

NIKE INC
Form 10-Q
January 06, 2011
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended November 30, 2010

Commission file number - 001-10635

NIKE, Inc.

(Exact name of registrant as specified in its charter)

OREGON

93-0584541

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(State or other jurisdiction of
incorporation or organization)
One Bowerman Drive, Beaverton, Oregon
(Address of principal executive offices)
Registrant's telephone number, including area code: (503) 671-6453

(I.R.S. Employer
Identification No.)
97005-6453
(Zip Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Shares of Common Stock outstanding as of November 30, 2010 were:

Class A	89,989,448
Class B	388,505,309
	478,494,757

Table of Contents

NIKE, Inc.

INDEX

PART I. FINANCIAL INFORMATION

Item 1.	<u>Financial Statements</u>	
	<u>Unaudited Condensed Consolidated Balance Sheets</u>	3
	<u>Unaudited Condensed Consolidated Statements of Income</u>	4
	<u>Unaudited Condensed Consolidated Statements of Cash Flows</u>	5
	<u>Notes to the Unaudited Condensed Consolidated Financial Statements</u>	6
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	22
Item 3.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	37
Item 4.	<u>Controls and Procedures</u>	37

PART II. OTHER INFORMATION

Item 1.	<u>Legal Proceedings</u>	39
Item 1A.	<u>Risk Factors</u>	39
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	39
Item 6.	<u>Exhibits</u>	40
	<u>Signature</u>	41

Table of Contents**PART I - FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS****NIKE, Inc.****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

	November 30, 2010	May 31, 2010
	(in millions)	
<u>ASSETS</u>		
Current assets:		
Cash and equivalents	\$ 1,768	\$ 3,079
Short-term investments (Note 5)	3,021	2,067
Accounts receivable, net	2,792	2,650
Inventories (Note 2)	2,348	2,041
Deferred income taxes (Note 6)	267	249
Prepaid expenses and other current assets (Note 10)	720	873
Total current assets	10,916	10,959
Property, plant and equipment	4,641	4,390
Less accumulated depreciation	2,638	2,458
Property, plant and equipment, net	2,003	1,932
Identifiable intangible assets, net (Note 3)	469	467
Goodwill (Note 3)	192	188
Deferred income taxes and other long-term assets (Note 6 and 10)	884	873
Total assets	\$ 14,464	\$ 14,419
<u>LIABILITIES AND SHAREHOLDERS' EQUITY</u>		
Current liabilities:		
Current portion of long-term debt	\$ 132	\$ 7
Notes payable	128	139
Accounts payable	1,225	1,255
Accrued liabilities (Note 4)	1,685	1,904
Income taxes payable (Note 6)	78	59
Total current liabilities	3,248	3,364
Long-term debt	338	446
Deferred income taxes and other long-term liabilities (Note 6 and 10)	929	855
Commitments and contingencies (Note 12)		
Redeemable preferred stock		
Shareholders' equity:		
Common stock at stated value:		
Class A convertible - 90.0 and 90.0 million shares outstanding		
Class B - 388.5 and 394.0 million shares outstanding	3	3
Capital in excess of stated value	3,752	3,441
Accumulated other comprehensive income (Note 7)	151	215
Retained earnings	6,043	6,095

Total shareholders equity	9,949	9,754
Total liabilities and shareholders equity	\$ 14,464	\$ 14,419

The accompanying Notes to Unaudited Condensed Consolidated Financial Statements are an integral part of this statement.

Table of Contents**NIKE, Inc.****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

	Three Months Ended November 30,		Six Months Ended November 30,	
	2010	2009	2010	2009
	(in millions, except per share data)			
Revenues	\$ 4,842	\$ 4,405	\$ 10,017	\$ 9,204
Cost of sales	2,649	2,445	5,390	5,028
Gross margin	2,193	1,960	4,627	4,176
Demand creation expense	574	573	1,253	1,127
Operating overhead expense	1,037	906	2,031	1,898
Total selling and administrative expense	1,611	1,479	3,284	3,025
Other (income), net	(28)	(12)	(21)	(24)
Interest expense, net	1	2		3
Income before income taxes	609	491	1,364	1,172
Income tax expense (Note 6)	152	116	348	284
Net income	\$ 457	\$ 375	\$ 1,016	\$ 888
Basic earnings per common share (Note 9)	\$ 0.96	\$ 0.77	\$ 2.12	\$ 1.83
Diluted earnings per common share (Note 9)	\$ 0.94	\$ 0.76	\$ 2.08	\$ 1.80
Dividends declared per common share	\$ 0.31	\$ 0.27	\$ 0.58	\$ 0.52

The accompanying Notes to Unaudited Condensed Consolidated Financial Statements are an integral part of this statement.

