

## ***SWOOSHING THE COST OF CAPITAL PRESENTATION***

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Josie had rarely experienced such a mix of emotions since starting at Central West University. She was simultaneously nervous and excited because she was about to make her first presentation as a junior analyst with the Centurion Fund, a student-managed investment fund with total assets of \$69,879. Josie was an avid runner who identified with the “swooshing” symbol in Nike’s “*Just Do It*” slogan. She seized the opportunity to combine her passions for finance and running in her presentation.

The presentation was one part of the Fund’s assessment of whether or not it made financial sense for the Centurion Fund to invest in Nike stock. Josie focused on the Weighted Average Cost of Capital (WACC) computation, a necessary step for a future full-fledged valuation of Nike. With her heart racing, she started her presentation.

Her presentation was moving along better than expected until she arrived at the slide containing her computation of Nike’s WACC. At this point, the junior analyst sensed that her presentation was not going very well because the faculty advisor, Dr. Ivanieva, and others raised questions about her calculations of WACC.

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The authors developed the case for class discussion rather than to illustrate either effective or ineffective handling of the situation. The case and its accompanying instructor's manual were anonymously peer reviewed and accepted by the *Journal of Case Research and Inquiry*, Vol. 3, 2017, a publication of the Western Casewriters Association. The authors and the *Journal of Case Research and Inquiry* grant state and nonprofit institutions the right to access and reproduce this manuscript for educational purposes. For all other purposes, all rights are reserved to the authors. Copyright 2017 © by Marco Pagani, Benjamin Anderson and George L. Whaley. Contact: Marco Pagani, Lucas College and Graduate School of Business, San José State University, One Washington Square, San Jose, CA, 95192-0066, tel. (408) 924-3477, [marco.pagani@sjsu.edu](mailto:marco.pagani@sjsu.edu)

One student questioned her choice of capital structure weights and her computation of the cost of debt capital. Dr. Ivanieva focused on the extensive use of Nike leases and asked,

*“Did you consider Nike’s operating leases in your WACC computation and are you aware that all U.S. firms would be required to implement a new accounting recognition method for leases by the end of the fiscal year 2018?”*

This question made Josie worry even more about the accuracy of her WACC computations, her future in the Centurion Fund process, and her reputation. She answered the questions as best as she could and concluded her presentation, disappointed.

Did she deserve another chance?

The presentation was an important step in the education and screening of junior analysts. Josie knew she could have done a better job, but remained committed to the Fund and to improving her understanding of Finance. She wanted to redo her calculations. She hoped for a second chance. If given one, she would try to give a flawless presentation.

## Centurion Fund

### ***Background and Purpose***

The Centurion Fund was a student-managed fund that started in September 2014 thanks to a generous gift of \$50,000 from Nellie and Albert Noland, two alumni of the College of Business at Central West University. The fund was started with the goal of providing Central West University students with an opportunity for experiential learning by managing an actual investment fund. The fund focused on investing in equity securities included in the S&P 500 index. The portfolio had outperformed its benchmark both over the last year (26.71% vs. 21.12%) and since inception (39.49% vs. 30.21%). Such performance was outstanding, especially considering that the fund held, on average, more than 10% of its assets in cash. Finance students managed the portfolio with oversight from a faculty advisor and an

independent administrator at the University who executed all final trades. The Centurion Fund had three student executives: Chief Executive Officer (CEO), a Chief Investment Officer (CIO), and a Chief Analyst. These three students, together with the faculty advisor, formed the board of directors (BOD) who voted on the final investment decisions, which were subsequently executed by the independent administrator.

### ***Selection Process and Structure***

The fund mainly relied on the work of twelve senior analysts, usually students in their senior year of college, who each covered one S&P 500 sector. Dr. Ivanieva selected the senior analysts with help from the Fund's board members at the beginning of each semester. Applicants were typically from the junior analyst pool. If selected as a senior analyst, a student would automatically be enrolled in a business course called, "Student-Managed Investment Fund." As part of the course, each senior analyst was required to perform an extensive valuation and pitch for two stocks, in addition to mid-term and final examinations. The senior analysts relied on the research support from junior analysts, who were interested in learning about investments and aimed at becoming senior analysts themselves. On average, a senior analyst would rely on three junior analysts, who were often students in their junior year who had successfully completed at least one finance course. After completing the "Student-Managed Investment Fund" course with at least a grade of B+, a senior analyst could apply for a board position: CEO, CIO, and Chief Analyst. Top-performing students usually held these prestigious volunteer positions during their last semester before graduation. Such curricular and co-curricular paths would ensure that students had opportunities to acquire hands-on experience in portfolio management and business valuation. Hence, a Central West University student interested in investments as a career had three semesters as a junior analyst, senior analyst or board member to gain valuable experience with the Centurion Fund.

