NIKE's CEO Discusses F1Q14 Results - Earnings Call Transcript

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NIKE, Inc. (NKE) F1Q14 Earnings Conference Call September 26, 2013 5:00 PM ET

Operator

Good afternoon everyone and welcome to NIKE’s Fiscal 2014 First Quarter Conference Call. For those who need to reference today's press release you’ll find it at http://investors.nikeinc.com. Leading today's call is Kelley Hall, Vice President, Treasury and Investor Relations. Before I turn the call over to Ms. Hall, 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 Forms 8-K, 10-K and 10-Q.

Some forward-looking statements concern future orders that are not necessarily indicative of changes in total revenues for subsequent periods due to mix of futures and at-once orders, exchange rate fluctuations, order cancellations, discounts and returns, which may vary significantly from quarter-to-quarter. In addition, it is important to remember a significant portion of NIKE Inc's continuing operations including equipment; Nike Golf, Converse and Hurley are not included in these future numbers.

Finally participants may discuss non-GAAP financial measures including references to wholesale equivalent sales. References to total wholesale equivalent sales are only intended to provide context as to the overall current market footprint of the current brands owned by NIKE Inc. and should not be relied upon as a financial measure of actual results. Participants may also make reference to other non-public financial and statistical information and non-GAAP financial measures.

Discussion of non-public financial and statistical information and presentations of comparable GAAP measures and quantitative reconciliations can be found at NIKE's website http://investors.nikeinc.com

Now, I would like to turn the call over to Kelley Hall, Vice President, Treasury and Investor Relations.

Kelley K. Hall

Thank you, operator. Hello everyone and thank you for joining us today, as we discuss NIKE's fiscal 2014 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 and at our website investors.nikeinc.com.

Before we begin our prepared remarks, I would like to take a few minutes to highlight changes to our segment reporting structure for FY 2014. Starting with Q1, we've changed our reporting structure for Other Businesses. First, Hurley and NIKE Golf are now included in our NIKE Brand geography results. This reflects changes we've made to integrate Hurley into our Action Sports category and optimize our golf business across our NIKE Brand geographies as part of our Category Offense strategies.

Second, we will be separately presenting the financial results of Converse. Converse is a key part of our continued growth strategy and this change will provide additional visibility to its financial performance and contribution to NIKE, Inc. For your benefit, we've posted a new schedule on our website at investors.nikeinc.com that provides comparable FY 2012 and FY 2013 quarterly revenues and EBIT reflecting the reporting changes we've made in FY 2014.

With that, let me now introduce the participants of today's call. Joining us will be NIKE, Inc. President and CEO, Mark Parker, followed by Trevor Edwards, the new President of the NIKE Brand; and finally you will hear from our Chief Financial Officer, Don Blair, who will give you an in-depth review of our financial results.

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, you have additional questions that are not covered by others, please feel free to re-queue and we would do our best to get back to you. Thanks for your cooperation on this.

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

Mark Parker

Thanks Kelley and hello everyone. 25 years ago NIKE launched its first "Just Do It" ad. Those are three simple words that remain a rallying cry for people striving to reach their full potential. It's a source of inspiration for me, this company and for consumers all over the world. It's that no excuses voice of the athletes that's really driven the success of this company from the very beginning. And it's what motivates us to achieve even more as we move forward.

Last quarter, I told you what to expect from NIKE in fiscal 2014. I said we were set to grow, that we would push ourselves and our partners to better serve the athlete and consumers, because that's how we will reach our full potential and deliver more value to shareholders.

Looking at Q1 results, I would say we're off to a great start. NIKE, Inc. first quarter revenues were up 8%, gross margins grew 120 basis points better than projected and diluted earnings per share increased 37% to $0.86. These are outstanding results and they demonstrate our ability to grow and more specifically that NIKE is able to generate profitable sustainable growth.

So how are we able to succeed in a challenging global economy? By focusing on the fundamentals, the competitive advantages that help us win and expand our leadership position. And today I want to highlight three, our ability to innovate, the power of the NIKE, Inc. portfolio and our ability to continue to make meaningful connections with consumers.

So let's take a look at the first one, our ability to innovate. It's what fuels our growth and it always starts with the athlete. How can we make the athletes faster, stronger, better and help them push themselves to new levels of performance.

In Q1, we launched a whole array of products that deliver on that promise, including, the Nike Free Flyknit, the next-generation of Flyknit products in our Running category. This shoe demonstrates how we take Flyknit and combining it with other footwear platforms, like Free in this case to continue to innovate and serve the athletes.

As you've heard me say before, Flyknit is high-performance visually iconic and manufactured in ways that reduce labor and waste. We've seen a strong response from runners to the Free Flyknit and we look to continue to drive innovation using this revolutionary upper technology both in the Running category and beyond. The potential for Flyknit is tremendous and it's safe to say, it's going to be a big year for Flyknit.

We launched the Hypervenom football boot, which features revolutionary design changes to improve the fit, touch and traction of the boot. This allows the player to have better ball control and improved agility on the pitch and as Trevor will detail, the Hypervenom has resonated with consumers making it the most successful boot launch in NIKE history.

We also extended our offering of Dri-FIT Knit incorporating different knit patterns to improve breathability while maintaining a seamless construction and comfortable fit. This product is one of many that have helped accelerate our premium apparel growth. And we brought a new level of sophistication and performance to Fleece with the NIKE Tech Pack, a new line of premium apparel that deliveries better fit, breathability and comfort by leveraging construction method to originally develop for technical performance product.

The Tech Pack is quickly becoming the go-to product for consumers, and will be a big driver of growth for our sportswear category going forward. This is only a small sample of our new products, we're accelerating our innovation agenda and it's paying off, and there is a lot more to come, including some real breakthroughs and game changers over the balance of this year and into the future.

The second competitive advantage I want to highlight is the power of our NIKE, Inc. portfolio. We've built the company with the focused group of high energy consumer relevant brands that create opportunity in the world of sport and youth culture. We've leveraged these brands across geographies and categories, further dimensionalizing the business. And we create innovative products to serve the consumer in their chosen sports all over the world.

The breadth and depth of the NIKE, Inc portfolio is unmatched in our industry and that means we're able to manage risk and deliver growth even when there is variability in the results of any of the individual components. We're able to leverage the strength in some areas of the business while investing in others, all with a focus on delivering sustainable, profitable growth at the NIKE, Inc. level. And our Q1 results reflect just that, we delivered a great quarter which Trevor and Don will discuss in more detail. However I would like to highlight two specific areas of our portfolio and that's Converse and China.

Let me start with Converse, Converse delivered tremendous growth in the quarter with revenue up 18% and EBIT up 36% contributing incremental growth to NIKE, Inc., on top of the strong performance of the NIKE Brand. Converse is a brand that has been bringing energy and style to consumers for many years and the opportunities ahead are even greater. We continue to diversify the Converse portfolio, expand the brands reach with new market conversions, grow the DTC business and unlock growth in apparel. I see tremendous long-term growth potential for the Converse brand.

Now let me turn to China. The NIKE Brand remains on top as the leading sport brand in China, as we continue to make progress on repositioning this market for long-term sustainable growth, I have to say, I'm truly excited about the progress we're making in this key market and the opportunity it represents. We're laying a strong foundation and mastering the fundamentals that will enable the next wave of growth in this very dynamic market.

I'm seeing a whole new level of engagement with our wholesale partners, as we work together to increase store productivity by creating a [pull] [ph] market fueled by amazing products and elevated retail presentation. We're increasing the power of our Category Offense by focusing our assortment with a greater level of precision on the sports and the products that mean the most for the Chinese consumer.

And in those stores that have been retrofitted to the new product assortment, we're seeing performance that significantly outpaces the rest of the fleet. The knowledge we've have gained from these early results can be leveraged and scaled to drive significant improvements across the entire market. And together with our partners, we have a shared vision. We both know the companies that will win in China are those that build their brands, capabilities, and connections with consumers.

And that brings me to the third competitive advantage I'd like to talk about, and that's our ability to make meaningful connections with consumers. And that really is key, as those connections ensure we continue to be the brand of choice for consumers. We connect with consumers in a number of ways through digital, which allows us to listen to the athlete and build communities and services that help expand the experience of sport, through key events, which brings consumers together to experience their favorite sport with other as passionate as they are. And through our retail stores, where we can interact directly with our consumers as they decide, which products are best for them.

A great example of these consumer connections is taking place in a market I recently visited and that's Russia. I feel great about the work our team is doing there. The energy for the NIKE Brand is incredible and that stems from the meaningful connections we're making with consumers and we're helping to increase activity levels and bring greater access to sport.

Let me share a few examples from Running, a category where we're bringing tremendous energy and seeing participation levels rapidly increase in Russia. We had Run Moscow and other NIKE We Run events, which bring out thousands of runners and the summer of running digital campaign created connections that lasts long after the last runner crosses the finish line.

These are just a few examples that show how NIKE is making meaningful connections with those consumers and it is really no coincidence that we see our revenues in futures growing at double-digit pace in Russia, quickly gaining share and growing the market. These are the kind of connections that excite us, our consumers and ultimately serve as building blocks to grow our business.

And that brings me to the final point I want to make today, and that's how we use these three competitive advantages, our ability to innovate, the power of our portfolio and our ability to connect with consumer to build our business. We do that by focusing on the greatest opportunities for growth.

Looking ahead, there are both risks and opportunities for NIKE. However, we're confident we have the strength across our brands, businesses and balance sheet, as well as a deep experience team to manage the risks and seize the opportunities. So thanks everybody and now I'm happy to welcome Trevor Edwards, our new NIKE Brand President. As you know, Trevor is new to this call, but he is certainly not new to NIKE. Trevor brings two decades of NIKE experience to the role, as well as a relentless focus on the consumer and a deep knowledge of the Category Offense.

And with that, I'll turn it over to Trevor to take you through the results of the NIKE Brand. Thank you.

Trevor Edwards

Thank you, Mark. As I start my new role and after more than 20 years with NIKE, it's exciting to see so much opportunity in front of us, and we are focused on realizing that opportunity. At NIKE, we always start with the consumer and as we've shared before our Category Offense brings us closer to the consumers, it focuses our teams, and underscores our competitive advantages.

