NIKE INC
Form 10-Q
October 06, 2015
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended August 31, 2015
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
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 þ 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 þ 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 þ	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	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 þ
Shares of Common Stock outstanding as of October 1, 2015 were:

Class A	177,457,876
Class B	674,735,884
	852,193,760

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PART I - FINANCIAL INFORMATION
ITEM 1. Financial Statements
NIKE, Inc. Unaudited Condensed Consolidated Balance Sheets

(In millions)	August 31, 2015	May 31, 2015
ASSETS		
Current assets:		
Cash and equivalents (Note 4)	$3,246	$3,852
Short-term investments (Note 4)	2,162	2,072
Accounts receivable, net	3,288	3,358
Inventories (Note 2)	4,414	4,337
Deferred income taxes (Note 6)	377	389
Prepaid expenses and other current assets (Notes 4 and 9)	1,751	1,968
Total current assets	15,238	15,976
Property, plant and equipment, net	3,112	3,011
Identifiable intangible assets, net	281	281
Goodwill	131	131
Deferred income taxes and other assets (Notes 4, 6 and Note 9)	2,004	2,201
TOTAL ASSETS	$20,766	$21,600
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt (Note 4)	$106	$107
Notes payable (Note 4)	23	74
Accounts payable	1,933	2,131
Accrued liabilities (Notes 3, 4 and 9)	3,139	3,951
Income taxes payable (Note 6)	75	71
Total current liabilities	5,276	6,334
Long-term debt (Note 4)	1,079	1,079
Deferred income taxes and other liabilities (Notes 4, 6 and 9)	1,517	1,480
Commitments and contingencies (Note 12)		
Redeemable preferred stock	—	—
Shareholders' equity:		
Common stock at stated value:		
Class A convertible — 177 and 178 shares outstanding	—	—
Class B — 677 and 679 shares outstanding	3	3
Capital in excess of stated value	7,029	6,773
Accumulated other comprehensive income (Note 10)	833	1,246
Retained earnings	5,029	4,685
Total shareholders' equity	12,894	12,707
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$20,766	$21,600

The accompanying Notes to the 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 August 31,	
(In millions, except per share data)	2015	2014
Revenues	$8,414	$7,982
Cost of sales	4,419	4,261
Gross profit	3,995	3,721
Demand creation expense	832	897
Operating overhead expense	1,745	1,583
Total selling and administrative expense	2,577	2,480
Interest expense (income), net (Note 4)	4	9
Other (income) expense, net (Note 9)	(31)	3
Income before income taxes	1,445	1,229
Income tax expense (Note 6)	266	267
NET INCOME	$1,179	$962
Earnings per common share:		
Basic	$1.38	$1.11
Diluted	$1.34	$1.09
Dividends declared per common share	$0.28	$0.24

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

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NIKE, Inc. Unaudited Condensed Consolidated Statements of Comprehensive Income

	Three Months Ended August 31,	
(In millions)	2015	2014
Net income	$1,179	$962
Other comprehensive income (loss), net of tax:		
Change in net foreign currency translation adjustment	(81)	2
Change in net gains (losses) on cash flow hedges	(329)	135
Change in net gains (losses) on other	(3)	2
Total other comprehensive income (loss), net of tax	(413)	139
TOTAL COMPREHENSIVE INCOME	$766	$1,101

The accompanying Notes to the 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

	Three Months Ended August 31,	
(In millions)	2015	2014
Cash provided by operations:		
Net income	$1,179	$962
Income charges (credits) not affecting cash:		
Depreciation	154	147
Deferred income taxes	(31)	35
Stock-based compensation (Note 7)	54	43
Amortization and other	11	8
Net foreign currency adjustments	32	53
Changes in certain working capital components and other assets and liabilities:		
Decrease (increase) in accounts receivable	52	(203)
(Increase) in inventories	(100)	(111)
(Increase) in prepaid expenses and other current assets	(73)	—
(Decrease) in accounts payable, accrued liabilities and income taxes payable	(787)	(251)
Cash provided by operations	491	683
Cash (used) provided by investing activities:		
Purchases of short-term investments	(1,188)	(1,296)
Maturities of short-term investments	721	1,074
Sales of short-term investments	450	762
Investments in reverse repurchase agreements	(50)	—
Additions to property, plant and equipment	(327)	(262)
Disposals of property, plant and equipment	9	2
Cash (used) provided by investing activities	(385)	280
Cash used by financing activities:		
Long-term debt payments, including current portion	(1)	(2)
(Decrease) in notes payable	(48)	(17)
Payments on capital lease obligations	—	(6)
Proceeds from exercise of stock options and other stock issuances	128	127
Excess tax benefits from share-based payment arrangements	75	44
Repurchase of common stock	(588)	(819)
Dividends — common and preferred	(240)	(209)
Cash used by financing activities	(674)	(882)
Effect of exchange rate changes on cash and equivalents	(38)	2
Net (decrease) increase in cash and equivalents	(606)	83
Cash and equivalents, beginning of period	3,852	2,220
CASH AND EQUIVALENTS, END OF PERIOD	$3,246	$2,303
Supplemental disclosure of cash flow information:		
Non-cash additions to property, plant and equipment	$152	$125
Dividends declared and not paid	239	207

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

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Notes to the Unaudited Condensed Consolidated Financial Statements

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NOTE 1 — Summary of Significant Accounting Policies

Basis of Presentation

The Unaudited Condensed Consolidated Financial Statements include the accounts of NIKE, Inc. and its subsidiaries (the "Company") and reflect all normal adjustments 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, 2015 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America ("U.S. 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 months ended August 31, 2015 are not necessarily indicative of results to be expected for the entire year.

