FY 2023 Q3 Earnings Release Conference Call Transcript March 21, 2023

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PRESENTATION

[Operator]

Good afternoon, everyone. Welcome to NIKE, Inc.'s fiscal 2023 third quarter conference call. For those who want to reference today's press release you'll find it at investors.nike.com. Leading today's call is Paul Trussell, VP of Investor Relations and Strategic Finance. Before I turn the call over to Mr. Trussell, let me remind you that participants on this call will make forward-looking statements based on current expectations and those statements are subject to certain risks and uncertainties that could cause actual results to differ materially. These risks and uncertainties are detailed in NIKE's reports filed with the SEC.

In addition, participants may discuss non-GAAP financial measures and non-public financial and statistical information. Please refer to NIKE's earnings press release or NIKE's website, investors.nike.com, for comparable GAAP measures and quantitative reconciliations.

Now I would like to turn the call over to Paul Trussell.

[Paul Trussell]

Thank you, operator.

Hello everyone and thank you for joining us today to discuss NIKE, Inc.'s fiscal 2023 third quarter results. Joining us on today's call will be NIKE, Inc. President and CEO John Donahoe, and our Chief Financial Officer, Matt Friend. Following their prepared remarks, we will take your questions. We would like to allow as many of you to ask questions as possible in our allotted time. So, we would appreciate you limiting your initial question to one. Thanks for your cooperation on this.

I'll now turn the call over to NIKE, Inc. President and CEO John Donahoe

[John Donahoe]

Thank you, Paul, and hello to everyone on today's call.

We delivered another strong quarter in Q3, with revenue growth of 14% on a reported basis and 19% on a currency-neutral basis, exceeding our plan.

Our growth this quarter was broad-based across our brands, channels and geographies. We had strong digital growth of 24%, which once again was fueled by double-digit increases in traffic on mobile and our apps. While Direct, led by digital, remains strong and will continue to drive our growth, our wholesale channel continues to be an important part of our strategy as we access key consumer segments and achieve distribution scale across the marketplace. Wholesale grew 18% in Q3, reflecting strong retail sales, with growth that over-indexed across our strategic partners.

This quarter continued our positive currency-neutral growth in all four of our geographies. North America, EMEA and APLA all delivered double-digit revenue growth. Greater China grew 1% despite a very challenging December following the shift in the country's COVID policies.

And we are making great progress on inventory, with our inventory dollars down sequentially vs. last quarter. In Q3, we had inventory growth of 16% year over year. Our decisive actions are enabling us to navigate through shifting dynamics with continued improved efficiency.

These results demonstrate yet again that we are on track to hit our FY23 priorities of getting inventory in a healthy position and delivering revenue consistent with the financial goals we set earlier in the year. In an environment of increasing macro volatility, the distinction of our brands and our Consumer Direct Acceleration strategy set NIKE apart.

Looking ahead, CDA continues to unlock our future growth potential by powering up our holistic offense across innovation, brand engagement and marketplace, all fueled by consumer insight.

As we know, consumers today have rising expectations and changing behaviors. What creates separation for NIKE in this dynamic environment is our innovative product, brand scale and the direct connections we have with our consumers.

It’s these connections that serve as one of our greatest competitive advantages, as we translate insight into innovation. Thanks to our consumers’ love of our brand, we enjoy a high rate of engagement, fueling richer, deeper understanding. Across the company, our insights model creates confidence and growth in ways that are uniquely NIKE, as we make the entire enterprise faster, more efficient and more targeted in the growth opportunities that we go after.

So, today I thought we’d go through three areas where we leveraged our insights model this quarter. You may have heard us say before that “running is the heart of NIKE, and basketball is the soul.” I’ll discuss these two businesses, and then I’ll talk about a product franchise that’s a multi-billion-dollar business in its own right: Air Max.

So first, let’s start with Running. Since our founding, we’ve used elite athlete insight to innovate at the edges of human potential.

That’s led to platforms like NEXT%, which remains at the front of the pack in the world of distance running. And we then use these insights and innovations to serve everyday consumers, no matter where they are on their running journey.

Today, we leverage our direct relationships with runners worldwide, fueled by insight from our NIKE Run Club app along with consumer feedback across brand and marketplace touchpoints to know how our consumers are using our product and what pain points we can solve to keep them moving.

For example, we saw our Invincible consumers pushing more distance on their runs, which requires better support and protection.

So this quarter, we introduced the Invincible 3, which is designed to provide maximum cushioning and comfort. It also offers a wider fit than some of our past Running footwear and uses the most ZoomX foam of any of our road running shoes. It's a shoe that demonstrates how NIKE isn't just innovating for performance, but also designing to drive the lifestyle of running.

Consumer response to the Invincible 3 was strong across our geos and throughout NIKE Direct, strategic wholesale partners and Running specialty doors. And what really sets Invincible 3 apart is how we executed across the marketplace: driving consistent storytelling across channels working closely with our partners to elevate our own retail presentation and theirs all with a sharp focus on helping consumers find the right shoe for them. This is an approach we'll be accelerating as we focus on positioning ourselves for share gains in this important category.