Our pipeline of innovative products to make athletes better, our ability to create deep and meaningful connections with consumer and our capability to elevate and transform the marketplace creating more space and more opportunity for our brand to grow. This is the complete offense we often talk about, it is the foundation of our growth strategy and allows us to continue to drive growth in both developed and developing markets. It's a strategy that only NIKE can execute at such a global scale and it's the basis for the strong financial performance we share today.

So on a constant dollar basis, NIKE brand revenue was up 7% for the quarter with growth across most of our key categories and geographies except Greater China. NIKE Brand DTC revenue increased 18% for the quarter with comp growth up 9% and online sales up 12%. And in addition our global futures grew 10%. Our strategies are working and our portfolio of businesses delivered during the quarter across product types, geographies and categories. Now let's focus on three of our key geographies.

Our business in North America continues to be a tremendous source of growth for the NIKE Brand. North America provides a great benchmark what is possible around the world, we continue to deliver innovative products, we deepen our consumer connections, we elevate our distribution strategies in the market and in our largest and most penetrated market, we continue to see further opportunities to growth.

For the quarter, revenues grew 9% to $3 billion and we grew in all key categories except Golf. Our two biggest categories Basketball and Running led the growth continuing their double-digit rate and it was very profitable. We continue to grow in North America, because of our focus on leveraging and integrated, yet differentiated marketplace as we consistently work to provide unique consumer experiences across wholesale, DTC and online. We are able to expand both the market and our share, this integrated approach ensures we continue to maintain a strong pool market and drive profitability.

Let me illustrate with one key example, our Women's business in North America. We've been building deep and meaningful relationships with women through our digital app called the NIKE Training Club. To date, we have 10 million downloads and 600,000 workouts every week. This virtual club creates a community of women who work out with us every single day.

This past quarter, we extended the idea of the training club to launch a new retail concept for our women's business to create new marketplace capacity. This catalyzing concept started with our own DTC doors and online and will eventually rollout to our retail partners. The concept is simple and powerful one stop shopping for our running, training and sportswear needs. It's where personal training meets personal shopping and styling. It starts with great premium product from footwear to apparel, performance to sportswear with style led presentations and limited edition offerings.

Next come Pinnacle Services, certified retail staff, personal stylist, and fitting room services. Finally we create community in-store studios events and our running and training clubs. This is one example of how we're continuing to capture growth opportunities in North America. Let me turn your attention now to China. As Mark mentioned, we continue to make progress against our strategic reset. However, the results in China will not always be linear.

For Q1 revenue declined by 3% and our wholesale comp performance slowed this quarter. However, the subset of our apartment doors that have been retrofitted with more focused assortments are performing well and in our own NIKE DTC doors, comp growth was up over 20%. The knowledge we've gained from these early successes can and will be leveraged across the entire markets. We are fully confident and committed to the strategies that we've laid out and more than ever believe in the long-term enormous opportunity in China.

I opened today talking about the consumer is at the centre of everything we do. This couldn't be more true than in China, we are the sport brand of choice and we continue to drive energy into the marketplace. Over this summer, we brought an All Star lineup of NBA athletes to China. LeBron, Kobe, Kevin Durant, Carmelo Anthony, Chris Paul, Blake Griffin and Russell Westbrook connecting them with hundreds of thousands of Chinese consumers.

Now, at the heart of our reset in China is the goal of creating more productive and profitable retail for our retail partners and NIKE. There are three core elements to these plans. First, we segment and differentiate our points of distribution to create more targeted consumer experiences and to increase marketplace capacity. Second, we are sharpening our merchandising strategies assorting at the door level focusing on the products and categories that the Chinese consumer wants most and third we are working to create more seamless operating platform ensuring we get the right product to the right door at the right time. We continue to be aggressive and take decisive action to reset this market, but we’ll do it the right way, creating a foundation for long-term sustainable and profitable growth.

Finally, let me touch on Western Europe. About 18 months ago, we made a decision to reorganize our business in Western Europe, to drive a more centralized and consistent consumer experience across the geography and elevate the distribution strategies, with North America serving as the blueprint, we invested in a market reset to create a platform to capture the next wave of growth in this geography.

I just got back from visiting the teams and seen the market. Great progress has been made and the teams are energized and passionate about the opportunities ahead. In the Northern territories, we are seeing tremendous results led by double-digit growth in two of our largest territories, the U.K., and along with AGS, which is made up of Austria, Germany and Switzerland.

The strength of the northern territories help balance the results in the southern territories which face macroeconomic challenges. Our results in Western Europe, demonstrate that our strategies are working, there is still a lot of work to be done and opportunity to be captured, but the early returns are very positive. We see Western Europe as a strong driver for growth for the NIKE Brand for the long-term.

Now let’s move to the category side and start where this company started over 40 years ago with Running. Q1 marks the 15th consecutive quarter of double-digit growth in Running, the success was broad based in footwear and apparel with men’s and women’s in North America and Internationally and our future orders are up double-digits as well. We lead in Running with the launch of innovative products, Nike Free Flyknit, LunarGlide 5, Pegasus 30 and our premium apparel Dri-FIT Knit all designed to help athletes perform better and there is a lot more on stage and ready to go to deliver for the balance of the year.

We continue to deepen our connection with runners at retail online and at events, our Nike Running Clubs continued to gaining popularity at the same time we are adding 100,000 new runners per week to Nike+. We also continue to elevate distribution. In our own DTC doors, we have seen strong performance in Running and the success of the Running category door like Flatiron in New York City and also Covent Garden in London. These stores validate our strategies and that wholesale were seeing results n the Running concepts like the Track Club with Finish Line that significantly outpaced the balance of their fleet of their fleet in North America. But we still have room for further penetration in North America and we are just getting started across our other geographies.

The last category I would touch on is global football or soccer to many of you. Even on the back of the prior year numbers, which include the European Championship, football grew double-digits in the quarter one, with futures order book also up double-digits. With the energy around the World Cup next year in Brazil, we intend to build on our position as the leading football brand in the world. And as we've said many times, we gain our insights from the best athletes on the planet, which allows us to deliver unparalleled innovation to our consumers globally from Rio to Paris to Tokyo.

A great example is the new Hypervenom boot, rooted in insights from the best players in the world like the Brazilian and FC Barcelona star, Neymar. We work with him and other football players to create this new boot, and as Mark mentioned, it has become the most successful boot launch for NIKE Football ever. I was in Brazil in May working with the team as part of the launch, the result was a phenomenal global marketplace execution, creating energy and excitements in all geographies. The Hypervenom is already our number two selling boot behind our iconic Mercurial boot.

You can expect to see us bring more amazing innovations, connect more powerfully with our consumers and drive more energy into the market, as we head into the World Cup in Brazil and well beyond. We're off to a great start on the fiscal year and our results show that NIKE is more than a brand, it's a portfolio of growth opportunities and we are set to capture those opportunities, because of the focus and investments we make for NIKE's long-term potential.

Thanks. Now, here is Don.

Don Blair

Thanks, Trevor. Earlier on this call, Mark and Trevor described how our Q1 results demonstrate key NIKE assets and capabilities that enable us to drive growth and competitive advantage. I'm going to build on that by illustrating how we use those competitive advantages to create value for our shareholders.

Let me start with the NIKE portfolio. As Mark indicated, our global portfolio of businesses gives us the ability to deploy our innovation, marketing and operational capabilities across the broadest range of opportunities in the industry. It also provides us with the diversification to deliver consistent growth and manage risk. Our Q1 results certainly reflect the strength of our portfolio.

Revenue was higher for every geography except China as our European geographies led the way with accelerated growth in revenues and futures. Converse also posted high-teens revenue growth. On a category basis, strength in Running, Basketball and global football set the pace. And on the product side, premium performance apparel outgrew moderately priced sportswear driving higher average prices and gross margin.

The second competitive edge is our ability to connect with consumers to our brands, our products and our retail presentation all through a category lens. As Trevor said, those connections have never been deeper or stronger allowing us to expand the market and gain share. They also enable us to move the consumer to more premium products and price points increasing productivity and profitability for NIKE and our retailers. You've seen this reflected in our Q1 results as our gross margins expanded 120 basis points due in part to higher net average prices and a shift in mix to higher margin products.

The third competitive edge is innovation. As Mark and Trevor both noted, innovative products such as Flyknit and Hypervenom footwear and Tech Pack sportswear apparel were examples of our innovation leadership in Q1. As we continue to invest in innovation, we expect to deliver even greater impact on revenue, gross margin and overall profitability.

Underlying those competitive edges is the financial and operational discipline to allocate resources to the highest potential opportunities and maximize ROI. We demonstrated that in Q1 as we delivered record revenues in EPS, raised our overall working capital productivity and increased our ROIC to a record a 25.4%, 410 basis points higher than last year.

With that introduction let me walk you through our first quarter results. First quarter revenue for NIKE Inc. increased 8% on both reported and currency neutral basis as revenue for the NIKE Brand including NIKE Golf and Hurley increased 7% and Converse increased 16%. NIKE Brand futures orders accelerated to 10% growth on a currency neutral basis reflecting a 7% increase in units and a 3% increase in average selling price.

The increase was led by double-digit growth in North America and both European geographies. Weaker foreign currencies reduced reported futures growth to 8%. First quarter diluted EPS increased 37% to $0.86 driven by revenue growth, gross margin expansion and leverage of SG&A expenses which were flat for the quarter. On our last call, we said we expected FY 2014 growth to be significantly front loaded in Q1 due largely to the comparison to last year's heavy demand creation investment and that's indeed been the case.

Gross margin for the quarter increased to 120 basis points, driven by lower raw material costs, a mix shift to higher margin products, higher average prices and lower discounts, as well as growth in our DTC business and Converse. These upsides were partially offset by higher labor costs and FX headwinds, due largely to weaker emerging market currencies.

Q1 demand creation decreased 16% versus heavy investments in the prior year to support the European Championships, Olympics and product launches. Operating overhead grew 12% for the quarter, due to continued investments to support growth initiatives particularly digital and our DTC business. Other expense, net was $28 million for the quarter, driven primarily by FX conversion losses due to weaker emerging market currencies.

The net year-over-year impact of these conversion gains and losses combined with the translation of our foreign earnings resulted in a $38 million downside to EBIT for the quarter. As I'll discuss in a moment, we expect FX headwinds to put pressure on the balance of year revenue and earnings. The Q1 effective tax rate was 25%, 190 basis point improvement due primarily to a lower effective tax rate on operations outside the United States.

