature phase with a CAGR of roughly 5% through 2021. Nike themselves are projecting high single digit growth with their implied strategy, using the industry as a base case. The overall consumer sentiment towards athletic apparel in everyday lifestyles is much different abroad than it is domestically. Consumers in Europe tend to wear athletic apparel only for the intended purpose of physical activity or heading to the gym. The lifestyle apparel image is not as heavily portrayed and common as it is in the United States, resulting in more stagnant growth in the next 5 years. Two main geographic areas for this industry moving forward include the greater Asian markets. China has been growing at four times the rate of the U.S. economy and the footwear and athletic apparel industry has been experiencing very high growth above that. Based on corporate reporting from competitors, the Chinese market has been experiencing revenue growth between 20-30%. Nike forecast expects to see growth continue in the low to mid-teens in this geographic area. Currently, China and Japan are the fastest growing markets, yet combined only account for 15.3% of LTM Revenue. This is a potential area for increased investment to spike revenue growth, however recent political instability between the U.S. and North Korea acts against the continuation of growth in these two highly anticipated areas. Overall, the current international political instability and overall industry reaching mature levels of growth is an area for concern moving forward, especially when companies are still forecasting revenue growth above industry expectations.

Board Analysis and Management Analysis:

The board of Directors has a strong independent component to them with 75% independent members. Of the current Board in place, most are very well qualified to offer valuable insight for corporate governance and aligning shareholders' interests. However, they have significant weight in directors with marketing or production backgrounds, which I don't believe is the focused shift of the current company strategic plan. One notable board member is John Donahue II, that fueled mid 2000 growth in eBay's global e-commerce business as the president and CEO. He also helped grow PayPal's digital payments platform to be much more widely accepted as a form of e-commerce payment stream. Beyond that, again the board is well qualified but the interests are fully aligned with management based on historical positions held by most independent members. Another level of concern develops with the co-founder's son holding a position on the board of directors, with almost 12% interest in class A shares and 3% in class B shares as part of an irrevocable trust. He is also the weakest link in terms of qualifications because his past roles were for running a feature film company. One thing that may silence the varying degrees of concern is that since 2013, all non-employee directors are required to hold five times their annual retainer in stock. That ensures a level of commitment to growth, better aligning shareholder values coming from the greater percentage of the entire Board.

Management compensation inside Nike is geared towards growth and beating set target objectives. Base salary compensation is competitive with other blue chip corporations, as to be expected. The depth of breakdown within target objectives is very limited for annual compensation packages. It states that the awards are supportive of delivering sustainable and profitable growth, but specific details are vague minus legal proceedings. The award is capable of reaching multiples of the base salary, and is rewarded based on the judgement of the impact created in each role. In the past, missing target goals still leads to sizeable bonuses that are just a reduction of expected payouts. That can be concerning that strict adherence to the compensation packages aren't followed. Nike also offers a long-term incentive plan based on revenue and EPS growth. Again, the compensation is multiples of base salary and missing target goals tends to lead to a reduced bonus, instead of foregoing a bonus. It is an area for concern because management in most cases will still end up with 2 or 3

times base salary regardless of operating performance because of weak adherence to pay nothing if goals aren't met.

Conclusion:

Based on multiples, the company is priced too high to justify entering a position currently. I propose a limit buy of Nike with the limit set at $55.03. The company is well set to be a growth stock that will likely match industry growth based on a worst-case basis. Based on success of the growth initiative, Nike may see roughly 10% growth in Revenue and a better bottom line from increased margins. I believe this is optimistic on the projections, and faith in the new demand creation initiative is high. That is my reasoning for waiting a little, as the optimism is priced in. Currently, the justification for entering a position in Nike is not there at the current share price as the downside potential highly outweighs the likelihood of outperforming already aggressive guidance. The projected 1-year return if exercised can be expected to be roughly $63.84

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NIKE, Inc. (nke)

