NIKE INC
Form 10-Q
April 07, 2010
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# 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 February 28, 2010**

**Commission file number - 001-10635**

# NIKE, Inc.

**(Exact name of registrant as specified in its charter)**

| **OREGON** | **93-0584541** |
|---|---|
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |
| **One Bowerman Drive, Beaverton, Oregon** | **97005-6453** |
| **(Address of principal executive offices)** | **(Zip Code)** |

**Registrant s telephone number, including area code: (503) 671-6453**

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 x 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 x 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 x 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 x

Shares of Common Stock outstanding as of March 31, 2010 were:

| | |
|---|---|
| Class A | 89,990,248 |
| Class B | 395,710,294 |
| | 485,700,542 |

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**NIKE, Inc.**

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**PART I. FINANCIAL INFORMATION**



**PART II. OTHER INFORMATION**

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## PART I - FINANCIAL INFORMATION

**Item 1. FINANCIAL STATEMENTS**

**NIKE, Inc.**

**UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

| | February 28, 2010 | May 31, 2009 |
|---|---|---|
| | (in millions) | |
| **ASSETS** | | |
| **Current assets:** | | |
| Cash and equivalents | $ 2,225.2 | $ 2,291.1 |
| Short-term investments (Note 5) | 1,813.7 | 1,164.0 |
| Accounts receivable, net | 2,833.8 | 2,883.9 |
| Inventories (Note 2) | 2,150.3 | 2,357.0 |
| Deferred income taxes (Note 6) | 221.7 | 272.4 |
| Prepaid expenses and other current assets (Note 11) | 843.3 | 765.6 |
| **Total current assets** | 10,088.0 | 9,734.0 |
| Property, plant and equipment | 4,437.2 | 4,255.7 |
| Less accumulated depreciation | 2,474.6 | 2,298.0 |
| Property, plant and equipment, net | 1,962.6 | 1,957.7 |
| Identifiable intangible assets, net (Note 3) | 468.0 | 467.4 |
| Goodwill (Note 3) | 190.7 | 193.5 |
| Deferred income taxes and other long-term assets (Note 6 and 11) | 867.0 | 897.0 |
| **Total assets** | $ 13,576.3 | $ 13,249.6 |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | |
| **Current liabilities:** | | |
| Current portion of long-term debt | $ 7.5 | $ 32.0 |
| Notes payable | 108.8 | 342.9 |
| Accounts payable | 994.7 | 1,031.9 |
| Accrued liabilities (Note 4) | 1,647.7 | 1,783.9 |
| Income taxes payable (Note 6) | 88.0 | 86.3 |
| **Total current liabilities** | 2,846.7 | 3,277.0 |
| Long-term debt | 451.9 | 437.2 |
| Deferred income taxes and other long-term liabilities (Note 6) | 848.5 | 842.0 |
| Commitments and contingencies (Note 13) | | |
| Redeemable preferred stock | 0.3 | 0.3 |
| **Shareholders equity:** | | |
| Common stock at stated value: | | |
| Class A convertible - 90.0 and 95.3 million shares outstanding | 0.1 | 0.1 |
| Class B - 393.7 and 390.2 million shares outstanding | 2.7 | 2.7 |
| Capital in excess of stated value | 3,272.6 | 2,871.4 |
| Accumulated other comprehensive income (Note 7) | 234.4 | 367.5 |
| Retained earnings | 5,919.1 | 5,451.4 |

| | | |
|---|---|---|
| **Total shareholders equity** | 9,428.9 | 8,693.1 |
| **Total liabilities and shareholders equity** | $ 13,576.3 | $ 13,249.6 |