Working capital productivity continued to improve in Q1 as accounts receivable fell 3%, while inventory grew only 6% below the rate of revenue and futures growth. Closed out inventory levels are healthy, reflecting tighter management of inventory supply as well as the expansion and increased productivity of our factory stores. We will continue to monitor both the inventory on our books and at retail as we work with our retailers to maintain a healthy marketplace.

Now let's take a look at our performance by segment. In North America Q1 revenue increased 9% on both reported and constant currency basis, driven by growth across all key categories except Golf including double-digit growth in Basketball, Running and Men's Training. For the quarter, footwear revenue increased 9% while apparel and equipment grew 9% and 13% respectively. DTC revenues grew 12% in the quarter driven by 5% comp store sales growth.

Q1 EBIT for North America grew 26% due to strong revenue growth, gross margin expansion and SG&A leverage. In Western Europe, Q1 revenue growth accelerated to 8% on a currency neutral basis. As Trevor noted, the growth was broad based and particularly impressive given the strong results last year driven by the London Olympics and the European Championships as well as the ongoing macroeconomic weakness, in the region.

On a reported basis, Q1 revenue for Western Europe increased 11% and EBIT increased 25% driven by revenue growth and lower demand creation spending, partially offset by gross margin compression driven primarily by FX. Central and Eastern Europe also delivered strong results in Q1 with currency neutral revenue growth of 10% led by double-digit growth in Russia, Turkey and Poland.

On a category basis revenue for Football, Running and Basketball also grew at a double-digit rate. On a reported basis, Q1 revenues for Central and Eastern Europe grew 12% and EBIT increased 50% driven by revenue growth, gross margin expansion and lower demand creation spending. In Greater China, currency neutral revenue declined 3% in Q1 as growth in sportswear and basketball was offset by declines in other categories.

On a reported basis, Q1 revenue in Greater China decreased 1%, but EBIT increased 3% due to gross margin expansion and lower demand creation spending largely offset by investments in our DTC business. You've heard from both Mark and Trevor about the progress we're making in resetting the market place in China. This work will take commitment and patience and we're confident the steps we're taking now will set the foundation for a continued market leadership and profitable growth well into the future.

As we've noted on previous calls, our reported futures and revenue growth for China won't always follow a smooth trajectory as we reset the market. At this point, we're expecting revenue growth in Q2 with overall FY 2014 revenues roughly inline with the prior year. In Japan, Q1 revenue increased 1% on a currency neutral basis, driven by double-digit revenue growth in football and basketball offset by declines in running NIKE sportswear in men's and women's training. On a reported basis, Q1 revenue for Japan decreased 20% reflecting the impact of the weaker Yen, while EBIT increased 4% as the drop in revenue was more than offset by lower SG&A spending and gross margin expansion.

Q1 revenue for our emerging markets geography was up 5% on a currency neutral basis, driven by strong growth in Brazil and Argentina. This performance was partially offset by weaker results in Korea and more prominently in Mexico where shipping delays caused by a distribution center transition reduced our revenue. Excluding the impact of the shipping disruption in Mexico emerging markets revenue would have increased at a double-digit rate.

Weaker currencies were also a significant financial drag in the emerging markets geography, reducing Q1 reported revenue growth to 1% and compressing gross margin. EBIT decreased 5% due largely to these FX headwinds and higher operating overhead, partially offset by lower demand creation spending.

For Converse, first quarter revenue increased 16% on a currency neutral basis driven by strong result in the U.S. and U.K., two of our largest owned markets. On a reported basis, revenue and EBIT increased 18% and 36% respectively. The growth in EBIT was driven by higher revenue and gross margin expansion due to a shift in mix to higher margin territories and products.

For the fiscal year, our expectations for the underlying performance of our business are essentially inline with the guidance we gave last quarter. However, as I mentioned earlier, we expect increased currency headwinds to put pressure on our reported revenue and earnings for the balance of the fiscal year. We expect revenue for the second quarter and full fiscal year to grow at a high single-digit rate reflecting FX headwinds. On a reported basis, this would be slightly below our earlier expectations.

On the other hand, we are encouraged by our gross margin performance, which exceeded our expectations in Q1. We continue to increase average selling prices by strengthening the premium segments of our business and by taking selective price increases around the world, and we are expanding our high margin DTC business. For the second quarter, we expect to see gross margin expansion of about 50 basis points driven by continued benefits from higher average prices, easing raw material costs and growth in DTC, partially offset by higher discounts to clear inventories in Mexico, start-up cost for our expanded U.S. distribution center and stiffening FX headwinds.

For the fiscal year, we also expect gross margin expansion of approximately 50 basis points, a modest increase from our prior guidance as the ongoing impact of the upside that drove our Q1 results are expected to more than offset FX headwinds and labor cost inflation.

For Q2, we expect SG&A to grow at a mid-teens rate reflecting shifts in demand creation facing and ongoing investments in strategic initiatives. As we indicated last quarter, there will be more volatility in the year-over-year comparisons of SG&A due to the timing of key sporting events this year and last.

For the full year, we continue to expect SG&A to grow at a low double-digit rate, as we invest in our brands, DTC and Innovation. For FY 2014, we continue to expect the effective tax rate will be about 25%.

Q1 was a great start for fiscal 2014 delivering strong growth in revenue and profitability. Over the balance of the year, we expect to continue to drive revenue growth and gross margin expansion, while making the investments in demand creation and innovation that will deliver sustainable profitable growth and consistent value to our shareholders in the future.

We're now ready to take your questions.

Question-and-Answer Session

Operator

[Operator Instructions] And your first question comes from Bob Drbul with Barclays. Your line is now open.

Robert Drbul – Barclays Capital

Good evening.

Kelley K. Hall

Hey Bob.

Trevor Edwards

Hi, Bob.

Robert Drbul – Barclays Capital

Trevor welcome.

Trevor Edwards

Thank you very much.

Robert Drbul – Barclays Capital

Good luck. The question that I have on the European business and the business in China can you talk about the macro impacting you, I mean the numbers have been very impressive and especially both Western Europe and Central Europe especially in the futures side. So is the macro a big factor there and how sustainable do you think these impressive results can be?

Mark Parker

Well Bob, first of all I just want to reiterate one of the things that we've seen over the course of years with our businesses is the strength of our business is much more a function of whether we've got the product right, the brand is strong and our distribution is really compelling than the macro. So I think we certainly have seen in Southern Europe some impact from macros, but I think our overall results in Western Europe and China is really driven by what we're putting out there in the marketplace.

Trevor Edwards

Yes Bob this is Trevor obviously. And probably what I would add is that, in both of those marketplaces that we're talking about what we've certainly seen is our ability to stay connected with our consumer and build the brand has been sort of like paramount in driving the growth that we've been seeing. Certainly the thing that we're working on and did in both markets was to reset them to ensure that we continue to maintain a really strong pull in the marketplace. And we're working through that in China, but obviously we're seeing some really good results come through in Western Europe.

Robert Drbul – Barclays Capital

Okay and then the other question was just on the Women's business in U.S., the training business, and I think some of the legend product. Can you just talk about -- if you feel like you're getting traction there and a lot of the initiatives if you could elaborate a little bit more just in that specific product?

Trevor Edwards

Yes I'm actually super excited about the work that we've been doing in the women's business. We are actually seeing some really good positive momentum as we talk about putting those new concepts into the marketplace. The things that we focused on really was first and foremost get the product right and so as you commented on the Legend Pant, we're seeing some great success with all the parts we are putting through. We're really focused at the premium end and that's been doing really well for us.

We continue to connect with our consumers, obviously the Training Club is a great example of how we do that. And so the third area that we're focused on right now is really the distribution. And really making sure that now we can get – give the consumer access to that product. That's why we've created these concepts. As these concepts get better, we'll roll them out into more of our retail stores. We're super excited about what we're seeing and the results that we're getting.

Robert Drbul – Barclays Capital

Okay. Thank you very much. Good luck.

Mark Parker

Thank you.

Kelley K. Hall

Thank you, Bob.

Operator

And your next question comes from Omar Saad with ISI Group. Your line is now open.

Omar Saad – ISI Group

Thanks. Good afternoon. One of the themes like kind of heard throughout the call and seems to have been present the last several quarters is your own retail business really performing extremely well, not that your wholesale business is struggling, but this relative out performance really sticks out even in places like China, but also in the U.S. can you talk about this shift? How much of it is strategic that you're directing or is that where your consumer is taking you, what does this mean for some of your wholesale partners? Kind of looking at this bigger picture here, any insight you could provide, because it's pretty interesting what's going on?

Trevor Edwards

Sorry Omar, great question there. I think part of it is our strategy around our DTC, we clearly use DTC as an opportunity for us to really improve our assortments to make sure that we have the best lines. And so what we're able to do is really use it as a spearhead and so what you're seeing in our DTC doors is really great performance, because we have the right assortments coming through those doors. The more we learn, the more we then take those to our retail partners. And so what we've been seeing is our ability to drive a really integrated marketplace is really helping to drive these kinds of results. But obviously, we use our DTC as a lab, as it were and also is a way to ensure that we can get our premium products to the marketplace.

Mark Parker

Yes, I'll jump into the – I have always said that focus on our DTC business, this effort to become a better retailer will make us a better wholesale partner, which is what Trevor just talked about, and I think that's really paying off. We've learned so much as we've committed to being a great retailer that we're applying to becoming a really good wholesale partner that's most obvious in the North America, in the U.S. market, where we are more advanced in the market segmentation that we're doing with some of our top accounts and that's the model that we're working diligently on in Europe, Western Europe, especially and then certainly in China. We are in different stages of that development. But very confident that that model will actually translate well around the world.

Omar Saad – ISI Group

Thanks. And then really quick on China, as you kind of go through the reset there, how do you think about maybe reducing or resetting all those lower volume concession shops and maybe doing more of these kind of high volume, whether it's DTC or with partners? Is that the kind of shift that's necessary on the ground at retail there?

Trevor Edwards

Yes. I would say that our true intent in China is to make sure that we drive a more productive and profitable retail. And we believe that you do that by segmenting the market and creating greater differentiation, I mean in the marketplace. That gives the consumer more targeted experiences.

At the same time, we're working really on driving our merchandising strategies, working at the door level. So that we can ensure that the consumers are getting exactly what they need. And then at the same point, we're also looking at driving a better operating platform that allows us to get the right product to that consumer at the right time. And so that obviously doing that will create more shifts, so that we have the opportunity to go for the next wave of growth that we see in China, because we truly see tremendous potential.