Our research with runners also leads us to launch product in complementary categories such as trail running, which is our fastest growing Running segment. This fueled the launch in Q3 of the Pegasus Trail 4.

The Peg Trail 4 which has seen over-indexing strength with female consumers takes many of the well-loved attributes of the Peg and adds rugged features that let runners keep the pace even on looser terrain. The combination of React foam and underfoot traction has proven to be a perfect crossover shoe for runners looking to split time between road and trail.

Thanks to our ability to use analytics and insight to discover opportunities for growth in Running, we continue to connect to the grassroots of this global community and we remain confident we can take full advantage of these opportunities over the long term.

Next, our Basketball category is in the strongest position it's ever been, as we continue to grow the energy of the game globally. Across NIKE Basketball, Jordan Brand and Converse, we've strengthened our signature athlete portfolio, adding Gen Z superstars while still being anchored by some of the game's greatest players.

Last month, LeBron James set the all-time NBA scoring record, in a thrilling game in L.A. I was fortunate enough to be there with our co-founder Phil Knight. After the game, Phil turned to me and said that moments and athletes like this are why we got into this business. And he's right.

As I said last quarter, the LeBron XX was the strongest LeBron launch in years, fueled by storytelling and the blend of innovation with sportswear design. This created greater commercial appeal, as seen in Q3 with very strong sell-through throughout the marketplace in full family sizing.

This is an approach we use across the portfolio and across our NIKE Basketball product construct. Thanks to our ongoing dialogue with athletes from the elite to the everyday we design around three key aspects of the game: cutting fast, playing long and jumping high all while emphasizing off-the-court style.

So when we began work on a signature shoe for a playmaker and generational talent like Sabrina Ionescu, we knew the shoe would focus on cutting: helping her stop on a dime and accelerate back again. The Sabrina 1 uses research from thousands of athletes – both female and male – to create a unique traction pattern and a low-to-the-ground design that has lifestyle appeal we're thrilled about.

We're excited about the potential with the Sabrina 1, and the continued power of our increased focus on Women's coming out of CDA.

Over in Jordan Brand, Q3 saw the release of its own young signature shoe. Jayson Tatum debuted the Tatum 1 last month at the NBA All-Star Game with fireworks, breaking the

All-Star record for points scored. The Tatum 1 joins the Luka, Zion, Westbrook and game shoe franchises for the strongest signature portfolio in Jordan Brand's history, helping fuel robust growth for the brand alongside its consistent strength in retro.

Crafted with efficiency in mind, the Tatum 1 is Jordan Brand's lightest basketball shoe and has a large-volume Zoom Air bag in the forefront for energy-returning stability.

Special care was given to the Tatum 1 kids design. The kids-specific model has specialized zonal rubber on the outsole for the durability needed for young kids' style of play.

But the biggest innovation in the kids' design came directly from parents, including Jayson himself, who asked for an easy-on, easy-off system. In pre-school and grade school versions, designers came up with a new innovative tailgate system. And in toddler sizing, there's an even-simpler collapsible entry technology.

The Tatum 1 represents an evolution for the Jordan Brand, shifting from serving an individual athlete to also serving the next generation to come as well. The potential here to bring innovation into our Kids business is vast, as we build lifelong relationships with younger generations.

Third, let's discuss NIKE's Air Max franchise. Our Air Max business continues to expand, growing double-digits in Q3. Like Air Jordan, Air Max is a great example of how we build significantly scaled businesses off our greatest performance innovations.

Looking again at our insights model, Air Max also exemplifies how we brief new product by leveraging qualitative and quantitative member data science to have a sharper and more targeted focus. We're able to ask ourselves, who are the consumers we want to serve and what are they looking for?

For example, the 270 has been a top 5 Air Max franchise for the past five years. But we heard from younger age groups that they want their own version: a more streetengineered, durable shoe one with a new lifestyle identity.

This vision of building a future franchise for the next generation led us to create the Air Max Pulse, with the broader goal of creating an entire portfolio of classics for this generation. The Pulse connects a 270-style Air bag with a brand-new upper, bold and versatile styling and new Air Max branding.

The Pulse launches on Air Max Day next week, and we can't wait for consumers to give it a try.

Another Air Max model launching next week is the "Design by Japan" Air Max 1 '87. This Women's-exclusive model represents the first time our members influenced product creation using polling on the SNKRS app as well as local member polling data. With just a year from conception to delivery, we relied on our Express Lane capabilities to make and deliver the product in such a short turnaround. Members who participated will be the first targeted for the shoe, creating NIKE's first full-circle insights-to-shopping experience.

This is only the first example of this kind of product creation, and we look forward to seeing what we can do next.

Overall, we're excited by how our focused approach to insights will fuel future growth. We're still in the early innings, and we're thrilled by the possibility ahead of us, as we stay dedicated to listening to the athlete and leveraging membership data to inform future products and consumer experiences.

Before I close, I want to mention that in two days, on March 23rd, we'll release our FY22 Impact Report. As you know, at NIKE, Purpose is deeply engrained in everything we do. For example, you'll read that we've given more than 375,000 girls expanded access to sport through our community partners. In addition, we've maintained 1:1 pay equity for women and U.S. racial and ethnic minorities internally, while also helping the first of our supplier facilities achieve a gender equitable workplace with upward mobility for women.

