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Nike (NKE)

Price as of 2.8.22:	\$144
Target:	\$175-185
Upside:	21%-28%

- I. Proven track record of sales and profit growth.
- II. World-leading brand provides a durable competitive advantage.
- III. Shift to direct-to-consumer accelerates earnings growth.
- IV. Recent price drop creates an attractive entry point.

Order Type: Market

Allocation: 32 shares (~\$4,300)

PHIG President

PHIG Director

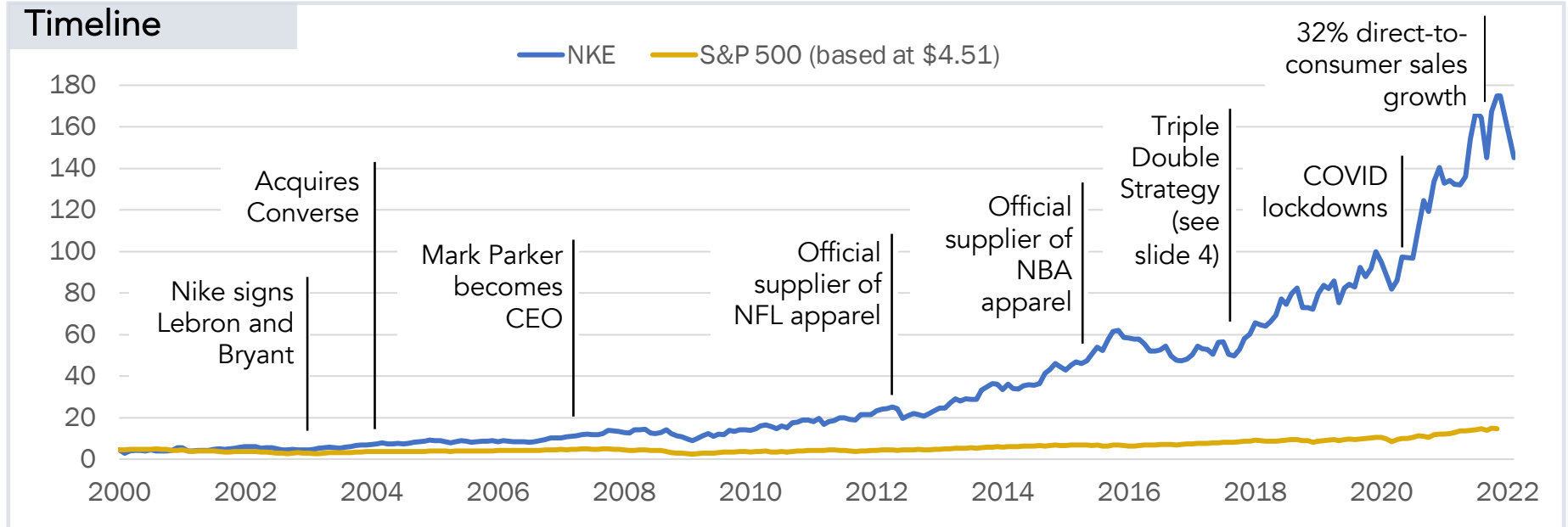
VP of Finance

Company Overview

Key Highlights

- World's largest seller of sports footwear and apparel. Nike's global market share stands at an impressive 26%. Founded in 1964, the company has grown to more than \$44.5 B in revenue (double that of its closest competitor) and now owns the Jordan, Converse, Hurley, and Cole Haan brands.
- **Value Proposition:** Quality sportswear that sets the pace on athletic fashion and design and bears the most recognizable status symbol in sports—the Nike brand.
- **Manufacturing:** Outsources all manufacturing. Nike has contracts with more than 500 factories, primarily located in East Asia (Vietnam, China, Cambodia, and Indonesia).
- **Distribution:** Sells through both wholesalers and its own operations (Nike Direct), which includes online and 1,000+ retail stores around the world. Nike Direct has in recent years grown to 38% of total sales.
- **Demand Creation:** Invests well over \$3 billion per year in marketing and pro sports contracts, which amounts to ~8.5% of sales.