Table of Contents**NIKE, Inc.****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Six Months Ended November 30,	
	2010	2009
	(in millions)	
Cash provided by operations:		
Net income	\$ 1,016	\$ 888
Income charges (credits) not affecting cash:		
Depreciation	161	159
Deferred income taxes	(3)	19
Stock-based compensation	50	115
Amortization and other	14	16
Changes in certain working capital components and other assets and liabilities:		
(Increase) decrease in accounts receivable	(36)	285
(Increase) decrease in inventories	(252)	252
Decrease (Increase) in prepaid expenses and other assets	10	(1)
(Decrease) in accounts payable, accrued liabilities and income taxes payable	(313)	(356)
Cash provided by operations	647	1,377
Cash used by investing activities:		
Purchases of investments	(3,363)	(1,580)
Maturities of investments	1,838	390
Sales of investments	561	359
Additions to property, plant and equipment	(191)	(173)
Proceeds from the sale of property, plant and equipment	9	9
Increase in other assets and liabilities, net	(4)	(3)
Settlement of net investment hedges	(12)	(67)
Cash used by investing activities	(1,171)	(1,065)
Cash used by financing activities:		
Reduction in long-term debt, including current portion	(4)	(29)
(Decrease) in notes payable	(15)	(245)
Proceeds from exercise of stock options and other stock issuances	228	179
Excess tax benefits from share-based payment arrangements	40	25
Repurchase of common stock	(785)	(193)
Dividends on common stock	(260)	(243)
Cash used by financing activities	(796)	(506)
Effect of exchange rate changes on cash	9	(62)
Net decrease in cash and equivalents	(1,311)	(256)
Cash and equivalents, beginning of period	3,079	2,291
Cash and equivalents, end of period	\$ 1,768	\$ 2,035
Supplemental disclosure of cash flow information:		
Dividends declared and not paid	\$ 148	\$ 132

The accompanying Notes to Unaudited Condensed Consolidated Financial Statements are an integral part of this statement.

Table of Contents**NIKE, Inc.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****NOTE 1 - Summary of Significant Accounting Policies:*****Basis of Presentation:***

The accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting of normal recurring accruals) which are, in the opinion of management, necessary for a fair statement of the results of operations for the interim period. The year-end condensed consolidated balance sheet data as of May 31, 2010 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America (US GAAP). The interim financial information and notes thereto should be read in conjunction with the Company's latest Annual Report on Form 10-K. The results of operations for the three and six months ended November 30, 2010 are not necessarily indicative of results to be expected for the entire year.

Demand Creation Expense:

Demand creation expense consists of advertising and promotion costs, including costs of endorsement contracts, television, digital and print advertising, brand events, and retail brand presentation. Advertising production costs are expensed the first time an advertisement is run. Advertising placement costs are expensed in the month the advertising appears, while costs related to brand events are expensed when the event occurs. Costs related to retail brand presentation are expensed when the presentation is completed and delivered. A significant amount of the Company's promotional expenses result from payments under endorsement contracts. Accounting for endorsement payments is based upon specific contract provisions. Generally, endorsement payments are expensed on a straight-line basis over the term of the contract after giving recognition to periodic performance compliance provisions of the contracts. Prepayments made under contracts are included in prepaid expenses or other assets depending on the period to which the prepayment applies.

Recently Adopted Accounting Standards:

In January 2010, the Financial Accounting Standards Board (FASB) issued guidance to amend the disclosure requirements related to recurring and nonrecurring fair value measurements. The guidance requires additional disclosures about the different classes of assets and liabilities measured at fair value, the valuation techniques and inputs used, the activity in Level 3 fair value measurements, and the transfers between Levels 1, 2, and 3 of the fair value measurement hierarchy. This guidance became effective for the Company beginning March 1, 2010, except for disclosures relating to purchases, sales, issuances and settlements of Level 3 assets and liabilities, which will be effective for the Company beginning June 1, 2011. As this guidance only requires expanded disclosures, the adoption did not and will not impact the Company's consolidated financial position or results of operations.

