**Capital Budgeting & Investment Decision.**

**Company Name: Nike, Inc.**

**1. Company Description & Financial Analysis**

**1) Summarize Part I. Item 1. Business Description on 10K**

**Item 1: Business**

* **General:** Nike, Inc. began in 1967 in Oregon, United States. Their main objective is to create and distribute athletic accessories that can be used for all types of exercise and sports whether it is individual or played in a team. Nike is the largest athletic goods producers in the world and are often the first choice for many people globally. Nike sells their products through their own stores which are located globally, their online store, and through several licensed third-party licensed stores as well. A majority of the products produced be Nike are manufactured by independent contractors. The majority of footwear products are manufactured abroad however, the equipment products are manufactured in the United States and abroad.
* **Products:** The products Nike offer are centered around the customer construct targeting Men’s, Women’s, and Kid’s sizes and preferences. They believe this approach meets customer needs as well as improves their chances to grow and take advantage of new opportunities. The products they produce are mainly intended on being worn for athletic activities however, consumers tend to wear them for leisure purposes as well. The footwear in the Jordan brand leads in sales and Nike expect them to continue to do so. The apparel that Nike sell also lead in sales and are often sold in collections. Nike also work with licensed college and professional teams and also league logos as well. Nike’s Jordan brand also sells similar footwear, apparel, and equipment which is centered around basketball and possesses the ‘Jumpman” logo. Nike’s subsidiary brand, Converse, sells footwear, apparel, and accessories and is head quartered in Boston, Massachusetts. The brand’s operating results are reported on a stand-alone basis.
* **Sales and Marketing:** Nike experience constant changes in sales volume throughout the year. Throughout history, the revenue gained in the first and fourth fiscal quarters have somewhat surpassed the revenues in the second and third quarters. These changes occur due to the demand of various products based off of the season of the year as well as other geographic, logistical, and macroeconomic reasons. The demand of our products changes due to the fact that there are constant changes in design trends and an increase in popularity of a certain sport and fitness activities. Nike adjust to this by changing current product offerings and implementing new products and styles of already existing products. If they don’t act according to these changes, they can miss out on the opportunity to increase sales and profitability.
* **Our Markets:** The Nike brand operations are reported based on the internal geographic organization. Nike’s reportable operating segments are North America, Europe, Middle East, and Africa (“EMEA”); Greater China; and Asia Pacific and Latin America (“APLA”). The United States market for fiscal 2023 generated approximately 43% of the total revenue with previous years being 39% to 40%. The products sold in the United States are through several footwear and sporting goods stores as well as online. In the United States, there are 213 Nike brand factory stores and 74 Nike brand in-line stores along with 82 Converse stores. The international market for fiscal 2023 generated approximately 57% of total revenues compared to the previous years where they generated 60% to 61%. Nike ship products from 67 distribution centers outside the United States. There are 560 Nike brand factory stores and 49 Nike brand in-line stores as well as 54 converse stores. Products are also sold through several sporting goods stores and Nike’s online stores internationally.
* **Significant Customer:** “No customer accounted for 10% or more of our consolidated net revenues during fiscal 2023.”
* **Product Research, Design and Development:** Nike believe their key factors for their success is the research, design, and development efforts they conduct. They have multiple specialists in several aspects that are considered when producing products for athletic use which range from biomechanics to digital technologies. They also seek data from athletes, physicians and other experts who can have important feedback regarding the products to make them more efficient. Nike has employee-athletes who wear-test their products to test them before they are released. Nike use market intelligence and research to implement innovative technologies into their current and new products to meet the market’s demands.
* **Manufacturing:** Majority of the products are manufactured outside of the United States by independent manufacturers. Nike has manufacturers that operate 123 finished goods footwear factories which are located in 11 countries. The contract manufacturers purchase raw materials to manufacture the products. In fiscal 2023, Nike experienced a continuous supply chain volatility in the first part of the year but has improved throughout the year.
* **International Operations and Trade:** Nike implements risk-provoking strategies to prevent any damage done to their business. They have not (up to now) been affected by any risk but can’t predict the chances of any occurrence in the future, so they choose to take precautionary action. The international operations are subject to compliance with the U.S. Foreign Corrupt Practices Act (“FCPA”) and other anti-bribery laws.
* **Competition:** Nike compete with brands from all around the world in the sporting goods industry with brands such as adidas, puma, under armour, etc. The important aspects of competition in this industry are product attributes, consumer connection and effective sourcing and distribution of products.
* **Trademarks and Patents:** Nike believe that the intellectual property rights they possess are important to their brand's success. They have copyright protection in their designs, graphics, software applications, digital goods, etc. They want to continue to protect their intellectual property as strongly as possible.
* **Human Capital Resources:** Nike’s mission is to bring inspiration and innovation to every athlete in the world. They aim to maintain an environment where all Nike employees can reach their full potential. In the last year, Nike has had about 83,700 employees worldwide, including retail and part-time. Nike are continuing to improve their efforts in implementing diversity, equity, and inclusion by recruiting diverse talent through their traditional channels and initiatives. Nike are committed to a competitive pay strategy and constantly review their promotion practices annually. They offer free access to their sport centers at their world headquarters for their full-time employees. Nike provides all U.S employees with unlimited free financial coaching through a third-party provider.
* **Available Information and Websites:** The Nike digital commerce website is located via their website and can be found in the investors section.
* **Information About Our Executive Officers:** Mark G. Parker, Executive chairman. John J. Donahoe II, President and chief executive officer. Matthew Friend, Executive vice president and chief financial officer. Monique S. Matheson, Executive vice president and chief human resources officer. Ann M. Miller, Executive vice president and chief legal officer. Heidi O’Neill, President, consumer, brand & product. Craig Williams, President, geographies & Marketplace.