Reclassifications

Certain prior year amounts have been reclassified to conform to fiscal 2016 presentation.

Revisions

During the third quarter of fiscal 2015, management determined it had incorrectly reflected unrealized gains and losses from re-measurement of non-functional currency intercompany balances between certain of its foreign wholly-owned subsidiaries in its Consolidated Statements of Cash Flows. These unrealized gains and losses should have been classified as non-cash reconciling items from Net income to Cash provided by operations, but were instead reported on the Effect of exchange rate changes on cash and equivalents line of the Consolidated Statements of Cash Flows. This resulted in an understatement of Cash provided by operations reported on the Consolidated Statements of Cash Flows for certain prior periods; there was no impact for any period to Net increase (decrease) in cash and equivalents reported on the Consolidated Statements of Cash Flows, or Cash and equivalents reported on the Consolidated Statements of Cash Flows and Balance Sheets. The Company assessed the materiality of the misclassifications on prior periods' financial statements in accordance with SEC Staff Accounting Bulletin ("SAB") No. 99, Materiality, codified in Accounting Standards Codification ("ASC") 250, Presentation of Financial Statements and concluded that these misstatements were not material to any prior annual or interim periods. Accordingly, in accordance with ASC 250 (SAB No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements), the amounts have been revised in the applicable Consolidated Statements of Cash Flows. For the three and six months ended August 31, 2014 and November 30, 2014 of fiscal 2015, the revisions increased Cash provided by operations and decreased Effect of exchange rate changes on cash and equivalents by $95 million and $312 million, respectively. These amounts have been reflected in the table below. As part of the revision to the Consolidated Statements of Cash Flows, the Company has updated its presentation to separately report Net foreign currency adjustments, which was previously included within Amortization and other.

	NIKE, Inc. Unaudited Condensed Consolidated Statements of Cash Flows					
	Three Months Ended August 31, 2014			Six Months Ended November 30, 2014		
(In millions)	As Reported	Adjustment	As Revised	As Reported	Adjustment	As Revised
Cash provided by operations:						
Net income	$962	$—	$962	$1,617	$—	$1,617
Income charges (credits) not affecting cash:						
Amortization and other	(34)	42	8	(54)	69	15
Net foreign currency adjustments	—	53	53	—	243	243
Cash provided by operations	588	95	683	1,235	312	1,547
Effect of exchange rate changes on cash and equivalents	97	(95)	2	288	(312)	(24)
Net increase (decrease) in cash and equivalents	83	—	83	53	—	53
Cash and equivalents, beginning of period	2,220	—	2,220	2,220	—	2,220
	$2,303	$—	$2,303	$2,273	$—	$2,273

CASH AND EQUIVALENTS, END OF PERIOD

Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board ("FASB") issued an accounting standards update that replaces existing revenue recognition guidance. The updated guidance requires companies to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, the new standard requires that reporting companies disclose the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Based on the FASB's decision in July 2015 to defer the effective date and to allow more flexibility with implementation, the Company anticipates the new standard will be effective for the Company beginning June 1, 2018. The new standard is required to be applied retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying it recognized at the date of initial application. The Company has not yet selected a transition method and is currently evaluating the effect the guidance will have on the Consolidated Financial Statements.

NOTE 2 — Inventories

Inventory balances of $4,414 million and $4,337 million at August 31, 2015 and May 31, 2015, respectively, were substantially all finished goods.

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NOTE 3 — Accrued Liabilities

Accrued liabilities included the following:

(In millions)	As of August 31, 2015	As of May 31, 2015
Compensation and benefits, excluding taxes	$672	$997
Collateral received from counterparties to hedging instruments	468	968
Endorsement compensation	393	388
Dividends payable	239	240
Taxes other than income taxes	218	174
Import and logistics costs	173	207
Advertising and marketing	126	117
Fair value of derivatives	118	162
Other(1)	732	698
TOTAL ACCRUED LIABILITIES	$3,139	$3,951

(1) Other consists of various accrued expenses with no individual item accounting for more than 5% of the total Accrued liabilities balance at August 31, 2015 and May 31, 2015.

NOTE 4 — 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 the price the Company would receive to sell an asset or pay to transfer a liability in an orderly transaction with a market participant at the measurement date. The Company uses the three-level hierarchy established by the FASB that 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 the fair value hierarchy are described below:

- Level 1: 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 assets or liabilities in markets that are not active.
- Level 3: Unobservable inputs for 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 conservative level of input that is significant to the fair value measurement.

Pricing vendors are utilized for certain Level 1 and Level 2 investments. These vendors either provide a quoted market price in an active market or use observable inputs without applying significant adjustments in their pricing. Observable inputs include broker quotes, interest rates and yield curves observable at commonly quoted intervals, volatilities and credit risks. The Company's fair value processes include controls that are designed to ensure appropriate fair values are recorded. These controls include a comparison of fair values to another independent pricing vendor.

The following tables present information about the Company's financial assets measured at fair value on a recurring basis as of August 31, 2015 and May 31, 2015, and indicate the level in the fair value hierarchy in which the Company classifies the fair value measurement.

