EXHIBIT 1.28

Starbucks Corporation Common-Size and Percentage Change Income Statements for the Year Ended September 30 (Integrative Case 1.1)

	Common-Size Income Statement			Percentage Change Income Statement	
	Year 4	Year 3	Year 2	Year 4	Year 3
Revenues					
Company-Operated Retail Stores	84.2%	84.6%	84.9%	29.2%	23.5%
Specialty:					
Licensing	10.7	10.1	9.5	38.1%	31.3%
Foodservice and Other	5.1	5.3	5.6	25.3%	17.4%
Total Revenues	100.0%	100.0%	100.0%	29.9%	23.9%
Expenses					
Cost of Sales Including Occupancy Costs	41.4%	41.2%	41.0%	30.3%	24.8%
Store Operating Expenses	33.8	33.8	33.7	29.8%	24.9%
Nonretail Operating Expenses	3.2	3.5	3.2	21.4%	33.2%
Depreciation and Amortization	5.5	6.0	6.4	18.2%	16.1%
General and Administrative	5.7	6.0	7.1	24.4%	4.3%
Total Expenses	89.6%	90.5%	91.4%	28.6%	22.7%
Income from Equity Investees	1.1	.9	1.0	58.1%	14.6%
Operating Income	11.5%	10.4%	9.6%	44.0%	34.4%
Interest and Other Income	.3	.3	.2	21.0%	20.8%
Interest Expense	—	—	—	—	—
Gain (Loss) on Investments	—	—	.4	—	—
Income before Income Taxes	11.8%	10.7%	10.2%	43.4%	28.8%
Income Tax Expense	4.4	4.1	3.8	38.7%	33.1%
Net Income	7.4%	6.6%	6.4%	46.4%	26.2%

CASE 1.2

NIKE: SOMEWHERE BETWEEN A SWOOSH AND A SLAM DUNK

Nike's principal business activity involves the design, development, and worldwide marketing of high-quality footwear, apparel, equipment, and accessory products. Almost 25,000 employees work for the firm. Nike boasts the largest worldwide market share in the athletic-footwear industry and a leading market share in sports and athletic apparel.

This case uses the financial statements for Nike and excerpts from its notes to review important concepts underlying the three principal financial statements (balance sheet,

income statement, and statement of cash flows) and relationships among them. The case also introduces tools for analyzing financial statements.

Industry Economics

Product Lines

Industry analysts debate whether the athletic-footwear industry is a performance-driven athletic-footwear industry or a fashion-driven sneaker industry. Proponents of the performance view point to Nike's dominant market position, which results in part from continual innovation in product development. Proponents of the fashion view point to the difficulty of protecting technological improvements from competitor imitation, the large portion of total expenses comprising advertising, the role of sports and other personalities in promoting athletic shoes, and the fact that only a small percentage of athletic-footwear consumers use the footwear for its intended purpose (such as basketball or running).

Growth

There are only modest growth opportunities for footwear in the United States. Concern exists with respect to both volume increases (how many pairs of athletic shoes will consumers tolerate in their closets) and price increases (will consumers continue to pay prices for innovative athletic footwear that is often twice as costly as other footwear).

Athletic-footwear companies have diversified their revenue sources in two directions in recent years. One direction involves increased emphasis on international sales. With dress codes becoming more casual in Europe and East Asia and interest in American sports such as basketball and football becoming more widespread, industry analysts view international markets as the major growth markets during the next several years. Increased emphasis on soccer in the United States aids companies such as Adidas with reputations for quality soccer footwear.

The second direction for diversification is sports and athletic apparel. The three leading athletic-footwear companies capitalize on their brand name recognition and distribution channels to create a line of sportswear that coordinates with their footwear. Team uniforms and matching apparel for coaching staffs have become a major growth avenue recently. For example, Bauer/Nike Hockey manufactures and distributes ice skates, skate blades, in-line roller skates, protective gear, hockey sticks, and hockey jerseys and accessories under both the Bauer and Nike brand names.

Production

Essentially all athletic footwear and most apparel come from factories in Asia, primarily China (40 percent), Indonesia (31 percent), Vietnam, South Korea, Taiwan, and Thailand. The footwear companies do not own any of these manufacturing facilities. They typically hire manufacturing representatives to source and oversee the manufacturing process, helping to ensure quality control and serving as a link between the design and the manufacture of products. The manufacturing process is labor intensive, with sewing machines used as the primary equipment. Footwear companies typically price their purchases from these factories in U.S. dollars.