**2) Summarize Part II. Item 7. Management’s Discussion and Analysis on 10K**

**Item 7: Management’s Discussion and Analysis**

* **Overview:** Nike have a Consumer Direct Acceleration strategy where they focus on inventing a marketplace filled with products that are designed with better quality for customers to have a better experience with their products which will keep them loyal. Financial highlights: Nike generated $51.2 billion in revenue in the 2023 fiscal year. Current economic conditions and market dynamics: Consumer spending, inflationary spending, supply chain volatility, COVID-19 impacts in greater China, and foreign currency impacts. Nike expects that the future operating model will have a positive impact on their profitability. Nike earned over $6 billion in earnings before interest and taxes with an EBIT margin of 12.1% and a 31.5% in return on invested capital.
* **Results of Operations:** Nike earned a total of $5,070,000,000 in net income in the 2023 fiscal year.
* **Consolidated Operating Results:** The total Nike brand wholesale equivalent revenues were $40,127,000,000 in the 2023 fiscal year. The gross margin was recorded as 43.5%, which was a decrease from the previous year of 46%. The total selling and administrative expense was 32% of the revenue which was $16,377,000,000. The tax rate for fiscal 2023 was 18.2%.
* **Operating Segments:** North America brought in the most revenue with over $21 billion and Asia Pacific & Latin America brought in the least amount of revenue with over $6 billion. The same can be said regarding income before taxes and interest. North America revenues increased by 18% due to the popularity in Men’s items and Jordan brand items. The reported EBIT was 7% higher. Europe, Middle East & Africa revenues increased by 21% due to the popularity of in Men’s, Women’s, Kid’s, and Jordan brand products. The reported EBIT increased by 7%. Greater China revenues increased by only 4% due to the popularity in the Jordan brand products. The reported EBIT decreased by 3% due to the lower revenues generated. Asia Pacific & Latin America revenues increased by 17% due to the demand for all Nike items in all the territories under this geographical operating segment. The reported EBIT increased by only 2% because of the increased revenues. Global Brand Divisions include revenues from Nike Brand licensing and other miscellaneous revenues that aren’t apart of a geographic operating segment. Converse generated over $2 billion in revenue. Converse had an 8% increase in revenue due to the growth in revenue in North America. The reported EBIT increased by just 1% because of higher revenues. Corporate revenues earned a total of $27 million.
* **Foreign Currency Exposures and Hedging Practices:** The Nike foreign exchange risk management program's main goal is to suppress the effects of currency changes on their consolidated results of operations. Their hedging policy is created to diminish the impact of exchange rate changes partially or entirely. Nike’s most significant transactional foreign currency exposures are product purchases denominated in currencies other than the functional currency of the transacting entity and factory input costs. Nike manages transactional exposures by taking advantage of natural offsets and currency correlations that exist within the portfolio. Nike manage translational exposures by the combination of purchases and sales of the U.S. Dollar investment and the hedging instrument.