### ***Performance Expectations***

Junior analysts were required to analyze a stock from the S&P 500 universe. Analysts completed the four tasks indicated below and presented their findings to other junior analysts, senior analysts, and the fund's executives:

- Brief company description
- Stock return analysis
- Financial analysis following the Du Pont model (Brigham & Daves 2016)
- Computation of the WACC

Following their presentations, junior analysts supported senior analysts who produced an in-depth analysis of the firm's industry and competitors, intrinsic and relative valuation, and technical price analysis. Senior analysts presented their findings in the form of a stock pitch to the other analysts and the full board of directors.

### **Josie's First Presentation**

Josie enjoyed participating in half-marathons three or four times a year. Running was the best way for her to manage the daily stress of college. During an average week, she ran 32 miles and her apparel needed to be both high performance and comfortable. She had been a loyal Nike customer for more than a decade and she was an especially strong devotee of Nike's running shoes. The "swooshing" symbol in Nike's "Just Do It" slogan gave her additional inspiration for her running. She bought a new pair of shoes every three months in order to support her competitive running endeavors. Josie knew that running took careful preparation. Similarly, she tried to prepare her first junior analyst presentation. This presentation was a great opportunity to assess whether it made financial sense for the Centurion Fund to invest in the stock of her favorite company, Nike.

Josie performed her WACC estimation using the balance sheet and income statement for Nike's fiscal year ending May 31, 2017 (see Exhibits 5 and 6 in Appendix B), and market data as of August 6, 2017 retrieved from Bloomberg Professional Service (2017). Josie computed the values of equity and debt by selecting the book value of total equity, short-term debt, and long-term debt. She then computed Nike's enterprise value by adding the three aforementioned items together and subtracting the cash balance. Since the firm displayed a negative net debt balance, the weight of the equity in the capital structure represented 123.70% of the enterprise value. She selected the beta, expected market return using the values displayed by Bloomberg, and chose the yield of the 1-year U.S. T-bill as the risk-free rate. She employed the CAPM model and computed a cost of equity of 10.21%. The junior analyst computed the pre-tax cost of debt as the ratio of the interest expenses divided by the total debt. Then, she estimated a post-tax cost of debt of 1.96% and finally calculated a 12.16% WACC. Exhibit 1 summarizes her calculations. See Appendix A for definitions of concepts and formulas.

### Exhibit 1. Nike WACC Data and Computation

Source: Bloomberg Professionals Service (2017) and junior analyst's computations. Millions of U.S. dollars.

<b>Equity</b>	<b>\$12,407</b>
<b>ST Debt</b>	<b>\$331</b>
<b>LT Debt</b>	<b>\$3,471</b>
Cash & Equivalents	\$6,179
<b>Interest Expenses</b>	<b>\$86</b>
Regression Beta	1.06
Expected Market Return	9.70%
<b>Risk-free Rate (1-Year T-bill)</b>	<b>1.23%</b>
<b>Effective Tax Rate</b>	<b>13.22%</b>
Net Debt	(\$2,377)
Equity	\$12,407
Enterprise Value	\$10,030
Net Debt Weight	-23.70%
Equity Weight	123.70%
<b>Pre-tax Cost of Debt</b>	<b>2.26%</b>
Post-tax Cost of Debt	1.96%
<b>Cost of Equity (CAPM)</b>	<b>10.21%</b>
<b>WACC</b>	<b>12.16%</b>

The audience at her first presentation had questioned her choice of equity and debt values. Moreover, they had pointed out that she had not considered the potential impact of operating leases. Josie felt that she needed to learn more about the new accounting treatment and the impact on financial statements of operating leases. The Centurion Fund's CEO had asked questions about her method for the estimation of the pre-tax cost of debt. (Note: Items that are boldfaced in Exhibit 1 are those items that potentially needed revision due to questions about Josie's computations).