	As of August 31, 2015			
(In millions)	Assets at Fair Value	Cash and Equivalents	Short-term Investments	Other Long-term Assets
Cash	$746	$746	$—	$—
Level 1:				
U.S. Treasury securities	1,050	275	775	—
Level 2:				

Time deposits	616	616	—	—
U.S. Agency securities	872	15	857	—
Commercial paper and bonds	685	155	530	—
Money market funds	1,439	1,439	—	—
Total Level 2:	3,612	2,225	1,387	—
Level 3:				
Non-marketable preferred stock	9	—	—	9
TOTAL	$5,417	$3,246	$2,162	$9

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(In millions)	As of May 31, 2015 Assets at Fair Value	Cash and Equivalents	Short-term Investments	Other Long-term Assets
Cash	$615	$615	$—	$—
Level 1:				
U.S. Treasury securities	869	225	644	—
Level 2:				
Time deposits	684	684	—	—
U.S. Agency securities	976	110	866	—
Commercial paper and bonds	914	352	562	—
Money market funds	1,866	1,866	—	—
Total Level 2:	4,440	3,012	1,428	—
Level 3:				
Non-marketable preferred stock	8	—	—	8
TOTAL	$5,932	$3,852	$2,072	$8

The Company elects to record the gross assets and liabilities of its derivative financial instruments on the Unaudited Condensed Consolidated Balance Sheets. The Company’s derivative financial instruments are subject to master netting arrangements that allow for the offset of assets and liabilities in the event of default or early termination of the contract. Any amounts of cash collateral received or posted related to these instruments associated with the Company's credit related contingent features are recorded in Cash and equivalents and Accrued liabilities, the latter of which would further offset against the Company’s derivative asset balance (refer to Note 9 — Risk Management and Derivatives). Cash collateral received or posted related to the Company's credit related contingent features is presented in the Cash provided by operations component of the Unaudited Condensed Consolidated Statement of Cash Flows. Any amounts of non-cash collateral received, such as securities, are not recorded on the Unaudited Condensed Consolidated Balance Sheets pursuant to the accounting standards for non-cash collateral received.

The following tables present information about the Company’s derivative assets and liabilities measured at fair value on a recurring basis as of August 31, 2015 and May 31, 2015, and indicate the level in the fair value hierarchy in which the Company classifies the fair value measurement.

	As of August 31, 2015					
	Derivative Assets			Derivative Liabilities		
(In millions)	Assets at Fair Value	Other Current Assets	Other Long-term Assets	Liabilities at Fair Value	Accrued Liabilities	Other Long-term Liabilities
Level 2:						
Foreign exchange forwards and options(1)	$1,070	$771	$299	$135	$116	$19
Embedded derivatives	8	4	4	12	2	10
Interest rate swaps(2)	76	76	—	—	—	—
TOTAL	$1,154	$851	$303	$147	$118	$29

(1) If the foreign exchange derivative instruments had been netted on the Unaudited Condensed Consolidated Balance Sheets, the asset and liability positions each would have been reduced by $135 million as of August 31, 2015. As of that date, the Company had received $417 million of cash collateral from various counterparties related to these foreign exchange derivative instruments. No amount of collateral was posted on the Company’s derivative liability balance as of August 31, 2015.

(2) As of August 31, 2015, the Company had received $51 million of cash collateral related to its interest rate swaps.

	As of May 31, 2015					
	Derivative Assets			Derivative Liabilities		
(In millions)	Assets at Fair Value	Other Current	Other Long-term	Liabilities at Fair	Accrued Liabilities	Other Long-term

		Assets	Assets	Value		Liabilities
Level 2:						
Foreign exchange forwards and options[1]	$1,554	$1,034	$520	$164	$160	$4
Embedded derivatives	7	2	5	11	2	9
Interest rate swaps[2]	78	78	—	—	—	—
TOTAL	$1,639	$1,114	$525	$175	$162	$13

(1) If the foreign exchange derivative instruments had been netted on the Consolidated Balance Sheets, the asset and liability positions each would have been reduced by $161 million as of May 31, 2015. As of that date, the Company had received $900 million of cash collateral and $74 million of securities from various counterparties related to these foreign exchange derivative instruments. No amount of collateral was posted on the Company's derivative liability balance as of May 31, 2015.

(2) As of May 31, 2015, the Company had received $68 million of cash collateral related to its interest rate swaps.

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Available-for-sale securities comprise investments in U.S. Treasury and Agency securities, money market funds, corporate commercial paper and bonds. These securities are valued using market prices on both active markets (Level 1) and less active markets (Level 2). The gross realized gains and losses on sales of available-for-sale securities were immaterial for the three months ended August 31, 2015 and 2014. Unrealized gains and losses on available-for-sale securities included in Accumulated other comprehensive income were immaterial as of August 31, 2015 and May 31, 2015.

The Company regularly reviews its available-for-sale securities for other-than-temporary impairment. For the three months ended August 31, 2015 the Company did not consider any of its securities to be other-than-temporarily impaired and, accordingly, did not recognize any impairment losses.

As of August 31, 2015, the Company held $1,905 million of available-for-sale securities with maturity dates within one year and $257 million with maturity dates over one year and less than five years within Short-term investments on the Unaudited Condensed Consolidated Balance Sheets.

Included in Interest expense (income), net for each of the three months ended August 31, 2015 and 2014 was interest income related to the Company's available-for-sale securities of $2 million and $1 million, respectively.