Timeline

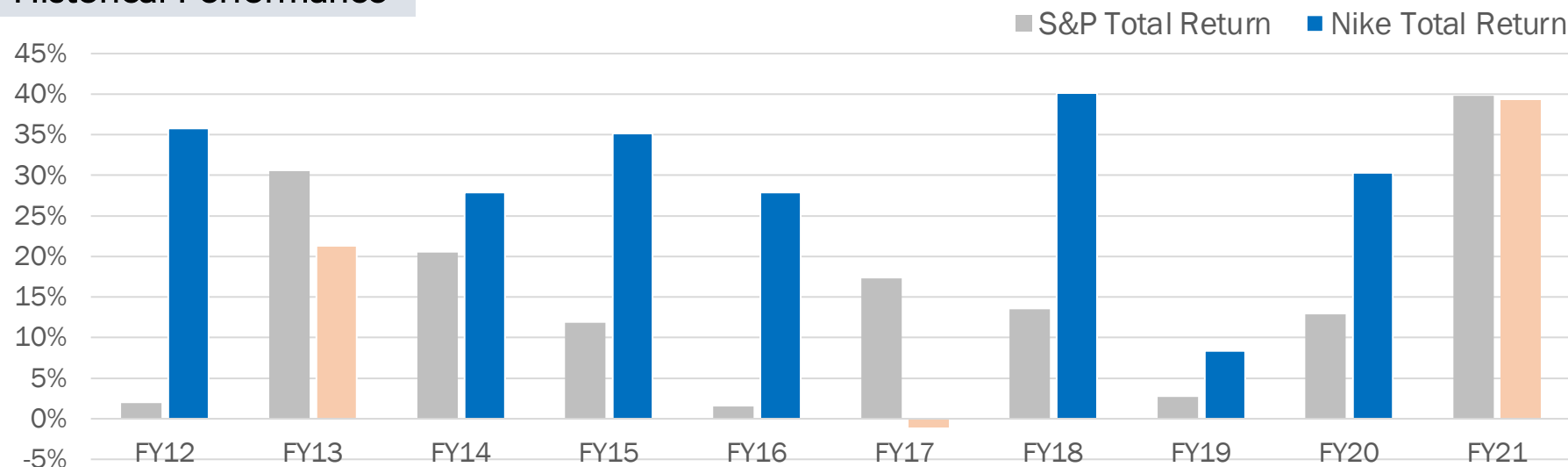


Sources: 10-K, Yahoo! (Price Data)

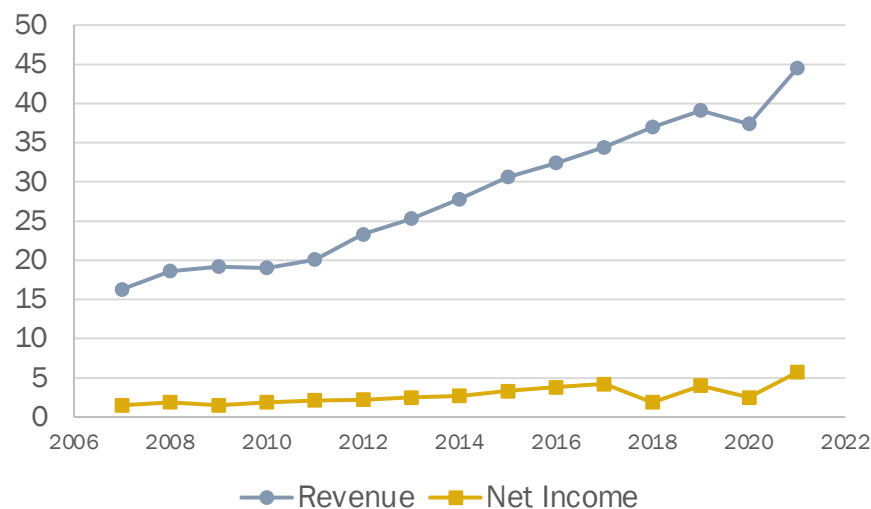
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Financial Overview

