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NIKE, Inc. (NKE) CEO Mark Parker on Q1 2020 Results - Earnings Call Transcript

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FQ1: 09-24-19 Earnings Summary

Press Release SEC *10-Q*

EPS of $0.86 beats by $0.15 | Revenue of $10.66B (7.16% Y/Y) beats by $226.56M

Earning Call Audio

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NIKE, Inc. (NYSE:NKE) Q1 2020 Earnings Conference Call September 24, 2019 5:00 PM ET

Company Participants

Mark Parker - Chairman, President and CEO

Andy Campion - EVP and CFO

Matt Friend - CFO NIKE Operating Segments and VP, IR

Conference Call Participants

Bob Drbul - Guggenheim Securities

Jamie Merriman - Bernstein

Paul Trussell - Deutsche Bank

Omar Saad - Evercore ISI

Jim Duffy - Stifel Nicolaus & Co.

Operator

Good afternoon, everyone. Welcome to NIKE, Inc.'s Fiscal 2020 First Quarter Conference Call. For those who want to reference today's press release, you'll find it at http://investors.nike.com. Leading today's call is Matt Friend, CFO NIKE Operating Segments and Vice President, Investor Relations.

Before I turn the call over to Mr. Friend, 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 the reports filed with the SEC, including the annual report filed on Form 10-K. Some forward-looking statements may concern expectations of future revenue growth or gross margin.

In addition, participants may discuss non-GAAP financial measures, including references to constant-dollar revenue. References to constant-dollar revenue are intended to provide context as to the performance of the business eliminating foreign exchange fluctuations. Participants may also make references to other non-public financial and statistical information and non-GAAP financial measures.

To the extent non-public financial and statistical information is discussed, presentations of comparable GAAP measures and quantitative reconciliations will be made available at NIKE’s website, http://investors.nike.com.

Now I would like to turn the call over to Matt Friend, CFO Operating Segments and Vice President, Investor Relations.

Matt Friend

Thank you, operator. Hello, everyone, and thank you for joining us today to discuss NIKE, Inc.'s fiscal 2020 first quarter results. As the operator indicated, participants on today's call may discuss non-GAAP financial measures. You will find the appropriate reconciliations in our press release, which was issued about an hour ago, at our Web site investors.nike.com.

Joining us on today's call will be NIKE, Inc. Chairman, President and CEO, Mark Parker; and our Chief Financial Officer, Andy Campion. Following their prepared remarks, we will take your 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 questions to two. In the event that you have additional questions that are not covered by others, please feel free to re-queue and we will do our best to come back to you. Thanks for your cooperation on this.

I’ll now turn the call over to NIKE, Inc. Chairman, President and CEO, Mark Parker.

Mark Parker

Thanks, Matt, and good afternoon, everyone. Many of you know Matt. I'd like to welcome him to his first call as he takes on the responsibility of Investor Relations. And then of course on behalf of the whole team, I’d like to thank Nitesh for his partnership over the last several years.

Turning to the results, we feel very good about our performance in the first quarter of fiscal year '20, growing revenue 10% on a currency neutral basis. It was a quarter that proved the depth and balance of our complete offense, building on the strengths of our foundational business drivers and capitalizing on the untapped dimensions of our portfolio.

For the quarter, this is reflected in the broad-based growth in all geographies, led by our international business, which grew 16%; in double-digit growth in our women's business off the back of an incredible summer of celebrating female athletes; in both footwear and apparel with our strong lineup of innovation and style which continues to feed the growing consumer demand for comfortable athletic product; and in digital which grew a very strong 42% showing the power of more personal relationships with the consumer.

Mobile continues to lead the way and within mobile, app experiences are fueling the most growth. And while this trend has held true in our own channels for some time, we’re beginning to leverage our digital experiences with our retail partners. As we set out to do, we’re creating a differentiated marketplace for NIKE by scaling our learnings and best in class experiences with our partners.

The key to expanding our competitive edge continues to be our total commitment to the consumer through the consumer-direct offense. We're focused. We're investing in our brand in key markets and we're accelerating in the high growth dimensions of our business. And that's especially important in the volatile macroeconomic and geopolitical environment that we see today.

In relation to tariffs, we've been clear that we strongly believe in the power of free and fair trade. Historically, we've effectively navigated through excessive duties and we're confident that we'll continue to do so under the current dynamic. In China, specifically, we continue to extend NIKE's lead. In our key cities of Beijing and Shanghai, we serve a generation of digital-first consumers and we support their love of sport by helping to grow participation through grassroots programs.

As I've said before, NIKE is a brand of China for China and the results continue to prove it out. We've driven double-digit growth in Greater China every quarter for more than five years. This quarter, we continued that momentum with an outstanding 27% revenue growth on a currency-neutral basis. In any environment, NIKE's foundation for success has always been great product. We continue to see that today with another huge quarter for NIKE innovation.

We're delivering more choice and fresh options on some of our hottest products and expansion of both new and existing platforms and a deeper commitment to serving a wider range of athletes. Sportswear continues to lead all categories in both footwear and apparel growing strong double-digits. One of NIKE's greatest strengths is how we mix style and innovation, and the Air Max React 270 is a perfect example. We've created a runway hit by blending Air Max and React with multiple bold colorways. In fact, the 270 Air Max React led to the largest gains in footwear revenue for the quarter.