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

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**NIKE, Inc.**

**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

| | Three Months Ended February 28, | | Nine Months Ended February 28, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (in millions, except per share data) | | | |
| Revenues | $ 4,733.0 | $ 4,440.8 | $ 13,937.1 | $ 14,463.1 |
| Cost of sales | 2,515.0 | 2,492.3 | 7,542.9 | 7,902.5 |
| Gross margin | 2,218.0 | 1,948.5 | 6,394.2 | 6,560.6 |
| Selling and administrative expense | 1,563.8 | 1,352.1 | 4,588.5 | 4,755.3 |
| Goodwill impairment | | 199.3 | | 199.3 |
| Intangible and other asset impairment | | 202.0 | | 202.0 |
| Other income, net | (8.6) | (43.3) | (32.2) | (54.1) |
| Interest expense (income), net | 0.9 | 3.0 | 3.8 | (12.1) |
| Income before income taxes | 661.9 | 235.4 | 1,834.1 | 1,470.2 |
| Income tax expense (benefit) (Note 6) | 165.5 | (8.4) | 449.3 | 324.9 |
| Net income | $ 496.4 | $ 243.8 | $ 1,384.8 | $ 1,145.3 |
| Basic earnings per common share (Note 9) | $ 1.02 | $ 0.50 | $ 2.85 | $ 2.36 |
| Diluted earnings per common share (Note 9) | $ 1.01 | $ 0.50 | $ 2.81 | $ 2.33 |
| Dividends declared per common share | $ 0.27 | $ 0.25 | $ 0.79 | $ 0.73 |

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

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**NIKE, Inc.**

**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

| | Nine Months Ended February 28, 2010 | Nine Months Ended February 28, 2009 |
|---|---|---|
| | (in millions) | |
| **Cash provided by operations:** | | |
| Net income | $ 1,384.8 | $ 1,145.3 |
| Income charges (credits) not affecting cash: | | |
| Depreciation | 240.5 | 246.6 |
| Deferred income taxes | 74.0 | (270.3) |
| Stock-based compensation | 137.5 | 127.0 |
| Amortization and other | 21.8 | 8.2 |
| Impairment of goodwill, intangibles and other assets | | 401.3 |
| Changes in certain working capital components and other assets and liabilities: | | |
| Decrease (increase) in accounts receivable | 89.0 | (373.8) |
| Decrease (increase) in inventories | 214.9 | (182.5) |
| Increase in prepaid expenses and other assets | (35.7) | (55.0) |
| Decrease in accounts payable, accrued liabilities and income taxes payable | (237.8) | (384.4) |
| **Cash provided by operations** | 1,889.0 | 662.4 |
| **Cash used by investing activities:** | | |
| Purchases of investments | (2,430.2) | (1,748.9) |
| Maturities of investments | 1,345.8 | 893.0 |
| Sales of investments | 406.3 | 790.4 |
| Additions to property, plant and equipment | (240.1) | (335.3) |
| Proceeds from the sale of property, plant and equipment | 9.8 | 14.6 |
| Increase in other assets and liabilities, net | (6.5) | (42.4) |
| Settlement of net investment hedges | (49.1) | 226.9 |
| **Cash used by investing activities** | (964.0) | (201.7) |
| **Cash used by financing activities:** | | |
| Reduction in long-term debt, including current portion | (30.5) | (5.1) |
| (Decrease) increase in notes payable | (237.4) | 171.8 |
| Proceeds from exercise of stock options and other stock issuances | 222.8 | 149.0 |
| Excess tax benefits from share-based payment arrangements | 36.5 | 22.0 |
| Repurchase of common stock | (526.0) | (649.2) |
| Dividends on common stock | (374.7) | (345.6) |
| **Cash used by financing activities** | (909.3) | (657.1) |
| Effect of exchange rate changes on cash | (81.6) | (45.4) |
| Net decrease in cash and equivalents | (65.9) | (241.8) |
| Cash and equivalents, beginning of period | 2,291.1 | 2,133.9 |
| **Cash and equivalents, end of period** | $ 2,225.2 | $ 1,892.1 |

Supplemental disclosure of cash flow information:

| | | |
|---|---|---|
| Dividends declared and not paid | $ 130.6 | $ 121.1 |

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

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## 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, 2009 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 nine months ended February 28, 2010 are not necessarily indicative of results to be expected for the entire year.

***Recently Adopted Accounting Standards:***

In February 2010, the Financial Accounting Standards Board ( FASB ) issued amended guidance on subsequent events. Under this amended guidance, SEC filers are no longer required to disclose the date through which subsequent events have been evaluated in originally issued and revised financial statements. This guidance was effective immediately and the Company adopted these new requirements for the period ended February 28, 2010.