Historical Performance



Revenue and Profit



Summary

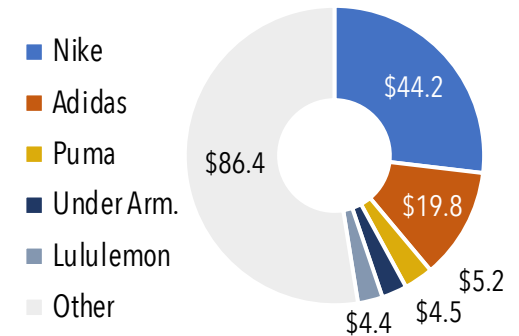
- NKE has outperformed the S&P 500 in total returns **7 of the past 10 years.**
- Nike has experienced consistent growth, in both revenue and net margin. 10-year average sales growth of 8%. **Average net income growth is at 10%.**
- Nike has an ROIC well above its competitors. Averaged more than 22.8% over the past 10 years. This indicates that Nike invests its capital more effectively than competitors like Adidas (15.1%), Under Armour (-0.7%), and Puma (-39%).

Industry Analysis: Summary

Industry Overview

- The sports apparel industry was valued at \$160 B in revenue in 2020. The market is dominated by Nike (28%) and Adidas (12%). In the industry, companies are primarily differentiated on brand and quality, not cost.
- **Athleisure trend:** Casual athletic clothes are increasingly popular. 76% of industry executives believe that athleisure growth will continue.
- **Shift to digital sales:** pre-pandemic, the average digital sales growth was ~2%. During COVID lockdowns, that rose to 16% growth. Online sales help companies to protect their brand and collect data on consumer behavior.

Market Share (\$B)



Porter's Five Forces

Competitive Rivalry	New Entrants	Power of Suppliers	Power of Buyers	Substitutes
Moderate	Low	Moderate	Moderate/Low	Moderate/Low
<ul style="list-style-type: none"> ▪ Fragmented industry with many int'l and regional players. ▪ Nike's brand gives it pricing power, achieving >10% avg. net margin. 	<ul style="list-style-type: none"> ▪ High entry barriers for diversified sportswear producers; capital intensive. ▪ Most top companies are 50+ yrs old. ▪ Lower barriers for niche fitness brands. 	<ul style="list-style-type: none"> ▪ Footwear suppliers: 15 contractors with 191 factories across 14 countries. ▪ Clothing suppliers: 344 factories across 33 countries. ▪ 4 footwear suppliers contribute 10% of production each. 	<ul style="list-style-type: none"> ▪ Large, diversified customer base. ▪ Brand gives it high pricing power. Nike charges at a premium above other brands. ▪ Low switching costs for customers. 	<ul style="list-style-type: none"> ▪ Many customers wear for casual/leisure purposes, making non-athletic wear a substitute. ▪ Few substitutes for athletic uses.

Competitive Advantage

Primary/Secondary Business Unit Strategy

Customer Intimacy
Emotional Bond thru Unique Experiences

Product Leadership
Constant Leapfrog of New Products

Operational Excellence
Execution Focus; Quality, Price & Ease

Customer Responsiveness
Customer Loyalty thru Consistent Service

Product Differentiation
Unique Product and/or Service

Operational Competency
Low Cost / Low Price Providers

Strategic Dimensions & Distinctives (*Economic Moat*)

