MARCH 29, 2021

Q3 2021 QUARTERLY UPDATE

ANALYST SUMMARY

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Executive Summary:

With this being the first time that I do concrete research on NIKE, I have to say that I am very impressed with the company's business model and management team. They have been transitioning their business to become more self-reliant, increasing their digital and direct-to-consumer presence, while at the same time growing the power of their premium brands to retain pricing power. NIKW's management team is clearly focused on having long-term profitability, and their long term vision has allowed the company to retain market share and sustain its competitive advantage over its peers in the past decade. The company has also positioned itself as the leader to capture the growth stemming from new consumer trends in athletic apparel, as NIKE holds the number one position in growing markets like China and Latin America, while also being the leader in developed markets where e-commerce has become increasingly prominent. The traditional financial metric (and thresholds) that we use to measure companies' performance do not accurately reflect NIKE's dramatic improvement over the past ten years, as the company is focused on operating and free cash flow generation instead of GAAP earnings. Therefore, I felt like it was important to look at those specific metrics (FCF and Operating CF) for the company's valuation. Although NIKE is trading at a premium, its rich valuation is not extremely concerning to me at the moment. When it comes to clients, I would not establish a new position in NIKE for clients who do not own it, however, I would keep it for clients who already own it.

Recent News:

NIKE is receiving negative attention on Chinese social media after the company reported that it was "concerned" about reports of forced labor in the Xinjiang Uyghur Autonomous Region. Popular Chinese actor, Wang Yibo, terminated his contract as a representative for Nike in response to the perceived social media outrage regarding this issue, but Nike refused to comment on the matter. Although we do live in a world now where social media can dictate the perceived brand of a company, it seems like there is not much substance towards corporate or ethical malpractice in this instance and Nike's financial performance will not be impacted in the long-term. We will have to keep an eye on the duration of potential boycotts regarding this issue.

Quarterly Results and Financial Position:

Nike reported revenues of $10.4 billion for their third fiscal quarter, which ended on February 28,2021. This meant that their revenues were up 3% on a comparative basis to a year ago, but down 1% on a currency-neutral basis. In my opinion, global companies like Nike will continue to experience foreign currency exchange headwinds going forward as other currencies devalue at a faster rate than the dollar. That being said, I feel like this year is somewhat of an outlier because the devaluation of other currencies due to the severe macroeconomic conditions caused by COVID-19 will most be something that the company will not experience on a yearly basis. Because of that, I believe that using the nominal revenue figure for Nike is acceptable.

Nike's revenue growth was largely due to a 51% YoY increase in sales in the Greater China region, offset by declines of 10% in North America (NA), 4% in Europe, Middle East & Africa (EMEA), and 7% in Asia Pacific & Latin America (APLA). The company mentions that supply chain challenges affected their NA sales figures and continued mandatory store closures in EMEA also affected their top line.

This meant that the total Nike Brand had a total revenue increase of 2%, with footwear and apparel each contributing 2% growth, while equipment revenue decreased 9%. Adding to that, the Converse Brand, whose revenues are accounted for separately and only make up about 5.5% of total revenue, increased by 13%.

Currently, about 35% of Nike's company-owned stores are still closed, which highlights Nike's strength in the digital sales environment. In this fiscal quarter, NIKE Digital grew 54% led by strong growth across their mobile app ecosystem. Customer demand grew by 90% on the NIKE app, which has allowed NIKE to continue to increase their market share across their key markets. This has contributed to the growth of premium brands, including the Jordan Brand, which grew by 15% in the past quarter and delivered its third consecutive quarter of double-digit growth with momentum for future growth.

NIKE's Consumer Direct Acceleration strategy is driving a meaningful and broader marketplace shift while transforming their business model. Their digital business has grown more than 70% year-to-date and their mix of owned and partner digital now exceeds 35% of their total business. NIKE's Digital business grew 60% on a currency-neutral basis led by the NIKE App, which grew triple-digits in the quarter. Although it is not clear whether all of these digital sales are attributable to lockdowns where customers are unable (or unwilling) to shop at stores, it is impressive to see that NIKE has been able to attract consumers to shop directly through their digital channels. It is still unknown whether NIKE is capturing all of its potential demand through its ecommerce cannels, especially in LA and EMEA where widespread internet usage is not particularly prominent. Keeping that in mind, I would expect that NIKE's sales mix will continue to be weighted increasingly towards digital transactions, as ecommerce has become more prevalent throughout the world in the past year and the trends towards online apparel shopping have certainly accelerated to a point where a significant reversal towards in-person shopping seems unlikely.

NIKE's successful execution of their Consumer Direct Acceleration strategy has led to significant gross and operating margin improvement. For the quarter, their gross profit margin improved by 130 basis points to 45.6%, while operating margin improved to 16.2%. Highlighting their direct-to-consumer strategy is important, as margins will continue to expand as digital sales become a greater part of their revenue mix. The company has outlined that looking ahead to fiscal 2022 and beyond, they expect digital to continue to be their fastest-growing marketplace channel, with their vision for the future being that digital mix increases towards 50% of total revenue.

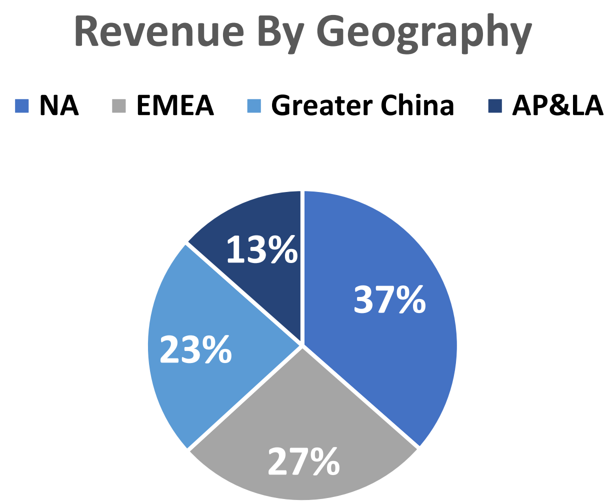
When it comes to expenses, NIKE has done an exceptional job to keep costs under control as they faced increased logistics and inventory costs. Because of lower marketing and advertising expenses (especially for brand events), as well as lower operating overhead costs due to cost cutting initiatives, SG&A expenses decreased by 7% in the quarter. With a tax rate of 11.4%, their net income for the quarter was up 71% in comparison to the 3rd quarter of FY 2020 which had a one-time $0.25 per share non-cash charge. This means that the company ended Q3 with a net income of $1.4 billion and a diluted earnings per share of $0.90.