The Company’s Level 3 assets comprise investments in certain non-marketable preferred stock. These Level 3 investments are an immaterial portion of the Company's portfolio. Changes in Level 3 investment assets were immaterial during the three months ended August 31, 2015 and the fiscal year ended May 31, 2015.

Derivative financial instruments include foreign exchange forwards and options, embedded derivatives and interest rate swaps. Refer to Note 9 — Risk Management and Derivatives for additional detail.

No transfers among the levels within the fair value hierarchy occurred during the three months ended August 31, 2015.

As of August 31, 2015 and May 31, 2015, the Company had no assets or liabilities that were required to be measured at fair value on a non-recurring basis.

Financial Assets and Liabilities Not Recorded at Fair Value

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 or quoted prices for identical instruments in inactive markets (Level 2). The fair value of the Company’s long-term debt, including the current portion, was approximately $1,130 million at August 31, 2015 and $1,160 million at May 31, 2015.

The carrying amounts reflected on the Unaudited Condensed Consolidated Balance Sheets for Notes payable approximate fair value.

At August 31, 2015 and May 31, 2015, the Company had $200 million and $150 million, respectively, of outstanding receivables related to its investments in reverse repurchase agreements recorded within Prepaid expenses and other current assets on the Unaudited Condensed Consolidated Balance Sheets. The carrying amount of these agreements approximates their fair value based upon observable inputs other than quoted prices (Level 2). The reverse repurchase agreements are fully collateralized.

NOTE 5 — Short-Term Borrowings and Credit Lines

There have been no significant changes to the short-term borrowings and credit lines reported in the Company’s Annual Report on Form 10-K for the fiscal year ended May 31, 2015, except for the following:

On August 28, 2015, the Company entered into a committed credit facility agreement with a syndicate of banks which provides for up to $2 billion of borrowings. The facility matures August 28, 2020, with a one year extension option prior to any anniversary of the closing date, provided that in no event shall it extend beyond August 28, 2022. Based on the Company’s current long-term senior unsecured debt ratings of AA- and A1 from Standard and Poor’s Corporation and Moody’s Investor Services, respectively, the interest rate charged on any outstanding borrowings would be the prevailing LIBOR plus 0.455%. The facility fee is 0.045% of the total commitment. Under this committed credit facility, the Company must maintain certain financial ratios, among other things, with which the Company was in compliance at August 31, 2015. This facility replaces the prior $1 billion credit facility agreement entered into on November 1, 2011, which would have matured November 1, 2017. As of and for the period ended August 31, 2015, no amounts were outstanding under either committed credit facility.

NOTE 6 — Income Taxes

The effective tax rate was 18.4% and 21.7% for the three month periods ended August 31, 2015 and 2014, respectively. The decrease in the Company's effective tax rate was primarily due to an increase in the proportion of earnings from operations outside of the United States, which are generally subject to a lower tax rate, as well as certain discrete items recognized in the quarter.

As of August 31, 2015, total gross unrecognized tax benefits, excluding related interest and penalties, were $460 million, $258 million of which would affect the Company's effective tax rate if recognized in future periods. As of May 31, 2015, total gross unrecognized tax benefits, excluding related interest and penalties, were $438 million. The liability for payment of interest and penalties increased $13 million during the three months ended August 31, 2015. As of August 31, 2015 and May 31, 2015, accrued interest and penalties related to uncertain tax positions were $177 million and $164 million, respectively (excluding federal benefit).

The Company incurs tax liabilities primarily in the United States, China and the Netherlands, as well as various other state and foreign jurisdictions. The Company is currently under audit by the U.S. Internal Revenue Service (IRS) for the 2013 and 2014 fiscal years. The Company has closed all U.S. federal income tax matters through fiscal 2012, with the exception of the validation of foreign tax credits utilized. As previously disclosed, the Company received a statutory notice of deficiency for fiscal 2011 proposing an increase in tax of $31 million, subject to interest, related to the foreign tax credit matter. This notice also reported a decrease in foreign tax credit carryovers for fiscal 2010 and 2011. The Company has contested this deficiency notice by filing a petition with the U.S. Tax Court in April 2015. The Company does not expect the outcome of this matter to have a material impact on the financial statements. No payments on the assessment would be required until the dispute is definitively resolved. Based on the information currently available, the Company does not anticipate a significant increase or decrease to its unrecognized tax benefits for this matter within the next 12 months.

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The Company's major foreign jurisdictions, China and the Netherlands, have concluded substantially all income tax matters through calendar 2005 and fiscal 2009, respectively. Although the timing of resolution of audits is not certain, the Company evaluates all domestic and foreign audit issues in the aggregate, along with the expiration of applicable statutes of limitations, and estimates that it is reasonably possible the total gross unrecognized tax benefits could decrease by up to $43 million within the next 12 months.

NOTE 7 — Common Stock and Stock-Based Compensation

The authorized number of shares of Class A Common Stock, no par value, and Class B Common Stock, no par value, are 400 million and 2,400 million, respectively. Each share of Class A Common Stock is convertible into one share of Class B Common Stock. Voting rights of Class B Common Stock are limited in certain circumstances with respect to the election of directors. There are no differences in the dividend and liquidation preferences or participation rights of the Class A and Class B common shareholders.