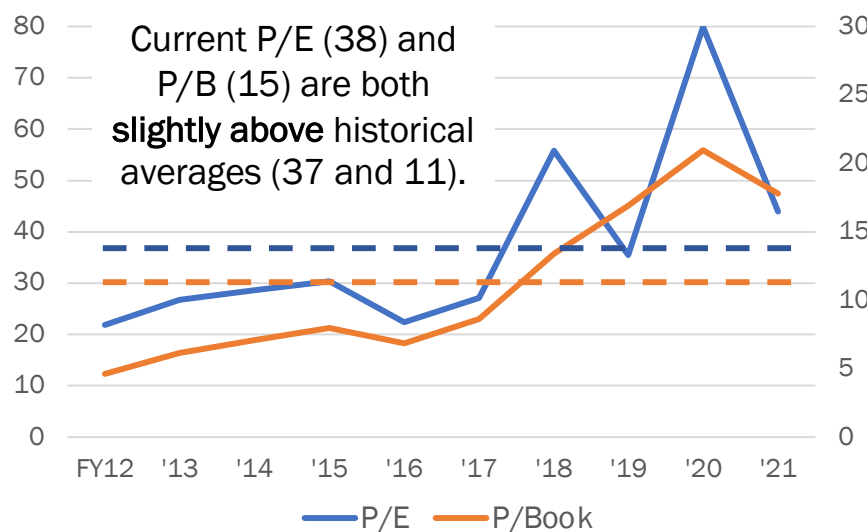
- **“Triple Double” Strategy** began in 2017 to achieve 2x growth in 3 areas in 5 years.
 - **2x Innovation.** Nike’s new, innovative footwear is worn by top athletes around the world. It is “the leader in sports performance technology” (Morningstar).
 - **2x Speed to Market.** Nike works with suppliers to develop manufacturing tech and aims to reduce lead times from 60 days (in 2017) to 10. Inventory turnover is 14% higher than Adidas’.
 - **2x Direct-to-Consumer.** Now 38% of sales, DTC affords a **10% wider gross margin** and provides insightful data on consumer behavior. Nike aims for DTC to make up 60% of sales by 2040.
- **Brand.** The Nike brand is valued at **\$30.4 B**, more than twice Adidas’. This creates a powerful flywheel—as Nike’s brand generates cash, the company reinvests those funds to bolster its brand.
 - **More sponsorships.** Nike is the #1 sponsor of pro athletes, with a sponsorship market share of 34%. Its current contracts are currently valued at **\$1.7 B** (\$300 M more than Adidas). In the NBA, for example, over 70% of players wear Nike shoes; only 17% wear Adidas.
 - **Superior sponsorships.** Nike contracts with many of the best, most talented athletes in the world. Its US athletes won 44 gold medals at the 2016 Summer Olympics. Adidas’ US athletes won only 4. At the Tokyo Olympics, 64% of track athletes who earned medals ran in Nike shoes.
- Given that the sports apparel market is highly brand-driven, Nike’s position as the leading sports brand gives the company pricing power over its competitors. Its footwear is, on average, more expensive than Adidas’.

Investment Summary

Investment Thesis

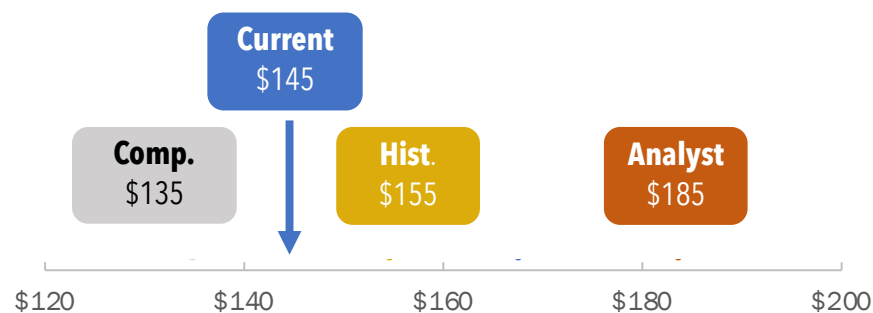
- Nike has a **proven track-record** of revenue and profit growth, a strong average ROIC of 35%, and the dominant market position, by a wide margin.
- Nike's **brand** gives it a durable competitive advantage that will allow it to maintain its market share into the foreseeable future. It continues to reinvest in that brand by being more selective about its wholesalers and spending 8% of revenue on demand creation.
- Nike's **shift to direct-to-consumer** sales will allow it to expand profit margins and capitalize on consumer data to increase sales, while also protecting brand image from the poor customer experience in 3rd party retail stores.
- Recent **drop in price** (\$145 down from \$170) driven primarily by 1) a strong market correction and 2) continued concerns over supply chain issues. These problems should alleviate in the near future, and in the midst of them Nike has continued to chart significant sales growth in DTC and beat analyst Q2 revenue estimates. The low price provides an attractive entry price.