After thinking about the first presentation, Josie seriously doubted that her choice of using the interest expenses listed in the income statement to determine the pre-tax cost of debt was the soundest approach. Her senior analyst had interrogated her on her choice of the risk-free rate for the computation of the cost of equity. The audience questions suggested that she needed to rethink her methodology and parameter choices. WACC was such a key component for a firm since it represented the discount rate for its corporate valuation and the cost of capital was the parameter against which its profitability would be judged.

### **Nike's Product and Leasing Background**

Founded in 1964 in Portland, Oregon, Nike was a relatively young member of the Fortune 500. The firm was originally founded as Blue Ribbon Sports in order to distribute shoes under the brand that eventually became known as Asics. Nike's original co-founder, Bill Bowerman, began experimenting with new ways to give athletes an edge. Bowerman's "waffle-inspired" lightweight design gave special traction to track runners. He patented this unique design and began to establish Nike as an innovative sports brand (Nike 2014). In 1971, the company renamed itself after the Greek winged goddess of victory and officially become Nike, Inc. (O'Reilly 2014).

Nike established itself as a major sports brand not only through innovative products, but also through distinctive marketing campaigns and strategic product endorsement. The original Nike “swoosh” was designed early on in the company’s life by a Portland State University student (O’Reilly 2014). Nike bolstered its brand with advertising slogans such as “Just Do It” in 1988 (O’Reilly 2014). An example of this iconic branding is provided in Exhibit 2.

### Exhibit 2. Nike Advertising Swoosh Symbol and Slogan

Source: <http://brandchannel.com/wp-content/uploads/2013/07/Nike-JustDolt-560.jpg>



Nike, like many other apparel companies, manufactured nearly all of its products overseas through independent contractors. Thus, currency fluctuations, disruptions in international trade, or international impacts on foreign contractors had the potential to harm the company’s profitability in the short term. Further, given the capital-intensive nature but rapid rate of change of the business, Nike rarely purchased plant, property, and equipment outright. Instead, Nike typically leased plant, property, and equipment in order to finance its operations and remain flexible in changing market conditions. Altogether, this resulted in Nike having operating lease obligations of over \$2 billion (Nike 2017).

Nike had historically relied on significant amounts of operating leases. Changes in how leases were accounted for could substantially affect the amount of debt the company reported. Operating leases provided more flexibility than fully owned assets. For instance, if Nike leased

rather than purchased stores and market dynamics changed, it could terminate a store lease and move to a different location. Terminating leases was more time and cost efficient than selling assets. Exhibit 8 in Appendix B shows the operating lease cash commitments of Nike for the fiscal years 2013 to 2017. Operating lease commitments were substantially larger than the total debt amount listed in the financial statements for every year of the period. For instance, in fiscal years 2014 and 2015, total cash commitments from operating leases represented more than double the total amount of Nike's balance sheet debt.

Nike was not the only company in the industry that made extensive use of operating leases. Exhibit 9 in Appendix B lists the cash commitments for operating leases and total debt for Nike's competitors: specifically, the industry group of all firms headquartered in developed nations classified by Bloomberg Professional Services (2017) as part of the Industry Apparel, Footwear & Accessory Design. All players in the industry used operating leases and their total cash commitments were significantly larger than their reported balance sheet debt.

### ***Changes in Accounting for Leasing Standards***

Nike's total future cash commitments amounted to several billions of U.S. dollars (Nike 2017). Hence, Nike was proactive and monitored the process of proposal, approval, and implementation of new lease accounting standards.

Under new accounting guidelines, corporations had to classify leases as either a finance lease or an operating lease. For each type of lease, the corporation reported the same total expenses as in existing guidelines. However, the corporation had to split the expense into interest expense and amortization expense. In addition, and more importantly, corporations had to report an asset and a lease liability, equal to the present value of all expected lease payments, for all leases with an impact of more than 12 months (FASB 2016 b). The new accounting standards had the goal of clear and transparent reporting of the future lease payments and their impact on the current financial situation of the corporation. For companies in asset-intensive industries that had relied on off-balance sheet financing, such as Nike, the new guidelines could



result in a dramatic change to the debt reported on a balance sheet. An article in the *Wall Street Journal* estimated that reported liabilities across all industries could increase by upwards of \$2 trillion (Rapoport 2016).

### Preparation for Josie's Second Presentation

Hoping for a second chance, Josie worked on her second presentation. Mindful of the upcoming change in financial reporting standards for operating leases because of Dr. Ivanieva's questions, Josie retrieved from Nike's 2017 annual report the accounting and financial information related to leases (Nike 2017). Exhibit 3 presents the information about Nike's capital and operating leases.