* **Liquidity and Capital Resources:** the total cash inflow for fiscal 2023 was $5,841 million. It has changed from previous years due to reduced inventory purchases in the current period. The total cash outflow for fiscal 2023 was $7,447 million. This has increased from previous years due to them buying 50 million shares of Nike’s class B common stock which equals to $5.5 billion with an average share price of $110.32 per share. Nike has a long-term debt rating of AA- and A1 from S&Ps corporation and Moody’s investor services. They believe that it is unlikely for them to fail to meet any of their covenants in the future. Their material cash requirements as of May 31, 2023, are debt obligations, operating leases, endorsement contracts, product purchase obligations and other purchase obligations. Nike do not have any off-balance sheet arrangements that have a material effect on their current and future financial condition, results, liquidity, capital resources or expenditures.
* **New Accounting Pronouncements:** “Summary of Accounting Policies within the accompanying Notes to the Consolidated Financial Statements for recently adopted and issued accounting standards.”
* Critical Accounting Estimates: Nike’s sales-related reserves consist of contractual return rights and discretionary authorized returns. The estimated discretionary authorized returns, discounts and claims are based on historical rates, specific identification of outstanding returns and estimated returns. Nike estimates that the net value of their inventory is less than the cost of inventory that is recorded in their books. The inventory reserves are recorded as a charge towards Cost of sales. Nike use derivative contracts to hedge certain anticipated foreign currency. Their estimates of anticipated transactions can change over time and can differ from actual transactions. Nike are required to pay taxes in the United States along with any other foreign areas they operate in. Nike record any contingent liabilities that are claimed against them to then determine whether they must be subject to a loss due to conflict of any kind.

**2. Explanations for All the input variables of free cash flows and weighted average cost of capital.**

**1) All the Input variables (I): Section 1. Free cash flows**

**Investment in plant and equipment, t0 (2023)**

**$5,081 million:** This data came from the balance sheet under Property, plant and equipment, net.

**The useful life of the plant and equipment (years)**

**7 years:** This data was found from the 10K in the asset age ratios section and was accessed via research from “Stock Analysis on Net”.

**Depreciation expense by straight line method**

**$726 million:** This was calculated by dividing investment in plant and equipment by the useful life of the plant and equipment in years.

**Revenue attributable to PP&E**

**$6,934 million:** This was calculated by multiplying revenues by the PPE and then dividing by the total assets.

**Revenue Growth (%)**

11% in 2023 16% in year 7: This data was found in the 10K under Total Nike Brand Wholesale Equivalent Revenues. Nike have claimed in their 10K that they are going to continue to invest in technology that will create demand throughout their customer base in all their operating segments and expect to grow their revenue throughout the next 10 years.

**Cost of Sales (%)**

56% in 2023 to 59% in year 7: This was calculated by dividing cost of sales by revenue. Nike have estimated their cost of sales to stagnate around the current value but somewhat increase throughout the next 10 years because of their investments and potential expansions.

**Demand Creation Expense**

8% in 2023 to 14% in year 7: This was calculated by dividing the demand creation expense by revenues. According to the 10K, this has been increasing throughout the years because of the increase in the cost of production and raw materials globally.