Omar Saad – ISI Group

Thanks, great quarter guys.

Kelley K. Hall

Thank you, Omar.

Mark Parker

Thank you.

Operator

Your next question comes from Robby Ohmes with Bank of America. Your line is now open.

Robert Ohmes – Bank of America Merrill Lynch

Thanks, great quarter guys.

Mark Parker

Thank you.

Kelley K. Hall

Hi, Robby.

Robert Ohmes – Bank of America Merrill Lynch

Hey, I just had two quick questions, one just a follow-up on North America. Some of the retailers have been talking about how great their business is with you. We've heard it start to come more from places like Kohl's and Macy's and even some of the shoes that have been highlighted, have been things like the Roshe, which is a lower price point so the ASPs still are positive and look strong in your futures. But could you maybe help us understand or is your channel distribution shifting a little bit in terms of what's leading the growth either with the family channel, or again Macy's et cetera and how that might play into the ASP outlook as we look over the next year? Thanks.

Mark Parker

Well, let me just jump in and say there is no shift in our channel strategy. What you I think are seeing is a result of our focus in we often like to say our complete offense. So you see shoes like the Roshe, which has been widely successful, more accessible price point in some ways. And that's actually taking place in many, many different channels. But really it's bringing that kind of innovation to more accessible price point in general.

But our fixation, our obsession on bringing performance not only to the very top of the line, but throughout the line is continuing. And I think you'll see some shifts here and there, but overall you're going to see us over the course of this coming year drive some incredible innovation that's going to keep the focus on premium and our unique position is then to draft off of that and create this complete offense down through the price points as well.

Robert Ohmes – Bank of America Merrill Lynch

And then just quick follow-up question, small business for you, but Golf, could you sort of walk us through what's made that business weaker and when you see it turning more positive?

Trevor Edwards

Yes, the issue with Golf is really – it's really much more of an operational issue that actually drove the weakness in this particular quarter. We had some supply chain challenge in Canada and that's really the impact that drove that. But other than that, the business continues and fundamentally being at really good place. So that was really just a result of just a small thing.

Robert Ohmes – Bank of America Merrill Lynch

Great. Thanks very much guys.

Operator

And your next question comes from Kate McShane with Citi. Your line is now open.

Kate McShane – Citigroup Global Markets Inc.

Thank you. Good afternoon.

Kelley K. Hall

Hi, Kate.

Mark Parker

Good afternoon.

Kate McShane – Citigroup Global Markets Inc.

I think you had mentioned in your comments that you saw some gross margin expansion in China and I wonder what that implies for where you are with working through your inventory in the region?

Don Blair

Well, I would go back to some of the language we used, which is there's going to be a lot of volatility in China, and I would say overall, we are continuing to make progress in managing inventory. I don't think I would read the gross margin results as any sort of milestone along the road. We are making progress. We do feel that we are getting that market set in right place. I think it's really more the broad global drivers that helped our margins everywhere. Things like easing raw materials cost, shifts and mix, those are the things that I think were the more powerful drivers of what was going on in China.

Kate McShane – Citigroup Global Markets Inc.

Okay. Great and my second question is, as you reset China, is there any change in mix of product in apparel versus footwear with the changes that you're making or is the mix of products generally staying the same?

Trevor Edwards

I would say that the broader mix will probably stay the same how the mix actually affected at a store level will be different because we really are working on just making sure that we have the right assortments in each of the doors, but I think overall the mix will generally be the same.

Mark Parker

Let me add that the category focus in China is going to be more intense, we're actually trying to zero-in on the shorter listed categories that have the greatest potential for growth. So we'll have the more targeted mix of products, but the ratio of footwear and apparel we're not seeing a dramatic shift in that ratio.

That said see tremendous upside in the apparel business in China for NIKE to move forward and frankly around the world. That's one of the – what I would call underpenetrated segments of our business today. But no specific targeted change in the overall mix in China except for maybe more of a focus in terms of the category breadth.

Kate McShane – Citigroup Global Markets Inc.

Thank you.

Operator

And your next question comes from Lindsay Drucker Mann with Goldman Sachs. Your line is now open.

Lindsay Drucker Mann – Goldman Sachs

Thanks. Good afternoon everyone.

Kate Mcshane

Hi Lindsay.

Mark Parker

Hi Lindsay.

Lindsay Drucker Mann – Goldman Sachs

On the gross margin front, can you talk about the key differences versus your original guidance that led to the upside to be versus your expectation and then as you think about the next quarter where you expect those tailwinds to moderate so that you see a little bit more modest improvement?

Don Blair

Well it's one of the things that were little better than what we expected. We did have an even more favorable product mix than we expected that was one of the pluses, we also had our investments in our North America distribution center come in a little bit later than what we had originally expected. We have had tremendous growth in North America and we've been doing some work in our Memphis hub putting some new capacity in down there and we expected a lot of those cost to hit in the first quarter and they came in the second.

So those are two other things that really shifted versus our guidance. I think if you look at the year-on-year drivers as I said, it was easing raw material costs, shifts to premium price increases. We had some great results out of Converse and DTC has been quite strong. We think those really will carry through a lot of the balance of the year plus or minus.

But couple of things that are changing. We are seeing the FX headwinds get a little stiffer and we also expect that we're going to have those supply chain investments particularly in North America start to flow in a little bit later in the year. So those are really what I would call out of the major shifts from the first quarter into the balance of the year.

Lindsay Drucker Mann – Goldman Sachs

Okay, thanks. And on the North American Direct-to-Consumer piece, can you maybe I missed it, but what was your e-commence growth in the region in the period, and can you talk about some of the initiatives you have in place to drive growth in that platform?

Don Blair

Yes usually we don't give that level of granularity by geography. Overall we were up. I believe it was 12% online. And one of the things to bear in mind is we had an extremely strong year last year. So we're about 50% two year growth on the online business and we are continuing to be extremely enthusiastic about the potential for that piece of our business.

Trevor Edwards

Yes, I mean I would say as Mark pointed out that's one of the most critical growth drivers for us in the future. So we expect to see continued momentum and growth in that part of the business.

Lindsay Drucker Mann – Goldman Sachs

Is there anything in terms of functionality or marketing or otherwise we can look forward to specifically in the U.S., balance of the year or in the next couple of years?

Trevor Edwards

Yes, we continue to make sure that we improved the site and all the experiences. But you will kind of see those as they rolled out in the months coming up.

Lindsay Drucker Mann – Goldman Sachs

Okay, thanks.

Operator

You are next question comes from Matthew Ross with JPMorgan. Your line is now opened.

Matthew Ross – JPMorgan

Yes, congrats on a good print. I wanted real quick, share repurchase was almost doubled last two quarters and you took on $1 billion of debt also in the quarter. Can you speak to the mindset around capital allocation and how should we think of this as part of the earnings algorithm going forward?

Don Blair

Well, the debt issuance does not signify any change in our approach to capital allocation. As we've been pretty consistent over the last few years that we believe we're going to be throwing off quite a bit of cash flow. We expect to be continuously raising our return of cash to the shareholders, at the same time that we will be investing in the business.

And that pattern of consistent increases in cash return to shareholders as well as consistent increase investment in our business is what we've actually demonstrated over the last decade, so no change there. The offering of debt at the time we did it, I think gives us tremendous flexibility in our capital structure and frankly those interest rates were outstanding.

Matthew Ross – JPMorgan

Okay. And then more of a clarification, on your full year guidance is EPS still expected to grow at a double-digit rate for the year?

Don Blair

We don't give that level of EPS guidance. We try to give people parameters to help them understand what's ahead. But at this point, I'd rather stay with the guidance that's in the prepared remarks.

Matthew Ross – JPMorgan

Okay. Was there any change from last quarter?

Don Blair

I think the conversation was about line-item guidance and I think that's where I'd like to stay on the guidance.

Kelley K. Hall

Matthew feel free to follow-up with the IR team. We'll walk you through it.

Matthew Ross – JPMorgan

Okay, great.

Kelley K. Hall

Operator, we have time for one more question.

Operator

And your last question comes from Jim Duffy with Stifel. Your line is now open.

Jim Duffy – Stifel Nicolaus

Thanks, hello everyone.

Kelley K. Hall

Hi, Jim

Mark Parker

Hi, Jim

Jim Duffy – Stifel Nicolaus

I'm interested in some more commentary on the strategy to continue to take prices higher, have you seen any evidence of resistance to price, and has the reception to price been consistent across regions?

Trevor Edwards

I think we're looking at in sort of a really two ways right, one is sort of making sure that we have great price value in the marketplace. So we always want to make sure that each season we go in and we're evaluating the pricing that we're currently setting to make sure that we actually are taking the opportunities when that there to go back to the right price, at the same time what we're also doing is driving the change in the mix of our business.

So you will see us really drive a lot of premium concepts certainly we've seen that across the board, and we're certainly seeing really not a lot of resistance to that at all. In fact we're seeing tremendous growth around our premium businesses. So as Mark talked about process really the complete offense, making sure that we are competitive on the one side, but also taking price when the opportunity prevails itself.

Jim Duffy – Stifel Nicolaus

Great, thanks. And then Don so some of the increased FX headwinds seem to be from emerging market currencies does that make it more costly or difficult to hedge against the exposure?

Don Blair

Well, you are exactly right. And in fact for many of those currencies it's really not very economical to hedge them, but over the last few years we've taken a number of steps to reduce our overall exposure, we have built an internal trading company we have really done some adjustments to how we source.

And so we think we've done some things that have reduced the exposure. But the currencies like the Reais, the Argentine Peso, the Russian Ruble, it's not great tools out there to economically hedge them. So to some degree, we are exposed at some level for those currencies.

And what we do is we really manage our overall P&L equation across the whole portfolio. So as we talked about these adjustments are there, but we're not so exposed to anyone currency and we've got lots of levers to pool across the portfolio to continue to deliver consistent growth.

Jim Duffy – Stifel Nicolaus

That's helpful. Thanks, see you in a couple of weeks.

Mark Parker

Thank you.

Kelley K. Hall

Thanks everyone for joining us. And we'll talk to you next quarter.

Operator

And this concludes today's conference call. You may now disconnect.

Executives

Kelley K. Hall – Vice President Treasurer & Investor Relations

Mark Parker – President and Chief Executive Officer

Trevor Edwards – President, NIKE Brand

Don Blair – Executive Vice President & Chief Financial Officer

Analysts

Robert Drbul – Barclays Capital

Omar Saad – ISI Group

Robert Ohmes – Bank of America Merrill Lynch

Kate McShane – Citigroup Global Markets Inc.