Historical Valuation



Target Prices

- Comparative and historical valuations suggest that NKE is around **market value**.
- An average of 29 analyst projections (185 at 12-months) suggests a **strong buy**.



Sources: 10-K, Argus, Morningstar

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Appendix: Nike (NKE)

- 1) Valuation: DCF Model and Analyst Estimates
- 2) Headwinds and Tailwinds
- 3) Direct-To-Consumer Strategy
- 4) Decision Day: Recap and Additional Data

Valuation

DCF Valuation

Equity Value Per Share: Multiple Method

		WACC				
		5.69%	6.19%	6.69%	7.19%	7.69%
Exit Multiple	26.9x	178.74	174.80	170.96	167.24	163.61
	27.9x	184.61	180.53	176.56	172.70	168.95
	28.9x	190.47	186.26	182.16	178.17	174.29
	29.9x	196.34	191.99	187.76	183.64	179.64
	30.9x	202.21	197.72	193.36	189.11	184.98

Analyst Views

Firm	Rating	Target
Morningstar	2/5 stars	\$132
CFRA	Sell	\$136
Argus	Buy	\$190
Charles Schwab	Outperform	
Analyst Median (29 analysts)	Outperform	\$185

Key Assumptions

Item	Assumption	Justification
Sales Growth	8%	Morningstar
Beta	0.96	Morningstar
Eff. Tax Rate	14%	Morningstar
Risk Free Rate	1.95%	10-Yr T-Bond
Equity Risk Prem.	5.17	Damodaran
EV/EBITDA Exit Multiple	28.85	Historical

Headwinds/Tailwinds Analysis

Headwinds



Supply Chain

- Supply chain issues, including factory closures in Vietnam (51% of shoe manufacturing). Nike was forced to lose 130 million pairs of shoes in production levels at the end of last year. Over 80% of Nike's total imports are from Vietnam.
- Likely to be only a short-term threat (ValueLine). This has placed downward pressure on stock prices and creates a value opportunity.



Chinese Boycott

- Backlash in China because of Nike's (and others') position on forced labor in Xinjiang. Citigroup survey of Chinese consumers: 34% were now "significantly less likely" to buy foreign brands.
- In FY21 Nike still had 14% sales growth over pre-COVID levels in Chinese markets.

Tailwinds



Demand Growth

- Global sports apparel market projected to reach \$248 B in revenue by 2026. This entails a 5.1% annual growth rate (CAGR).
- There is a building trend toward athleisure attire. The global athleisure market is valued \$285 and is projected to have an 8.6% CAGR through 2028.
- In the broader activewear market, women's apparel is the fastest growing sector. This is significant for Nike given that its current men's sales are well over double women's.



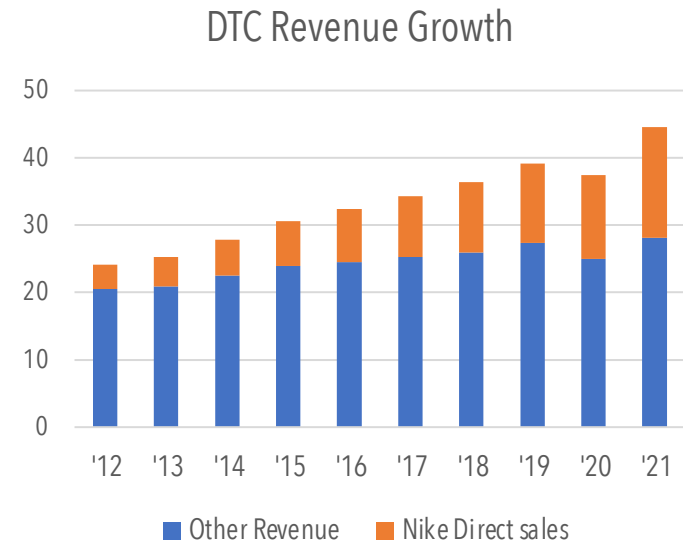
Digital Retail

- COVID has propelled expansion of e-commerce. Bloomberg estimates that digital sales will grow from 24% (as of 2020) to 35% as of 2025.
- Nike is well-positioned: digital sales drove much of its growth in FY21 and gross margins for digital are ~10% higher than wholesale.