Future Outlook:

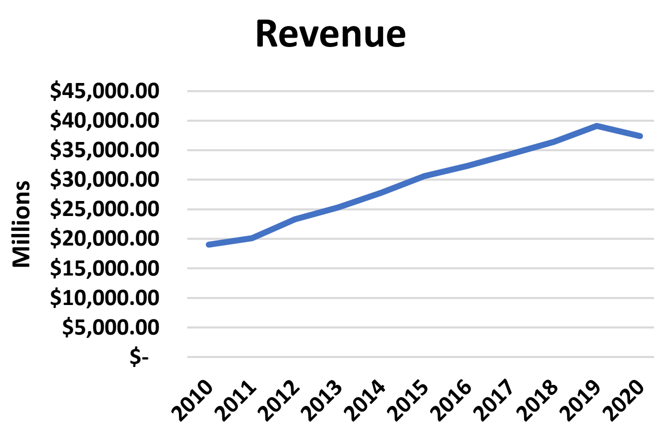
For the full year, the company expects low-to-mid-teens revenue growth in comparison to the prior year. This means that in Q4 specifically, they expect revenue growth of roughly 75% (as this was the period most affected by COVID-19 and restrictions across the world are starting to ease). The company expects gross margin to expand 75 basis points in comparison to the prior. Foreign currency is expected to be a 35 basis point headwind for the full year with the macroeconomic climate improving around the world. The company expects to increase SG&A expenses in the fourth fiscal quarter as demand picks up and it expects is tax rate to be in the low-to-mid teens for the full year. Lastly, the company expects to modestly start repurchasing shares in the fourth quarter with increased free cash flow generation.

The Investment Thesis:

Top–Line Growth **-** NIKE is a global business, with most of its revenue coming from North America and EMEA. China, however, is the fastest growing region for NIKE, as cultural and digital commerce trends continue to work in their favor due to the influence of Western culture and the growth of the middle class in this region. Going forward, this is going to be a key geographic region for them, as it shows potential to have a large addressable market. With the company addressing their goal to have a revenue mix that is 50% digital, China will be a large contributor to this target as it continues to show that its customers are willing and able to use the internet to make purchases.

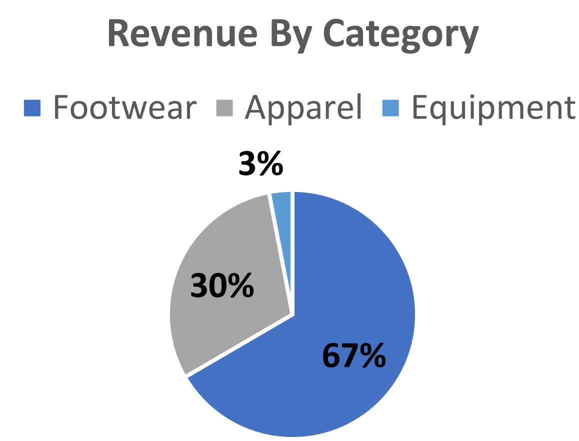


When it comes to their past 10 years of revenue growth, NIKE has done well, using its scale and innovation skills to capture the growing trends of athleisure as well as win customers in niche market areas. It has continued to establish itself as the clear leader in the athletic apparel market, allowing it to make beneficial sponsorship deals with athletes like Kylian Mbappe and Giannis Antetokounmpo, two of the brightest young talents in sports that are becoming increasingly globalized (soccer and basketball respectively). NIKE has found a way to make sponsorship deals with teams which have become apparel bestsellers like Liverpool FC, Chelsea FC, and Paris Saint German, whose recent success have allowed them to become a premium brand and given NIKE the opportunity sell exclusive jerseys which have been met by enormous demand. This conservative capital allocation towards making partnership and advertising deals with only the fastest-growing, global, and premium teams have allowed them to capture massive amounts of world-wide sales. Obviously, FY 2020 was a disruption to their normal business

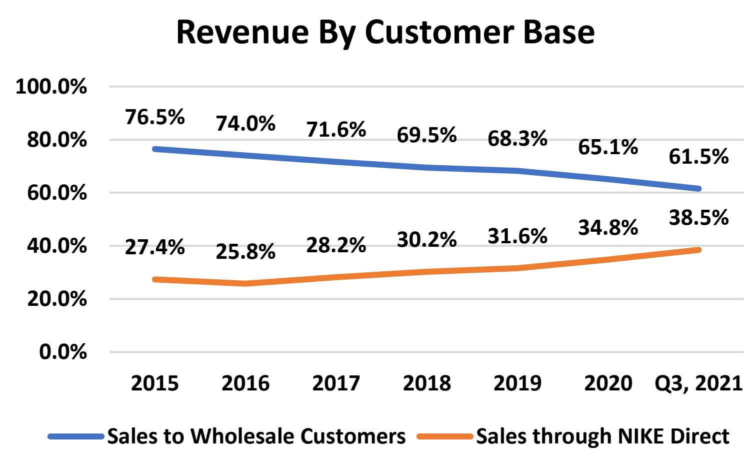


operations, with their revenue declining by 4%, however the company has done well to grow at a CAGR of 7% in the past 10 years.