In June 2009, the FASB issued a new accounting standard that revised the guidance for the consolidation of variable interest entities (VIE). This new guidance requires a qualitative approach to identifying a controlling financial interest in a VIE, and requires an ongoing assessment of whether an entity is a VIE and whether an interest in a VIE makes the holder the primary beneficiary of the VIE. This guidance became effective for the Company beginning June 1, 2010. The adoption of this guidance did not have an impact on the Company's consolidated financial position or results of operations.

Recently Issued Accounting Standards:

In October 2009, the FASB issued new standards that revised the guidance for revenue recognition with multiple deliverables. These new standards impact the determination of when the individual deliverables included in a multiple-element arrangement may be treated as separate units of accounting. Additionally, these new standards modify the manner in which the transaction consideration is allocated across the separately identified deliverables by no longer permitting the residual method of allocating arrangement consideration. These new standards are effective for the Company beginning June 1, 2011. The Company does not expect the adoption will have a material impact on its consolidated financial positions or results of operations.

NOTE 2 - Inventories:

Inventory balances of \$2,348 million and \$2,041 million at November 30, 2010 and May 31, 2010, respectively, were substantially all finished goods.

Table of Contents**NIKE, Inc.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 3 - Identified Intangible Assets and Goodwill:**

The following tables summarize the Company's identifiable intangible assets and goodwill balances at November 30, 2010 and May 31, 2010:

	November 30, 2010			May 31, 2010		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
(in millions)						
Amortized intangible assets:						
Patents	\$ 72	\$ (23)	\$ 49	\$ 69	\$ (21)	\$ 48
Trademarks	42	(21)	21	40	(18)	22
Other	34	(20)	14	32	(18)	14
Total	\$ 148	\$ (64)	\$ 84	\$ 141	\$ (57)	\$ 84
Unamortized intangible assets- Trademarks			\$ 385			\$ 383
Identifiable intangible assets, net			\$ 469			\$ 467

	November 30, 2010			May 31, 2010		
	Goodwill	Accumulated Impairment	Goodwill, net	Goodwill	Accumulated Impairment	Goodwill, net
(in millions)						
Goodwill	\$ 391	\$ (199)	\$ 192	\$ 387	\$ (199)	\$ 188

The effect of foreign exchange fluctuations for the six month period ended November 30, 2010 increased unamortized intangible assets and goodwill by approximately \$2 million and \$4 million, respectively, resulting from the weakening of the U.S. dollar in relation to the British Pound.

Amortization expense, which is included in selling and administrative expense, was \$4 million and \$3 million for the three month periods ended November 30, 2010 and 2009, respectively, and \$7 million for each of the six month periods ended November 30, 2010 and 2009, respectively. The estimated amortization expense for intangible assets subject to amortization for the remainder of fiscal year 2011 and each of the years ending May 31, 2012 through May 31, 2015 are as follows: \$7 million; 2012: \$13 million; 2013: \$12 million; 2014: \$10 million; 2015: \$6 million.

All goodwill balances are included in the Company's Other category for segment reporting purposes.

Table of Contents**NIKE, Inc.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 4 - Accrued Liabilities:**

Accrued liabilities include the following:

	November 30, 2010	May 31, 2010
	(in millions)	
Compensation and benefits, excluding taxes	\$ 431	\$ 599
Endorsee compensation	217	267
Taxes other than income taxes	201	158
Dividends payable	148	131
Advertising and marketing	137	125
Fair value of derivatives	105	164
Import and logistics costs	87	80
Other ⁽¹⁾	359	380
Total accrued liabilities	\$ 1,685	\$ 1,904

⁽¹⁾ Other consists of various accrued expenses. No individual item accounted for more than 5% of the total balance at November 30, 2010 and May 31, 2010.

NOTE 5 - Fair Value Measurements:

The Company measures certain financial assets and liabilities at fair value on a recurring basis, including derivatives and available-for-sale securities. Fair value is a market-based measurement that should be determined based on the assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, the Company uses a three-level hierarchy established by the FASB which prioritizes fair value measurements based on the types of inputs used for the various valuation techniques (market approach, income approach, and cost approach).

The levels of hierarchy are described below:

Level 1: Observable inputs such as quoted prices in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly; these include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.

Level 3: Unobservable inputs in which there is little or no market data available, which require the reporting entity to develop its own assumptions.

The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability. Financial assets and liabilities are classified in their entirety based on the most stringent level of input that is significant to the fair value measurement.