Another strong addition to our lineup this quarter is the Air Max 200, the layered upper with a new visible Air Sole unit continues to build on the energy we're driving in running silhouettes. We're also reimagining and clearly segmenting our top sportswear franchises like the Air Force 1 and Tech Fleece. By adapting the Air Force 1 into models like the

N.354 and the Sage, we grew the Air Force 1 businesses with women's and kids faster than men’s this quarter. It’s an approach we’re using with our Tech Fleece collection too adding new silhouettes and shapes throughout our lines.

Our strategy of designing apparel through themes and collections continues to connect with the consumer, as we drove double-digit growth in sportswear apparel for the 22nd consecutive quarter. Our kids business is one that doesn't get a lot of attention on our calls but it is in fact a critical part of our business. Overall, kids’ footwear and apparel just experienced its biggest back-to-school season ever, driving double-digit growth for the quarter.

In kids, we’re earning significant gains through core footwear and apparel for both boys and girls and in basketball and the Air Max 270 which drove triple-digit growth for kids’ power franchises. How we present and distributed kids’ product also provides new opportunities. We see more parents buying on our apps, so we continue to invest in more dynamic imagery on our digital platforms and we’re testing new business models through membership to make it easier for parents to buy at the pace that their kids need new product.

In performance product, we saw very strong momentum in basketball internationally this quarter especially with the AlphaDunk. To be honest, we’re excited about the long-term potential of this signature line. Not only did the Zoom Freak 1 become the largest initial signature launch in NIKE basketball history, its apparel line sold out quickly as well with the Freak T-shirt becoming the top selling apparel item on Nike.com.

This quarter, we were all inspired by the incredible athletes and performances at the Women's World Cup. It was also a tremendous stage for NIKE innovation. During the all-NIKE final, we also debuted our top football boot innovation, the Mercurial 2019. In addition, apparel revenue from the 2019 Women's World Cup was 4x bigger than it was for the 2015 event. Across the wider business, we stayed intensely focused on the apparel classifications that matter the most to the female athlete; bras and tights.

For the quarter, the light-support Indy Bra led the way and our NIKE One Tight is creating incredible demand, especially in NIKE direct and strategic retail partner doors. The NIKE One collection is a great example of our edit to amplify approach that will stretch to other categories putting more focus on our most profitable items across price points and distribution channels.

In running, we launched Joyride which was designed to encourage more everyday athletes to get moving. We're excited about the incredible comfort this system delivers with responsive beads that conform to the foot. The customer response to the running silhouette this quarter was very strong and we’re just now beginning to scale the Joyride platform across multiple categories through women’s, sportswear and kids.

As we began to communicate through Joyride, one of the biggest opportunity for NIKE is to continue to serve an even wider range of athletes. As leader in our industry, we will add to the growing movement of health and wellness around the world. We’ve been broadening our definition of sport through our brand, but more and more we’re doing it through product innovation.

From competition to fitness to light activity to play, our more inclusive view on design is opening up new lanes of opportunity for growth. For example, we’re studying the fit of our products to serve more body types with our successful plus size line. Our teams are designing for modesty to match more people’s preferences and our FLYEASE system has been updated for easier entry and exit to appeal to even more people.

We will be expanding into a new high performance basketball shoe and one of the most coveted sneakers of all time, the Air Jordan 1. Making more athletes comfortable and confident can be an incredible catalyst to bringing more people into sport and that’s a theme we’ll continue to champion as we lead into the Tokyo Olympics.

On last quarter’s call we told you that the Jordan brand was accelerating and finished with over $3 billion in revenue for fiscal '19. Jordan followed up that record breaking year with the quarter of healthy double-digit growth in all geographies, including mid-teens growth in North America. We're growing at an accelerated pace in new areas like performance basketball, women's, international and apparel and the Air Jordan 1 franchise continues to create incredible demand all over the world.

This quarter, we were incredibly excited to announce that Zion joined the Jordan family. We're proud that Zion will wear the Air Jordan 34 to start this season and we're already developing new innovation with one of the NBA's most anticipated rookies. Looking over the next few seasons, our pipeline is set to fuel growth in our biggest businesses while also carving out new space for future opportunities.

New LeBron and Kyrie signature models will arrive as the NBA season gets started. Women's apparel will lead with new materials of performance types. Training will introduce a new franchise designed for a range of fitness activities, including high-intensity workouts, station-based training and spinning classes. Running will introduce more innovation that's proven to help make athletes faster as we headed into Tokyo. And our adaptive platform will continue to evolve with new features like voice activation from your phone. There's much more to come from NIKE innovation in fiscal year '20.

While products are usually the first to grab the attention of our consumers, we deepened those relationships through the power of digital. To do that, we're investing in three areas. We're building industry leading personal experiences. We're quickly ramping up our backend capabilities to capture more of that demand. And the final critical piece is to create scale through our own channels and with our partners.

Membership sits at the heart of that strategy giving consumers a more personal relationship with NIKE. Fundamentally, that gives them easier access to more tailored products and services. With product, there are multiple advantages to being a logged in member. In some cases, it means they have early access to our latest innovation like we did this quarter with the launch of Joyride and the Air Max 270 React. It can also be as simple as giving better access to the product they want in the moment, so you're capturing more full-price demand. Connected inventory is critical to that capability.