CENTER FOR GLOBAL FINANCIAL STUDIES

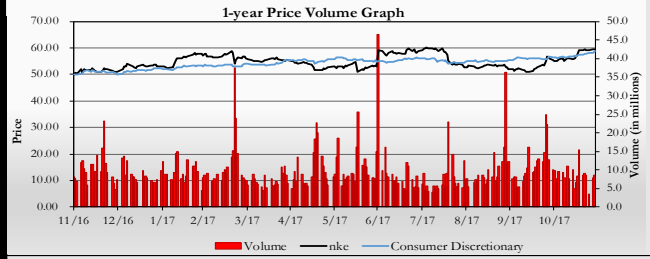
NEUTRAL

Analysis by Joseph Carey
11/30/2017

Current Price:	$60.42	Intrinsic Value	$58.23
Divident Yield:	1.2%	Target Price	$63.84

Target 1 year Return: 6.84%
Probability of Price Increase: 74.6%

1-year Price Volume Graph



Description

NIKE, Inc., together with its subsidiaries, designs, develops, markets, and sells athletic footwear, apparel, equipment, and accessories worldwide.

General Information

Sector	Consumer Discretionary
Industry	Textiles, Apparel and Luxury Goods
Last Guidance	November 3, 2015
Next earnings date	December 21, 2017
Estimated Country Risk Premium	9.13%
Effective Tax rate	18%
Effective Operating Tax rate	-4%

Market Data

Market Capitalization	$98,576.34
Daily volume (mil)	12.02
Shares outstanding (mil)	1631.52
Diluted shares outstanding (mil)	1684.00
% shares held by institutions	32%
% shares held by investments Managers	53%
% shares held by hedge funds	2%
% shares held by insiders	21.16%
Short interest	2.23%
Days to cover short interest	3.61
52 week high	$60.63
52-week low	$50.06
Levered Beta	0.60
Volatility	20.86%

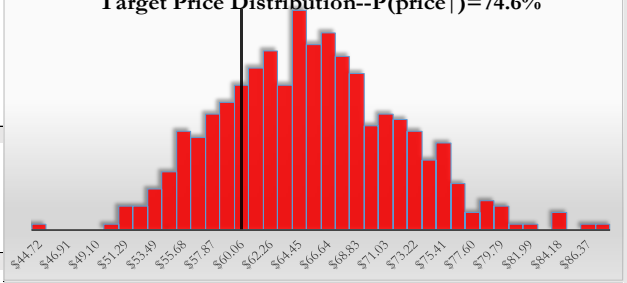
Past Earning Surprises

Quarter ending	Revenue	EBITDA
8/31/2016	0.64%	-5.94%
11/30/2016	-0.66%	8.69%
2/28/2017	-2.11%	0.21%
5/31/2017	-1.39%	-3.67%
8/31/2017	-1.31%	2.30%
Mean	-0.96%	0.32%
Standard error	0.5%	2.5%

Peers

Under Armour, Inc.
V.F. Corporation
The Gap, Inc.
Nordstrom, Inc.
Foot Locker, Inc.
L Brands, Inc.
Deckers Outdoor Corporation
Wolverine World Wide, Inc.

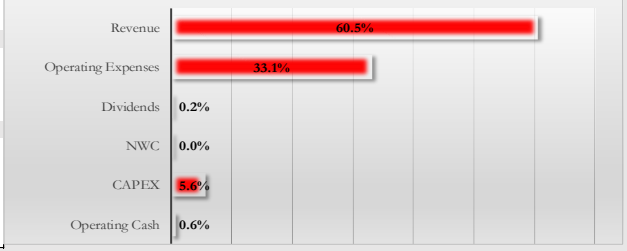
Target Price Distribution--P(price↑)=74.6%