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The following table presents information about the Company's financial assets and liabilities measured at fair value on a recurring basis as of November 30, 2010 and May 31, 2010 and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value.

Table of Contents**NIKE, Inc.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	Fair Value Measurements Using			November 30, 2010	Balance Sheet Classification
	Level 1	Level 2	Level 3	Assets/Liabilities at Fair Value (in millions)	
Assets					
Derivatives:					
Foreign exchange forwards and options	\$	\$ 159	\$	\$ 159	Other current assets and other long-term assets
Interest rate swap contracts		18		18	Other current assets and other long-term assets
Total derivatives		177		177	
Available-for-sale securities:					
U.S. Treasury securities	225			225	Cash and equivalents
Commercial paper and bonds		154		154	Cash and equivalents
Money market funds		665		665	Cash and equivalents
U.S. Treasury securities	1,434			1,434	Short-term investments
U.S. agency securities		356		356	Short-term investments
Commercial paper and bonds		1,231		1,231	Short-term investments
Total available-for-sale securities	1,659	2,406		4,065	
Total assets	\$ 1,659	\$ 2,583	\$	\$ 4,242	
Liabilities					
Derivatives:					
Foreign exchange forwards and options	\$	\$ 113	\$	\$ 113	Accrued liabilities and other long-term liabilities
Total liabilities	\$	\$ 113	\$	\$ 113	

Table of Contents**NIKE, Inc.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	Fair Value Measurements Using			May 31, 2010	Balance Sheet Classification
	Level 1	Level 2	Level 3	Assets /Liabilities at Fair Value (in millions)	
Assets					
Derivatives:					
Foreign exchange forwards and options	\$	\$ 420	\$	\$ 420	Other current assets and other long-term assets
Interest rate swap contracts		15		15	Other current assets and other long-term assets
Total derivatives		435		435	
Available-for-sale securities:					
U.S. Treasury securities	1,232			1,232	Cash and equivalents
Commercial paper and bonds		462		462	Cash and equivalents
Money market funds		685		685	Cash and equivalents
U.S. Treasury securities	1,085			1,085	Short-term investments
U.S. agency securities		298		298	Short-term investments
Commercial paper and bonds		684		684	Short-term investments
Total available-for-sale securities	2,317	2,129		4,446	
Total assets	\$ 2,317	\$ 2,564	\$	\$ 4,881	
Liabilities					
Derivatives:					
Foreign exchange forwards and options	\$	\$ 165	\$	\$ 165	Accrued liabilities and other long-term liabilities
Total liabilities	\$	\$ 165	\$	\$ 165	

Derivative financial instruments include foreign currency forwards and option contracts and interest rate swaps. The fair value of derivative contracts is determined using observable market inputs such as the forward pricing curve, currency volatilities, currency correlations and interest rates, and considers nonperformance risk of the Company and that of its counterparties. Adjustments relating to these risks were not material at November 30, 2010 or May 31, 2010.

Available-for-sale securities are primarily comprised of investments in U.S. Treasury and agency securities, corporate commercial paper and bonds. These securities are valued using market prices on both active markets (Level 1) and less active markets (Level 2). Level 1 instrument valuations are obtained from real-time quotes for transactions in active exchange markets involving identical assets. Level 2 instrument valuations are obtained from readily available pricing sources for comparable instruments.

As of November 30, 2010 and May 31, 2010, the Company had no Level 3 financial assets and liabilities and no assets or liabilities that were required to be measured at fair value on a non-recurring basis.

Short-Term Investments:

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As of November 30, 2010 and May 31, 2010, short-term investments consisted of available-for-sale securities. Available-for-sale securities are recorded at fair value with unrealized gains and losses reported, net of tax, in other comprehensive income, unless unrealized losses are determined to be other than temporary. As of November 30, 2010, the Company held \$2.7 billion of available-for-sale securities with maturity dates within one year and \$277 million with maturity dates over one year and less than five years within short-term investments. As of May 31, 2010, the Company held \$1.9 billion of available-for-sale securities with maturity dates within one year and \$167 million with maturity dates over one year and less than five years within short-term investments.