With services, we're bringing real value to our members' lives consistently. Our teams are assessing different ways to engage with more people completely and have them coming back for more. Over the last three years, we more than doubled the number of active users across all of our apps. With more active engagement we create more value for both our members and for NIKE.

In this quarter, for example, over 50% of our NIKE direct digital growth came from numbers. Becoming personal at scale is the ultimate objective. We start in our own channels and then amplify those experiences through partnerships. The sneakers app has truly redefined our connection with the sneaker community. It's now in 22 countries with more room to grow in EMEA and APLA and grew roughly 50% this quarter. We've also begun to test a new opportunity within sneakers on high heat apparel. The early read from our members on our pilots has been very positive.

As I've said before, the NIKE app is the most comprehensive one-stop shop for NIKE. It's become the largest and fastest-growing platform in our portfolio, growing almost triple digits this quarter. The NIKE app is already in 21 countries and will go live in China in holiday. Just as exciting is the impact that the NIKE app is having on the physical shopping experience. It's scaling in North America and features can be now activated in every store owned NIKE location, most factory stores including most factory stores and in this quarter alone we added nearly 1 million new NIKE members from interactions in our North America doors.

NIKE Fit is our technology that scans the foot, eliminating a significant consumer friction point by providing an accurate read of a users shoe size. The in-store experience is currently available in all North America locations and is moving quickly into Europe and Japan. We'll also be launching an at-home in app experience later this fiscal year.

We're moving at an impressive pace in the channels that we control and while we continue to invest in stronger more distinctive partnerships. When coming together with another platform or retailer, our objective is to create a better experience in the path of the consumer. We want them to be able to move seamlessly from online to offline and easily find the product they want, when they want it across the marketplace.

Ultimately by recognizing, serving and rewarding members, it will engage with NIKE more often across multiple channels and touch points. Our teams continue to be very active in this space. NIKE App at Retail is already showing the ability to scale with partners.

This quarter, for the first time, NIKE App at Retail features and NIKE membership were activated with a wholesaler through a pilot with Foot Locker's Washington Heights store. We plan to integrate NIKE App at Retail in more Foot Locker doors in North America and bring new experiences to Zalando in Europe and top sports in China later this fiscal year.

Our inventory partnership program also continued to scale, including Zalando, JD and Pro-Direct in Europe. And we're leveraging the world's top social media platforms with Instagram where consumers can use direct messaging for commerce in our women's and training channels and with WeChat with a new feature that allows users to check product availability in nearby stores instantly.

A critical component to accelerating all of our opportunities is our ability to become smarter through our supply chain. And to do that we’re bringing science to the art of retail like never before. With Zodiac, we've acquired proprietary technology and teams to better know our members, give them better experiences and expand their lifetime value to the NIKE brand.

Invertex brought us computer visioning capabilities for NIKE Fit which we talked about and in addition to more accurate fitting sizes we’re already using the insights we gain to inform better design product. And just last month we acquired a new predictive analytics platform and team of data scientists through our acquisition of Celect. This game will greatly accelerate our ability to turn raw data into actionable demand insights, and this allows us to make more accurate inventory decisions closer to market.

We’re partnering, investing in our own teams and we’re gaining new capabilities all in the name of serving the consumer more completely. It was a great start to the year for NIKE. The global shift towards more active lifestyles continues to accelerate and demand for athletic product is high.

As a company, we have a sharper focus on these areas that will drive the greatest growth. We’re bringing the joy of sport to even more people and we continue to build our more valuable relationships with the consumer through the power of digital. Our fundamentals are strong, but what excites me the most is the significant opportunity ahead for our industry and for NIKE.

Thanks. And now here’s Andy.

Andy Campion

Thank you, Mark, and hello to everyone on the call. First, I want to take a moment to personally thank Nitesh for his incredibly valuable partnership and leadership over Investor Relations as he now transitions into a new and expanded set of responsibilities. And I also want to welcome Matt to his first call as he expands his responsibilities to include leadership over Investor Relations.

In Q1, we came out of the block strong with our results meeting or exceeding the expectations we set 90 days ago on every dimension. Most notably, we delivered currency neutral revenue growth of 10%, 150 basis point of gross margin expansion, EPS growth of 28% and high expanding returns on invested capital. Those are extraordinary numbers, but what we're most excited about is the quality of our performance.

Our financial performance in Q1 reflects exceptional strategic execution by our teams around the world. We continue on our relentless drive to transform how NIKE serves consumers. There are three key themes that really stand out when we reflect on Q1. One, the strategic transformation of NIKE continues to be the fuel for accelerating broad-based growth across our global portfolio.

Two, this transformational growth is not happening by accident. Our targeted investments are extending our competitive advantage. And three, while the geopolitical and macro environment is increasingly volatile and in some respects unpredictable, consumer sentiment for the NIKE brand remains incredibly strong and consistent around the world.

Let’s go a bit deeper on these three themes. First, strategic transformation is driving our broad-based global growth. When it comes to creating value for shareholders it all starts with growth. And as Mark has said, when it comes to grow, at NIKE it all starts with product. NIKE is bringing innovative new product to market at an unrivaled pace and scale.

New innovation platforms equated to over 100% of our incremental growth in Q1. That includes the successful launch of Joyride and strong sustained consumer demand for recently launched platforms from React to the range of compelling new Air Max platforms launched over the past two years such as VaporMax, 270, 720 and 200.