When it comes to their revenue breakdown for clothing and item type, footwear continues to be the largest part of their revenue mix. This makes sense, as this is the category in which NIKE has specialized in the past, and it continues to be where they hold the largest amount of pricing power. NIKE holds an impressive array of premium products within each sporting category like the AirMax for leisure, Jordan for basketball, and Mercurial for soccer, which allows them to continue to be the leaders in the premium athletic footwear industry.



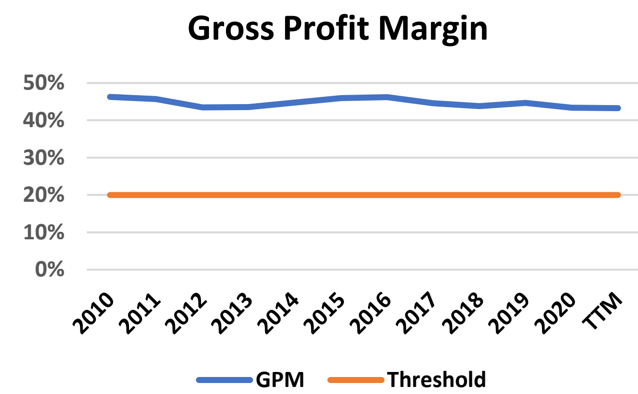
Although it has already been mentioned before, it is key to look at the progression of NIKE's Digital Sales effort. NIKE has outlined that it is investing in its direct-to-consumer network while reducing the number of retail partners that carry its product. In North America and elsewhere, NIKE is reducing its exposure to undifferentiated retailers while increasing distribution through a small number of retailers, like Nordstrom, Dick's Sporting Goods, and Foot Locker. This outlines a very clear intent by the company to shift its sales mix towards the higher margin NIKE direct platform, which has been growing faster and gives the company more pricing power. With more company-owned stores reopening, it is difficult to say how much of their revenue mix will permanently come from digital channels, but the company is certainly expecting digital revenues to keep growing at a much faster rate than revenues from wholesale customers, ensuring that Nike's competitive advantage will be strengthened, and their margins will improve. Nike direct sales increased by 20% in the past quarter, showing a mild slowdown from where they were throughout the second half of FY 2020, however, the

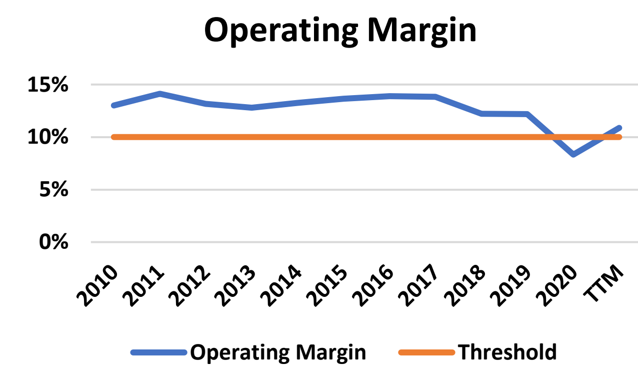


Revenue CAGR (FY 2020)	5-year	1-year
Sales to Wholesale Custon	1.07%	-8.92%
Sales through NIKE Direct	9.52%	57.59%

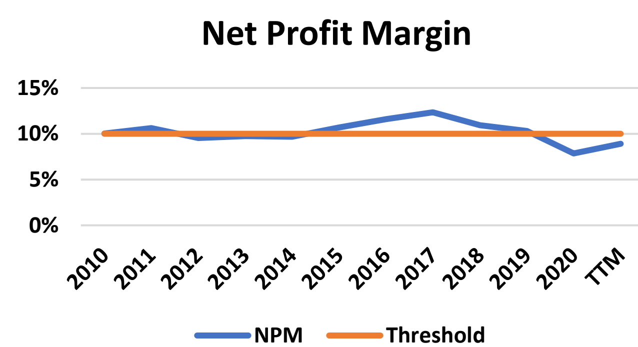
company's growth in this space will continue to be a key factor for their top line growth.

Margin Expansion – NIKE has outlined a "Triple Double" strategy where the company focuses on innovation, speed, and direct connections to consumers. This strategy includes cutting production times in half, increasing membership in NIKE's mobile apps, and improving the selection of key franchises while reducing its styles by 25%. This strategy will allow NIKE to have more cost efficiencies (gross margin improvement), more predictable cash flow from app members (data analytics and inventory flow improvements), and have a less diverse, but higher margin, premium assortment of product.