Table of Contents**NIKE, Inc.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Short-term investments classified as available-for-sale consist of the following at fair value:

	November 30, 2010	May 31, 2010
	(in millions)	
Available-for-sale investments:		
U.S. Treasury and Agencies	\$ 1,790	\$ 1,383
Corporate commercial paper and bonds	1,231	684
Total available-for-sale investments	\$ 3,021	\$ 2,067

Fair Value of Long-Term Debt and Notes Payable:

The Company's long-term debt is recorded at adjusted cost, net of amortized premiums and discounts and interest rate swap fair value adjustments. The fair value of long-term debt is estimated based upon quoted prices for similar instruments. The fair value of the Company's long-term debt, including the current portion, was approximately \$480 million at November 30, 2010 and \$453 million at May 31, 2010.

The carrying amounts reflected in the unaudited condensed consolidated balance sheet for notes payable approximate fair value.

NOTE 6 - Income Taxes:

The effective tax rate was 25.5% and 24.2% for the six months ended November 30, 2010 and 2009, respectively. The increase in the Company's effective tax rate was primarily driven by an increase in the percentage of pre-tax income related to operations in the United States. The United States statutory tax rate is generally higher than the tax rate on operations outside the United States.

As of November 30, 2010, total gross unrecognized tax benefits, excluding related interest and penalties, were \$278 million, \$147 million of which would affect the Company's effective tax rate if recognized in future periods. As of May 31, 2010, total gross unrecognized tax benefits, excluding interest and penalties, were \$282 million, \$158 million of which would affect the Company's effective tax rate if recognized in future periods. The gross liability for payment of interest and penalties increased \$14 million during the six months ended November 30, 2010. As of November 30, 2010, accrued interest and penalties related to uncertain tax positions were \$95 million (excluding federal benefit).

The Company is subject to taxation primarily in the United States, China and the Netherlands as well as various state and other foreign jurisdictions. The Company has concluded substantially all U.S. federal income tax matters through fiscal year 2006. The Company is currently under audit by the Internal Revenue Service (IRS) for the 2009 and 2010 tax years, and is appealing certain issues related to the IRS audits of its 2007 and 2008 tax years. The Company's major foreign jurisdictions, China and the Netherlands, have concluded substantially all income tax matters through calendar 1999 and fiscal 2004, respectively. It is reasonably possible that the IRS audit for the 2009 tax year will be completed during the next 12 months, which could result in a decrease in our balance of unrecognized tax benefits. The Company does not anticipate that total gross unrecognized tax benefits will change significantly as a result of full or partial settlement of audits within the next 12 months.

Table of Contents**NIKE, Inc.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 7 - Comprehensive Income:**

Comprehensive income, net of taxes, is as follows:

	Three Months Ended November 30,		Six Months Ended November 30,	
	2010	2009	2010	2009
	(in millions)			
Net income	\$ 457	\$ 375	\$ 1,016	\$ 888
Other comprehensive income (loss):				
Changes in cumulative translation adjustment and other (net of tax expense of \$24 million, \$34 million, \$51 million, and \$55 million, respectively)	51	61	104	85
Changes due to cash flow hedging instruments:				
Net (loss) on hedge derivatives (net of tax benefit of \$10 million, \$36 million, \$38 million, and \$61 million, respectively)	(3)	(92)	(75)	(156)
Reclassification to net income of previously deferred (gains) related to hedge derivative instruments (net of tax expense of \$11 million, \$11 million, \$26 million, and \$32 million, respectively)	(33)	(29)	(77)	(90)
Reclassification of ineffective hedge (gains) losses to net income (net of tax expense of \$1 million for the six month period ended November 30, 2009) ⁽¹⁾				(4)
Changes due to net investment hedges:				
Net (loss) on hedge derivatives (net of tax benefit of \$2 million, \$14 million, \$8 million, and \$23 million, respectively)	(2)	(28)	(16)	(46)
Other comprehensive income (loss):	13	(88)	(64)	(211)
Total comprehensive income	\$ 470	\$ 287	\$ 952	\$ 677

⁽¹⁾ Refer to Note 10 - Risk Management and Derivatives for additional detail.

NOTE 8 - Stock-Based Compensation:

A committee of the Board of Directors grants stock options and restricted stock under the NIKE, Inc. 1990 Stock Incentive Plan (the 1990 Plan). The committee has granted substantially all stock options at 100% of the market price on the date of grant. Substantially all stock option grants outstanding under the 1990 Plan were granted in the first quarter of each fiscal year, vest ratably over four years, and expire 10 years from the date of grant. In addition to the 1990 Plan, the Company gives employees the right to purchase shares at a discount to the market price under employee stock purchase plans (ESPPs).