#### **Exhibit 3. Nike, Inc. Capital and Operating Leases**

Source: Nike's 2017 Annual Report (Nike 2017)

Type of Commitment	Cash Payments Due During each year Ending May 31 (Millions)						Total
	2018	2019	2020	2021	2022	Thereafter	
Capital Leases	\$34	\$32	\$28	\$25	\$26	\$225	\$370
Operating Leases	\$537	\$509	\$438	\$399	\$350	\$1,672	\$3,905

Josie was eager to understand how such leases could be integrated in the capital structure of Nike and how they would affect the WACC calculation. She knew from previous accounting and finance courses that capital leases, consistent with current U.S. Generally Accepted Accounting Principles (GAAP), were already capitalized onto Nike's current balance sheet. However, only the current annual cost of Nike's operating leases appeared as rent expense on the income statement. All future obligations under the leases were not reported on the balance sheet but were instead treated as off-balance sheet items and reported only in the notes. Josie noticed that Nike's commitments related to operating leases were substantially higher than the commitments recorded as capital leases. In fact, the total commitments for operating leases were 10.6 times larger than the amount capitalized as capital leases. She also realized that Nike

detailed only the operating lease obligations for the following five years. All payments after 2022 were instead displayed as a cumulative sum. Josie realized that she would need to assume a specific pattern of annual payments for the cumulative amount. One option available to her was to assume constant annual payments equal to the amount listed for the last detailed year of 2022 (Damodaran 2002).

During Josie's first presentation, the audience had challenged her choices related to Nike's capital structure and her computation of the firm's debt. In particular, the questions focused on her choices of weights for the firm's capital structure and the cost of debt capital. Dr. Ivanieva asked about the pending change in lease regulations. Specifically, did this accounting change dramatically increase the amount of debt reported on the balance sheet? Josie decided to investigate the debt issued by Nike and collected information about both the short-term and long-term debt. The short-term borrowing was comprised of commercial paper with a nominal value of \$325 million and a coupon of 0.86% (see Exhibit 4).

**Exhibit 4. Nike, Inc. Short-Term and Long-Term Debt**

Source: Nike's 2017 Annual Report and Bloomberg Professional Service (2017). Dollars and Yen in millions.

Balance Sheet Debt									
Type	Interest Rate or Coupon	Maturity	Principal Amount (Millions)	Currency	Interest PMTs	Count Day Convention	Credit Rating S&P/Moody's	Settlement Date	yield-to-maturity YTM
Commercial paper	0.86%		325	USD			A-1+/P-1		
Current Portion LT Debt			6	USD					
US Corporate Notes and Bonds	2.25%	05/01/2023	500	USD	Semi-Annual	30/360	AA-/A1	8/9/2017	2.19583%
	2.38%	11/01/2026	1000	USD	Semi-Annual	30/360	AA-/A1	8/9/2017	2.83779%
	3.63%	05/01/2043	500	USD	Semi-Annual	30/360	AA-/A1	8/9/2017	3.72181%
	3.88%	11/01/2045	1000	USD	Semi-Annual	30/360	AA-/A1	8/9/2017	3.69332%
	3.38%	11/01/2046	500	USD	Semi-Annual	30/360	AA-/A1	8/9/2017	3.67330%
Japanese Yen Notes	2.60%	11/20/2020	9000	JPN	Quarterly	Actual/365	AA-/A1	8/9/2017	0.1%
	2.00%	11/20/2020	4000	JPN	Quarterly	Actual/365	AA-/A1	8/9/2017	0.1%

Nike's long-term debt included both U.S. dollar and Japanese yen fixed-income securities with maturities ranging from three years to almost thirty years and with nominal values totaling respectively \$3.5 billion and ¥13 billion. The debt instruments were rated AA-/A1 by S&P and Moody's rating services (Bloomberg Professional Service 2017). The junior analyst knew that she needed to estimate the value of Nike's debt using the appropriate yield-to-maturity, count-day conventions, settlement dates, and, for the yen-denominated securities, the JPN/US exchange rate of 109.0704. Exhibit 7 in Appendix B provides further information about yield for several types and rating classes of debt securities.