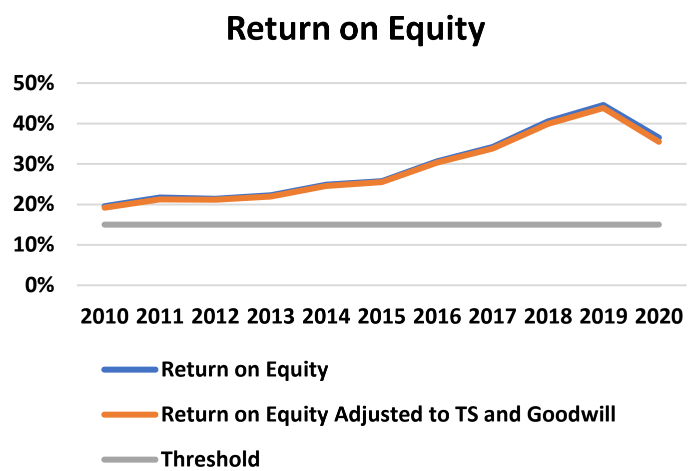


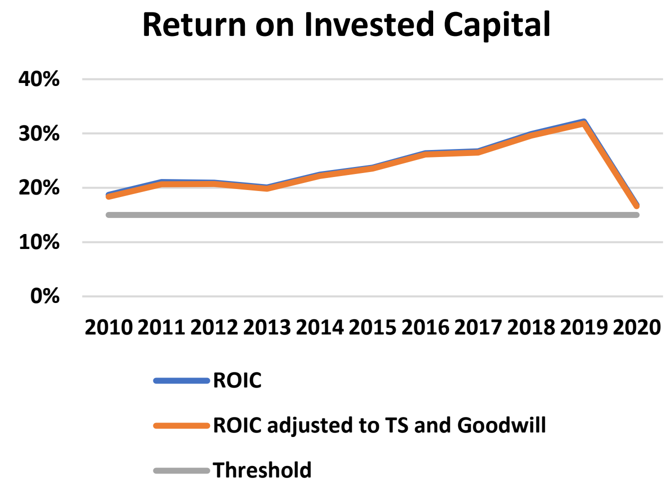


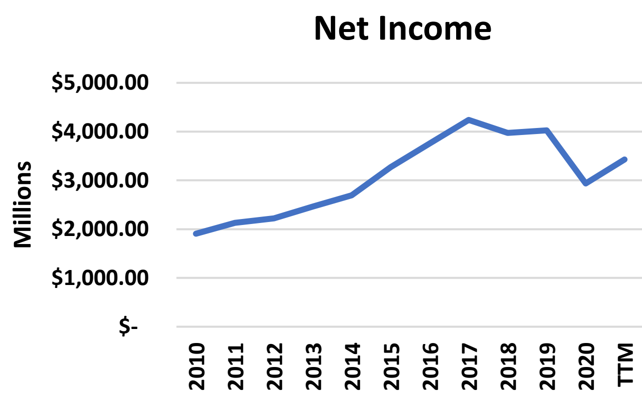
Although the company has had a ratio of increasingly higher digital/direct sales to consumers, margins have not considerably improved in the past ten years. This is because NIKE's long-term oriented management team has invested heavily in their supply chain capabilities over the past few years to ensure that the company has a self-reliant supply chain that can provide its customers with a better experience, while expanding its own profit margins in the long-term as they have direct access to consumers without the medium of a wholesale retailer. Although the company net margin pressure during COVID-19 and the Sports Authority fiasco in FY 2018-19, I believe that margins will ultimately rebound, and the company will be able to grow its net income at a faster rate than revenue.



Management Efficiency and Capital Allocation – The company has done very well at transitioning their business model at a time where they face increasing competition from niche competitors. They have been able to use their scale to compete with companies like Lululemon, while also transitioning their sales mix towards digital channels to compete with unique start-up brands which have a strong digital presence like Fabletics. Because of this, the company has been able to ensure strong returns on equity as well as returns on invested capital.



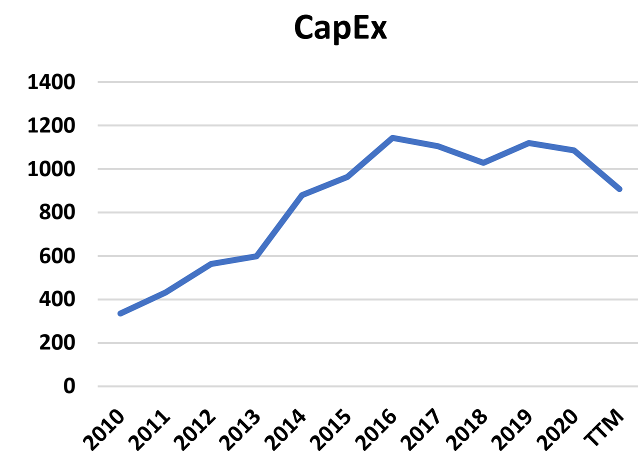




CAGR	10-year	5-year	1-year
Net Income	4.41%	-2.14%	-27.10%
EPS	6.69%	-0.06%	-25.88%

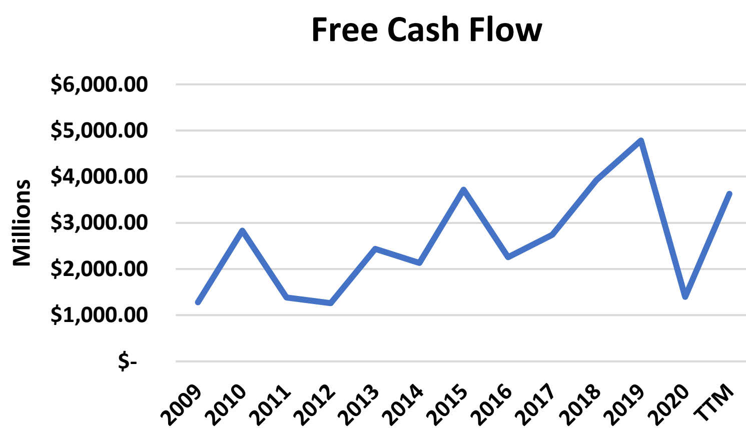
Although some of the company's improving returns on capital are attributable to a decreasing amount of retained earnings due to buybacks and dividend payments, the company has been relatively effective at returning cash flow to shareholders, decreasing shares outstanding by a CAGR of nearly 2% in the past ten years paying an average price of $62.47. The company has also increased its dividend per share payment by a CAGR of nearly 14% in the past ten years, which currently yields 0.78%. When it comes to reinvestment options, the company is now looking more towards cost-cutting initiatives and new product innovation to maintain high margins and maintain a steady pipeline of premium products. While its growth prospects largely depend on more customers shopping online rather than the company going out and building out the supply chain in different areas around the world, reinvestment of free cash flow into capital expenditure projects in less developed areas is a possibility. However, it is becoming increasingly likely that the company will continue to repurchase shares (as outlined by management in the most recent earnings call) and increase their dividend to return cash flow to shareholders. Morningstar projects that Nike will repurchase $13 billion of its stock over the next five years, allowing current shareholders to benefit from a reduced number of shares outstanding in the future.