The Company accounts for stock-based compensation by estimating the fair value of options granted under the 1990 Plan and employees purchase rights under the ESPPs using the Black-Scholes option pricing model. The Company recognizes this fair value as operating overhead expense over the vesting period using the straight-line method.

The following table summarizes the Company's total stock-based compensation expense:

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	Three Months Ended		Six Months Ended	
	November 30, 2010	2009	November 30, 2010	2009
	(in millions)			
Stock options ⁽¹⁾	\$ 21	\$ 17	\$ 35	\$ 102
ESPPs	4	4	8	8
Restricted stock	4	3	7	5
Total stock-based compensation expense	\$ 29	\$ 24	\$ 50	\$ 115

⁽¹⁾ Accelerated stock option expense is recorded for employees eligible for accelerated stock option vesting upon retirement. In the first quarter of fiscal 2011, the Company changed the accelerated vesting provisions of its stock option plan. Under the new provisions, accelerated stock option expense for the three and six month periods ended November 30, 2010 was \$4 million and \$6 million, respectively. The accelerated stock option expense for the three and six month periods ended November 30, 2009 was \$1 million and \$72 million, respectively.

Table of Contents**NIKE, Inc.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

As of November 30, 2010, the Company had \$152 million of unrecognized compensation costs from stock options, net of estimated forfeitures, to be recognized as operating overhead expense over a weighted average period of 2.7 years.

The weighted average fair value per share of the options granted during the six months ended November 30, 2010 and 2009 as computed using the Black-Scholes pricing model was \$17.66 and \$23.41, respectively. The weighted average assumptions used to estimate these fair values are as follows:

	Six Months Ended November 30,	
	2010	2009
Dividend yield	1.6%	1.9%
Expected volatility	31.5%	57.8%
Weighted-average expected life (in years)	5.0	5.0
Risk-free interest rate	1.7%	2.5%

Expected volatility is estimated based on the implied volatility in market traded options on the Company's common stock with a term greater than one year, along with other factors. The weighted average expected life of options is based on an analysis of historical and expected future exercise patterns. The interest rate is based on the U.S. Treasury (constant maturity) risk-free rate in effect at the date of grant for periods corresponding with the expected term of the options.

NOTE 9 - Earnings Per Common Share:

The following is a reconciliation from basic earnings per share to diluted earnings per share. Options to purchase an additional 6.3 million and 0.2 million shares of common stock were outstanding for the three month periods ended November 30, 2010 and 2009, respectively, and 0.2 million and 12.6 million shares of common stock were outstanding for the six month periods ended November 30, 2010 and 2009, respectively, but were not included in the computation of diluted earnings per share because the options were anti-dilutive.

	Three Months Ended November 30,		Six Months Ended November 30,	
	2010	2009	2010	2009
	(in millions, except per share data)			
Determination of shares:				
Weighted average common shares outstanding	477.9	487.2	478.8	486.5
Assumed conversion of dilutive stock options and awards	9.7	7.3	9.6	7.0
Diluted weighted average common shares outstanding	487.6	494.5	488.4	493.5
Basic earnings per common share	\$ 0.96	\$ 0.77	\$ 2.12	\$ 1.83
Diluted earnings per common share	\$ 0.94	\$ 0.76	\$ 2.08	\$ 1.80

NOTE 10 - Risk Management and Derivatives:

The Company is exposed to global market risks, including the effect of changes in foreign currency exchange rates and interest rates, and uses derivatives to manage financial exposures that occur in the normal course of business. The Company does not hold or issue derivatives for trading purposes.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking hedge transactions. This process includes linking all derivatives to either specific firm commitments or forecasted

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transactions. The Company also enters into foreign exchange forwards to mitigate the change in fair value of specific assets and liabilities on the balance sheet, which are not designated as hedging instruments under the accounting standards for derivatives and hedging. Accordingly, changes in the fair value of these non-designated instruments of recorded balance sheet

Table of Contents**NIKE, Inc.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

positions are recognized immediately in other (income), net, on the income statement together with the transaction gain or loss from the hedged balance sheet position. The Company classifies the cash flows at settlement from these undesignated instruments in the same category as the cash flows from the related hedged items, generally within the cash provided by operations component of the cash flow statement.

The majority of derivatives outstanding as of November 30, 2010 are designated as cash flow, fair value or net investment hedges. All derivatives are recognized on the balance sheet at their fair value and classified based on the instrument's maturity date. The total notional amount of outstanding derivatives as of November 30, 2010 was \$6 billion, which is primarily comprised of cash flow hedges denominated in Euros, British Pounds and Japanese Yen.