The NIKE, Inc. Stock Incentive Plan (the "Stock Incentive Plan") provides for the issuance of up to 359 million previously unissued shares of Class B Common Stock in connection with stock options and other awards granted under the Stock Incentive Plan. The Stock Incentive Plan authorizes the grant of non-statutory stock options, incentive stock options, stock appreciation rights, restricted stock, restricted stock units and performance-based awards. The exercise price for stock options and stock appreciation rights may not be less than the fair market value of the underlying shares on the date of grant. A committee of the Board of Directors administers the Stock Incentive Plan. The committee has the authority to determine the employees to whom awards will be made, the amount of the awards and the other terms and conditions of the awards. Substantially all stock option grants outstanding under the Stock Incentive Plan are 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 Stock Incentive Plan, the Company gives employees the right to purchase shares at a discount to the market price under employee stock purchase plans ("ESPPs"). Employees are eligible to participate through payroll deductions of up to 10% of their compensation. At the end of each six-month offering period, shares are purchased by the participants at 85% of the lower of the fair market value at the beginning or the end of the offering period.

The Company accounts for stock-based compensation by estimating the fair value of options granted under the Stock Incentive 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 recognized in Operating overhead expense:

	Three Months Ended August 31,	
(In millions)	2015	2014
Stock options[1]	$39	$30
ESPPs	7	6
Restricted stock	8	7
TOTAL STOCK-BASED COMPENSATION EXPENSE	$54	$43

(1) Expense for stock options includes the expense associated with stock appreciation rights. Accelerated stock option expense is recorded for employees eligible for accelerated stock option vesting upon retirement. Accelerated stock option expense for the three month periods ended August 31, 2015 and 2014 was $6 million and $4 million, respectively.

As of August 31, 2015, the Company had $377 million of unrecognized compensation costs from stock options, net of estimated forfeitures, to be recognized in Operating overhead expense over a weighted average remaining period of 2.7 years.

The weighted average fair value per share of the options granted during the three month periods ended August 31, 2015 and 2014, computed as of the grant date using the Black-Scholes pricing model, was $25.32 and $16.91, respectively. The weighted average assumptions used to estimate these fair values are as follows:

Three Months Ended August 31,

	2015		2014	
Dividend yield	1.0	%	1.2	%
Expected volatility	23.6	%	23.6	%
Weighted average expected life (in years)	5.8		5.8	
Risk-free interest rate	1.7	%	1.7	%

The Company estimates the expected volatility 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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NOTE 8 — Earnings Per Share

The following is a reconciliation from basic earnings per common share to diluted earnings per common share. The computations of diluted earnings per common share excluded options to purchase an additional 10.2 million and 9.2 million shares of common stock outstanding for the three month periods ended August 31, 2015 and 2014, respectively, because the options were anti-dilutive.

	Three Months Ended August 31,	
(In millions, except per share data)	2015	2014
Determination of shares:		
Weighted average common shares outstanding	854.5	864.9
Assumed conversion of dilutive stock options and awards	22.8	21.3
DILUTED WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	877.3	886.2
Earnings per common share:		
Basic	$1.38	$1.11
Diluted	$1.34	$1.09

NOTE 9 — 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 or speculative purposes.

The Company may elect to designate certain derivatives as hedging instruments under the accounting standards for derivatives and hedging. The Company formally documents all relationships between designated hedging instruments and hedged items as well as its risk management objectives and strategies for undertaking hedge transactions. This process includes linking all derivatives designated as hedges to either recognized assets or liabilities or forecasted transactions.

The majority of derivatives outstanding as of August 31, 2015 are designated as foreign currency cash flow hedges, primarily for Euro/U.S. Dollar, British Pound/Euro and Japanese Yen/U.S. Dollar currency pairs. All derivatives are recognized on the Unaudited Condensed Consolidated Balance Sheets at fair value and classified based on the instrument's maturity date.

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The following table presents the fair values of derivative instruments included within the Unaudited Condensed Consolidated Balance Sheets as of August 31, 2015 and May 31, 2015:

	Derivative Assets			Derivative Liabilities		
(In millions)	Balance Sheet Location	August 31, 2015	May 31, 2015	Balance Sheet Location	August 31, 2015	May 31, 2015
Derivatives formally designated as hedging instruments:						
Foreign exchange forwards and options	Prepaid expenses and other current assets	$662	$825	Accrued liabilities	$90	$140
Interest rate swaps	Prepaid expenses and other current assets	76	78	Accrued liabilities	—	—
Foreign exchange forwards and options	Deferred income taxes and other assets	298	520	Deferred income taxes and other liabilities	10	4
Total derivatives formally designated as hedging instruments		1,036	1,423		100	144
Derivatives not designated as hedging instruments:						
Foreign exchange forwards and options	Prepaid expenses and other current assets	109	209	Accrued liabilities	26	20
Embedded derivatives	Prepaid expenses and other current assets	4	2	Accrued liabilities	2	2
Foreign exchange forwards and options	Deferred income taxes and other assets	1	—	Deferred income taxes and other liabilities	9	—
Embedded derivatives	Deferred income taxes and other assets	4	5	Deferred income taxes and other liabilities	10	9
Total derivatives not designated as hedging instruments		118	216		47	31
TOTAL DERIVATIVES		$1,154	$1,639		$147	$175

The following tables present the amounts affecting the Unaudited Condensed Consolidated Statements of Income for the three months ended August 31, 2015 and 2014:

	Amount of Gain (Loss) Recognized in Other	Amount of Gain (Loss) Reclassified From Accumulated Other Comprehensive Income into Income[1]
(In millions)		