Lindsay Drucker Mann – Goldman Sachs

Matthew Ross – JPMorgan

Jim Duffy – Stifel Nicolaus

NIKE, Inc. (NKE) F1Q14 Earnings Conference Call September 26, 2013 5:00 PM ET

Operator

Good afternoon everyone and welcome to NIKE's Fiscal 2014 First Quarter Conference Call. For those who need to reference today's press release you'll find it at http://investors.nikeinc.com. Leading today's call is Kelley Hall, Vice President, Treasury and Investor Relations. Before I turn the call over to Ms. Hall, 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 Forms 8-K, 10-K and 10-Q.

Some forward-looking statements concern future orders that are not necessarily indicative of changes in total revenues for subsequent periods due to mix of futures and at-once orders, exchange rate fluctuations, order cancellations, discounts and returns, which may vary significantly from quarter-to-quarter. In addition, it is important to remember a significant portion of NIKE Inc's continuing operations including equipment; Nike Golf, Converse and Hurley are not included in these future numbers.

Finally participants may discuss non-GAAP financial measures including references to wholesale equivalent sales. References to total wholesale equivalent sales are only intended to provide context as to the overall current market footprint of the current brands owned by NIKE Inc. and should not be relied upon as a financial measure of actual results. Participants may also make reference to other non-public financial and statistical information and non-GAAP financial measures.

Discussion of non-public financial and statistical information and presentations of comparable GAAP measures and quantitative reconciliations can be found at NIKE's website http://investors.nikeinc.com

Now, I would like to turn the call over to Kelley Hall, Vice President, Treasury and Investor Relations.

Kelley K. Hall

Thank you, operator. Hello everyone and thank you for joining us today, as we discuss NIKE's fiscal 2014 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 and at our website investors.nikeinc.com.

Before we begin our prepared remarks, I would like to take a few minutes to highlight changes to our segment reporting structure for FY 2014. Starting with Q1, we've changed our reporting structure for Other Businesses. First, Hurley and NIKE Golf are now included in our NIKE Brand geography results. This reflects changes we've made to integrate Hurley into our Action Sports category and optimize our golf business across our NIKE Brand geographies as part of our Category Offense strategies.

Second, we will be separately presenting the financial results of Converse. Converse is a key part of our continued growth strategy and this change will provide additional visibility to its financial performance and contribution to NIKE, Inc. For your benefit, we've posted a new schedule on our website at investors.nikeinc.com that provides comparable FY 2012 and FY 2013 quarterly revenues and EBIT reflecting the reporting changes we've made in FY 2014.

With that, let me now introduce the participants of today's call. Joining us will be NIKE, Inc. President and CEO, Mark Parker, followed by Trevor Edwards, the new President of the NIKE Brand; and finally you will hear from our Chief Financial Officer, Don Blair, who will give you an in-depth review of our financial results.

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, you have additional questions that are not covered by others, please feel free to re-queue and we would do our best to get back to you. Thanks for your cooperation on this.

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

Mark Parker

Thanks Kelley and hello everyone. 25 years ago NIKE launched its first "Just Do It" ad. Those are three simple words that remain a rallying cry for people striving to reach their full potential. It's a source of inspiration for me, this company and for consumers all over the world. It's that no excuses voice of the athletes that's really driven the success of this company from the very beginning. And it's what motivates us to achieve even more as we move forward.

Last quarter, I told you what to expect from NIKE in fiscal 2014. I said we were set to grow, that we would push ourselves and our partners to better serve the athlete and consumers, because that's how we will reach our full potential and deliver more value to shareholders.

Looking at Q1 results, I would say we're off to a great start. NIKE, Inc. first quarter revenues were up 8%, gross margins grew 120 basis points better than projected and diluted earnings per share increased 37% to $0.86. These are outstanding results and they demonstrate our ability to grow and more specifically that NIKE is able to generate profitable sustainable growth.

So how are we able to succeed in a challenging global economy? By focusing on the fundamentals, the competitive advantages that help us win and expand our leadership position. And today I want to highlight three, our ability to innovate, the power of the NIKE, Inc. portfolio and our ability to continue to make meaningful connections with consumers.

So let's take a look at the first one, our ability to innovate. It's what fuels our growth and it always starts with the athlete. How can we make the athletes faster, stronger, better and help them push themselves to new levels of performance.

In Q1, we launched a whole array of products that deliver on that promise, including, the Nike Free Flyknit, the next-generation of Flyknit products in our Running category. This shoe demonstrates how we take Flyknit and combining it with other footwear platforms, like Free in this case to continue to innovate and serve the athletes.

As you've heard me say before, Flyknit is high-performance visually iconic and manufactured in ways that reduce labor and waste. We've seen a strong response from runners to the Free Flyknit and we look to continue to drive innovation using this revolutionary upper technology both in the Running category and beyond. The potential for Flyknit is tremendous and it's safe to say, it's going to be a big year for Flyknit.

We launched the Hypervenom football boot, which features revolutionary design changes to improve the fit, touch and traction of the boot. This allows the player to have better ball control and improved agility on the pitch and as Trevor will detail, the Hypervenom has resonated with consumers making it the most successful boot launch in NIKE history.

We also extended our offering of Dri-FIT Knit incorporating different knit patterns to improve breathability while maintaining a seamless construction and comfortable fit. This product is one of many that have helped accelerate our premium apparel growth. And we brought a new level of sophistication and performance to Fleece with the NIKE Tech Pack, a new line of premium apparel that deliveries better fit, breathability and comfort by leveraging construction method to originally develop for technical performance product.

The Tech Pack is quickly becoming the go-to product for consumers, and will be a big driver of growth for our sportswear category going forward. This is only a small sample of our new products, we're accelerating our innovation agenda and it's paying off, and there is a lot more to come, including some real breakthroughs and game changers over the balance of this year and into the future.

The second competitive advantage I want to highlight is the power of our NIKE, Inc. portfolio. We've built the company with the focused group of high energy consumer relevant brands that create opportunity in the world of sport and youth culture. We've leveraged these brands across geographies and categories, further dimensionalizing the business. And we create innovative products to serve the consumer in their chosen sports all over the world.

The breadth and depth of the NIKE, Inc portfolio is unmatched in our industry and that means we're able to manage risk and deliver growth even when there is variability in the results of any of the individual components. We're able to leverage the strength in some areas of the business while investing in others, all with a focus on delivering sustainable, profitable growth at the NIKE, Inc. level. And our Q1 results reflect just that, we delivered a great quarter which Trevor and Don will discuss in more detail. However I would like to highlight two specific areas of our portfolio and that's Converse and China.

Let me start with Converse, Converse delivered tremendous growth in the quarter with revenue up 18% and EBIT up 36% contributing incremental growth to NIKE, Inc., on top of the strong performance of the NIKE Brand. Converse is a brand that has been bringing energy and style to consumers for many years and the opportunities ahead are even greater. We continue to diversify the Converse portfolio, expand the brands reach with new market conversions, grow the DTC business and unlock growth in apparel. I see tremendous long-term growth potential for the Converse brand.

Now let me turn to China. The NIKE Brand remains on top as the leading sport brand in China, as we continue to make progress on repositioning this market for long-term sustainable growth, I have to say, I'm truly excited about the progress we're making in this key market and the opportunity it represents. We're laying a strong foundation and mastering the fundamentals that will enable the next wave of growth in this very dynamic market.

I'm seeing a whole new level of engagement with our wholesale partners, as we work together to increase store productivity by creating a [pull] [ph] market fueled by amazing products and elevated retail presentation. We're increasing the power of our Category Offense by focusing our assortment with a greater level of precision on the sports and the products that mean the most for the Chinese consumer.

And in those stores that have been retrofitted to the new product assortment, we're seeing performance that significantly outpaces the rest of the fleet. The knowledge we've have gained from these early results can be leveraged and scaled to drive significant improvements across the entire market. And together with our partners, we have a shared vision. We both know the companies that will win in China are those that build their brands, capabilities, and connections with consumers.

And that brings me to the third competitive advantage I'd like to talk about, and that's our ability to make meaningful connections with consumers. And that really is key, as those connections ensure we continue to be the brand of choice for consumers. We connect with consumers in a number of ways through digital, which allows us to listen to the athlete and build communities and services that help expand the experience of sport, through key events, which brings consumers together to experience their favorite sport with other as passionate as they are. And through our retail stores, where we can interact directly with our consumers as they decide, which products are best for them.

A great example of these consumer connections is taking place in a market I recently visited and that's Russia. I feel great about the work our team is doing there. The energy for the NIKE Brand is incredible and that stems from the meaningful connections we're making with consumers and we're helping to increase activity levels and bring greater access to sport.

Let me share a few examples from Running, a category where we're bringing tremendous energy and seeing participation levels rapidly increase in Russia. We had Run Moscow and other NIKE We Run events, which bring out thousands of runners and the summer of running digital campaign created connections that lasts long after the last runner crosses the finish line.

These are just a few examples that show how NIKE is making meaningful connections with those consumers and it is really no coincidence that we see our revenues in futures growing at double-digit pace in Russia, quickly gaining share and growing the market. These are the kind of connections that excite us, our consumers and ultimately serve as building blocks to grow our business.

And that brings me to the final point I want to make today, and that's how we use these three competitive advantages, our ability to innovate, the power of our portfolio and our ability to connect with consumer to build our business. We do that by focusing on the greatest opportunities for growth.

Looking ahead, there are both risks and opportunities for NIKE. However, we're confident we have the strength across our brands, businesses and balance sheet, as well as a deep experience team to manage the risks and seize the opportunities. So thanks everybody and now I'm happy to welcome Trevor Edwards, our new NIKE Brand President. As you know, Trevor is new to this call, but he is certainly not new to NIKE. Trevor brings two decades of NIKE experience to the role, as well as a relentless focus on the consumer and a deep knowledge of the Category Offense.

And with that, I'll turn it over to Trevor to take you through the results of the NIKE Brand. Thank you.

Trevor Edwards

Thank you, Mark. As I start my new role and after more than 20 years with NIKE, it's exciting to see so much opportunity in front of us, and we are focused on realizing that opportunity. At NIKE, we always start with the consumer and as we've shared before our Category Offense brings us closer to the consumers, it focuses our teams, and underscores our competitive advantages.