In June 2009, the FASB established the FASB Accounting Standards Codification (the Codification ) as the single source of authoritative US GAAP for all non-governmental entities. The Codification, which launched July 1, 2009, changes the referencing and organization of accounting guidance. The Codification became effective for the Company beginning September 1, 2009. The issuance of FASB Codification did not change GAAP and therefore the adoption has only affected how specific references to GAAP literature are disclosed in the notes to the Company s consolidated financial statements.

In April 2009, the FASB updated guidance related to fair-value measurements to clarify the guidance related to measuring fair-value in inactive markets, to modify the recognition and measurement of other-than-temporary impairments of debt securities, and to require public companies to disclose the fair values of financial instruments in interim periods. This updated guidance became effective for the Company beginning June 1, 2009. The adoption of this guidance did not have an impact on the Company s consolidated financial position or results of operations. See Note 5 - Fair Value Measurements for the disclosure required under the updated guidance.

In June 2008, the FASB issued new accounting guidance applicable when determining whether instruments granted in share-based payment transactions are participating securities. This guidance clarifies that share-based payment awards that entitle their holders to receive non-forfeitable dividends before vesting should be considered participating securities and included in the computation of earnings per share pursuant to the two-class method. This guidance became effective for the Company beginning June 1, 2009. The adoption of this guidance did not have a material impact on the Company s consolidated financial position or results of operations.

In April 2008, the FASB issued amended guidance regarding the determination of the useful life of intangible assets. This guidance amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. The intent of the position is to improve the consistency between the useful life of a recognized intangible asset and the period of expected cash flows used to measure the fair value of the asset. This guidance became effective for the Company beginning June 1, 2009. The adoption of this guidance did not have a material impact on the Company s consolidated financial position or results of operations.

In December 2007, the FASB issued amended guidance regarding business combinations, establishing principles and requirements for how an acquirer recognizes and measures identifiable assets acquired, liabilities assumed, any resulting goodwill, and any non-controlling interest in an acquiree in its financial statements. This guidance also provides for disclosures to enable users of the financial statements to evaluate the nature and financial effects of a business combination. This amended guidance became effective for the Company beginning June 1, 2009. The adoption of this amended guidance did not have an impact on the Company s consolidated financial statements, but could impact the accounting for future business combinations.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In December 2007, the FASB issued new guidance regarding the accounting and reporting for non-controlling interests in subsidiaries. This guidance clarifies that non-controlling interests in subsidiaries should be accounted for as a component of equity separate from the parent s equity. This guidance became effective for the Company beginning June 1, 2009. 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 January 2010, the FASB issued guidance to amend the disclosure requirements related to recurring and nonrecurring fair value measurements. The guidance requires disclosure of transfers of assets and liabilities between Level 1 and Level 2 of the fair value measurement hierarchy, including the reasons and the timing of the transfers and information on purchases, sales, issuance, and settlements on a gross basis in the reconciliation of the assets and liabilities measured under Level 3 of the fair value measurement hierarchy. This guidance is effective for the Company beginning March 1, 2010. The Company does not expect the adoption will have an impact on its consolidated financial position or results of operations.

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.

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 is effective for the Company beginning June 1, 2010. The Company is currently evaluating the impact of the provisions of this new standard.

**NOTE 2 - Inventories:**

Inventory balances of $2,150.3 million and $2,357.0 million at February 28, 2010 and May 31, 2009, respectively, were substantially all finished goods.

**NOTE 3 - Identified Intangible Assets and Goodwill:**

The following table summarizes the Company s identifiable intangible assets and goodwill balances as of February 28, 2010 and May 31, 2009:

| | February 28, 2010 | | | May 31, 2009 | | |
|---|---|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| | (in millions) | | | | | |
| Amortized intangible assets: | | | | | | |
| Patents | $ 64.4 | $ (19.6) | $ 44.8 | $ 56.6 | $ (17.2) | $ 39.4 |
| Trademarks | 39.4 | (16.0) | 23.4 | 37.5 | (10.9) | 26.6 |
| Other | 33.7 | (18.5) | 15.2 | 40.0 | (19.6) | 20.4 |
| Total | $ 137.5 | $ (54.1) | 83.4 | $ 134.1 | $ (47.7) | 86.4 |

| | | |
|---|---|---|
| Unamortized intangible assets - Trademarks | 384.6 | 381.0 |
| Identifiable intangible assets, net | $ 468.0 | $ 467.4 |
| Goodwill | $ 190.7 | $ 193.5 |

The effect of foreign exchange fluctuations for the nine month period ended February 28, 2010 decreased goodwill and unamortized intangible assets by approximately $2.8 million and $1.5 million, respectively, resulting from the strengthening of the U.S. dollar in relation to the British pound sterling.