	Comprehensive Income on Derivatives[(1)] Three Months Ended August 31,		Location of Gain (Loss) Reclassified From Accumulated Other Comprehensive Income into Income	Three Months Ended August 31,	
	2015	2014		2015	2014
Derivatives designated as cash flow hedges:					
Foreign exchange forwards and options	$ 33	$ (38)	Revenues	$ (43)	$ (17)
Foreign exchange forwards and options	(118)	119	Cost of sales	160	(8)
Foreign exchange forwards and options	(95)	37	Other (income) expense, net	31	5
Interest rate swaps	—	—	Interest expense (income), net	—	—
Total designated cash flow hedges	$ (180)	$ 118		$ 148	$ (20)

(1) For the three months ended August 31, 2015, the amounts recorded in Other (income) expense, net as a result of hedge ineffectiveness and the discontinuance of cash flow hedges because the forecasted transactions were no longer probable of occurring were immaterial.

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(In millions)	Amount of Gain (Loss) Recognized in Income on Derivatives Three Months Ended August 31, 2015	2014	Location of Gain (Loss) Recognized in Income on Derivatives
Derivatives designated as fair value hedges:			
Interest rate swaps[1]	$1	$1	Interest expense (income), net
Derivatives not designated as hedging instruments:			
Foreign exchange forwards and options	(29)	93	Other (income) expense, net
Embedded derivatives	—	(1)	Other (income) expense, net

(1) All interest rate swaps designated as fair value hedges meet the shortcut method requirements under the accounting standards for derivatives and hedging. Accordingly, changes in the fair values of the interest rate swaps are considered to exactly offset changes in the fair value of the underlying long-term debt. Refer to "Fair Value Hedges" in this note for additional detail.

Refer to Note 3 — Accrued Liabilities for derivative instruments recorded in Accrued liabilities, Note 4 — Fair Value Measurements for a description of how the above financial instruments are valued and Note 10 — Accumulated Other Comprehensive Income for additional information on changes in Accumulated other comprehensive income for the three months ended August 31, 2015 and 2014.

Cash Flow Hedges

The purpose of the Company's foreign exchange risk management program is to lessen both the positive and negative effects of currency fluctuations on the Company's consolidated results of operations, financial position and cash flows. Foreign currency exposures that the Company may elect to hedge in this manner include product cost exposures, non-functional currency denominated external and intercompany revenues, selling and administrative expenses, investments in U.S. Dollar-denominated available-for-sale debt securities and certain other intercompany transactions.

Product cost exposures are primarily generated through non-functional currency denominated product purchases and the foreign currency adjustment program described below. NIKE entities primarily purchase products in two ways: (1) Certain NIKE entities purchase product from the NIKE Trading Company ("NTC"), a wholly-owned sourcing hub that buys NIKE branded products from third party factories, predominantly in U.S. Dollars. The NTC, whose functional currency is the U.S. Dollar, then sells the products to NIKE entities in their respective functional currencies. When the NTC sells to a NIKE entity with a different functional currency, the result is a foreign currency exposure for the NTC. (2) Other NIKE entities purchase product directly from third party factories in U.S. Dollars. These purchases generate a foreign currency exposure for those NIKE entities with a functional currency other than the U.S. Dollar.

The Company operates a foreign currency adjustment program with certain factories. The program is designed to more effectively manage foreign currency risk by assuming certain of the factories' foreign currency exposures, some of which are natural offsets to the Company's existing foreign currency exposures. Under this program, the Company's payments to these factories are adjusted for rate fluctuations in the basket of currencies ("factory currency exposure index") in which the labor, materials and overhead costs incurred by the factories in the production of NIKE branded products ("factory input costs") are denominated. For the portion of the indices denominated in the local or functional currency of the factory, the Company may elect to place formally designated cash flow hedges. For all currencies within the indices, excluding the U.S. Dollar and the local or functional currency of the factory, an embedded derivative contract is created upon the factory's acceptance of NIKE's purchase order. Embedded derivative contracts are separated from the related purchase order, and their accounting treatment is described further below.

The Company's policy permits the utilization of derivatives to reduce its foreign currency exposures where internal netting or other strategies cannot be effectively employed. Typically, the Company may enter into hedge contracts starting up to 12 to 24 months in advance of the forecasted transaction and may place incremental hedges up to 100% of the exposure by the time the forecasted transaction occurs. The total notional amount of outstanding foreign