The following table presents the fair values of derivative instruments included within the unaudited condensed consolidated balance sheet as of November 30, 2010 and the condensed consolidated balance sheet as of May 31, 2010:

	Asset Derivatives			Liability Derivatives		
	Balance Sheet Location	November 30, 2010	May 31, 2010 (in millions)	Balance Sheet Location	November 30, 2010	May 31, 2010
Derivatives formally designated as hedging instruments:						
Foreign exchange forwards and options	Prepaid expenses and other current assets	\$ 124	\$ 316	Accrued liabilities	\$ 54	\$ 25
Foreign exchange forwards and options	Deferred income taxes and other long-term assets	12		Deferred income taxes and other long-term liabilities	8	
Interest rate swap contracts	Deferred income taxes and other long-term assets	18	15	Deferred income taxes and other long-term liabilities		
Total derivatives formally designated as hedging instruments		154	331		62	25
Derivatives not formally designated as hedging instruments:						
Foreign exchange forwards and options	Prepaid expenses and other current assets	23	104	Accrued liabilities	51	139
Foreign exchange forwards and options	Deferred income taxes and other long-term assets			Deferred income taxes and other long-term liabilities		1
Total derivatives not formally designated as hedging instruments		23	104		51	140
Total derivatives		\$ 177	\$ 435		\$ 113	\$ 165

Table of Contents**NIKE, Inc.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following tables present the amounts affecting the unaudited condensed consolidated statements of income for the three and six month periods ended November 30, 2010 and 2009:

	Amount of Gain (Loss) Recognized in Other Comprehensive Income on Derivatives ⁽¹⁾			Amount of Gain (Loss) Reclassified From Accumulated Other Comprehensive Income into Income ⁽¹⁾	
	Three Months Ended November 30, 2010	Six Months Ended November 30, 2010		Three Months Ended November 30, 2010	Six Months Ended November 30, 2010
	(in millions)			(in millions)	
Derivatives designated as hedges					
Derivatives designated as cash flow hedges:					
Foreign exchange forwards and options	\$ 33	\$ 4	Revenue	\$ (10)	\$ (23)
Foreign exchange forwards and options	(36)	(86)	Cost of sales	35	87
Foreign exchange forwards and options	(3)	(1)	Selling and administrative expense	1	1
Foreign exchange forwards and options	(7)	(30)	Other (income), net	18	38
Total designated cash flow hedges	\$ (13)	\$ (113)		\$ 44	\$ 103
Derivatives designated as net investment hedges:					
Foreign exchange forwards and options	\$ (4)	\$ (24)	Other (income), net	\$	\$

⁽¹⁾ For the three and six month periods ended November 30, 2010, the Company recorded an immaterial amount of ineffectiveness from cash flow hedges in other (income), net.

	Amount of Gain (Loss) Recognized in Other Comprehensive Income on Derivatives ⁽¹⁾			Amount of Gain (Loss) Reclassified From Accumulated Other Comprehensive Income into Income ⁽¹⁾	
	Three Months Ended November 30, 2009	Six Months Ended November 30, 2009		Three Months Ended November 30, 2009	Six Months Ended November 30, 2009
	(in millions)			(in millions)	
Derivatives designated as hedges					
Derivatives designated as cash flow hedges:					
Foreign exchange forwards and options	\$ 9	\$ (3)	Revenue	\$ 21	\$ 39
Foreign exchange forwards and options	(115)	(171)	Cost of sales	11	53
Foreign exchange forwards and options		1	Selling and administrative expense		(1)
Foreign exchange forwards and options	(22)	(44)	Other (income), net	8	36

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Total designated cash flow hedges	\$ (128)	\$ (217)		\$ 40	\$ 127
Derivatives designated as net investment hedges:					
Foreign exchange forwards and options	\$ (42)	\$ (69)	Other (income), net	\$	\$

⁽¹⁾ For the three and six month periods ended November 30, 2009, the Company recorded an immaterial amount of ineffectiveness from cash flow hedges in other (income), net.

Table of Contents

NIKE, Inc.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Amount of Gain (Loss) Recognized in Income on Derivatives				Location of Gain (Loss) Recognized in Income on Derivatives
Three Months Ended November 30, 2010	Three Months Ended November 30, 2009	Six Months Ended November 30, 2010	Six Months Ended November 30, 2009	