## Conclusion

Josie decided to attend Central West University in part because she had been attracted by the possibility of becoming an analyst for the prestigious Centurion Fund. Her short-run goal was getting selected as a senior analyst. If she were selected, she would enroll in the “Student-Managed Investment Fund” course related to the Centurion Fund, and she might be able to convince the board of directors to add Nike to the fund’s portfolio. Participating in the Centurion Fund was a step toward a financial analyst job in the financial services industry after graduation. As a volunteer junior analyst, she understood that demonstrating her ability to analyze Nike’s capital structure and accurately compute its WACC were necessary first steps to collaborating with a senior analyst on a future Nike stock pitch. She was disappointed by the results of her initial presentation, but motivated to improve and to gain the praise of her fellow students and the faculty advisor.

Did Josie’s concerns, questions, decisions, and preparation for her second presentation cover what was needed to “just do it” and to swoosh the next presentation, if given the chance to make one?

After her initial presentation to the Centurion Fund stakeholders, Josie understood that she had to perform a more in-depth analysis of Nike’s capital structure and a more appropriate computation of the firm’s WACC parameters. Ultimately, Josie believed that she needed to make a reasonable estimate for Nike’s WACC. She practiced what to do and say if given another chance to present the Nike scenario. She also felt that she needed to determine whether her measures of the components of the Nike capital structure were flawed. Josie felt that she needed to grasp the changes concerning the new accounting recognition method for leases and determine the impact on firms for present and potential investors.

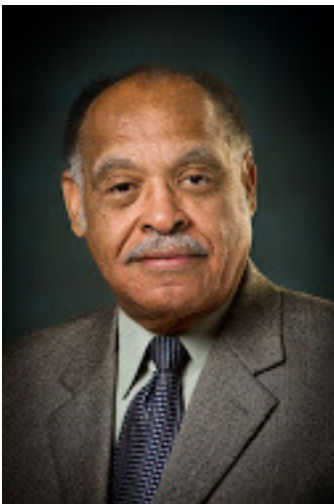
Assuming that Josie is given a second chance, what should she present to the Centurion Fund?



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## Appendix A

### Definitions

a) *Gross Debt* = *ST Debt* + *LT Debt*

b) *Net Debt* = *Gross Debt* – *Cash & Equivalent*

c) *Market Capitalization* = *Common Stock Price* × *Number of Common Equity Shares*

d) *Enterprise Value (EV)* = *Net Debt* + *Market Capitalization*

The *EV* is a measure of the net investment necessary for investors to acquire all outstanding debt and equity securities.

e)  $w_D = \frac{\text{Net Debt}}{EV}$  ;  $w_E = \frac{\text{Market Capitalization}}{EV}$  ;

f)  $r_E = r_{RF} + \beta \times (r_M - r_{RF})$  is the required rate of return for an equity security and is estimated using the Capital Asset Pricing Model (CAPM). The parameter  $r_{RF}$  is the risk-free rate of return,  $\beta$  is a measure of market risk, and  $r_M$  is the required rate of return on the market index.

g)  $WACC = w_D r_D (1 - T) + w_E r_E$

$r_D$  is the current required (pre-tax) rate of return on debt capital and  $T$  is the forecasted corporate income tax rate.

## Appendix B

## Exhibit 5. Balance Sheet - NIKE Inc. (NKE US) – Standardized

Source: Bloomberg Professional Service (2017)