As you recall, two years ago we set new, quantifiable ESG targets, focusing on a wide range of priorities across People, Planet and Play. I encourage everyone to learn about the measurable progress we've made at *purpose.nike.com*, as we continue to create long-term value by shaping a better future through sport.

In the end, we are redefining what's possible thanks to our close connections with consumers, and how those relationships make us better again and again. We are supercharging how we serve athletes around the world with innovative product, brand engagement and experiences at retail. This promises to be yet another incredible year for sport, and there's never been a better time to be in the business we're in. I could not be more excited about our future.

And with that, I'll turn the call over to Matt.

[Matt Friend]

Thanks John, and hello to everyone on the call.

NIKE's third quarter showed that in a dynamic environment, strong brands set the pace. Two quarters ago, we took clear and decisive action in response to changing marketplace and supply chain conditions. Our top priority was to strategically manage excess inventory and drive a quicker return to a healthy pull market, and our Q3 results prove that NIKE is leading the way.

NIKE is more agile, responsive and resilient than before the pandemic, with operational capabilities and an experienced team that enable us to create competitive separation. While we may continue to face heightened volatility, we are confident in our ability to drive sustainable and more profitable growth.

Consumer demand for our portfolio of brands remains uniquely strong, fueling unit growth of approximately 10% despite increased macro uncertainty.

NIKE, Jordan, and Converse all drove double-digit currency-neutral growth this quarter. NIKE Direct outperformed, with member buying frequency increasing and store sales growing across all geographies. Another quarter of industry-leading digital growth – up 24% in Q3 – drove our digital share of business up to 27%. Our Wholesale channel delivered a second straight quarter of outsized growth, with a planned recapture of retail partner open to buy on improved inventory supply versus the prior year, and strong consumer sell-thru.

Revenue from performance dimensions grew double-digits versus the prior year, with strong momentum from the Phantom GX, Invincible 3, LeBron XX, and other new product innovations. Revenue from Lifestyle dimensions also remain strong, as consumers continue to shift wallet share towards sport-inspired products that provide innovation, comfort and style.

NIKE has been fueling this shift for more than fifty years, built on our passion for serving athletes. We have created the lifestyle around sport and have forged a deep connection to youth culture through our most iconic footwear franchises. Time and again, we take the consumer somewhere new.

This quarter we introduced new iterations of the Air Force 1 with Tiffany's, Undefeated, and Drake. We drove energy around our top Jordan franchises with our latest Travis Scott AJ1 and a women's-exclusive AJ4. We welcomed the Year of the Rabbit with a Dunk inspired by the iconic White Rabbit candy. We celebrated the NBA All-Star Game with an Air Force 1, Dunk, and Blazer collection inspired by its host city. And we connected consumers to the Air Max 1 through craftsmanship, heritage storytelling, and new modern renditions.

The energy that we are creating for the consumer continues to set NIKE apart. Even in a promotional environment, full-price sales remain strong. And for the seventh consecutive quarter, ASP growth was positive for NIKE, Inc., with benefits from strategic pricing, product mix, and our shift to Direct more than offsetting the short-term cost of promotions to liquidate excess inventory.

In addition to driving strong topline results, we are making tremendous progress on inventory. Let me walk through a few key points.

First, inventory dollars and units are down meaningfully from last quarter. In the third quarter, total inventory dollar growth was 16% year-over-year. In North America, inventory dollar growth was 14%. In Greater China, inventory dollars declined 4% versus the prior year, positioning us well for the momentum that we are creating in the China marketplace.

Next, we are making even greater progress where we are focused most. In Q3, total apparel units were down year-over-year as we continue our sharp focus on liquidating excess apparel inventory. In North America, apparel units were down high single-digits.

Finally, we are confident looking ahead. With strong traffic and retail sales growth, and reduced inventory buys for the spring and summer seasons, we are increasingly confident that we will exit the year with healthy inventories across the marketplace. In fact, given our brand momentum, we now intend to move through even more units by year-end than we had previously considered.

Both transit and buying timelines continue to tighten towards pre-pandemic levels, and free cash flow accelerated this quarter through improvements in working capital. Along with an improving flow of seasonal supply, our decisive actions will enable NIKE to compete at its best: driving consumer energy through new product, seasonally relevant assortments and fresh storytelling, and premium retail experiences. Regardless of the near-term uncertainty facing consumers, we will be prepared to lead and operate from a position of strength.

Now, let me turn to our NIKE, Inc. third quarter financial results.

In Q3, NIKE, Inc. revenue grew 14% and 19% on a currency-neutral basis, with broad-based growth across brands, channels, and geographies. NIKE Direct grew 22%, led by 24% growth in NIKE Digital and 19% growth in NIKE Stores.

Wholesale grew by 18%, driven by strong partner demand based on accelerating retail sales, higher shipments based on earlier supply availability and lower shipments in the prior year given supply constraints.

Third quarter reported gross margins declined 330 basis points to 43.3%, due to higher markdowns increased product input costs, elevated freight and logistics expenses, including higher supply chain network costs in North America partially offset by strategic pricing actions. This also includes approximately 140 basis points of impact from unfavorable changes in net foreign currency exchange rates.