currency derivatives designated as cash flow hedges was $13.5 billion as of August 31, 2015.
As of August 31, 2015, the Company had outstanding a series of forward-starting interest rate swap agreements with a total notional amount of $1 billion. These instruments were designated as cash flow hedges of the variability in the expected cash outflows of interest payments on future debt due to changes in benchmark interest rates.
All changes in fair value of derivatives designated as cash flow hedges, excluding any ineffective portion, are recorded in Accumulated other comprehensive income until Net income is affected by the variability of cash flows of the hedged transaction. In most cases, amounts recorded in Accumulated other comprehensive income will be released to Net income in periods following the maturity of the related derivative, rather than at maturity. Effective hedge results are classified within the Unaudited Condensed Consolidated Statements of Income in the same manner as the underlying exposure, with the results of hedges of non-functional currency denominated revenues and product cost exposures, excluding embedded derivatives as described below, recorded in Revenues or Cost of sales, when the underlying hedged transaction affects consolidated Net income. Results of hedges of selling and administrative expense are recorded together with those costs when the related expense is recorded. Amounts recorded in Accumulated other comprehensive income related to forward-starting interest rate swaps will be released through Interest expense (income), net over the term of the issued debt. Results of hedges of anticipated purchases and sales of U.S. Dollar-denominated available-for-sale securities are recorded in Other (income) expense, net when the securities are sold. Results of hedges of certain anticipated intercompany transactions are recorded in Other (income) expense, net when the transaction occurs. The Company classifies the cash flows at settlement from these designated cash flow hedge derivatives in the same category as the cash flows from the related hedged items, primarily within the Cash provided by operations component of the Unaudited Condensed Consolidated Statements of Cash Flows.
Premiums paid on options are initially recorded as deferred charges. The Company assesses the effectiveness of options based on the total cash flows method and records total changes in the options’ fair value to Accumulated other comprehensive income to the degree they are effective.
The Company formally assesses, both at a hedge’s inception and on an ongoing basis, whether the derivatives that are used in the hedging transaction have been highly effective in offsetting changes in the cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. Effectiveness for cash flow hedges is assessed based on changes in forward rates. Ineffectiveness was immaterial for the three months ended August 31, 2015 and 2014.

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The Company discontinues hedge accounting prospectively when: (1) it determines that the derivative is no longer highly effective in offsetting changes in the cash flows of a hedged item (including hedged items such as firm commitments or forecasted transactions); (2) the derivative expires or is sold, terminated or exercised; (3) it is no longer probable that the forecasted transaction will occur; or (4) management determines that designating the derivative as a hedging instrument is no longer appropriate.

When the Company discontinues hedge accounting because it is no longer probable that the forecasted transaction will occur in the originally expected period, but is expected to occur within an additional two-month period of time thereafter, the gain or loss on the derivative remains in Accumulated other comprehensive income and is reclassified to Net income when the forecasted transaction affects consolidated Net income. However, if it is probable that a forecasted transaction will not occur by the end of the originally specified time period or within an additional two-month period of time thereafter, the gains and losses that were in Accumulated other comprehensive income will be recognized immediately in Other (income) expense, net. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, the Company will carry the derivative at its fair value on the Unaudited Condensed Consolidated Balance Sheets, recognizing future changes in the fair value in Other (income) expense, net. For the three months ended August 31, 2015 and 2014, the amounts recorded in Other (income) expense, net as a result of the discontinuance of cash flow hedging because the forecasted transaction was no longer probable of occurring were immaterial.

As of August 31, 2015, $603 million of deferred net gains (net of tax) on both outstanding and matured derivatives in Accumulated other comprehensive income were expected to be reclassified to Net income during the next 12 months concurrent with the underlying hedged transactions also being recorded in Net income. Actual amounts ultimately reclassified to Net income are dependent on the exchange rates in effect when derivative contracts that are currently outstanding mature. As of August 31, 2015, the maximum term over which the Company was hedging exposures to the variability of cash flows for its forecasted transactions was 33 months.

Fair Value Hedges

The Company is also exposed to the risk of changes in the fair value of certain fixed-rate debt attributable to changes in interest rates. Derivatives currently used by the Company to hedge this risk are receive-fixed, pay-variable interest rate swaps. All interest rate swaps designated as fair value hedges of the related long-term debt meet the shortcut method requirements under the accounting standards for derivatives and hedging. Accordingly, changes in the fair values of the interest rate swaps are considered to exactly offset changes in the fair value of the underlying long-term debt. The cash flows associated with the Company’s fair value hedges are periodic interest payments while the swaps are outstanding, which are reflected within the Cash provided by operations component of the Unaudited Condensed Consolidated Statements of Cash Flows. The Company recorded no ineffectiveness from its interest rate swaps designated as fair value hedges for the three months ended August 31, 2015 or 2014. As of August 31, 2015, interest rate swaps designated as fair value hedges had a total notional amount of $100 million.

Net Investment Hedges

The Company has, in the past, hedged and may, in the future, hedge the risk of variability in foreign-currency-denominated net investments in wholly-owned international operations. All changes in fair value of the derivatives designated as net investment hedges, except ineffective portions, are reported in the cumulative translation adjustment component of Accumulated other comprehensive income along with the foreign currency translation adjustments on those investments. The Company classifies the cash flows at settlement of its net investment hedges within the Cash (used) provided by investing activities component of the Unaudited Condensed Consolidated Statements of Cash Flows. The Company assesses hedge effectiveness based on changes in forward rates. The Company recorded no ineffectiveness from its net investment hedges for the three months ended August 31, 2015 or 2014. The Company had no outstanding net investment hedges as of August 31, 2015.

Undesignated Derivative Instruments

The Company may elect to enter into foreign exchange forwards to mitigate the change in fair value of specific assets and liabilities on the Unaudited Condensed Consolidated Balance Sheets and/or the embedded derivative contracts explained above. These forwards are not designated as hedging instruments under the accounting standards for derivatives and hedging. Accordingly, these undesignated instruments are recorded at fair value as a derivative asset or liability on the Unaudited Condensed Consolidated Balance Sheets with their corresponding change in fair value recognized in Other (income) expense, net, together with the re-measurement gain or loss from the hedged balance sheet position or embedded derivative contract. The Company classifies the cash flows at settlement from 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 Unaudited Condensed Consolidated Statements of Cash Flows. The total notional amount of outstanding undesignated derivative instruments was $5.3 billion as of August 31, 2015.