Marketing

Athletic-footwear and sportswear companies sell their products to consumers through various independent department, specialty, and discount stores. Their sales forces educate

retailers on new product innovations, store display design, and similar activities. The dominant market shares of Nike and the other major players limit retailers' shelf space, and slower growth in sales makes it increasingly difficult for the remaining athletic footwear companies to gain market share. The slower growth has also led the major players to increase significantly their advertising and payments for celebrity endorsements.

Athletic-footwear and sportswear companies have typically used independent distributors to market their products in other countries. With increasing brand recognition and anticipated growth in international sales, these companies have recently acquired an increasing number of their distributors to capture more of the profits generated in other countries and maintain better control of international marketing.

Finance

Compared to other apparel firms, the athletic-footwear firms generate higher profit margins and rates of return. These firms use cash flow generated from this superior profitability to finance needed working capital investments (receivables and inventories). Long-term debt tends to be minimal, reflecting the absence of significant investments in manufacturing facilities.

Nike

Nike targets the serious athlete with performance-driven footwear. In recent years, the firm has particularly emphasized growth outside the United States. The firm sums up the company's philosophy and driving force behind Nike's success by saying: "We are midway on our journey to becoming a truly global company. We are creating a product that is meaningful beyond the stick-and-ball shores of the United States. Consumers around the world are seeing and embracing Nike."

To maintain its technological edge, Nike engages in extensive research at its research facilities in Beaverton, Oregon. It continually alters its product line to introduce new footwear and evolutionary improvements in existing products.

Nike maintains a reputation for timely delivery of footwear products to its customers, primarily as a result of its "Futures" ordering program. Under this program, retailers book orders five to six months in advance. Nike guarantees 90 percent delivery of the order within a set time period at the agreed price at the time of ordering. Approximately 86 percent of footwear orders received by Nike during Year 4 came though its Futures program. This program allows the company to improve production scheduling, thereby reducing inventory risk. However, the program locks in prices and increases Nike's risk of change in raw materials and labor costs.

Independent contractors manufacture virtually all of Nike's products. Nike sources all of its footwear from other countries and approximately 95 percent of its apparel.

The following exhibits present information for Nike:

Exhibit 1.29: Consolidated balance sheets for Year 3 and Year 4.
Exhibit 1.30: Consolidated income statements for Year 2, Year 3, and Year 4.
Exhibit 1.31: Consolidated statements of cash flows Year 2, Year 3, and Year 4.
Exhibit 1.32: Excerpts from the notes to Nike's financial statements.
Exhibit 1.33: Common-size and percentage change income statements.
Exhibit 1.34: Common-size and percentage change balance sheets.

Required

Study the financial statements and notes for Nike and then respond to the following questions.

EXHIBIT 1.29

Consolidated Balance Sheet for Nike (amounts in millions) (Case 1.2)

May 31:	Year 4	Year 3
Assets		
Cash and Cash Equivalents	$ 828	$ 634
Short-Term Investments	401	—
Accounts Receivable, less allowance for doubtful accounts of $95 and $82	2,120	2,084
Inventories	1,634	1,515
Deferred Income Taxes	165	222
Prepayments	364	332
Total Current Assets	$5,512	$4,787
Property, Plant, and Equipment, net of accumulated depreciation of $1,545 and $1,368	1,587	1,621
Identifiable Intangible Assets	367	118
Goodwill	135	66
Deferred Income Taxes and Other Assets	291	229
Total Assets	$7,892	$6,821
Liabilities and Shareholders' Equity		
Accounts Payable	$ 764	$ 573
Notes Payable	146	75
Current Portion of Long-Term Debt	7	206
Other Current Liabilities	1,092	1,167
Total Current Liabilities	$2,009	$2,021
Long-Term Debt	683	551
Deferred Income Taxes and Other Liabilities	418	258
Total Liabilities	$3,110	$2,830
Common Stock	$ 3	$ 3
Additional Paid-In Capital	888	589
Accumulated Other Comprehensive Income	(86)	(240)
Retained Earnings	3,977	3,639
Total Shareholders' Equity	$4,782	$3,991
Total Liabilities and Shareholders' Equity	$7,892	$6,821

Income Statement

a. Identify the time at which Nike recognizes revenues. Does this timing of revenue recognition seem appropriate? Explain.

b. Identify the cost-flow assumption(s) that Nike uses to measure cost of goods sold. Does Nike's choice of cost-flow assumption(s) seem appropriate? Explain.