SG&A grew 15% in Q3, primarily due to wage-related expenses, variable NIKE Direct costs, and increased demand creation expenses.

Our effective tax rate for the quarter was 16%, and substantially consistent to the same period as last year.

Third quarter diluted earnings per share was $0.79.

Now, let's review the operating segment results.

In North America, we drove strong holiday sales with momentum continuing into the new calendar year. Q3 revenue grew 27% on a currency-neutral basis, with NIKE Direct up 23% and NIKE Digital up 25%. EBIT grew 23% on a reported basis.

Consumer demand drove strong growth across performance and lifestyle. LeBron, Giannis, and Luka grew high double digits, fueling market share gains in Basketball. A strong Invincible 3 launch energized the marketplace, doubling digital sales compared to the Invincible 2. Air Max grew double digits. And the Jordan Brand kicked off its 23rd year – also known as Jordan Year with strong double-digit growth incredible momentum, especially with women consumers and even greater potential with a path toward becoming the #2 footwear brand in North America.

Across the marketplace, we continue to capture opportunity with our growing digital advantage. Member moments throughout the quarter drove double-digit growth in repeat member buying. On the NIKE App, we integrated personalized product recommendations for members using available inventory to increase sell-thru of key products. In addition, return on ad spend improved for another quarter as we test personalization in consumer experiences with activity and preference data.

In EMEA, we saw strong growth across all Western European markets, including positive trends in the UK. Q3 revenue grew 26% on a currency-neutral basis, with NIKE Direct up 39% and NIKE Digital up 43%. EBIT grew 10% on a reported basis.

New product innovation resonated deeply. Invincible 3 drove strong sell-through in NIKE Direct and with our retail partners. Our statement Go Leggings delivered positive early results, with strong sales in NIKE Live and NIKE Rise doors, where we've been able to create a unique retail experience for her. In Football, we are gaining share with a very successful launch of the Phantom GX plus sustained momentum in the Mercurial franchise.

We saw strong consumer response as we continue to transform the consumer journey in Digital. Traffic grew double-digits, with average order value growing mid-single digits and nike.com leading new member acquisition. On the NIKE App, member engagement grew double-digits with a new Jordan member home button driving the highest click-through rate ever on the app. We also continue to drive convenience and improve NIKE Digital profitability by expanding O2O services, optimizing last-mile delivery, and reducing digital split shipments.

In Greater China, we drove topline growth despite another quarter of volatility. Q3 revenue grew 1% on a currency-neutral basis, declining 8% on a reported basis. NIKE Direct grew 3% on a currency-neutral basis, with NIKE Digital declining 11% as consumer buying shifted to brick-and-mortar with the country's reopening. EBIT declined 10% on a reported basis.

In December, we managed through disruption from the country's shift in COVID policies with widespread door closures. Starting in January, we began to see a rebound in brick-and-mortar traffic, with strong retail momentum around Chinese New Year accelerating into February, especially as our clean inventory position enabled us to serve consumers with fresh seasonal assortments.

Throughout the quarter, we gained traction in some of our most important business dimensions. Performance footwear outpaced lifestyle, with running up double-digits, led by the Invincible 3. Meanwhile, in Basketball, LeBron XX and the GT Series resonated deeply, with energy around our local Space Maker Summit and Jordan Brand's China High School Basketball League All-Star Weekend. Growth in Kids surpassed other consumer segments, with positive response to hyperlocal collections such as our Chinese New Year "Leap High" Express Lane pack.

We are optimistic as our business momentum continues to build. In Beijing, NIKE's brand strength is deepening, extending our lead as the #1 cool and favorite brand. We are also seeing the benefits of a more local operating model as we have made investments over the past two years to serve the marketplace's unique needs. Long-term, we are confident that the fundamentals of growth for NIKE in China remain strong.

Finally, in APLA, NIKE's brand momentum continues to fuel strong growth. Q3 revenue grew 15% on a currency-neutral basis, including approximately 8 percentage points of a headwind due to the first full quarter of impact from the transition of our Chile, Argentina, and Uruguay businesses to a distributor model. NIKE Direct was up 22%, with NIKE Digital growing 23%. EBIT grew 1% on a reported basis.

Football grew double digits, with a successful Phantom GX launch, strong sales for the Men's World Cup in December and excitement building for the Women's World Cup this summer. In Running, we saw strong momentum across our top footwear franchises, including double-digit growth for Invincible, Infinity, and Pegasus. And in fitness, the Metcon Free continues to win with consumers, growing triple-digits.

We also continue to accelerate opportunity in this geography through marketplace innovation. This quarter, we expanded Express Lane to bring more hyperlocal product to consumers. In March, we introduced the NIKE App in Korea, which launched as the #1 free shopping app in one of our most digitally-connected markets. And later this week, we'll open our newest World of Flight door in Tokyo, expanding Jordan Brand's international growth.

I will now turn to our financial outlook for fiscal '23.

To date, we continue to see uniquely strong consumer demand as our product innovation, brand storytelling, and consumer connections drive distinction and growth in the marketplace. That being said, we are closely monitoring the building pressure on consumer confidence and the uncertainties of the macro environment.