At the same time digital is transforming and amplifying everything we do at NIKE. In Q1, NIKE digital grew 42% on a currency neutral basis driven by enhanced digital services and the expansion of our ecosystem internationally. The NIKE app and sneakers app are now both live in over 20 countries with more expansion coming over the balance of fiscal year '20.

As for the second key theme, we are making deliberate investments both organically and through acquisitions to extend NIKE’s competitive advantage. For example, we've enhanced our ability to test and scale new digital services faster by investing in the migration of over 95% of our consumer experiences to a more nimble cloud-based architectural.

Our acquisition of Celect in Q1 was another accelerator of our transformation. Celect’s team and proprietary digital demand sensing tools will help us more effectively predict demand, plan supply, allocate product to the right stores and sharpen our pricing and markdown gains. Celect’s capabilities are first of their kind in our industry. Most other industries sell the same products season after season.

Celect has developed unique models the leverage data science and machine learning in our industry where we bring new and innovative product to market every season. The acquisition of Celect accelerates our building of digital demand sensing capabilities by at least three years.

With NIKE's unrivaled scale and resources, we will continue to capitalize on opportunities such as these to invest and extend our leadership and competitive advantage. At the same time, we’re also increasingly offsetting our incremental investment through the editing of resources within our legacy operating models.

The third key theme as we reflect on Q1 relates to the environment in which we’re operating. Despite increasingly dynamic and somewhat unpredictable macro and geopolitical factors, consumer sentiment and affinity for the NIKE brand remained strong and consistent. NIKE’s growth continues to outpace GDP growth and broader retail growth in our major markets around the world, and NIKE continues to be the number one favorite brand in our 12 key global cities.

Since launching our consumer direct offense two years ago, our currency neutral performance has exceeded our long-term financial model in terms of growth, profitability and return on invested capital and we see that momentum continuing over the balance of fiscal year '20. While the macro dynamics are even more volatile than they were 90 days ago, NIKE has a long track record of remaining agile and managing all of the levers we control.

We are also increasingly engaging with all of our constituents on the levers that are outside of our direct control. As a result, to-date our net real dollar reported results have remained strong and consistent. We continue to deliver strong financial performance despite FX having had a roughly $3 billion negative impact on our reported revenue and over $1.5 billion of negative impact on our EBIT over the past four years.

Despite the recently implemented tariffs and associated FX headwinds, we expect to continue delivering strong financial performance going forward. But before sharing our positive outlook for the balance of fiscal year '20, I'll first touch on our reported Q1 results in a bit more detail.

NIKE, Inc. Q1 revenue increased 10% on a currency neutral basis and 7% on a reported basis. Our stronger than projected overall growth reflects healthy balanced growth across all four of our geographies, led by NIKE digital globally in Greater China. Gross margin expanded by 150 basis points in Q1 as average gross selling prices expanded and higher margin NIKE direct growth outpaced wholesale growth.

Q1 gross margin significantly exceeded our guidance, driven primarily by a shift in the timing of supply chain and other investments out of Q1 and into the balance of the year, significantly lower than planned markdown rates in our NIKE factory stores; in fact even lower than we'd expect in a typical quarter and the favorable mix impact from stronger than planned growth in our high-margin international geographies and NIKE direct. We nonetheless expect gross margin expansion over the balance of the fiscal year, though of course not at the same level as we saw in Q1. I'll touch on this more specifically in our guidance.

SG&A grew 9% in Q1 as we continue to invest in our digital transformation and in part driven by brand marketing associated with the Women's World Cup and the Joyride innovation launch. Our effective tax rate for the quarter was 12.4% which would have been largely in line with guidance but for favorable non-recurring items.

First quarter diluted earnings per share increased 28% to $0.86. And as of August 31st, inventories were up 12% reflecting strong forward-looking consumer demand globally and also in support of key consumer moments such as back-to-school which has extended into September this year and looking ahead to Singles’ Day on 11.11 in Greater China.

Now let’s turn to the financial performance for our reported operating segments. In North America, Q1 revenue grew 4%. Our growth in Q1 was right on plan, led by digital from a channel perspective and sportswear in Jordan categorically. We are reshaping the marketplace in North America with NIKE digital growing over 30% on a currency neutral basis and with high single-digit growth across our key strategic and differentiated partners.

In Q1, we also drove an intentional decline in undifferentiated multi-brand wholesale. We continue to reallocate our best product and our retail investment dollars to NIKE direct and differentiated partner experiences. That includes, for example, testing new services, leveraging the NIKE app in partner doors such as in Washington Heights with Foot Locker.

Now let’s turn to EMEA where revenue grew 12% on a currency neutral basis in Q1. Growth was broad based across our categories and amplified by strong double-digit growth in NIKE digital. We see continued strong digital momentum in Europe with the Nike app having just launched in 13 new countries across this geography.

We extended our lead in Europe in Q1 with the NIKE brand rated the number one favorite brand in all of our key cities and our business growing at strong double-digit rates in London, Berlin and Milan. While NIKE direct is a key driver, our strategic partnerships with JD and Zalando are also contributing to our strong sustained growth in Europe.

Now let’s turn to Greater China, which continues to set the pace for NIKE's growth globally. Q1 marks the 21st consecutive quarter of double-digit revenue growth in Greater China. In Q1, Greater China grew 27% on a currency neutral basis fueled by nearly all key categories led by sportswear and Jordan.