Growth Strategy: Direct to Consumer

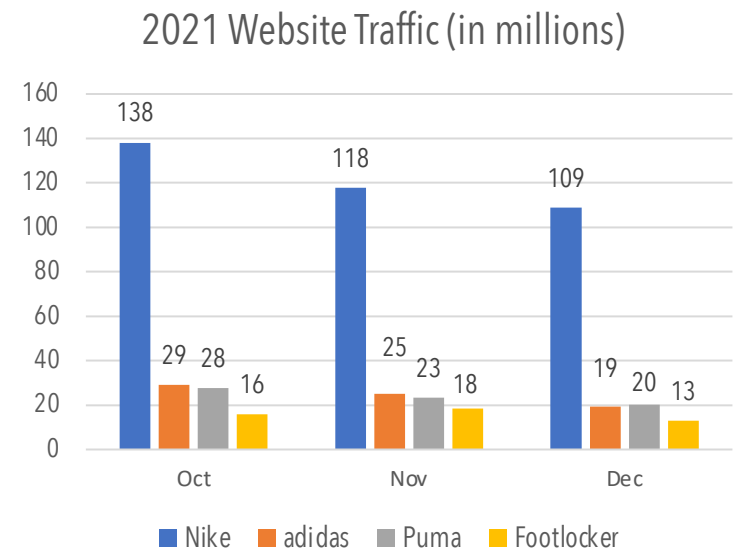
Move to Direct

- In June 2020, CEO John Donahoe, former CEO of e-commerce giant eBay, announced Consumer Direct Acceleration strategy.
- DTC accounts for 38% of revenue for FY21, and **48% of revenue for 2Q22**. Nike aims for DTC to make up 60% of sales by 2025.
 - Nike has reduced its wholesalers, selling only to companies that further the Nike brand (like Dick's and Footlocker).
 - Supply chain backlogs (shipping times from Asia are double pre-pandemic) will accelerate DTC as Nike prioritizes supplying its own stores.



DTC Advantage

- **Margin Growth.** DTC affords a **10-20% wider gross margin**. NKE plans to push its gross margins into the high 40s by the end of FY25. Retailers' ~100% markup flows to NKE.
- **Customer Data & Personalization.** Over **79M engaged members** in Nike digital ecosystem, with member engagement up 27% YoY. Four recent data & analytics acquisitions, including Celect (demand prediction) and Datalogue (personalizing search and product recommendations).
- **Brand Control.** Nike has greater protection of its brand when selling through its own channels.



Decision Day: NKE Investment Summary

Why Nike? Why Now?

I. Proven track record of sales and profit growth.

Nike's performance has demonstrated **impressive yet steady growth over the last 10 years** (8% revenue growth and 10% earnings). This has been reflected in consistent stock outperformance (7/10 years).

II. World-leading brand provides a durable competitive advantage.

Nike's brand is valued at **double** that of its closest competitor. It has superior traction with star athletes: **64%** of Olympic track medalists, **70%** of NBA players, **50%** of top 50 soccer players in 2018 (Adidas accounted for 40%). This translates to price premiums and substantially higher margins.

III. Shift to direct-to-consumer accelerates earnings growth.

A win-win-win move. At least **10% higher margins**, better **consumer data**, and greater **brand control**.

IV. Recent price drop creates an attractive entry point.

Down at \$146 from high of \$177. Likely because of **temporary** headwinds of supply chain disruptions and Chinese backlash, as well as a general downward trend in the market.

Competitor Analysis

	Nike	Adidas	Lululemon	Puma	Under Armour
Oper. Margin (5 yr average)	12.5%	8.9%	22.3%	6.1%	4.1%
Net Margin (5 yr average)	9.6%	6.0%	16.2%	3.4%	-1.4%
Profit Growth (10 yr average)	10%	-3%	17%	-9%	-
Debt/Equity	0.02	0.60	0.25	0.39	0.70