***Cash Flow* –** Obviously, NIKE is far ahead of its direct competitors because it has come up with unique ways to innovate premium products to maintain pricing power, however, the company has also been able to maintain its sustainable competitive advantage by investing heavily in their independent infrastructure operations to ensure that they will continue to profit in the long run from being less reliant on retailers and having a strong direct to consumer presence. This has caused the company to make a substantial amount of capital expenditures over the past ten years, as NIKE's long-term minded management team identified that they needed to invest in the short-term, to profit in the long term.

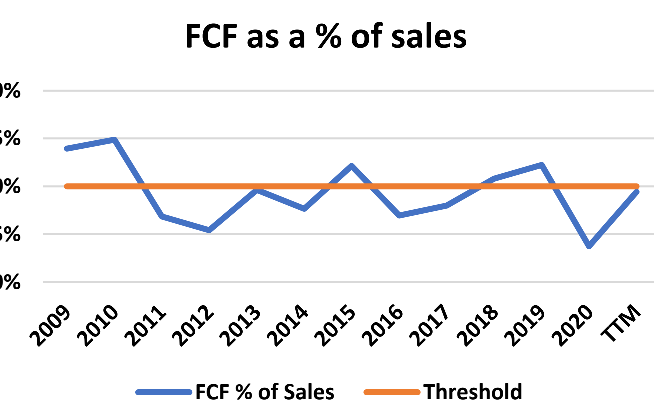


CAGR	10-year	5-year	1-year
CAPEX	12.48%	2.43%	-2.95%

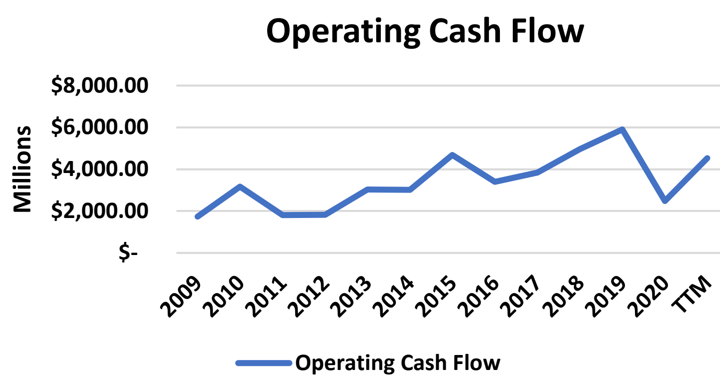
This obviously affected the company's GAAP free cash flow metric, which does not look attractive over the past ten years, and when combined with the company's performance in 2020, free cash flow seems very underwhelming. However, if we take out 2020 as an outlier for the company (I think it is fair to say that 2020 was an outlier for a company like NIKE) and look at the figures from 2009 to 2019, we can see that the company's free cash flow growth has been very strong. However, like mentioned before, significant upticks in capital expenditures (especially from 2010 to 2015) did somewhat handicap NIKE's performance over the past ten years, with the CAGRs being somewhat boosted by lower capital expenditures in 2009 and 2014. Because of the increases in capital expenditures, the company's free cash flow margin has not always been above our threshold of



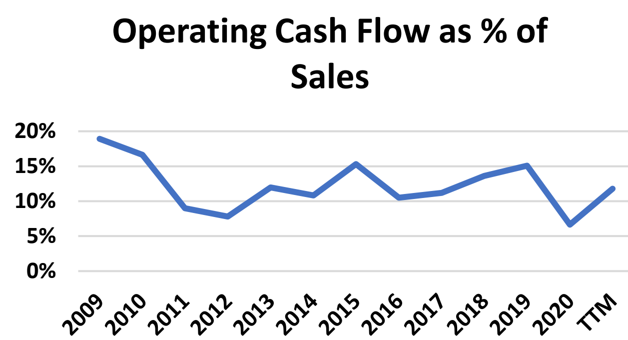
CAGR (09-19)	10-year	5-year	1-year
Free Cash Flo	14.09%	17.53%	21.82%
FCF PS	16.32%	20.21%	24.89%



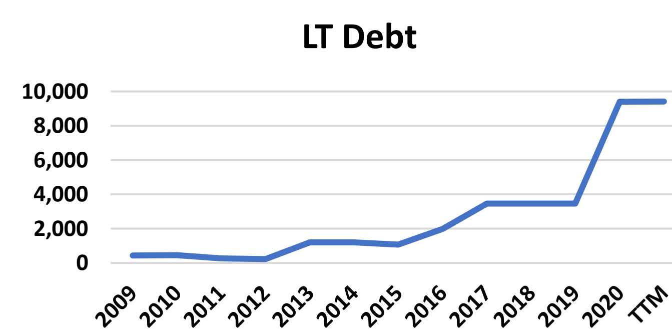
10%. However, I do not think this is reflective of the company's overall ability to generate cash flow, as they are intentionally trying to make significant long-term investments through capital expenditures that reduce their overall free cash flow. Therefore, I believe the most accurate way to measure this company's performance on a normalized basis would be look at operating cash flow from 2009 to 2019. This is because NIKE, who reaches hundreds of millions of customers every day, is creating long-term shareholder wealth through the generation of cash flow from daily sales and harvesting customer data from every purchase. Not only is the cash flow important in the terms of short-term profit generation, it also allows the company to use customer data to adapt its innovation pipeline to align with consumer buying trends for the long-term improvement of the business. When we take a look at their operating cash flow from 2009-2019, we can see that the company has been able to have steady cash flow growth fueled by strong sales demand. With the company being able to generate more and more cash flow as a percentage of total sales in the past ten years, I believe that the company still has a long runway for growth ahead.