In Millions of USD except Per Share	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	Current/LTM
12 Months Ending	05/31/2013	05/31/2014	05/31/2015	05/31/2016	05/31/2017	8/6/2017
<b>Total Assets</b>						
+ Cash, Cash Equivalents & ST Invest.	5,965.0	5,142.0	5,924.0	5,457.0	6,179.0	
+ Accounts Receivable	3,117.0	3,434.0	3,358.0	3,241.0	3,677.0	
+ Inventories	3,484.0	3,947.0	4,337.0	4,838.0	5,055.0	
+ Other ST Assets	1,064.0	1,173.0	1,968.0	1,489.0	1,150.0	
<b>Total Current Assets</b>	<b>13,630.0</b>	<b>13,696.0</b>	<b>15,587.0</b>	<b>15,025.0</b>	<b>16,061.0</b>	
+ Property, Plant & Equip, Net	2,452.0	2,834.0	3,011.0	3,520.0	3,989.0	
+ Property, Plant & Equip	5,500.0	6,220.0	6,352.0	7,038.0	7,958.0	
- Accumulated Depreciation	3,048.0	3,386.0	3,341.0	3,518.0	3,969.0	
+ Other LT Assets	1,463.0	2,064.0	2,999.0	2,834.0	3,209.0	
<b>Total Noncurrent Assets</b>	<b>3,915.0</b>	<b>4,898.0</b>	<b>6,010.0</b>	<b>6,354.0</b>	<b>7,198.0</b>	
<b>Total Assets</b>	<b>17,545.0</b>	<b>18,594.0</b>	<b>21,597.0</b>	<b>21,379.0</b>	<b>23,259.0</b>	
<b>Liabilities &amp; Shareholders' Equity</b>						
+ Payables & Accruals	3,755.0	4,769.0	5,989.0	5,152.0	4,975.0	
+ ST Debt	155.0	174.0	181.0	45.0	331.0	
+ ST Borrowings	98.0	167.0	74.0	1.0	325.0	
+ Current Portion of LT Debt	57.0	7.0	107.0	44.0	6.0	
+ Other ST Liabilities	52.0	84.0	162.0	161.0	168.0	
<b>Total Current Liabilities</b>	<b>3,962.0</b>	<b>5,027.0</b>	<b>6,332.0</b>	<b>5,358.0</b>	<b>5,474.0</b>	
+ LT Debt	1,210.0	1,199.0	1,079.0	1,993.0	3,471.0	
+ Other LT Liabilities (accruals and misc. LT liab.)	1,292.0	1,544.0	1,479.0	1,770.0	1,907.0	
<b>Total Noncurrent Liabilities</b>	<b>2,502.0</b>	<b>2,743.0</b>	<b>2,558.0</b>	<b>3,763.0</b>	<b>5,378.0</b>	
<b>Total Liabilities</b>	<b>6,464.0</b>	<b>7,770.0</b>	<b>8,890.0</b>	<b>9,121.0</b>	<b>10,852.0</b>	
+ Preferred Equity	0.0	0.0	0.0	0.0	0.0	
+ Share Capital & APIC	5,187.0	5,868.0	6,776.0	7,789.0	8,641.0	
+ Common Stock	3.0	3.0	3.0	3.0	3.0	
+ Additional Paid in Capital	5,184.0	5,865.0	6,773.0	7,786.0	8,638.0	
+ Retained Earnings	5,620.0	4,871.0	4,685.0	4,151.0	3,979.0	
+ Other Equity	274.0	85.0	1,246.0	318.0	-213.0	
<b>Total Equity</b>	<b>11,081.0</b>	<b>10,824.0</b>	<b>12,707.0</b>	<b>12,258.0</b>	<b>12,407.0</b>	
<b>Total Liabilities &amp; Equity</b>	<b>17,545.0</b>	<b>18,594.0</b>	<b>21,597.0</b>	<b>21,379.0</b>	<b>23,259.0</b>	
<b>Reference Items</b>						
Number of Employees	48,000.0	56,500.0	62,600.0	70,700.0	74,400.0	
Market Capitalization	55,124.0	66,911.7	87,131.2	92,880.0	87,062.6	98,089.7

**Exhibit 6. Income Statement - NIKE Inc. (NIKE US) – Standardized**

Source: Bloomberg Professional Service (2017)