We continue to take a cautious approach in planning our business, leading with intentional financial and operational guardrails. And looking ahead, we will continue to transform our operating model unlocking speed, agility, and efficiency with an improved marginal cost of growth.

As a result of our strong Q3 performance, we now expect Fiscal '23 reported revenue to grow high single-digits, an improvement from mid-single-digit guidance in the prior quarter, with approximately 600 basis points of foreign exchange headwinds. For the fourth quarter, this translates into flat to low single-digit revenue growth.

Remember, more than six months ago, we strategically reduced our inventory commitments for the spring and summer seasons to ensure that both NIKE and our partners can work through excess and early-arriving inventory. As a result, we expect wholesale revenue growth to moderate for the next few quarters.

We expect Fiscal '23 gross margin to decline approximately 250 basis points, at the low end of our previous guidance range. This reflects ongoing and accelerated actions to reduce inventory by year-end elevated freight and logistics expenses including higher supply chain network costs in North America and 100 basis points of foreign exchange headwinds.

For the full year, we expect SG&A to grow approximately 10%.

We continue to expect our tax rate to be in the high teens range.

And consistent with my approach over the past few years, I will provide specific guidance for fiscal 24 on our next earnings call.

In this environment, what sets NIKE apart is our portfolio of leading brands, our proven playbook and a team and culture of innovation that continues to deliver. We have managed through cycles like this before, and we will be well-prepared for the volatility that is in front of us.

With that, let’s open up the call for questions.

[Operator]
We will go first to Matthew Boss, JPMorgan.

[Matthew Boss]
Great. Congrats on a very nice quarter and progression with all of your priorities. So John, maybe as you break down underlying drivers of the current business momentum, could you just speak to market share acceleration opportunities that you see across running, basketball and women's? As from your tone, the forward-looking product pipeline sounds pretty robust. And then just, Matt, with increased confidence in the inventory on track to finish the year in a healthy position, help us to think about the timing or magnitude of margin headwinds from this year turning to tailwinds as we look forward?

[John Donahoe]

Yes. Matt, so we feel very good about our ability to accelerate share in each of the 3 areas you mentioned and more broadly, and we feel very good about our product pipeline. Let me just briefly touch on the 3 areas you mentioned. Just -- let me start with running. As you know, we segment running into 3 segments based on consumer insights, racing where we continue to dominate race day with the NEXT% platform, trail where we're gaining share as we speak with shoes such as the Peg Trail 4 and other very innovative models.

And then in road racing, as you know, we've really refocused over the past 6 to 12 months around 6 models. And in Q3, we launched the Invincible 3, which both Matt and I mentioned, was very well received in all 4 geographies across all of our channels, our direct channels, wholesale partners like DICK'S as well as running specialty doors. And so the Invincible we just launched, we see a lot of legs left with Invincible in the coming quarters and years. And then in the next 6 to 12 months, we'll do major updates to the other 5 road running models, where we're taking some of the innovations from our racing platform and putting them in for everyday runners, very strong innovations around foams and other materials. So running is a very important priority for us, and we see some share gains currently and in road running a lot of focus in the coming 6 to 12 to 18 months.

Basketball, as I mentioned in my remarks, our signature portfolio, I don't think it's ever been stronger, and it's refreshed. You take LeBron, Giannis, KD, new next-gen stars like Ja, Devin Booker, Sabrina. In Jordan, we've got Zion, Luka, Tatum. And by the way, the return of the Kobe. And then our G.T. Series will have major updates in each of the run, cut and jump silos. So our basketball portfolio is almost an embarrassment of riches that we want to continue driving through the marketplace in the coming 6 to 12 months.

And then Women's, we're really encouraged by Early Reception of Go and Zenvy and Alate, the Go and Zenvy leggings, the Alate bras And we're encouraged by the pipeline. In fact, coincidentally, this week, we've got several hundred of our global leaders on campus planning our spring '24 season, which is, in essence, January through March of next year, next calendar year. And I've got to tell you the breadth and depth -- while we can't talk about specifics now, the breadth and depth of the innovation pipeline is really strong.

And what's clear is as we return to the office, as our teams are now back together in person, that NIKE magic of consumer insight driving product innovation, combined with storytelling, combined with the marketplace, is really picking up steam. So I'd say we're feeling very good about the future on the product pipeline front.

[Matt Friend]

And I'll just jump in, Matt, on inventory. We've made tremendous progress on inventory. And 2 quarters ago, you'll recall, we made clear set clear goals and decisive actions in response to changing conditions in the supply chain and the marketplace. And we've been able to leverage our brand momentum into and through the holiday season and continue to be able to sustain it into spring. And we're increasingly confident that we're going to exit fiscal year '23 with healthy inventory levels across the marketplace, across channels in the marketplace. And in fact, I mentioned in my prepared remarks that within the financial parameters that we had set 2 quarters ago, we're going to exit with even leaner inventory than we had anticipated given the momentum that we're seeing.