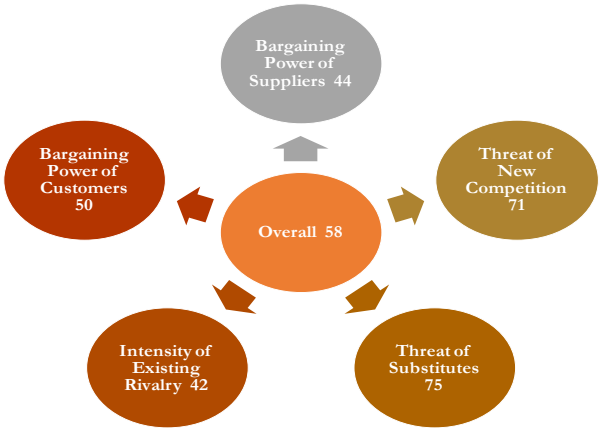
Management	Position	Total compensations growth	Total return to shareholders
Parker, Mark	Chairman, CEO & President	-14.4% per annum over 6y	3.51% per annum over 6y
Campion, Andrew	CFO & Executive VP	-9.76% per annum over 2y	-0.88% per annum over 2y
Sprunk, Eric	Chief Operating Officer	-0.02% per annum over 6y	3.51% per annum over 6y
Edwards, Trevor	President of NIKE Brand	1.94% per annum over 6y	3.51% per annum over 6y
Spillane, Michael	President of Categories & Pr	N/M	1.02% per annum over 1y
Knight, Philip	Co-Founder and Chairman Emer	N/M	N/M

Profitability	nke (LTM)	nke (5 years historical average)	Industry (LTM)
ROIC	33.4%	20.46%	15.77%
NOPAT Margin	19%	13.25%	10.2%
Revenue/Invested Capital	1.73	1.54	1.55
ROE	44.2%	21.79%	14.44%
Adjusted net margin	18%	12.75%	9.2%
Revenue/Adjusted Book Value	2.39	1.71	1.57
Invested Funds	**nke (LTM)**	**nke (5 years historical average)**	**Industry (LTM)**
Total Cash/Total Capital	23.2%	26.9%	18%
Estimated Operating Cash/Total Capital	14.4%	15.1%	N/A
Non-cash working Capital/Total Capital	20.9%	20.1%	28%
Invested Capital/Total Capital	89.7%	86.3%	82%
Capital Structure	**nke (LTM)**	**nke (5 years historical average)**	**Industry (LTM)**
Total Debt/Common Equity (LTM)	0.10	0.07	0.20
Cost of Existing Debt	4.61%	4.84%	27.59%
Estimated Cost of new Borrowing	5.80%	5.80%	27.59%
CGFS Risk Rating	D	D	CC
Unlevered Beta (LTM)	0.56	0.62	0.43
WACC	8.57%	9.48%	7.26%

Sensitivity Attribution Analysis



Porter's 5 forces (scores are out of 100)



Valuation

Period	Revenue growth	NOPAT margin	ROIC/WACC
Base Year	4.0%	19.3%	3.89
8/31/2018	2.9%	12.2%	2.46
8/31/2019	4.6%	12.4%	2.59
8/31/2020	6.7%	14.2%	3.04
8/31/2021	13.1%	15.0%	3.50
8/31/2022	11.7%	15.4%	3.71
8/31/2023	10.4%	15.7%	3.84
8/31/2024	9.0%	16.0%	3.98
8/31/2025	7.6%	16.3%	4.12
8/31/2026	6.2%	16.6%	4.26
8/31/2027	4.9%	17.0%	4.43
Continuing Period	3.5%	17.3%	3.28

Period	Invested Capital	Net Claims	Price per share
Base Year	$14,427.97	$10,791.58	$57.71
8/31/2018	$14,506.94	$6,515.35	$63.11
8/31/2019	$16,827.97	$2,505.41	$68.76
8/31/2020	$18,226.06	-$2,437.57	$74.67
8/31/2021	$19,868.02	-$7,588.31	$80.87
8/31/2022	$21,315.36	-$13,095.84	$87.19
8/31/2023	$21,554.49	-$24,174.90	$96.40
8/31/2024	$22,370.46	-$31,537.66	$102.89
8/31/2025	$23,227.57	-$39,858.78	$109.38
8/31/2026	$25,053.24	-$49,282.50	$115.79
8/31/2027	$27,268.42	-$59,428.67	$122.08
Continuing Period			