In Millions of USD except Per Share	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
12 Months Ending	05/31/2013	05/31/2014	05/31/2015	05/31/2016	05/31/2017
	3	4	5	6	7
Revenue	25,313.0	27,799.0	30,601.0	32,376.0	34,350.0
- Cost of Goods & Services	14,279.0	15,353.0	16,534.0	17,405.0	19,038.0
Gross Profit	11,034.0	12,446.0	14,067.0	14,971.0	15,312.0
- Operating Expenses (Selling, General & Admin)	7,796.0	8,766.0	9,892.0	10,469.0	10,563.0
Operating Income (Loss)	3,238.0	3,680.0	4,175.0	4,502.0	4,749.0
- Non-Operating (Income) Loss	-18.0	136.0	-30.0	-121.0	-137.0
+ Interest Expense, Net	-3.0	33.0	28.0	19.0	59.0
+ <i>Interest Expense</i>	23.0	38.0	34.0	31.0	86.0
- <i>Interest Income</i>	26.0	5.0	6.0	12.0	27.0
+ Other Non-Op (Income) Loss	-15.0	103.0	-58.0	-140.0	-196.0
Pretax Income (Loss), GAAP	3,256.0	3,544.0	4,205.0	4,623.0	4,886.0
- Income Tax Expense (Benefit)	805.0	851.0	932.0	863.0	646.0
Income (Loss) from Cont. Ops	2,451.0	2,693.0	3,273.0	3,760.0	4,240.0
- Net Extraordinary Losses (Gains)	-21.0	0.0	0.0	0.0	0.0
Net Income, GAAP	2,472.0	2,693.0	3,273.0	3,760.0	4,240.0
- Preferred Dividends	0.0	0.0	0.0	0.0	0.0
Net Income Avail to Common, GAAP	2,472.0	2,693.0	3,273.0	3,760.0	4,240.0
Basic Weighted Avg. Shares	1,794.6	1,766.8	1,723.4	1,697.9	1,657.8
Diluted Weighted Avg. Shares	1,832.8	1,811.6	1,768.8	1,742.5	1,692.0
Basic EPS, GAAP	1.38	1.53	1.90	2.21	2.56
Diluted EPS, GAAP	1.35	1.49	1.85	2.16	2.51
Reference Items					
Accounting Standard	US GAAP	US GAAP	US GAAP	US GAAP	US GAAP
EBITDA	3,676.0	4,198.0	4,781.0	5,151.0	5,455.0
EBITDA Margin (T12M)	14.52	15.10	15.62	15.91	15.88
EBITA	3,238.0	3,680.0	4,175.0	4,502.0	4,749.0
EBIT	3,238.0	3,680.0	4,175.0	4,502.0	4,749.0
Effective Tax Rate	24.72%	24.01%	22.16%	18.67%	13.22%
Sales per Employee	527,354.17	492,017.70	488,833.87	457,934.94	461,693.55
Dividends per Share	0.41	0.47	0.54	0.62	0.70
Total Cash Common Dividends	726.8	821.6	930.6	1,052.7	1,160.5
Depreciation Expense	438.0	518.0	606.0	649.0	706.0



**Exhibit 7. Yield Curves for Selected Fixed-Income Securities and Credit Ratings**

Source: Bloomberg Professional Service (2017)

Type/Rating	Yield Curve 08/06/2017								
	3M	1Y	2Y	3Y	5Y	10Y	15Y	20Y	30Y
US Sovereign	1.135	1.227	1.373	1.524	1.836	2.293	2.463	2.642	2.865
JPY Sovereign		-0.112	-0.106	-0.08	-0.058	0.065	0.28	0.578	0.873
US Corporate AA+, AA, AA-	1.273	1.424	1.653	1.863	2.242	3.004	3.434	3.683	3.844
JPY Corporate AA+, AA, AA-	0.029	0.061	0.084	0.096	0.147	0.31	0.546	0.767	0.957
EUR Corporate AA+, AA, AA-	-0.455	-0.278	-0.184	-0.073	0.227	0.979	1.666	1.804	1.9
US Corporate A+, A, A-	1.406	1.579	1.814	2.037	2.413	3.152	3.687	3.914	3.908
EUR Corporate A+, A, A-	-0.371	-0.21	-0.113	0	0.317	1.148	1.615	1.843	1.959
US Corporate BB+, BB, BB-	2.165	2.458	2.938	3.358	4.039	5.213	5.961	6.352	6.38
EUR Corporate BBB+, BBB, BBB-	-0.198	-0.1	-0.029	0.1	0.455	1.298	1.735	1.923	2.023

**Exhibit 8. Nike's Historical Operating Leases Commitments and Total Balance Sheet Debt**

Source: Bloomberg Professional Service (2017)

NIKE Operating Leases Cash Payments Due During the year Ending May 31 (Millions)									
FY	1	2	3	4	5	Thereafter	Total Operating Leases Cash Commitments	Total Debt (ST + LT Debt)	Ratio (Operating Leases/Debt)
2013	\$403	\$340	\$304	\$272	\$225	\$816	\$2,360	\$1,365	1.73
2014	\$427	\$399	\$366	\$311	\$251	\$1,050	\$2,804	\$1,373	2.04
2015	\$447	\$423	\$371	\$311	\$268	\$1,154	\$2,974	\$1,260	2.36
2016	\$491	\$453	\$395	\$347	\$301	\$1,244	\$3,231	\$2,038	1.59
2017	\$537	\$509	\$436	\$399	\$350	\$1,672	\$3,905	\$3,802	1.03

**Exhibit 9. Industry Operating Leases Cash Commitments and Total Balance Sheet Debt**

Source: Bloomberg Professional Service (2017)