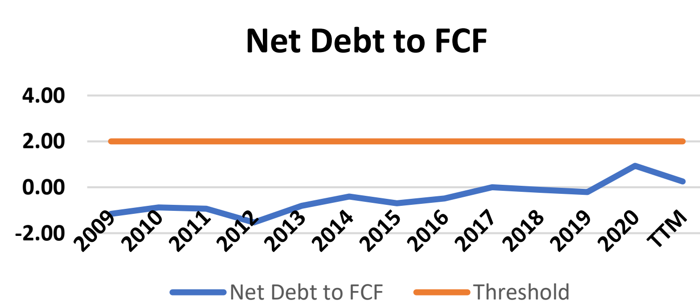


CAGR (09-19)	10-year	5-year	1-year
Cash Flow Fro	13.02%	14.40%	19.13%



Liquidity – Although NIKE has taken on more debt to enhance its growth prospects and make significant investments that will be beneficial to the long- term health of the business, the company is still in a very stable financial position. Their obligation ratio and debt to free cash flow metrics both meet our thresholds, and the company's debt maturities schedule do not show



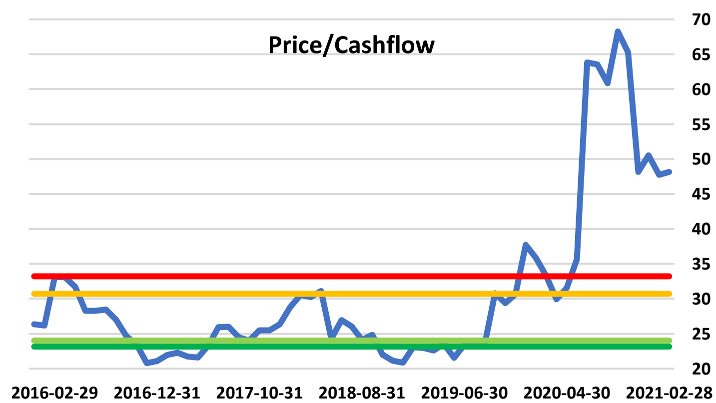


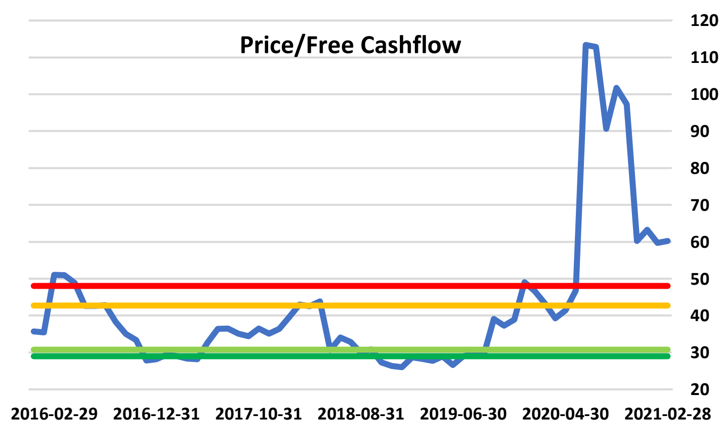
any significant warning signs. I wonder if the company will continue to increase its debt load to finance more buybacks, especially with the company running out of options in terms of investment opportunities to generate organic growth (like global supply chain expansion).

LT Debt	9,412	
ST Debt	4	
Leases*7	3871	
Pension SF	0	
Preferred Stock	0	
Cash Assets	-8516	
Net Income	$ 2,937 (2020)	$ 4,029 (2019)
Obligation Ratio	1.62	1.18

	EXPECTED MATURITY DATE YEAR ENDING MAY 31,							
(Dollars in millions)	**2021**	**2022**	**2023**	**2024**	**2025**	**THEREAFTER**	**TOTAL**	**FAIR VALUE**
Foreign Exchange Risk								
Japanese Yen Functional Currency								
Long-term Japanese Yen debt — Fixed rate								
Principal payments	$ 3	$ —	$ —	$ —	$ —	$ —	$ 3	$ 3
Average interest rate	2.4%	0.0%	0.0%	0.0%	0.0%	0.0%	2.4%	
Interest Rate Risk								
Japanese Yen Functional Currency								
Long-term Japanese Yen debt — Fixed rate								
Principal payments	$ 3	$ —	$ —	$ —	$ —	$ —	$ 3	$ 3
Average interest rate	2.4%	0.0%	0.0%	0.0%	0.0%	0.0%	2.4%	
U.S. Dollar Functional Currency								
Long-term U.S. Dollar debt — Fixed rate								
Principal payments	$ —	$ —	$ 500	$ —	$ 1,000	$ 8,000	$ 9,500	$ 10,642
Average interest rate	0.0%	0.0%	2.3%	0.0%	2.4%	3.1%	3.0%	

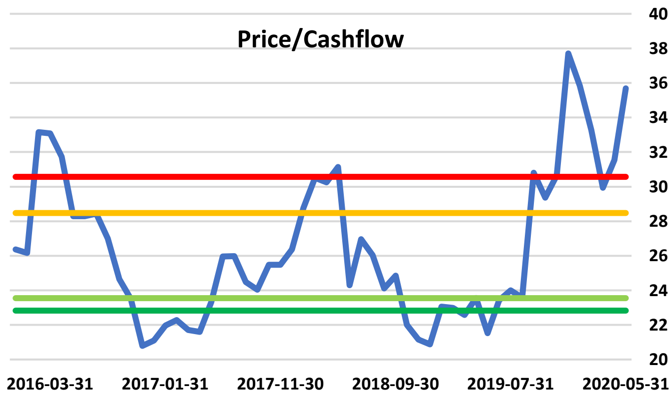
Valuation:

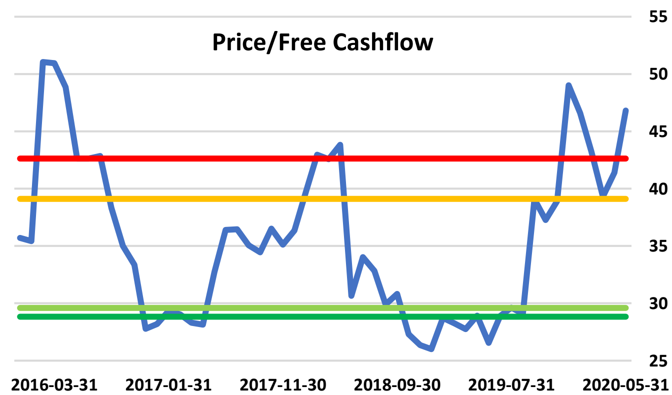




Like mentioned above, I believe that the metrics that are creating long-term shareholder wealth are operating cash flow and free cash flow. Therefore, my valuation work will be guided and adapted towards both of those metrics. Before we go in depth about these particular metrics, it is probably a good idea to clearly state that the company's current FCF and Operating Cash Flow multiples are going to look overstated because the company is currently "under-earning," as the pandemic uniquely affected their business and the past 12 months have certainly been a one-time, non-recurring event. However, for the purpose of isolating what NIKE has been trading for in the past to make a forward-looking prediction about multiple expansion or contraction. Therefore, I think it would be accurate to look at the company's performance 5 years prior to COVID. I think looking at the multiples 10 years prior would not be as accurate since the company has improved significantly over this time frame and investors are willing to pay higher multiples for a better business.

We can see from the graphs displayed above that NIKE has generally traded between 20x and 40x cashflow, and 25x and 55x free cash flow. I will this data to project exit multiples for my valuation model going forward.





For my forward-looking projections, I expect NIKE to be able to grow overall revenues at a rate between 8 and 10% with the company being able to capitalize on the growth of the middle class in emerging markets and China, as well as being able to keep growing its customer base for premium products in developed markets. Now that the company has been able to complete the majority of the infrastructure projects that they needed to be self-reliant in terms of direct-to-consumer sales, I believe that margins will expand as they take on less capital expenditures. Since we are looking at operating cash flow and free cash flow for my valuation model, I believe that operating cash flow will grow faster than revenue, meaning that both operating and free cash flow margins will expand. With the company outlying that they will pick up their share repurchase program in the future (and having bought back nearly 20% of the shares outstanding in the past ten years), I expect NIKE to buy back between 1-2% of the company's shares outstanding every year. I will use three cases to project out the company's revenue growth, operating cash flow margin, capital expenditure growth, and shares outstanding, to get a FCF per share estimate for FY 2026. This FCF per share figure will then be multiplied by Price/FCF exit multiples for FY 2026, which will be discounted into present value with a discount rate of 10%. The bear case will have the lowest revenue and operating cash flow growth, as well as the lowest possible buyback rate. The bull case will be trying to price this asset to perfection. The base case will show my projection for this company's performance into the future. These three cases will then be summarized in a sensitivity analysis.

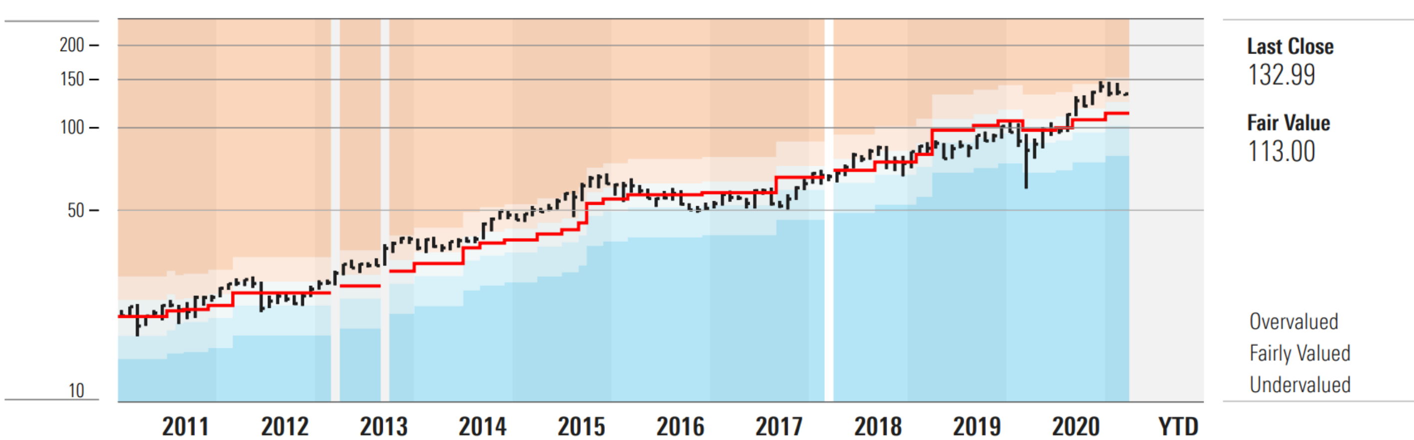
Base Case	Financial Projection Model					
	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026
Growth Estimate		*9.0%*	*9.0%*	*9.0%*	*9.0%*	*9.0%*
Revenue	$ 39,560.00	$ 43,120.40	$ 47,001.24	$ 51,231.35	$ 55,842.17	$ 60,867.96
Operating CF Margin	13.0%	14.0%	14.0%	15.0%	15.0%	15.0%
Operating CF	$ 5,142.80	$ 6,036.86	$ 6,580.17	$ 7,684.70	$ 8,376.33	$ 9,130.19
Growth Estimate		*4.0%*	*4.0%*	*4.0%*	*4.0%*	*4.0%*
Capital Expenditures	$ 900.00	$ 936.00	$ 973.44	$ 1,012.38	$ 1,052.87	$ 1,094.99
Free Cash Flow	$ 4,242.80	$ 5,100.86	$ 5,606.73	$ 6,672.32	$ 7,323.45	$ 8,035.21
Buyback Rate		*1.50%*	*1.50%*	*1.50%*	*1.50%*	*1.50%*
Shares Outstanding	1617.00	1592.75	1568.85	1545.32	1522.14	1499.31
FCF Per Share	$ 2.62	$ 3.20	$ 3.57	$ 4.32	$ 4.81	$ 5.36
				2020 - 2025 FCF CAGR		13.62%

Multiple Valuation Model				
2025 EPS	P/FCF Multip	2025 Stock P	Discount Rate	PV of Stock P
	28	$ 150.06		$ 93.18
$ 5.36	35	$ 187.57	10%	$ 116.47
	42	$ 225.09		$ 139.76

Sensitvity Analysis: FCF using P/FCF				
		5-year FCF Growth Rate		
		9.50%	13.62%	20.73%
P/FCF	28	$ 71.82	$ 93.18	$ 117.01
	35	$ 89.77	$ 116.47	$ 146.27
	42	$ 107.72	$ 139.76	$ 175.52

I believe that for a company like NIKE, a two stage discounted cash flow valuation model wouldn't accurately display the company's earnings power or growth capabilities. Therefore, I displayed the base case for NIKE's financial model which I personally believe displays the most likely scenario for NIKE's performance and valuation going forward.