As it relates to the impact on gross margins and fiscal year '24, I mentioned that next quarter I'll provide full and complete guidance. But what I will tell you is that we've been talking about 350 basis points of transitory cost headwinds in our gross margins over the past 2 years between elevated ocean freight and logistics and then the promotions required to move through excess and early arriving inventory. And we expect that those transitory headwinds will begin to recover in fiscal year '24, and I'll give specific guidance about how much next quarter.

[Operator]

Next, we'll take a question from Omar Saad, Evercore Partners.

[Omar Saad]

I'd love to ask my question on China. Maybe you could dive in a little bit deeper on the outlook for the recovery there, maybe across a few different dimensions, the consumer recovery, how the consumer is behaving, what you're seeing there, the competitive landscape, especially vis-a-vis locals, which may have taken some share and then also the marketing landscape. Are you having unfettered access to all the different marketing channels that you need to, to resonate with the consumers?

[John Donahoe]

Yes. Omar, bottom line is we feel good about our momentum in China. And that's both Q3, where you saw in a post-lockdown environment growth really pick up the second month of the quarter, and our inventory is in a very healthy position. But even more importantly and to the -- some of your specifics, we look going forward, the fundamentals of this market are good, right? It is a large -- it is a very large market that's growing. Sport and wellness is a key trend and tailwind there. There's a desire for innovation and style. And the key to winning in this market is, simply put, having great innovation and connecting with Chinese consumers in a locally relevant way. And so that's what we're doing.

On the great innovation front, our product innovation is resonating with the Chinese consumer, and it's a nice blend of global platforms like the LeBron XX; the G.T. Cut, which, by the way, was very well received in China; the Invincible, our lifestyle franchises, along with hyperlocal innovations through our gel of the examples, the Chinese New Year pack or we did a Year of the Rabbit pack focused on Gen Z and Gen Alpha that's really resonating with that constituency, and we're really focused on those younger consumers in China.

And our brand strength, I think Matt mentioned this in his remarks, is growing. We're #1 cool and favorite brand. That gap widened in Q3 in Beijing. And it's an environment where 6,000 monobrand stores are a real advantage. And so we're going to continue to invest in China for China. We have a great team there. We were delighted that they were able to come -- we got to see them in person for the first time this quarter in 3 years, and they are very optimistic and excited about our future.

We're building, as you talk about hyperlocal product and storytelling ability. And that enables us to – for the first time, we have locally driven apps there and our ability to do rapid storytelling there. And our tech stack is increasingly China for China. So there's really not been a time when we can serve consumers in China in a more agile and personalized way. And that is helping our competitive position in China. So we're very focused on it and very -- feel very good about our momentum.

[Matt Friend]
Yes. And Omar, I just would add on some of the monthly trends that I commented on in my script that, in December, we talked about the shift in COVID policy and the impact that, that had both on the amount of doors that were open and retail traffic. And our business in December was down high single digits.

We flipped to growth in January, and we saw a rebound in brick-and-mortar traffic and strong retail sales performance. And then in the month of February, we saw our momentum accelerate even further relative to January. And that's with comping the 9-month comp of Lunar New Year in the prior year.

So when we look at our inventory position being down again this year versus -- or this quarter, I should say, versus prior year for the second straight quarter, the fundamentals are there for us to continue the momentum that we've been talking about for several quarters. And we absolutely expect that China continues to be a growth opportunity for NIKE.

[Operator]
And your next question comes from Paul Lejuez, Citigroup.

[Paul Lejuez]

Can you give us an update on your shared apps and the partnerships that you've developed with certain retailers? Are they progressing as planned? And what are your thoughts on linking up with any new partners in the future?

[John Donahoe]

Yes, Paul, as you know, our whole marketplace strategy is to allow consumers to get what they want, when they want, how they want it across our own digital, across our own retail and across our wholesale partners, all tied together with our membership program, which is 150 million active members. And this notion of connected membership with our wholesale partners is really beginning to bear fruit. And some of the early examples with, let's say, DICK'S, you're seeing examples where we can provide a personalized experience to a shared NIKE and DICK'S member in a way they can't get elsewhere that benefits us and benefits DICK'S.

So a simple example might be, I guess, baseball season is about to be upon us. And so we can find a baseball consumer, a DICK'S consumer who is a baseball consumer, and we can send an e-mail focused on NIKE's baseball cleats, along with DICK'S a bat and a mitt. And consumers are responding to that very personalized messaging from NIKE and DICK's.

And so clear early positive benefits for both. I think our Chinese partners and JD and others are feeling the same. So we'll continue to expand that in a very thoughtful way with our other strategic wholesale partners. And again, I think it gives us a competitive advantage of being able to serve consumers across multiple channels and having the largest and most engaged membership program in the industry.

[Operator]

Our next question comes from Alex Straton, Morgan Stanley.

[Alex Straton]

Great. And congrats on another really great quarter. I saw that you guys took the SG&A guide up a bit for the full year. So I'm just wondering, can you just review what's driving that? And should we think about that as moderating next year? Or what are your priorities going forward?

Then just one quick second one. I think you mentioned numerous quarters of ASP growth that you guys have posted. How much pricing have you taken versus pre-COVID levels? And are you expecting to take more in the upcoming seasons? Or how should we think about that?