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**NIKE, Inc.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Amortization expense, which is included in selling and administrative expense, was $3.3 million and $2.6 million for the three-month periods ended February 28, 2010 and 2009, respectively and $9.9 million and $7.1 million for the nine-month periods ended February 28, 2010 and 2009, respectively. The estimated amortization expense for intangible assets subject to amortization for the remainder of fiscal year 2010 and each of the years ending May 31, 2011 through May 31, 2014 are as follows: $3.4 million; 2011: $13.1 million; 2012: $12.3 million; 2013: $10.5 million; 2014: $8.4 million.

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

**NOTE 4 - Accrued Liabilities:**

Accrued liabilities include the following:

| | February 28, 2010 | May 31, 2009 |
|---|---|---|
| | (in millions) | |
| Compensation and benefits, excluding taxes | $ 488.6 | $ 491.9 |
| Endorsee compensation | 211.4 | 237.1 |
| Taxes other than income taxes | 176.2 | 161.9 |
| Advertising and marketing | 140.6 | 97.6 |
| Dividends payable | 130.6 | 121.4 |
| Import and logistics costs | 76.0 | 59.4 |
| Fair value of derivatives | 43.3 | 68.9 |
| Restructuring charges[1] | 12.7 | 149.6 |
| Other[2] | 368.3 | 396.1 |
| Total Accrued Liabilities | $ 1,647.7 | $ 1,783.9 |

[1] Accrued restructuring charges primarily consist of severance costs relating to the Company s restructuring activities that took place during the fourth quarter of fiscal 2009. See Note 10 - Restructuring Activities for more information.

[2] Other consists of various accrued expenses. No individual item accounted for more than 5% of the total balance at February 28, 2010 and May 31, 2009.

**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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**NIKE, Inc.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table presents information about the Company s financial assets and liabilities measured at fair value on a recurring basis as of February 28, 2010 and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value.

| | February 28, 2010 | | | | |
|---|---|---|---|---|---|
| | Fair Value Measurements Using | | | | |
| | Level 1 | Level 2 | Level 3 | Assets/Liabilities at Fair Value (in millions) | Balance Sheet Classification |
| **Assets** | | | | | |
| Derivatives | $ | $ 301.7 | $ | $ 301.7 | Other current assets and other long-term assets |
| Available-for-sale securities | 437.5 | 1,120.5 | | 1,558.0 | Cash equivalents |
| Available-for-sale securities | 922.4 | 891.3 | | 1,813.7 | Short-term investments |
| **Total assets** | $ 1,359.9 | $ 2,313.5 | $ | $ 3,673.4 | |
| **Liabilities** | | | | | |
| Derivatives | $ | $ 46.3 | $ | $ 46.3 | Accrued liabilities and other long-term liabilities |
| **Total Liabilities** | $ | $ 46.3 | $ | $ 46.3 | |

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 February 28, 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. The Company had no material Level 3 measurements at February 28, 2010.

***Short-Term Investments***

As of February 28, 2010 and May 31, 2009, short-term investments consist 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. The Company considers all available-for-sale securities, including those with maturity dates beyond 12 months, as available to support current operational liquidity needs and therefore classifies all securities with maturity dates beyond three months as current assets within short-term investments on the consolidated balance sheet. As of February 28, 2010, the Company held $1,612.6 million of available-for-sale securities with maturity dates within one year and $201.1 million with maturity dates over one year and less than five years within short-term investments.

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

| | February 28, 2010 | May 31, 2009 |
|---|---|---|
| | (in millions) | |
| Available-for-sale investments: | | |
| U.S. treasury and agencies | $ 1,317.3 | $ 772.8 |
| Corporate commercial paper and bonds | 496.4 | 391.2 |
| | $ 1,813.7 | $ 1,164.0 |

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**NIKE, Inc.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***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 $468 million at February 28, 2010 and $456 million at May 31, 2009.