Our pipeline of innovative products to make athletes better, our ability to create deep and meaningful connections with consumer and our capability to elevate and transform the marketplace creating more space and more opportunity for our brand to grow. This is the complete offense we often talk about, it is the foundation of our growth strategy and allows us to continue to drive growth in both developed and developing markets. It's a strategy that only NIKE can execute at such a global scale and it's the basis for the strong financial performance we share today.

So on a constant dollar basis, NIKE brand revenue was up 7% for the quarter with growth across most of our key categories and geographies except Greater China. NIKE Brand DTC revenue increased 18% for the quarter with comp growth up 9% and online sales up 12%. And in addition our global futures grew 10%. Our strategies are working and our portfolio of businesses delivered during the quarter across product types, geographies and categories. Now let's focus on three of our key geographies.

Our business in North America continues to be a tremendous source of growth for the NIKE Brand. North America provides a great benchmark what is possible around the world, we continue to deliver innovative products, we deepen our consumer connections, we elevate our distribution strategies in the market and in our largest and most penetrated market, we continue to see further opportunities to growth.

For the quarter, revenues grew 9% to $3 billion and we grew in all key categories except Golf. Our two biggest categories Basketball and Running led the growth continuing their double-digit rate and it was very profitable. We continue to grow in North America, because of our focus on leveraging and integrated, yet differentiated marketplace as we consistently work to provide unique consumer experiences across wholesale, DTC and online. We are able to expand both the market and our share, this integrated approach ensures we continue to maintain a strong pool market and drive profitability.

Let me illustrate with one key example, our Women's business in North America. We've been building deep and meaningful relationships with women through our digital app called the NIKE Training Club. To date, we have 10 million downloads and 600,000 workouts every week. This virtual club creates a community of women who work out with us every single day.

This past quarter, we extended the idea of the training club to launch a new retail concept for our women's business to create new marketplace capacity. This catalyzing concept started with our own DTC doors and online and will eventually rollout to our retail partners. The concept is simple and powerful one stop shopping for our running, training and sportswear needs. It's where personal training meets personal shopping and styling. It starts with great premium product from footwear to apparel, performance to sportswear with style led presentations and limited edition offerings.

Next come Pinnacle Services, certified retail staff, personal stylist, and fitting room services. Finally we create community in-store studios events and our running and training clubs. This is one example of how we're continuing to capture growth opportunities in North America. Let me turn your attention now to China. As Mark mentioned, we continue to make progress against our strategic reset. However, the results in China will not always be linear.

For Q1 revenue declined by 3% and our wholesale comp performance slowed this quarter. However, the subset of our apartment doors that have been retrofitted with more focused assortments are performing well and in our own NIKE DTC doors, comp growth was up over 20%. The knowledge we've gained from these early successes can and will be leveraged across the entire markets. We are fully confident and committed to the strategies that we've laid out and more than ever believe in the long-term enormous opportunity in China.

I opened today talking about the consumer is at the centre of everything we do. This couldn't be more true than in China, we are the sport brand of choice and we continue to drive energy into the marketplace. Over this summer, we brought an All Star lineup of NBA athletes to China. LeBron, Kobe, Kevin Durant, Carmelo Anthony, Chris Paul, Blake Griffin and Russell Westbrook connecting them with hundreds of thousands of Chinese consumers.

Now, at the heart of our reset in China is the goal of creating more productive and profitable retail for our retail partners and NIKE. There are three core elements to these plans. First, we segment and differentiate our points of distribution to create more targeted consumer experiences and to increase marketplace capacity. Second, we are sharpening our merchandising strategies assorting at the door level focusing on the products and categories that the Chinese consumer wants most and third we are working to create more seamless operating platform ensuring we get the right product to the right door at the right time. We continue to be aggressive and take decisive action to reset this market, but we'll do it the right way, creating a foundation for long-term sustainable and profitable growth.

Finally, let me touch on Western Europe. About 18 months ago, we made a decision to reorganize our business in Western Europe, to drive a more centralized and consistent consumer experience across the geography and elevate the distribution strategies, with North America serving as the blueprint, we invested in a market reset to create a platform to capture the next wave of growth in this geography.

I just got back from visiting the teams and seen the market. Great progress has been made and the teams are energized and passionate about the opportunities ahead. In the Northern territories, we are seeing tremendous results led by double-digit growth in two of our largest territories, the U.K., and along with AGS, which is made up of Austria, Germany and Switzerland.

The strength of the northern territories help balance the results in the southern territories which face macroeconomic challenges. Our results in Western Europe, demonstrate that our strategies are working, there is still a lot of work to be done and opportunity to be captured, but the early returns are very positive. We see Western Europe as a strong driver for growth for the NIKE Brand for the long-term.

Now let's move to the category side and start where this company started over 40 years ago with Running. Q1 marks the 15th consecutive quarter of double-digit growth in Running, the success was broad based in footwear and apparel with men's and women's in North America and Internationally and our future orders are up double-digits as well. We lead in Running with the launch of innovative products, Nike Free Flyknit, LunarGlide 5, Pegasus 30 and our premium apparel Dri-FIT Knit all designed to help athletes perform better and there is a lot more on stage and ready to go to deliver for the balance of the year.

We continue to deepen our connection with runners at retail online and at events, our Nike Running Clubs continued to gaining popularity at the same time we are adding 100,000 new runners per week to Nike+. We also continue to elevate distribution. In our own DTC doors, we have seen strong performance in Running and the success of the Running category door like Flatiron in New York City and also Covent Garden in London. These stores validate our strategies and that wholesale were seeing results n the Running concepts like the Track Club with Finish Line that significantly outpaced the balance of their fleet of their fleet in North America. But we still have room for further penetration in North America and we are just getting started across our other geographies.

The last category I would touch on is global football or soccer to many of you. Even on the back of the prior year numbers, which include the European Championship, football grew double-digits in the quarter one, with futures order book also up double-digits. With the energy around the World Cup next year in Brazil, we intend to build on our position as the leading football brand in the world. And as we've said many times, we gain our insights from the best athletes on the planet, which allows us to deliver unparalleled innovation to our consumers globally from Rio to Paris to Tokyo.

A great example is the new Hypervenom boot, rooted in insights from the best players in the world like the Brazilian and FC Barcelona star, Neymar. We work with him and other football players to create this new boot, and as Mark mentioned, it has become the most successful boot launch for NIKE Football ever. I was in Brazil in May working with the team as part of the launch, the result was a phenomenal global marketplace execution, creating energy and excitements in all geographies. The Hypervenom is already our number two selling boot behind our iconic Mercurial boot.

You can expect to see us bring more amazing innovations, connect more powerfully with our consumers and drive more energy into the market, as we head into the World Cup in Brazil and well beyond. We're off to a great start on the fiscal year and our results show that NIKE is more than a brand, it's a portfolio of growth opportunities and we are set to capture those opportunities, because of the focus and investments we make for NIKE's long-term potential.

Thanks. Now, here is Don.

Don Blair

Thanks, Trevor. Earlier on this call, Mark and Trevor described how our Q1 results demonstrate key NIKE assets and capabilities that enable us to drive growth and competitive advantage. I'm going to build on that by illustrating how we use those competitive advantages to create value for our shareholders.

Let me start with the NIKE portfolio. As Mark indicated, our global portfolio of businesses gives us the ability to deploy our innovation, marketing and operational capabilities across the broadest range of opportunities in the industry. It also provides us with the diversification to deliver consistent growth and manage risk. Our Q1 results certainly reflect the strength of our portfolio.

Revenue was higher for every geography except China as our European geographies led the way with accelerated growth in revenues and futures. Converse also posted high-teens revenue growth. On a category basis, strength in Running, Basketball and global football set the pace. And on the product side, premium performance apparel outgrew moderately priced sportswear driving higher average prices and gross margin.

The second competitive edge is our ability to connect with consumers to our brands, our products and our retail presentation all through a category lens. As Trevor said, those connections have never been deeper or stronger allowing us to expand the market and gain share. They also enable us to move the consumer to more premium products and price points increasing productivity and profitability for NIKE and our retailers. You've seen this reflected in our Q1 results as our gross margins expanded 120 basis points due in part to higher net average prices and a shift in mix to higher margin products.

The third competitive edge is innovation. As Mark and Trevor both noted, innovative products such as Flyknit and Hypervenom footwear and Tech Pack sportswear apparel were examples of our innovation leadership in Q1. As we continue to invest in innovation, we expect to deliver even greater impact on revenue, gross margin and overall profitability.

Underlying those competitive edges is the financial and operational discipline to allocate resources to the highest potential opportunities and maximize ROI. We demonstrated that in Q1 as we delivered record revenues in EPS, raised our overall working capital productivity and increased our ROIC to a record a 25.4%, 410 basis points higher than last year.

With that introduction let me walk you through our first quarter results. First quarter revenue for NIKE Inc. increased 8% on both reported and currency neutral basis as revenue for the NIKE Brand including NIKE Golf and Hurley increased 7% and Converse increased 16%. NIKE Brand futures orders accelerated to 10% growth on a currency neutral basis reflecting a 7% increase in units and a 3% increase in average selling price.

The increase was led by double-digit growth in North America and both European geographies. Weaker foreign currencies reduced reported futures growth to 8%. First quarter diluted EPS increased 37% to $0.86 driven by revenue growth, gross margin expansion and leverage of SG&A expenses which were flat for the quarter. On our last call, we said we expected FY 2014 growth to be significantly front loaded in Q1 due largely to the comparison to last year's heavy demand creation investment and that's indeed been the case.

Gross margin for the quarter increased to 120 basis points, driven by lower raw material costs, a mix shift to higher margin products, higher average prices and lower discounts, as well as growth in our DTC business and Converse. These upsides were partially offset by higher labor costs and FX headwinds, due largely to weaker emerging market currencies.

Q1 demand creation decreased 16% versus heavy investments in the prior year to support the European Championships, Olympics and product launches. Operating overhead grew 12% for the quarter, due to continued investments to support growth initiatives particularly digital and our DTC business. Other expense, net was $28 million for the quarter, driven primarily by FX conversion losses due to weaker emerging market currencies.

The net year-over-year impact of these conversion gains and losses combined with the translation of our foreign earnings resulted in a $38 million downside to EBIT for the quarter. As I'll discuss in a moment, we expect FX headwinds to put pressure on the balance of year revenue and earnings. The Q1 effective tax rate was 25%, 190 basis point improvement due primarily to a lower effective tax rate on operations outside the United States.