[Matt Friend]

Sure, Alex. Well, we wanted to sharpen our guidance as we finished the fiscal year. But maybe to take a step back for a second as it relates to SG&A, we started the year with an SG&A guide of high single digits to low double-digit growth. And at the end of the first quarter, when we saw the change in conditions, we decided that we were going to prioritize our efforts around inventory liquidation and getting back to a healthy pull market. And so what we said was that we were going to prioritize the investments that we've been making for several years in our consumer-led digital transformation, the capabilities and the ways of working that are enabling us to create a new operating model for NIKE. And we would manage expense growth tightly, and we would reduce our planned head count growth.

And we've absolutely done that over the last 2 quarters and feel very good about the momentum that we've been making with regards to ensuring that our resources are flowing towards the priorities that we have. And we've got some exciting things that are going to land from a transformation perspective in the next 6 months.

When you step back even further, our revenue guidance at that point in time was for low single-digit to mid-single-digit revenue growth. And given the brand momentum that we're seeing, our updated revenue guidance now being high single-digit revenue growth, I'm actually quite proud that we've been able to manage expense growth on a variable basis even as we've seen our revenue continue to increase. And that focus and attention on expense growth or managing expense growth and head count growth, we definitely intend to carry into our next fiscal year.

As it relates to your question about ASPs and pricing, we've increased prices this year mid-single digits on average across our portfolio. As I think I've said in prior quarters, it wasn't a peanut butter across every product and style. It was a surgical approach, but on average, it averages out to mid-single-digit growth.

As we look ahead to next year, we're absolutely continually looking at the profitability of our product. We're looking at inflationary costs in supply chain and also inflationary costs that are impacting the make of our product. And we will continue to focus on managing those levers together in order to try to drive profitable growth going forward. I'll give you more guidance next quarter on the specifics, but that's absolutely our strategy and the way that we've been managing product pricing and margin for many, many years.

[Operator]
Bob Drbul from Guggenheim is up next.

[Bob Drbul]

Just a couple of questions on inventory. You made a lot of progress with your numbers. Can you talk about 2 pieces I'm interested in, wholesale inventories, meaning at the wholesale level at your retail partners, where you see the channels, specifically in North America, maybe even in Europe. And then on the apparel side, that's been where you had a lot of excess inventory. Just wanted to understand your sort of learnings from working through all the apparel. And maybe you could give us an updated outlook on how you think apparel is positioned over the next few quarters in the pipeline there.

[Matt Friend]
Sure, Bob. Well, as it relates to inventories across the overall marketplace, when we set the actions that we put into place 2 quarters ago, that was across channels with partners and NIKE Direct. And given the momentum that we're seeing and the momentum that we saw from the holiday season heading into holiday and into spring, we had very specific plans with our partners in order to balance promotions across the marketplace in order to

be able to move inventory on slower moving products and also, in particular, as it relates to apparel, to be more aggressive in order to be able to address some of the late-arriving seasonal product, which was part of our challenge at the beginning. And we've made great progress on it.

So when we look across our wholesale partners or the wholesale channel, I should say, North America and EMEA overall, and we look at the rate of sales that we're seeing in those channels, we feel very good about the progress that we and our partners have made. And in fact, this quarter, our retail sales to the consumer in the wholesale side was larger than our sell-in. So we feel very good about our progress there.

As it relates to specifics in apparel, I think that one of the biggest learnings we had was after our factories closed in the fall or in the late summer and early fall of last year, we decided to continue to carry forward with making late product because there was so much constraint in the marketplace. And I think in hindsight, that was -- we would take a do-over on that one and focus on getting seasonally right product in front of the consumer.

And what I would tell you is that the benefit of us moving so fast against the excess and early arriving inventory that we've had is that we're now actually watching the timing of delivery of current season product up significantly versus prior quarters and now starting to rival the levels of deliveries that we were seeing in pre pandemic. And so having the right assortment, the right colors, the right materials, the right stories at retail is NIKE -- it creates competitive advantage for NIKE because we can pull the consumer experience together in a way that is very difficult to match.

[John Donahoe]
Yes, I'll just build on that. The learning is don't have a supply chain crisis in a highly seasonal business. But I referenced earlier, Matt and I were overseeing our spring '24. Again, that's 6 months -- 6 to 9 months away. And you just see when you have the right assortments in apparel and the right colors coming together in the right way, it's very powerful. And so the pipeline there looks very exciting.

[Operator]
Your next question comes from Aneesha Sherman, Bernstein.

[Aneesha Sherman]
I'm curious to know a little bit more about your trends through the quarter in China. I know you talked about December being a really tough month. Would it be possible for you to talk about December versus 2023 in terms of how the quarter behaved and possibly the exit rate out of the quarter so we can get a sense of how demand is trending at the moment?

And then I have a second question around your sales guidance. Your sales guidance implies about flat quarter-over-quarter between Q4 versus Q3. Are you expecting inventory to be down kind of similarly to this quarter, so down a few percent quarter-over-quarter on a flat sales base?