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

**NOTE 6 - Income Taxes:**

The effective tax rate was 24.5% and 22.1% for the nine months ended February 28, 2010 and 2009, respectively. The Company s effective tax rate for the nine months ended February 28, 2009 includes a tax benefit related to the impairment of Umbro s goodwill, intangible and other assets. Excluding the tax benefit of the impairment charges in the prior year period, our fiscal year 2010 tax rate would have been 1.4 percentage points lower compared to fiscal 2009. This comparable decrease in fiscal 2010 was due to ongoing reduction in the effective tax rate on operations outside of the United States.

As of February 28, 2010, total gross unrecognized tax benefits, excluding related interest and penalties, were $251.7 million, $153.1 million of which would affect the Company s effective tax rate if recognized in future periods. Total gross unrecognized tax benefits, excluding interest and penalties, as of May 31, 2009 were $273.9 million, $110.6 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 decreased $0.9 million during the nine months ended February 28, 2010. As of February 28, 2010, accrued interest and penalties related to uncertain tax positions were $74.5 million (excluding federal benefit).

The Company is subject to taxation primarily in the U.S., 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 for the 2007, 2008 and 2009 tax years. The Company s major foreign jurisdictions, China and the Netherlands, have concluded substantially all income tax matters through calendar 1998 and fiscal 2002, respectively. It is reasonably possible that the Internal Revenue Service audits for the 2007, 2008 and 2009 tax years will be completed during the next twelve months, which could result in a decrease in our balance of unrecognized tax benefits. An estimate of the range cannot be made at this time; however, we do 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.

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**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 February 28, | | Nine Months Ended February 28, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (in millions) | | | |
| Net income | $ 496.4 | $ 243.8 | $ 1,384.8 | $ 1,145.3 |
| Other comprehensive income (loss): | | | | |
| Changes in cumulative translation adjustment and other[1] | (136.3) | (52.0) | (51.2) | (507.9) |
| Changes due to cash flow hedging instruments: | | | | |
| Net gain (loss) on hedge derivatives | 154.7 | 95.6 | (1.3) | 634.4 |
| Reclassification to net income of previously deferred (gains) losses related to hedge derivative instruments | (2.7) | (76.2) | (93.0) | (30.4) |
| Reclassification of ineffective hedge (gains) losses to net income[2] | | | (3.8) | |
| Changes due to net investment hedges: | | | | |
| Net gain on hedge derivatives | 62.7 | 29.1 | 16.2 | 189.8 |
| Other comprehensive income (loss): | 78.4 | (3.5) | (133.1) | 285.9 |
| Total comprehensive income | $ 574.8 | $ 240.3 | $ 1,251.7 | $ 1,431.2 |

(1) Certain prior year amounts have been revised to properly reflect Changes in cumulative translation adjustment and other in the table above. These revisions affected certain balances reported in our unaudited condensed consolidated balance sheets as of February 28, 2009. As of and for the nine month period ended February 28, 2009, these revisions resulted in an increase in other comprehensive income of $346.0 million, an increase in long-term deferred tax assets of $372.0 million and an increase in long-term deferred tax liabilities of $26.0 million. For the three month period ended February 28, 2009, these revisions resulted in an increase in other comprehensive income of $58.0 million, an increase in long-term deferred tax assets of $197.0 million and an increase in long-term deferred tax liabilities of $139.0 million. These revisions did not affect the Company s previously reported results of operations and the Company has concluded that these revisions were not material to the financial position for the quarter ended February 28, 2009 or any other subsequent period.

In addition, certain prior period amounts have been reclassified to conform to current period presentation. These changes had no impact on previously reported total comprehensive income.

(2) Refer to Note 11 - Risk Management and Derivatives for additional detail.

NIKE, Inc.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**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 selling and administrative expense over the vesting period using the straight-line method.