**Operating overhead expense**

24% in 2023 to 28% in year 7: This was calculated by dividing operating overhead expense by revenues. In the 10K, it shows that there has been a tremendous increase in this expense so it can be predicted that it will continue to increase.

**Tax Rate (%)**

18.2% in 2023 to 20% in year 7: This was calculated by dividing the income tax expense by the income before income taxes. This data can also be found in the 10K as well. It states in the 10K that the tax rate has doubled from the previous years, and this is because of decreased benefits from stock-compensation and a non-cash, one-time benefit in the year prior.

**NOWC attribute to PPE (%)**

230% in 2023 to 235% in year 7: This can be calculated by subtracting the total current assets by the total current liabilities and then dividing by the revenue attributable to PP&E. This is because of the constant increase in sales that Nike has been generating according to the 10K. So, it is predicted that they will continue to increase in sales.

**2) All the Input variables (II): Section 2. Weighted Average Cost of Capital (%)**

**Market price per share, as of today ($)**

**$94.32**

**Number of Shares Outstanding**

**305 million:** The class A convertible shares outstanding found in the balance sheet.

**Market Value of Equity**

**28,768 million:** This was calculated by multiplying the market price per share by the number of shares outstanding.

**Market Value of Debt**

**14,271 million:** This was found by identifying and adding up the non-current liabilities which in this case were the long-term debt, operating lease liabilities and the deferred income tax and other liabilities from the balance sheet.

**Total MV of Equity and Debt**

**43,039 million:** This was calculated by adding the market value of debt with the market value of equity.

**Risk free rate (T-bill %)**

**5.16%:** This data was found via research through “YCharts” as of June 10, 2024, and is the 1-year treasury rate.

**Market rate (S&P 500 %)**

**10%:** This data was found via research through “NerdWallet” as of May 3, 2024.

**Beta of the Equity**

**1.01:** This was found via the price and monthly rate of the market (S&P 500) and Nike within a 60-month period.

**Equity risk premium %**

**4.89%:** This was calculated by subtracting the market rate by the risk-free rate and then multiplying it by the beta of the equity.

**Cost of equity by CAPM %**

**10.05%:** This was calculated by adding the risk-free rate with the equity risk premium.

**Cost of Debt %**

**3.875%:** This data was found in the 10K in Part 4 Item 15 where it states that 3.875% of Notes will be due in 2045.

**Weighted Average Cost of Capital**

**7.77%:** This was calculated by the following formulae: Cost of debt \* (1-Tax rate) \* MV of Debt / Total MV of Equity & Debt + Cost of Equity by CAPM \* MV of Equity / Total MV of Equity & Debt.

**3. Evaluation of the PPE investment**

**1) Interpretation of NPV, IRR, PI, DPP, and Evaluation of the capital investment (Section 7 on the Excel)**

**NPV**

**$8,050.12:** Net present value = (present value of all the future annual free cash flows) – (the initial cash outlay). From the NPV that has been calculated, we can say that it is feasible because it is greater than 0 meaning that this project is a worthwhile investment and is worth the time and money, thus we can accept it.

**IRR**

**19.56%:** Internal Rate of Return is the rate of return of the project. The IRR that has been calculated is positive and is greater than the Required rate of return (Cost of Capital) (5,081) so, we can accept it meaning that it is expected to generate greater returns which will increase profitability.

**PI**

**2.58:** Profitability Index =present value of all the future annual free cash flows / initial cash outlay. From PI has been calculated, we can suggest that it is greater than 1 which means that it is feasible and that we can accept it. Since it is greater than 1, not only will this project break even, but it will also remain profitable.

**DPP**

**6.61:** Discounted Payback Period = number of years just prior to complete recovery of the initial outlay using discounted cash flows + unrecovered amount at the beginning of year payback is completed / discounted free cash flow in year payback is completed. According to the assumptions made, it will be in the 6th year that the initial cash outlay will recover.

**4. References**

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