Coming off of the FIBA World Cup in China, we are also excited about the energy around the basketball category in this geography and globally as we enter the new NBA season. The impact of digital in China has been nothing short of extraordinary. NIKE digital grew over 70% in Q1, in part amplified by our strategic partnerships with Tmall and WeChat. And looking ahead we are pulling forward the launch of the NIKE app in Greater China into late Q2.

Based on trade and other dynamics we continue to be deeply engaged with all of our constituents in China and we’re also closely monitoring consumer sentiment. At the same time, affinity for the NIKE brand continues to build and our sell-through at retail remains very strong. We believe we're extending the NIKE brand’s leadership in China by remaining authentically focused on serving the Chinese consumer while fueling their passion for sport and a broader movement toward a more active lifestyle.

So now let's turn from China to another fast-growing geography, APLA. In Q1, APLA revenue grew 13% on a currency neutral basis driven by nearly 50% growth in NIKE digital. In Q1, we launched the NIKE App at Retail in our [indiscernible] store, a great example of bringing the consumer direct offense to life globally through the key city of Tokyo.

The culture of basketball was also driving force behind the momentum we saw in APLA with the Jordan brand growing strong double digits year-over-year. APLA is an extremely entrepreneurial and diverse geography. In APLA we continue testing new concepts with local partners such as our digital commerce relationship with Flipkart in India to leveraging the social media platform Kakao in Korea on the launch of Joyride and on ramping new members.

Finally, at Converse, revenue increased 8% on a currency neutral basis with the Converse brand delivering strong double-digit growth in China and across digital globally, while returning to growth in Europe. Growth is being fueled by an increasingly stronger and diversified product portfolio, including across the Chuck Taylor franchise, the Chuck 70 and the Chuck Taylor Lift. We're also excited about Converse’s reentry into performance basketball, which got off to a great start with the successful launch of the All Star Pro BB.

Now turning to our outlook. We see continued momentum going forward. Accordingly, our projected currency neutral growth and profitability are improving. One might have expected the recently implemented tariffs and associated FX headwinds to result in lower real dollar expectations; however, our real dollar outlook remains consistent to slightly improved net of all of the dynamics in our business.

For the full year we continue to expect reported revenue growth within the high single-digit range, slightly exceeding fiscal year '19 reported revenue growth. This incorporates our improved currency neutral outlook being largely offset by the more intense FX headwinds of late associated with trade dynamics.

Recall that the impact of foreign exchange hedges is not accounted for within our revenue line item. We now expect to deliver full year gross margin expansion within the 50 to 75 basis point range. That assumes that the negative impact of recently implemented tariffs remains in effect for the balance of our fiscal year. And again remember that our Q1 gross margin expansion was amplified by timing shifts and other discrete items.

While our recent acquisition of Celect will have some impact on SG&A, we still expect SG&A to grow roughly in line with revenue for the year. We expect our effective tax rate to be in the mid-teens. And for OIE, net of interest expense, we continue to expect $50 million to $100 million of income for the year.

Our focus first and foremost is on sustaining strong currency neutral operating momentum over the full year and longer term, but based on the volatile dynamics of late I'll provide a bit of context on Q2. We expect reported revenue growth in Q2 to be in line with our Q1 reported revenue growth. That assumes our strong currency neutral revenue growth will be dampened by roughly 3 points of FX headwinds.

For gross margin, we expect Q2 expansion to be roughly 25 basis points with slightly greater expansion than that in the second half of the year. The impact of tariffs will be most pronounced in Q2. In Q2, we expect SG&A growth in the high single-digit range. We expect our effective tax rate to be in the mid-teens range. And for OIE, we expect income in Q2 to be roughly $10 million to $30 million.

We are extremely pleased with our brand momentum and the strong currency neutral growth we delivered since implementing our new offense two years ago. That said, we are still in the early stages of NIKE strategic transformation. Our execution of the consumer direct offense will continue to fuel growth across our portfolio of key categories, key cities in key countries as well as accelerate our growth against the outside long-term opportunities that we see in women's, apparel, digital and international.

With that, we'll now open up the call for questions.

Question-and-Answer Session

Operator

[Operator Instructions]. Our first question comes from Bob Drbul with Guggenheim. Your line is open.

Bob Drbul

Hi, guys. Good afternoon.

Mark Parker

Hi, Bob.

Andy Campion

Hi, Bob.

Bob Drbul

I guess the question I have is – two questions really. On the first part of it is in North America, can you talk a little bit more about the apparel performance in terms of some success in women's but just generally the level of growth and sort of how we should approach that? And the second question is just around the inventory levels, any pockets of concerns there, any areas geographically that you're concerned about or anything we should think about from that perspective?

Mark Parker

Sure. I'll start on North America apparel. We continue – you asked about women's in particular, we continue to grow the women's apparel business in North America. It's in fact growing at a very strong rate. At the same time we see great opportunity ahead, even greater than we've capitalized on to date. Overall, in terms of apparel growth, we're really pleased with the growth. The number in Q1 does compare unfavorably to some prior year comps. As you may recall last year in Q1, apparel in North America grew 8% and that was in part impacted by the jersey business relative to the NBA. As you may recall, LeBron changed teams last year and that had some impact. We also were seeing this year back-to-school extend a bit out of Q1 and into our Q2. So in short we see really strong demand for our apparel in North America. We've had a little bit of pressure on supply but you're going to see the rates of growth in North America apparel accelerate over the balance of the year.