Working capital productivity continued to improve in Q1 as accounts receivable fell 3%, while inventory grew only 6% below the rate of revenue and futures growth. Closed out inventory levels are healthy, reflecting tighter management of inventory supply as well as the expansion and increased productivity of our factory stores. We will continue to monitor both the inventory on our books and at retail as we work with our retailers to maintain a healthy marketplace.

Now let's take a look at our performance by segment. In North America Q1 revenue increased 9% on both reported and constant currency basis, driven by growth across all key categories except Golf including double-digit growth in Basketball, Running and Men's Training. For the quarter, footwear revenue increased 9% while apparel and equipment grew 9% and 13% respectively. DTC revenues grew 12% in the quarter driven by 5% comp store sales growth.

Q1 EBIT for North America grew 26% due to strong revenue growth, gross margin expansion and SG&A leverage. In Western Europe, Q1 revenue growth accelerated to 8% on a currency neutral basis. As Trevor noted, the growth was broad based and particularly impressive given the strong results last year driven by the London Olympics and the European Championships as well as the ongoing macroeconomic weakness, in the region.

On a reported basis, Q1 revenue for Western Europe increased 11% and EBIT increased 25% driven by revenue growth and lower demand creation spending, partially offset by gross margin compression driven primarily by FX. Central and Eastern Europe also delivered strong results in Q1 with currency neutral revenue growth of 10% led by double-digit growth in Russia, Turkey and Poland.

On a category basis revenue for Football, Running and Basketball also grew at a double-digit rate. On a reported basis, Q1 revenues for Central and Eastern Europe grew 12% and EBIT increased 50% driven by revenue growth, gross margin expansion and lower demand creation spending. In Greater China, currency neutral revenue declined 3% in Q1 as growth in sportswear and basketball was offset by declines in other categories.

On a reported basis, Q1 revenue in Greater China decreased 1%, but EBIT increased 3% due to gross margin expansion and lower demand creation spending largely offset by investments in our DTC business. You've heard from both Mark and Trevor about the progress we're making in resetting the market place in China. This work will take commitment and patience and we're confident the steps we're taking now will set the foundation for a continued market leadership and profitable growth well into the future.

As we've noted on previous calls, our reported futures and revenue growth for China won't always follow a smooth trajectory as we reset the market. At this point, we're expecting revenue growth in Q2 with overall FY 2014 revenues roughly inline with the prior year. In Japan, Q1 revenue increased 1% on a currency neutral basis, driven by double-digit revenue growth in football and basketball offset by declines in running NIKE sportswear in men's and women's training. On a reported basis, Q1 revenue for Japan decreased 20% reflecting the impact of the weaker Yen, while EBIT increased 4% as the drop in revenue was more than offset by lower SG&A spending and gross margin expansion.

Q1 revenue for our emerging markets geography was up 5% on a currency neutral basis, driven by strong growth in Brazil and Argentina. This performance was partially offset by weaker results in Korea and more prominently in Mexico where shipping delays caused by a distribution center transition reduced our revenue. Excluding the impact of the shipping disruption in Mexico emerging markets revenue would have increased at a double-digit rate.

Weaker currencies were also a significant financial drag in the emerging markets geography, reducing Q1 reported revenue growth to 1% and compressing gross margin. EBIT decreased 5% due largely to these FX headwinds and higher operating overhead, partially offset by lower demand creation spending.

For Converse, first quarter revenue increased 16% on a currency neutral basis driven by strong result in the U.S. and U.K., two of our largest owned markets. On a reported basis, revenue and EBIT increased 18% and 36% respectively. The growth in EBIT was driven by higher revenue and gross margin expansion due to a shift in mix to higher margin territories and products.

For the fiscal year, our expectations for the underlying performance of our business are essentially inline with the guidance we gave last quarter. However, as I mentioned earlier, we expect increased currency headwinds to put pressure on our reported revenue and earnings for the balance of the fiscal year. We expect revenue for the second quarter and full fiscal year to grow at a high single-digit rate reflecting FX headwinds. On a reported basis, this would be slightly below our earlier expectations.

On the other hand, we are encouraged by our gross margin performance, which exceeded our expectations in Q1. We continue to increase average selling prices by strengthening the premium segments of our business and by taking selective price increases around the world, and we are expanding our high margin DTC business. For the second quarter, we expect to see gross margin expansion of about 50 basis points driven by continued benefits from higher average prices, easing raw material costs and growth in DTC, partially offset by higher discounts to clear inventories in Mexico, start-up cost for our expanded U.S. distribution center and stiffening FX headwinds.

For the fiscal year, we also expect gross margin expansion of approximately 50 basis points, a modest increase from our prior guidance as the ongoing impact of the upside that drove our Q1 results are expected to more than offset FX headwinds and labor cost inflation.

For Q2, we expect SG&A to grow at a mid-teens rate reflecting shifts in demand creation facing and ongoing investments in strategic initiatives. As we indicated last quarter, there will be more volatility in the year-over-year comparisons of SG&A due to the timing of key sporting events this year and last.

For the full year, we continue to expect SG&A to grow at a low double-digit rate, as we invest in our brands, DTC and Innovation. For FY 2014, we continue to expect the effective tax rate will be about 25%.

Q1 was a great start for fiscal 2014 delivering strong growth in revenue and profitability. Over the balance of the year, we expect to continue to drive revenue growth and gross margin expansion, while making the investments in demand creation and innovation that will deliver sustainable profitable growth and consistent value to our shareholders in the future.

We're now ready to take your questions.

Question-and-Answer Session

Operator

[Operator Instructions] And your first question comes from Bob Drbul with Barclays. Your line is now open.

Robert Drbul – Barclays Capital

Good evening.

Kelley K. Hall

Hey Bob.

Trevor Edwards

Hi, Bob.

Robert Drbul – Barclays Capital

Trevor welcome.

Trevor Edwards

Thank you very much.

Robert Drbul – Barclays Capital

Good luck. The question that I have on the European business and the business in China can you talk about the macro impacting you, I mean the numbers have been very impressive and especially both Western Europe and Central Europe especially in the futures side. So is the macro a big factor there and how sustainable do you think these impressive results can be?

Mark Parker

Well Bob, first of all I just want to reiterate one of the things that we've seen over the course of years with our businesses is the strength of our business is much more a function of whether we've got the product right, the brand is strong and our distribution is really compelling than the macro. So I think we certainly have seen in Southern Europe some impact from macros, but I think our overall results in Western Europe and China is really driven by what we're putting out there in the marketplace.

Trevor Edwards

Yes Bob this is Trevor obviously. And probably what I would add is that, in both of those marketplaces that we're talking about what we've certainly seen is our ability to stay connected with our consumer and build the brand has been sort of like paramount in driving the growth that we've been seeing. Certainly the thing that we're working on and did in both markets was to reset them to ensure that we continue to maintain a really strong pull in the marketplace. And we're working through that in China, but obviously we're seeing some really good results come through in Western Europe.

Robert Drbul – Barclays Capital

Okay and then the other question was just on the Women's business in U.S., the training business, and I think some of the legend product. Can you just talk about -- if you feel like you're getting traction there and a lot of the initiatives if you could elaborate a little bit more just in that specific product?

Trevor Edwards

Yes I'm actually super excited about the work that we've been doing in the women's business. We are actually seeing some really good positive momentum as we talk about putting those new concepts into the marketplace. The things that we focused on really was first and foremost get the product right and so as you commented on the Legend Pant, we're seeing some great success with all the parts we are putting through. We're really focused at the premium end and that's been doing really well for us.

We continue to connect with our consumers, obviously the Training Club is a great example of how we do that. And so the third area that we're focused on right now is really the distribution. And really making sure that now we can get – give the consumer access to that product. That's why we've created these concepts. As these concepts get better, we'll roll them out into more of our retail stores. We're super excited about what we're seeing and the results that we're getting.

Robert Drbul – Barclays Capital

Okay. Thank you very much. Good luck.

Mark Parker

Thank you.

Kelley K. Hall

Thank you, Bob.

Operator

And your next question comes from Omar Saad with ISI Group. Your line is now open.

Omar Saad – ISI Group

Thanks. Good afternoon. One of the themes like kind of heard throughout the call and seems to have been present the last several quarters is your own retail business really performing extremely well, not that your wholesale business is struggling, but this relative out performance really sticks out even in places like China, but also in the U.S. can you talk about this shift? How much of it is strategic that you're directing or is that where your consumer is taking you, what does this mean for some of your wholesale partners? Kind of looking at this bigger picture here, any insight you could provide, because it's pretty interesting what's going on?

Trevor Edwards

Sorry Omar, great question there. I think part of it is our strategy around our DTC, we clearly use DTC as an opportunity for us to really improve our assortments to make sure that we have the best lines. And so what we're able to do is really use it as a spearhead and so what you're seeing in our DTC doors is really great performance, because we have the right assortments coming through those doors. The more we learn, the more we then take those to our retail partners. And so what we've been seeing is our ability to drive a really integrated marketplace is really helping to drive these kinds of results. But obviously, we use our DTC as a lab, as it were and also is a way to ensure that we can get our premium products to the marketplace.

Mark Parker

Yes, I'll jump into the – I have always said that focus on our DTC business, this effort to become a better retailer will make us a better wholesale partner, which is what Trevor just talked about, and I think that's really paying off. We've learned so much as we've committed to being a great retailer that we're applying to becoming a really good wholesale partner that's most obvious in the North America, in the U.S. market, where we are more advanced in the market segmentation that we're doing with some of our top accounts and that's the model that we're working diligently on in Europe, Western Europe, especially and then certainly in China. We are in different stages of that development. But very confident that that model will actually translate well around the world.

Omar Saad – ISI Group

Thanks. And then really quick on China, as you kind of go through the reset there, how do you think about maybe reducing or resetting all those lower volume concession shops and maybe doing more of these kind of high volume, whether it's DTC or with partners? Is that the kind of shift that's necessary on the ground at retail there?

Trevor Edwards

Yes. I would say that our true intent in China is to make sure that we drive a more productive and profitable retail. And we believe that you do that by segmenting the market and creating greater differentiation, I mean in the marketplace. That gives the consumer more targeted experiences.