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

| | Three Months Ended February 28, | | Nine Months Ended February 28, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (in millions) | | | |
| Stock Options[(1)] | $ 16.4 | $ 18.6 | $ 117.7 | $ 110.4 |
| ESPPs | 3.7 | 3.2 | 11.9 | 10.8 |
| Restricted Stock | 2.9 | 1.9 | 7.9 | 5.8 |
| Total stock-based compensation expense | $ 23.0 | $ 23.7 | $ 137.5 | $ 127.0 |

(1) Accelerated stock option expense is recorded for employees eligible for accelerated stock option vesting upon retirement. Accelerated stock option expense was $1.2 million and $1.0 million for the three months ended February 28, 2010 and 2009, respectively, and was $73.2 million and $57.7 million for the nine months ended February 28, 2010 and 2009 respectively.

As of February 28, 2010, the Company had $102.3 million of unrecognized compensation costs from stock options, net of estimated forfeitures, to be recognized as selling and administrative expense over a weighted average period of 2.4 years.

The weighted average fair value per share of the options granted during the nine months ended February 28, 2010 and 2009 as computed using the Black-Scholes pricing model was $23.42 and $17.13, respectively. The weighted average assumptions used to estimate these fair values are as follows:

| | Nine Months Ended February 28, | |
|---|---|---|
| | 2010 | 2009 |
| Dividend yield | 1.9% | 1.5% |
| Expected volatility | 57.8% | 32.5% |
| Weighted-average expected life (in years) | 5.0 | 5.0 |
| Risk-free interest rate | 2.5% | 3.4% |

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.

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NIKE, Inc.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**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 0.2 million and 13.8 million shares of common stock were outstanding for both the three and nine month periods ended February 28, 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 February 28, | | Nine Months Ended February 28, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (in millions, except per share data) | | | |
| Determination of shares: | | | | |
| Weighted average common shares outstanding | 484.4 | 484.0 | 485.8 | 485.0 |
| Assumed conversion of dilutive stock options and awards | 7.9 | 4.1 | 7.5 | 6.2 |
| Diluted weighted average common shares outstanding | 492.3 | 488.1 | 493.3 | 491.2 |
| Basic earnings per common share | $ 1.02 | $ 0.50 | $ 2.85 | $ 2.36 |
| Diluted earnings per common share | $ 1.01 | $ 0.50 | $ 2.81 | $ 2.33 |

**NOTE 10 - Restructuring Activities:**

During the fourth quarter of fiscal 2009, the Company took necessary steps to streamline its management structure, enhance consumer focus, drive innovation more quickly to market and establish a more scalable, long-term cost structure. As a result, the Company reduced its global workforce by approximately 5% and incurred gross restructuring charges of $195 million, primarily consisting of severance costs related to the workforce reduction. As nearly all of the restructuring activities were completed in the fourth quarter of fiscal 2009, the Company does not expect to recognize additional costs in future periods relating to these actions.

The activity in the restructuring accrual for the nine month period ended February 28, 2010 is as follows (in millions):

| | |
|---|---|
| Restructuring accrual - May 31, 2009 | $ 149.6 |
| Cash payments | (138.4) |
| Foreign currency translation and other | 1.5 |
| Restructuring accrual - February 28, 2010 | $ 12.7 |

The accrual balance as of February 28, 2010 will be relieved throughout the remainder of fiscal year 2010 and early 2011, as severance payments are completed. The restructuring accrual is included in the balance of accrued liabilities in the unaudited condensed consolidated balance sheets.

**NOTE 11 - 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 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 hedges of recorded balance sheet 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 majority of derivatives outstanding as of February 28, 2010 are designated as either 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 February 28, 2010 was $6.2 billion, which is primarily comprised of cash flow hedges denominated in Euros, British Pounds and Japanese Yen.

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**NIKE, Inc.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table presents the fair values of derivative instruments included within the unaudited condensed consolidated balance sheet as of February 28, 2010 and the condensed consolidated balance sheet as of May 31, 2009:

| | Asset Derivatives | | | Liability Derivatives | | |
|---|---|---|---|---|---|---|
| | Balance Sheet Location | February 28, 2010 | May 31, 2009 | Balance Sheet Location | February 28, 2010 | May 31, 2009 |
| | | (in millions) | | | | |
| Derivatives designated as hedging instruments: | | | | | | |
| Foreign exchange forwards and options | Prepaid expenses and other current assets | $ 256.4 | $ 270.4 | | | |