And then you asked about inventory. I guess I'll take that one too. Inventory as we spoke about was up 12% versus prior year. That was primarily driven by strong consumer demand. A majority of our inventories in new seasonal product, some of which is in transit to the marketplace and we'll sell in to the marketplace and sell through over the quarter and into Q3. There was also a little bit of an impact from foreign exchange in that inventory number. So if you look at it on a unit basis, our unit inventory growth is really well aligned with our forward-looking unit growth. And kind of combining those two themes, one, the fact that it's largely seasonal inventory and, two, that the overall unit numbers are aligned with what you're seeing and you would expect and hope to see is that our closeout mix is low and it is in fact very low. So our inventory is very healthy in our geographies. There are a couple of other dynamics that are probably worth calling out. One, again, is this extended back-to-school season. So you see some of that inventory now selling through as back-to-school extended into September, which is in our Q2. And then we also have been building inventory in anticipation of Singles' Day on 11.11 in China. So the punch line is we feel great about the inventory that we have on hand and it's reflective of the strong demand for the brand.

Bob Drbul

Great.

Mark Parker

Thank you. Operator, next question.

Operator

Our next question is from Jamie Merriman with Bernstein. Your line is open.

Jamie Merriman

Thanks very much for all the color on the call. The first question is with respect to North America and you talked about the decision to purposely ramp down some of those – not strategic partners in the market. Can you talk about how those plans play out for the balance of 2020 and how we should think about that? And then can you just give us an update on how you're thinking about some of those strategic partners, specifically with e-commerce on whether you have an update on partnerships with Amazon, Jet, partners like that and what you've seen so far? Thank you.

Mark Parker

Hi, Jamie. I'll take the first question relative to North America. As you may recall from our call 90 days ago, we highlighted that we were going to have some year-over-year comparison dynamics in North America. So I'd start by saying we're right on plan in North America. We're really pleased with the growth that we're seeing in that geography. We still see that geography as sustaining strong healthy mid-single digit growth. You'll see slightly higher growth rates in North America over the balance of the year than what we delivered in Q1 and of course remember not all percents are created equal. A point or two of growth in North America is a pretty significant impact.

And then again I think I touched on this a little bit with respect to Bob's question. The growth in Q1 was slightly impacted again by some year-over-year comparisons not just in the jersey business but also the timing of innovation launches in footwear and then again with that kind of extended back-to-school season spanning over Q1 and into our Q2, which begins in September. So again, we see tremendous momentum in North America.

You also asked about the distinction between NIKE direct differentiated consumer experiences and undifferentiated consumer experiences. That is really a tale of two cities. We are seeing strong in fact accelerating growth in NIKE digital. We're seeing high-single digit growth in differentiated retail with our strategic partners. And we're seeing an expected in fact somewhat intentional and deliberate decline in undifferentiated retail and the drivers of that are how we allocate product and where we put our retail investment dollars. So we would expect that trend to continue in the short term.

Of course, long term our goal is we have reshaped this marketplace to one in which we're connecting much more directly with NIKE consumers and members through NIKE direct in our strategic wholesale partners. So again, we're on plan in North America. The brand's extremely strong and really excited about the opportunities ahead including in those areas we consistently touched on; digital, women's, core footwear below $100 which is touched on in apparel.

Andy Campion

Let me touch on the second question you had on the digital partnerships. Obviously, digital growth is driving much of NIKE's overall growth and that's importantly obviously for direct but also the digital base business with our partners both wholesalers who are expanding their growth through the digital channel as well as digital platforms. We don't have anything new to update you on in terms of Amazon. So far the work with Amazon, the relationship has gone well. The business is performing well that is, so nothing new to report there.

We continue to sort of analyze that relationship and the other opportunities we have from a platform partnership standpoint. It's really critical that our platform partners are actually serving our members or serving our consumers at the highest level possible so that means sort of seamless interaction, frictionless experiences in terms of commerce, looking at an environment where they know that they're buying authentic NIKE products and ultimately just to better know and serve our consumers. So those are things that we expect from our digital platform partners.

We feel really good about our partners in Europe and in China and then also growing through the digital channels here in the United States with partners like Instagram through social media, just getting on Jet so there's lots of opportunity ahead there. So this will be an important part of our growth going forward. And I should mention – I failed to mention one of our biggest most successful partners here is in China and that's Tmall. So tremendous relationship there, continues to add energy to the brand as well as help to drive our business in China.

Mark Parker

Okay. Operator, next question.

Operator

Your next question is from Paul Trussell with Deutsche Bank. Your line is open.

Paul Trussell

Congrats on a great quarter. Thanks for taking our question. I wanted to touch base on the gross margin performance. Perhaps you could just walk through a little bit more detail on the spread versus your original estimates, how we should think about the supply chain impact in 1Q and how that will affect the balance of the quarters as well as what were the drivers behind the lower than expected markdowns and what is the impact in 2Q of tariffs, color on that would be helpful? Thank you.

Mark Parker

Sure. Thanks, Paul. I will first walk you through some of the impacts or drivers as you said in terms of the spread versus our guidance. So as compared to the expectations we said 90 days ago, 150 basis points significantly exceeded those. I'd say, first, I would touch on higher growth and favorable mix in our international geographies; second, higher growth in our NIKE direct business and again both of those are I would say over-indexing growth versus the plan we had 90 days ago, so strong momentum in those dimensions of our business versus plan. And again, our international geographies are higher margin geographies than North America and our NIKE direct business is a higher margin business than the wholesale business.