Other sources share my views on NIKE's current valuation, including Value Line and Morninstar. Here is Morningstar's most recent price to fair value:

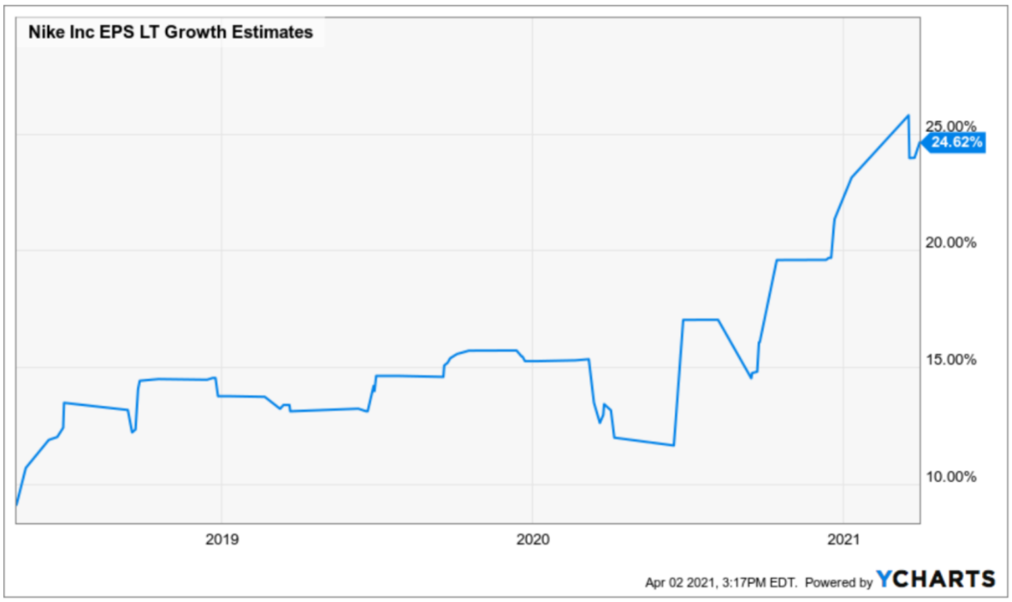


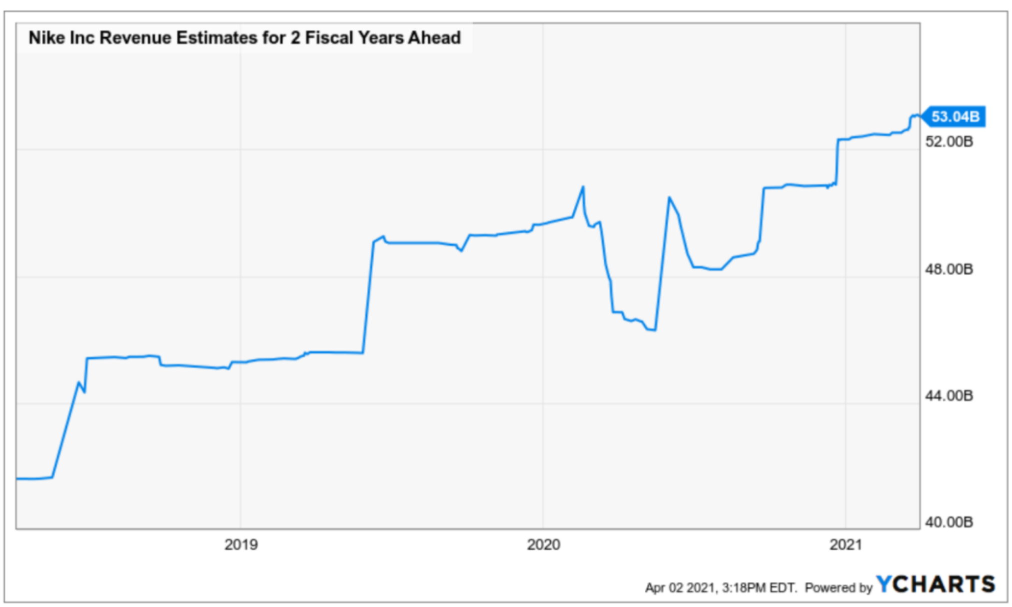
Here are Value Line's projections for price and rate of return when NIKE was trading for $147 per share:

2023-25 PROJECTIONS			
	Price	Gain	Ann'l Total Return
High	160	(+10%)	3%
Low	130	(-10%)	-2%

ANNUAL RATES of change (per sh)	Past 10 Yrs.	Past 5 Yrs.	Est'd '18-'20 to '23-'25
Sales	9.5%	8.5%	10.0%
"Cash Flow"	10.0%	7.5%	23.0%
Earnings	9.5%	7.5%	27.0%
Dividends	13.5%	13.0%	12.0%
Book Value	2.5%	-3.0%	11.0%

Lastly, here are S&P Global's projections of revenue and earnings for the upcoming years:





Things to Keep in Mind

* Nike Direct sales cannibilization
* Nike Direct Margins
* Capex and opex
* Market EPS growth vs. Projections