At the same time, we're working really on driving our merchandising strategies, working at the door level. So that we can ensure that the consumers are getting exactly what they need. And then at the same point, we're also looking at driving a better operating platform that allows us to get the right product to that consumer at the right time. And so that obviously doing that will create more shifts, so that we have the opportunity to go for the next wave of growth that we see in China, because we truly see tremendous potential.

Omar Saad – ISI Group

Thanks, great quarter guys.

Kelley K. Hall

Thank you, Omar.

Mark Parker

Thank you.

Operator

Your next question comes from Robby Ohmes with Bank of America. Your line is now open.

Robert Ohmes – Bank of America Merrill Lynch

Thanks, great quarter guys.

Mark Parker

Thank you.

Kelley K. Hall

Hi, Robby.

Robert Ohmes – Bank of America Merrill Lynch

Hey, I just had two quick questions, one just a follow-up on North America. Some of the retailers have been talking about how great their business is with you. We’ve heard it start to come more from places like Kohl's and Macy's and even some of the shoes that have been highlighted, have been things like the Roshe, which is a lower price point so the ASPs still are positive and look strong in your futures. But could you maybe help us understand or is your channel distribution shifting a little bit in terms of what’s leading the growth either with the family channel, or again Macy's et cetera and how that might play into the ASP outlook as we look over the next year? Thanks.

Mark Parker

Well, let me just jump in and say there is no shift in our channel strategy. What you I think are seeing is a result of our focus in we often like to say our complete offense. So you see shoes like the Roshe, which has been widely successful, more accessible price point in some ways. And that’s actually taking place in many, many different channels. But really it’s bringing that kind of innovation to more accessible price point in general.

But our fixation, our obsession on bringing performance not only to the very top of the line, but throughout the line is continuing. And I think you’ll see some shifts here and there, but overall you’re going to see us over the course of this coming year drive some incredible innovation that’s going to keep the focus on premium and our unique position is then to draft off of that and create this complete offense down through the price points as well.

Robert Ohmes – Bank of America Merrill Lynch

And then just quick follow-up question, small business for you, but Golf, could you sort of walk us through what's made that business weaker and when you see it turning more positive?

Trevor Edwards

Yes, the issue with Golf is really – it’s really much more of an operational issue that actually drove the weakness in this particular quarter. We had some supply chain challenge in Canada and that's really the impact that drove that. But other than that, the business continues and fundamentally being at really good place. So that was really just a result of just a small thing.

Robert Ohmes – Bank of America Merrill Lynch

Great. Thanks very much guys.

Operator

And your next question comes from Kate McShane with Citi. Your line is now open.

Kate McShane – Citigroup Global Markets Inc.

Thank you. Good afternoon.

Kelley K. Hall

Hi, Kate.

Mark Parker

Good afternoon.

Kate McShane – Citigroup Global Markets Inc.

I think you had mentioned in your comments that you saw some gross margin expansion in China and I wonder what that implies for where you are with working through your inventory in the region?

Don Blair

Well, I would go back to some of the language we used, which is there’s going to be a lot of volatility in China, and I would say overall, we are continuing to make progress in managing inventory. I don't think I would read the gross margin results as any sort of milestone along the road. We are making progress. We do feel that we are getting that market set in right place. I think it's really more the broad global drivers that helped our margins everywhere. Things like easing raw materials cost, shifts and mix, those are the things that I think were the more powerful drivers of what was going on in China.

Kate McShane – Citigroup Global Markets Inc.

Okay. Great and my second question is, as you reset China, is there any change in mix of product in apparel versus footwear with the changes that you're making or is the mix of products generally staying the same?

Trevor Edwards

I would say that the broader mix will probably stay the same how the mix actually affected at a store level will be different because we really are working on just making sure that we have the right assortments in each of the doors, but I think overall the mix will generally be the same.

Mark Parker

Let me add that the category focus in China is going to be more intense, we're actually trying to zero-in on the shorter listed categories that have the greatest potential for growth. So we'll have the more targeted mix of products, but the ratio of footwear and apparel we're not seeing a dramatic shift in that ratio.

That said see tremendous upside in the apparel business in China for NIKE to move forward and frankly around the world. That's one of the – what I would call underpenetrated segments of our business today. But no specific targeted change in the overall mix in China except for maybe more of a focus in terms of the category breadth.

Kate McShane – Citigroup Global Markets Inc.

Thank you.

Operator

And your next question comes from Lindsay Drucker Mann with Goldman Sachs. Your line is now open.

Lindsay Drucker Mann – Goldman Sachs

Thanks. Good afternoon everyone.

Kate Mcshane

Hi Lindsay.

Mark Parker

Hi Lindsay.

Lindsay Drucker Mann – Goldman Sachs

On the gross margin front, can you talk about the key differences versus your original guidance that led to the upside to be versus your expectation and then as you think about the next quarter where you expect those tailwinds to moderate so that you see a little bit more modest improvement?

Don Blair

Well it's one of the things that were little better than what we expected. We did have an even more favorable product mix than we expected that was one of the pluses, we also had our investments in our North America distribution center come in a little bit later than what we had originally expected. We have had tremendous growth in North America and we've been doing some work in our Memphis hub putting some new capacity in down there and we expected a lot of those cost to hit in the first quarter and they came in the second.

So those are two other things that really shifted versus our guidance. I think if you look at the year-on-year drivers as I said, it was easing raw material costs, shifts to premium price increases. We had some great results out of Converse and DTC has been quite strong. We think those really will carry through a lot of the balance of the year plus or minus.

But couple of things that are changing. We are seeing the FX headwinds get a little stiffer and we also expect that we're going to have those supply chain investments particularly in North America start to flow in a little bit later in the year. So those are really what I would call out of the major shifts from the first quarter into the balance of the year.

Lindsay Drucker Mann – Goldman Sachs

Okay, thanks. And on the North American Direct-to-Consumer piece, can you maybe I missed it, but what was your e-commence growth in the region in the period, and can you talk about some of the initiatives you have in place to drive growth in that platform?

Don Blair

Yes usually we don't give that level of granularity by geography. Overall we were up. I believe it was 12% online. And one of the things to bear in mind is we had an extremely strong year last year. So we're about 50% two year growth on the online business and we are continuing to be extremely enthusiastic about the potential for that piece of our business.

Trevor Edwards

Yes, I mean I would say as Mark pointed out that's one of the most critical growth drivers for us in the future. So we expect to see continued momentum and growth in that part of the business.

Lindsay Drucker Mann – Goldman Sachs

Is there anything in terms of functionality or marketing or otherwise we can look forward to specifically in the U.S., balance of the year or in the next couple of years?

Trevor Edwards

Yes, we continue to make sure that we improved the site and all the experiences. But you will kind of see those as they rolled out in the months coming up.

Lindsay Drucker Mann – Goldman Sachs

Okay, thanks.

Operator

You are next question comes from Matthew Ross with JPMorgan. Your line is now opened.

Matthew Ross – JPMorgan

Yes, congrats on a good print. I wanted real quick, share repurchase was almost doubled last two quarters and you took on $1 billion of debt also in the quarter. Can you speak to the mindset around capital allocation and how should we think of this as part of the earnings algorithm going forward?

Don Blair

Well, the debt issuance does not signify any change in our approach to capital allocation. As we've been pretty consistent over the last few years that we believe we're going to be throwing off quite a bit of cash flow. We expect to be continuously raising our return of cash to the shareholders, at the same time that we will be investing in the business.

And that pattern of consistent increases in cash return to shareholders as well as consistent increase investment in our business is what we've actually demonstrated over the last decade, so no change there. The offering of debt at the time we did it, I think gives us tremendous flexibility in our capital structure and frankly those interest rates were outstanding.

Matthew Ross – JPMorgan

Okay. And then more of a clarification, on your full year guidance is EPS still expected to grow at a double-digit rate for the year?

Don Blair

We don't give that level of EPS guidance. We try to give people parameters to help them understand what's ahead. But at this point, I'd rather stay with the guidance that's in the prepared remarks.

Matthew Ross – JPMorgan

Okay. Was there any change from last quarter?

Don Blair

I think the conversation was about line-item guidance and I think that's where I'd like to stay on the guidance.

Kelley K. Hall

Matthew feel free to follow-up with the IR team. We'll walk you through it.

Matthew Ross – JPMorgan

Okay, great.

Kelley K. Hall

Operator, we have time for one more question.

Operator

And your last question comes from Jim Duffy with Stifel. Your line is now open.

Jim Duffy – Stifel Nicolaus

Thanks, hello everyone.

Kelley K. Hall

Hi, Jim

Mark Parker

Hi, Jim

Jim Duffy – Stifel Nicolaus

I'm interested in some more commentary on the strategy to continue to take prices higher, have you seen any evidence of resistance to price, and has the reception to price been consistent across regions?

Trevor Edwards

I think we're looking at in sort of a really two ways right, one is sort of making sure that we have great price value in the marketplace. So we always want to make sure that each season we go in and we're evaluating the pricing that we're currently setting to make sure that we actually are taking the opportunities when that there to go back to the right price, at the same time what we're also doing is driving the change in the mix of our business.

So you will see us really drive a lot of premium concepts certainly we've seen that across the board, and we're certainly seeing really not a lot of resistance to that at all. In fact we're seeing tremendous growth around our premium businesses. So as Mark talked about process really the complete offense, making sure that we are competitive on the one side, but also taking price when the opportunity prevails itself.

Jim Duffy – Stifel Nicolaus

Great, thanks. And then Don so some of the increased FX headwinds seem to be from emerging market currencies does that make it more costly or difficult to hedge against the exposure?

Don Blair

Well, you are exactly right. And in fact for many of those currencies it's really not very economical to hedge them, but over the last few years we've taken a number of steps to reduce our overall exposure, we have built an internal trading company we have really done some adjustments to how we source.

And so we think we've done some things that have reduced the exposure. But the currencies like the Reais, the Argentine Peso, the Russian Ruble, it's not great tools out there to economically hedge them. So to some degree, we are exposed at some level for those currencies.

And what we do is we really manage our overall P&L equation across the whole portfolio. So as we talked about these adjustments are there, but we're not so exposed to anyone currency and we've got lots of levers to pool across the portfolio to continue to deliver consistent growth.

Jim Duffy – Stifel Nicolaus

That's helpful. Thanks, see you in a couple of weeks.

Mark Parker

Thank you.

Kelley K. Hall

Thanks everyone for joining us. And we'll talk to you next quarter.

Operator

And this concludes today's conference call. You may now disconnect.