You asked about lower than expected markdowns in our factory store business, I'd say that was most pronounced in Europe. In Europe, we've really just had extraordinary separation. You've seen strong double-digit currency neutral growth in Europe for quite some time. We're taking share and our brand's just incredibly strong in all of our key cities in Europe. So frankly our markdowns were much lower than we had planned there and in some other areas of our business. Not only we planned for the quarter but then you'd expect in a typical quarter. You also asked about the impact of tariffs. Tariffs will impact Q2 through Q4. Now again, we guided to slightly improved overall gross margin even taking into account those tariffs, but the impact is more pronounced in Q2.

As you know they were announced in August and implemented on September 1. That doesn't give us much time to manage any of the levers within our overall portfolio. As we look out to the balance of the year, there are a lot of levers within our portfolio. We've managed them over time. We're a big proponent of free and fair trade and that's because tariffs have always been part of the financial equation in NIKE, so with a little bit of time we have a lot of levers we can work with from sourcing to other levers. So the impact of tariffs is most significant in Q2. And then as you likely inferred from our guidance, we expect slightly greater gross margin expansion in Q3 and Q4 as compared to Q2.

Paul Trussell

I really appreciate that color. My quick follow up is just regarding the product pipeline. You spoke about a lot of the exciting platforms that are delivering results for you already. Just curious if there's a way that you could maybe rank for us your excitement or how you think about the platforms and new areas of innovation that will drive these strong high-single digit revenue gains over the balance of the year as we think about Joyride and Air Max now moving to 200, what you're doing in women's, just any color on that would be helpful? Thank you.

Mark Parker

Yes, absolutely. The excitement meter is very high over this next year. We sort of look at the Summer Olympics as term papers due and so we're – this is the time when we bring our best work not only from a brand standpoint but certainly from a product standpoint. And in this case both performance-based innovation that actually leverages into sport style or sportswear, so we feel like the portfolio of innovation or the pipeline of innovation is more complete. I always talk about the complete offense and that's how we line up innovation is against our complete offense.

You mentioned women's. I would include core in that, more accessibly priced innovation coming particularly in the spring/summer seasons. We've got incredible again sportswear. We've good performance up in here for a long time at NIKE and some of the most incredible breakthroughs in performance coming for the Tokyo Olympics building on some of the great platforms that we've learned how to leverage more completely. That includes the cadence of the innovations, how we manage the lifecycle of innovations and how we again leverage that across multiple categories both in performance and sportswear. So incredibly high level of excitement. I would add we've talked about adapt. It's still in the early stages.

NIKE Fit will include both the powered adaptive systems as well as non-powered hands free systems and that's incredibly exciting as we bring innovation to more – make innovation more accessible to more people. Women's of course will continue to be a high priority. We're shifting resources to amp up our innovation agenda there, feel really good both footwear and apparel. Kids I mentioned is an incredible category to leverage the innovation that we have more completely across the portfolio, so that's a major source for us for growth as well. So I think the opportunities ahead are as bright as I've ever seen them, so very bullish.

Paul Trussell

Sounds like --

Mark Parker

Okay. Operator?

Operator

Our next question is from Omar Saad with Evercore ISI. Your line is open.

Omar Saad

Hi. Thanks for taking my questions and congrats on another great quarter. I wanted to ask my first question, another follow up on North America. The 30% DTC growth obviously that's a huge number, a smaller piece of the business. We talked about that still kind of being offset by the intentional reduction and undifferentiated of the wholesale. If we think about when DTC – kind of the time horizon looking out when the DTC just to become a material mover for the overall North American market or you get to a point where you're happy with kind of the wholesale footprint. And then I have another follow up for Mark as well. Thanks.

Andy Campion

Yes, Omar, we at our Investor Day a couple of years ago talked about our business being 30% or greater digital, owned and partnered over the next five years. That's a global measure of success, but I would say North America is in that same range in terms of the [indiscernible]. So we see digital alone not necessarily all of NIKE direct, but digital alone being in that range. And as we've discussed we see that continuing to build beyond that and potentially accelerating towards that date based on the incredible momentum that we've had.

As I noted, that was an accelerated level of growth in NIKE digital in Q1. So much like we discussed at our Investor Day two years ago, our view is that over the next five years, sustainable profitable growth in North America would equate to a mid-single digit range of growth. But what we're really excited about is we think the next five years in North America is building the platform for the long term future. North America is the marketplace where the most reshaping and transformation is required and frankly is underway.

Omar Saad

Got it. And then stepping back, I don't think and watching the different components of the company perform year-after-year or quarter-after-quarter, I've never seen such consistent positive performance across categories, regions, price points, channels, age groups, genders. Maybe help us understand – NIKE obviously performed exceptionally in the past, but maybe if you can help us understand or give us some insight into why that kind of broader platform seems to be performing so much more consistently than it has historically? Thanks.

Mark Parker

I think we're actually a lot smarter about how we – not only where we invest in terms of new product innovation but as I said we better leverage that innovation across multiple categories and then up and down the price point spectrum across genders. Again, I was fixated on complete offense and it's one of those areas where you go no matter how well we're doing across all those dimensions, we see more opportunity areas where we have – we are underpenetrated where we have what we call outsized opportunities. We've talked about apparel. We've talked about women's, digital, international as examples.