Bloomberg Sub-industry - Apparel, Footwear & Accessory Design - Fiscal Year 2017 (USD Millions)										
Company	Stock Ticker	Operating Leases Cash Commitments						Total Operating Leases Cash Commitments	Total Debt (ST+LT Debt)	Ratio (Operating Leases/Debt)
		Year 1	Year 2	Year 3	Year 4	Year 5	Thereafter			
Nike	NKE US	\$537.0	\$509.0	\$438.0	\$399.0	\$350.0	\$1,672.0	\$3,905.0	\$3,802.0	1.03
Skechers	SKX US	\$191.3	\$179.9	\$156.9	\$143.3	\$141.2	\$557.3	\$1,369.9	\$74.1	18.49
Adidas	ADS GR	\$725.6	\$1,359.5				\$551.6	\$2,636.7	\$2,251.8	1.17
Puma	PUM GR	\$131.1	\$282.1				\$123.7	\$536.9	\$40.4	13.29
Columbia Sportswear	COLM US	\$61.7	\$56.7	\$46.7	\$39.2	\$33.6	\$111.8	\$349.7	\$0.0	NA
Under Armour	UAA US	\$114.9	\$127.5	\$136.0	\$133.1	\$122.8	\$788.2	\$1,422.5	\$954.7	1.49
Tod's	TOD IM	\$104.9	\$88.9	\$66.4	\$56.5	\$45.6	\$123.0	\$485.3	\$274.6	1.77
Geox	GEO IM	\$80.9	\$168.1				\$77.9	\$326.9	\$96.5	3.39
Steven Madden	SHOO US	\$41.3	\$37.8	\$35.2	\$33.7	\$29.2	\$71.0	\$248.2	\$0.0	NA

## Appendix C

### Historical Background to the Change in Accounting Standards for Leasing

In 2008, The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) jointly remarked on the issues relating to the accounting for leases when they drafted an initial memorandum of understanding for accounting standard convergence (Financial Accounting Standards Board [FASB] 2008). Under extant accounting standards, corporations classified leases as either a capital lease or an operating lease. Leases were classified according to a set of four criteria: if the lease met a single one of these criteria, then it would be classified as a capital lease, otherwise it would be classified as an operating lease. Capital leases required capitalization of a leased asset and a lease liability that equaled the present value of the lease payments. Operating leases, meanwhile, were simply expensed (typically, as ‘rent expense’) when incurred (FASB, n.d.). Accordingly, companies who wanted to avoid increasing their liabilities while gaining use of assets negotiated their leases to avoid the aforementioned criteria. Accordingly, some companies tried to arrange transactions such that the lease was identified as an operating lease, even if the companies were getting substantially all of the risks and rewards of ownership of the asset and had a large series of contractual future payments. This arrangement was often referred to as “off-balance sheet financing.”

The weaknesses of the extant lease accounting and the issue of off-balance sheet financing was additionally identified as a major cause for concern since 2005 when the SEC first issued a report reviewing discoveries following the passage of the Sarbanes-Oxley Act of 2002 (United States Securities and Exchange Commission [SEC] 2005). Specifically, the SEC estimated that approximately \$1.25 trillion of future lease payments were currently unrecorded on corporate balance sheets (SEC 2005). The SEC recommended that the FASB undertake a project to reconsider accounting standards that would bring these previously unrecorded assets and liabilities onto the balance sheet. Accordingly, in 2006, the FASB began work to reconsider accounting for leases in coordination with the IASB. From 2006 until the final new lease accounting guidance was announced in 2016, the FASB and IASB issued three documents for public comment and received in response over 1,700 comment letters from a variety of stakeholders (FASB 2016a). Due to the major impact on corporate balance sheets, the new accounting standard was controversial. As such, the FASB and IASB attempted to address these corporate concerns by filers by meeting with and getting input from a huge array of stakeholders. An excerpt from the press release in which the new guidance was announced demonstrated the exhaustive process:

*Throughout the project, the FASB and the IASB also conducted extensive outreach with diverse groups of stakeholders. That outreach included more than 200 meetings with preparers and users of financial statements; 15 public round tables, with more than 180 representatives and organizations; 15 preparer workshops attended by representatives from more than 90 organizations; and 14 meetings with preparers. The FASB and the IASB also met with more than 500 users of financial statements covering a broad range of industries (FASB 2016a).*

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