Embedded Derivatives

As part of the foreign currency adjustment program described above, an embedded derivative contract is created upon the factory's acceptance of NIKE's purchase order for currencies within the factory currency exposure indices that are neither the U.S. Dollar nor the local or functional currency of the factory. Embedded derivative contracts are treated as foreign currency forward contracts that are bifurcated from the related purchase order and recorded at fair value as a derivative asset or liability on the Unaudited Condensed Consolidated Balance Sheets with their corresponding change in fair value recognized in Other (income) expense, net from the date a purchase order is accepted by a factory through the date the purchase price is no longer subject to foreign currency fluctuations.

In addition, the Company has entered into certain other contractual agreements which have payments that are indexed to currencies that are not the functional currency of either substantial party to the contracts. These payment terms expose NIKE to variability in foreign exchange rates and create embedded derivative contracts that must be bifurcated from the related contract and recorded at fair value as derivative assets or liabilities on the Unaudited Consolidated Balance Sheets with their corresponding changes in fair value recognized in Other (income) expense, net until each payment is settled.

At August 31, 2015, the total notional amount of embedded derivatives outstanding was approximately $225 million.

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Credit Risk

The Company is exposed to credit-related losses in the event of nonperformance by counterparties to hedging instruments. The counterparties to all derivative transactions are major financial institutions with investment grade credit ratings. However, this does not eliminate the Company's exposure to credit risk with these institutions. This credit risk is limited to the unrealized gains in such contracts should any of these counterparties fail to perform as contracted. To manage this risk, the Company has established strict counterparty credit guidelines that are continually monitored.

The Company's derivative contracts contain credit risk related contingent features designed to protect against significant deterioration in counterparties' creditworthiness and their ultimate ability to settle outstanding derivative contracts in the normal course of business. The Company's bilateral credit related contingent features generally require the owing entity, either the Company or the derivative counterparty, to post collateral for the portion of the fair value in excess of $50 million should the fair value of outstanding derivatives per counterparty be greater than $50 million. Additionally, a certain level of decline in credit rating of either the Company or the counterparty could also trigger collateral requirements. As of August 31, 2015, the Company was in compliance with all credit risk related contingent features and had no derivative instruments with credit risk related contingent features in a net liability position. Accordingly, the Company was not required to post any collateral as a result of these contingent features. Further, as of August 31, 2015, the Company had received $468 million of cash collateral from various counterparties to its derivative contracts (refer to Note 4 — Fair Value Measurements). Given the considerations described above, the Company considers the impact of the risk of counterparty default to be immaterial.

NOTE 10 — Accumulated Other Comprehensive Income

The changes in Accumulated other comprehensive income, net of tax, for the three months ended August 31, 2015 were as follows:

(In millions)	Foreign Currency Translation Adjustment[1]	Cash Flow Hedges	Net Investment Hedges[1]	Other	Total
Balance at May 31, 2015	$(11)	$1,220	$95	$(58)	$1,246
Other comprehensive gains (losses) before reclassifications[2]	(81)	(182)	—	—	(263)
Reclassifications to net income of previously deferred (gains) losses[3]	—	(147)	—	(3)	(150)
Other comprehensive income (loss)	(81)	(329)	—	(3)	(413)
Balance at August 31, 2015	$(92)	$891	$95	$(61)	$833

(1) The accumulated foreign currency translation adjustment and net investment hedge gains/losses related to an investment in a foreign subsidiary are reclassified to Net income upon sale or upon complete or substantially complete liquidation of the respective entity.

(2) Net of tax benefit (expense) of $0 million, $(2) million, $0 million, $0 million and $(2) million, respectively.

(3) Net of tax (benefit) expense of $0 million, $1 million, $0 million, $0 million and $1 million, respectively.

The changes in Accumulated other comprehensive income, net of tax, for the three months ended August 31, 2014 were as follows:

(In millions)	Foreign Currency Translation Adjustment[1]	Cash Flow Hedges	Net Investment Hedges[1]	Other	Total
Balance at May 31, 2014	$9	$32	$95	$(51)	$85
Other comprehensive gains (losses) before reclassifications[2]	2	119	—	5	126
Reclassifications to net income of previously deferred (gains) losses[3]	—	16	—	(3)	13

Other comprehensive income (loss)	2	135	—	2	139
Balance at August 31, 2014	$11	$167	$95	$(49)	$224

(1) The accumulated foreign currency translation adjustment and net investment hedge gains/losses related to an investment in a foreign subsidiary are reclassified to Net income upon sale or upon complete or substantially complete liquidation of the respective entity.

(2) Net of tax benefit (expense) of $(11) million, $1 million, $0 million, $(2) million and $(12) million, respectively.

(3) Net of tax (benefit) expense of $0 million, $(4) million, $0 million, $1 million and $(3) million, respectively.

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The following table summarizes the reclassifications from Accumulated other comprehensive income to the Unaudited Condensed Consolidated Statements of Income:

(In millions)	Amount of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income into Income Three Months Ended August 31, 2015	2014	Location of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income into Income
Gains (losses) on cash flow hedges:			
Foreign exchange forwards and options	$(43)	$(17)	Revenues
Foreign exchange forwards and options	160	(8)	Cost of sales
Foreign exchange forwards and options	—	—	Total selling and administrative expense
Foreign exchange forwards and options	31	5	Other (income) expense, net
Total before tax	148	(20)	
Tax (expense) benefit	(1)	4	