But even in our foundational business I think we've got tremendous upside ahead in terms of core. Striking that right balance across the complete portfolio or the complete offense as we call it is never ending challenge for us or opportunity, let me put it that way. So the innovation that we're putting out there I think we're just getting better at how we're leveraging that across the entire offense. And I feel like this has always been a competitive advantage for NIKE as the source of brand energy but also tremendous growth for us and I've never seen or been at NIKE during a period where there's such robust and strong innovation that's relevant to consumers across the portfolio.

That said, I'd be the first one as people here at NIKE would tell you to say that we have a lot more opportunity. So the challenge or the opportunity is to focus on the things that matter the most. We have unlimited opportunities. The fixation or the focus on the things that are really going to drive the needle from a consumer standpoint that are really going to be relevant and ultimately drive growth is what creates success.

Andy Campion

And Omar I'd just add maybe from a framework perspective or framing of how you might think about it, our key categories in our 12 key cities and our 10 key countries are really the where in terms of growth opportunity is for NIKE. The consumer direct offense is the how and it applies to all of those categories, all those cities and all those countries and that's about doubling the cadence and impact of innovation, being faster to market so that's 2x speed and then being more directly connected to consumers. And there isn't any dimension of our offense, the complete offense that Mark refers to, that isn't [indiscernible] can be positively impacted by those strategic principles.

And then of course the overarching or maybe you'd say underlying fuel is this digital transformation of NIKE, it's impacting everything we do from how we create product to how we assess demand and plan supply all the way through to consumer services through the NIKE app that are now not just in our digital offerings but in our retail stores and increasingly in our partner doors. So it's really a strategy the consumer racked off in the sense of that, impacting every dimension of the portfolio.

Mark Parker

Yes, I want to put an exclamation point on that. The digital capabilities that we're creating and investing in are really going to make us a better innovation company understanding the consumer, serving the consumer, leveraging the innovation that we invest in, it's all making us better. I see so much more opportunity from advancing our digital capabilities going forward.

Okay. Operator, maybe we have time for one more call.

Operator

Our last question is from Jim Duffy with Stifel Nicolaus & Co. Your line is open.

Jim Duffy

Thank you. Thanks for squeezing me in. A couple of questions from me on the gross margin. Andy, as we think about gross margin in the context of historical performance, you've got pricing power afforded by innovations, structural shifts from outgrowth of direct, you're reshaping the North American marketplace and then some more nuance factors that can help margin like leveraging Celect and NIKE Fit and so forth. Is there a reason to think that NIKE gross margin shouldn't go past peaks in the near future? It seems like a lot of good things are coming together.

Andy Campion

The short answer is no. I think many of the drivers you mentioned and some others are long-term drivers of expansion in margin. NIKE direct is a significantly higher margin business than the wholesale business and as we just touched on as part of Omar's question, we see digital and direct being increasingly larger part of our business long term. The price value equation is also an opportunity to expand margin.

And as Mark just touched on, we've never been more excited about the innovation pipeline we're bringing to market and that means bringing tangible value to the consumer. In your own question you touched on a huge opportunity. At our Investor Day we talked about the potentially significant impact from having a greater mix of full-price sell through and lower markdowns and closeout, and Celect is just spot on in terms of the capabilities that we had planned to build organically but are now able to start leveraging, thanks to this acquisition and drive that.

If I was to tell you the one thing that we're not as pleased about are the FX headwinds that have impacted us. As I touched on, on the call over the last four years we've had about $3 billion headwind on revenue and $1.5 billion more headwind on profitability. Of course, if we could add this back we would. That would be a pretty significant expansion in our operating margin that's more reflective of what we're doing from an operating perspective. But again, the short answer is yes. We see some pretty systemic drivers of gross margin expansion over the short, medium and long term.

Jim Duffy

And then as it relates to FX and gross margin, to what extent are more favorable hedge rates a positive contributor to gross margin in the first quarter and fiscal '20?

Andy Campion

Yes, the way I would think about FX in fiscal year '20 is we came into the year expecting FX to be sort of neutral to slightly favorable. It's now a net negative from an EBIT perspective. Again that's in the context of our slightly improved guidance, so we are thrilled that our operational performance just continues to be so strong that it's offsetting that. Over the balance of the year one thing to keep in mind is it's somewhat difficult to predict – not to predict but to model the impact of FX.

You have very volatile actual spot rates. Certainly the Renminbi is at the top of the list in that regard of late. The timing of our hedges over the course of the year as well as the timing which is kind of backward looking timing aspect in terms of when we lock in product costs. So I think that the easiest way for me to say it is, FX will be about 3 points negative headwind on revenue as I spoke about in my guidance. It will be a slightly negative impact on margin over the course of the full fiscal year and it's now shifted to a slightly negative impact from an EBIT perspective.

Mark Parker

We're hopeful that those are more transient impacts. And that as we go forward and we get more certainty with respect to trade and some resolution that maybe we see things turn from a headwind into a tailwind.

Okay. Thank you, Jim, and thank you everybody. Thank you for joining us on the call today and we look forward to speaking to you next quarter. Take care. Bye-bye.

Operator

This concludes today's conference. You may now disconnect.