[Matt Friend]
Sure, Aneesha. I mentioned earlier in response to Omar's question the monthly trends in China, but I'll just hit it again quickly. With the door closures and retail traffic under pressure and the shift of COVID policy in December, our business was down high single digits. We flipped to growth year-over-year in the month of January and saw an improvement in brick-and-mortar traffic in China. And then in the month of February, we saw an even greater improvement relative to January. And that includes lapping the Lunar New Year period in the prior year because it was in a different month. So we are encouraged – I mentioned that our inventory levels are healthy there, and so we're encouraged based on the momentum that we had as we exited the quarter.

As it relates to our full year revenue guidance. We revised our full year revenue guidance again upward, and that was based on strong momentum this month -- this quarter. But also when I look at Q4 in particular, our fourth quarter outlook at this point in time is higher than it has been in the previous 2 quarters. So we're continuing to see our brand momentum and our confidence continue to build. The largest driver of our Q4 revenue guidance is, 6 months ago, we made the decision to cut our spring and summer buys to help ensure that we finish this fiscal year in a healthy place from an inventory perspective, that we and our partners finish this year in a healthy place from an inventory perspective. And we're making great progress against that. So we expect to continue to see improvement in Q4 in our inventory and are confident that we're going to finish this year in a position of strength as we look ahead to fiscal year '24.

[Operator]

We'll take our next question from Kate Fitzsimons, Wells Fargo.

[Kate Fitzsimons]

Curious if you can just expand on some of the movement we've seen in digital margins over the last couple of quarters. Sounds like you continue to see benefits associated with reduced digital shipments. It seems like you're pleased with some of the movement on the ROAS front. So I'm curious now if you can just kind of speak to more detail about the margin delta maybe you're seeing between the wholesale and direct channels. And just how should we think about the digital margin flow-through at this point?

[Matt Friend]

Sure. Well, we've been talking for some time about the -- how our consumer-led digital transformation is transforming NIKE's financial model. And you really see it both in terms of revenue and in gross margin. And if you look at the momentum that we've been driving from a top line perspective, I would say that we've benefited from roughly 3 points of benefit related to a higher mix of business going through our digital and our direct channels. And you can see that not only in the algorithm that we provided around high single digit to low double-digit growth but just looking at our ASP performance and the continued momentum that we're seeing as digital goes from being about 9% of our business in fiscal year '19 to exiting this quarter at 27% of our mix of business.

We've always said that the margin contribution from our digital business is higher than the wholesale channels. And that had fueled gross margin expansion from fiscal year '19 to fiscal year '22. And as we look at some of the dynamics that I referenced on the call this quarter, what I was really trying to highlight is that not only is the channel mix a tailwind for us as we grow our digital business, but we actually think there's opportunities for us to improve the profitability of the digital channel. And those 2 examples that I gave this quarter really were intended to reflect that.

One, we talked specifically in EMEA about some of the efforts that the team is making to lower our fulfillment cost from a digital perspective through O2O, through reducing split shipments and adding pickup points. And then on the membership and marketing side, the idea that if we've got more members coming in through the top of the funnel who are more engaged and buying more frequently, we should start to see an improvement in our ROAS or return on ad spend from a digital perspective and give us a lot of confidence that we're building a moat to be able to continue to serve and grow our digital business.

So those are 2 examples, in particular, of us working hard to improve even greater the profitability of our digital channel. I think as we look longer term, we remain confident in our ability to continue to drive towards the long-term goals that we've provided. Obviously, this year, we've seen higher markdowns and promotions in our direct channels as we've been moving through excess inventory, but we think those are transitory costs, and we should begin to see the recovery of those beginning in fiscal year '24.

[Operator]
The next question will come from Gaby Carbone, Deutsche Bank.

[Gabriella Carbone]
My question is on EMEA. Curious if you can dig into what you're seeing in the region. It seems like it continues to be quite resilient despite the macro environment. But are you seeing any meaningful differences between countries?

[John Donahoe]
I mean I'd just say a broad statement, and then, Matt, you can fill in some of the specifics. The EMEA consumer has held up remarkably well. And what's clear is our brand strength -- as really strong across demand. That's both for NIKE and Jordan. You saw really strong across channels, digital, very strong this entire year as well as this quarter as well as our

direct and wholesale channels. So the brand connection with NIKE across our major fields of play across NIKE and Jordan is as strong there as it is anywhere.

[Matt Friend]

Yes. And I just would add that we're running a complete offense in that marketplace, and we've seen strong growth across brands, across performance and lifestyle, across different genders, sport dimensions, up and down price points. I mean we're -- that team is doing a phenomenal job running a complete offense there. And when we look across the country portfolio, several quarters ago, we had highlighted some softness in the U.K, but we're continuing to see strong growth across all of our Western European markets and including the U.K., which has bounced back.

And so as we look at the dynamics that John referenced, we're continuing to focus on driving authenticity for the brand through sport and in lifestyle in that important region. And I'll be honest with you, a lot of things that resonate and incorporate in sneaker culture around the world find their place starting in the Europe market. And so our closeness to the consumer in that market is critical not just to drive growth in that region but to drive trends and behavior in markets outside of that region.

[Paul Trussell]

Thanks for the question, Gaby, and thank you all for participating in our Q3 earnings call. This concludes the conference call for today. We'll talk to you next time. Thank you.

[Operator]

Thank you, everyone. Once again, that does conclude this call. You may now disconnect.