EXHIBIT 1.30

Consolidated Income Statement for Nike (amounts in millions) (Case 1.2)

Year Ended May 31:	Year 4	Year 3	Year 2
Sales Revenue	$12,253	$10,697	$ 9,893
Cost of Goods Sold	(7,001)	(6,314)	(6,005)
Selling and Administrative	(3,702)	(3,154)	(2,836)
Interest	(25)	(29)	(34)
Other Income (Expense), net	(75)	(77)	(1)
Income before Income Taxes	$ 1,450	$ 1,123	$ 1,017
Income Taxes	(504)	(383)	(349)
Net Income	$ 946	$ 740	$ 668

c. Nike reports property, plant, and equipment on its balance sheet and discloses the amount of depreciation for each year in its statement of cash flows. Why doesn't depreciation expense appear among its expenses on the income statement?

d. Identify the portion of Nike's income tax expense of $504 million for Year 4 that is currently payable to governmental entities and the portion that is deferred to future years. Why do governmental entities permit firms to defer payment of their income taxes to future years?

Balance Sheet

a. Why do accounts receivable appear net of allowance for doubtful accounts? Identify the events or transactions that cause the allowance account to increase or decrease.

b. Identify the depreciation method(s) that Nike uses for its buildings and equipment. Does Nike's choice of depreciation method(s) seem appropriate?

c. Nike includes identifiable intangible assets on its balance sheet as an asset. Does this account include the value of the Nike name and "swoosh" trademark? Explain.

d. Nike includes deferred income taxes among current assets, noncurrent assets, and noncurrent liabilities. Under what circumstances will deferred income taxes give rise to an asset? To a liability?

e. Nike reports accumulated other comprehensive income of ($86) million at the end of Year 4 and ($240) million at the end of Year 3. Why are these "losses" reported as part of shareholders' equity and not as part of net income in the income statement?

Statement of Cash Flows

a. Why does the amount of net income differ from the amount of cash flow from operations?

b. Why does Nike report depreciation as an addition to net income in calculating cash flow from operations?

c. Why does Nike report deferred income taxes as an addition to net income in calculating cash flow from operations for Year 4 (as well as each of the previous years)?

EXHIBIT 1.31

Consolidated Statement of Cash Flows for Nike (amounts in millions) (Case 1.2)

Year Ended May 31:	Year 4	Year 3	Year 2
Operations			
Net Income	$ 946	$ 740	$ 668
Depreciation	252	239	224
Deferred Income Taxes	19	55	16
Other	105	36	62
(Increase) Decrease in Accounts Receivable	83	(136)	(135)
(Increase) Decrease in Inventories	(56)	(103)	55
(Increase) Decrease in Other Current Assets	(104)	61	17
Increase (Decrease) in Accounts Payable and Other Current Liabilities	269	30	175
Cash Flow from Operations	$1,514	$ 922	$1,082
Investing			
Additions to Property, Plant, and Equipment	$ (224)	$(186)	$ (283)
Disposals of Property, Plant, and Equipment	12	15	16
Purchase of Short-Term Investments	(401)	—	—
Acquisition of Subsidiary	(289)	—	—
Additions to Other Assets	(43)	(47)	(29)
Increases (Decrease) in Other Liabilities	(1)	2	(7)
Cash Flow from Investing	$ (946)	$(216)	$ (303)
Financing			
Additions to Long-Term Debt	$ 154	$ 90	$ 330
Reductions in Long-Term Debt	(207)	(56)	(80)
Increase (Decrease) in Notes Payable	—	(351)	(433)
Proceeds from Exercise of Stock Options and Other Stock Issues	254	44	60
Repurchase of Common Stock	(420)	(196)	(227)
Dividends	(179)	(138)	(129)
Other	24	(41)	(28)
Cash Flow from Financing	$ (374)	$(648)	$ (507)
Change in Cash	$ 194	$ 58	$ 272
Cash—Beginning of Year	634	576	304
Cash—End of Year	$ 828	$ 634	$ 576

d. Why does Nike add decreases in accounts receivable to net income when calculating cash flow from operations for Year 4?

e. Why does Nike subtract increases in inventory from net income when calculating cash flow from operations for Year 4?

EXHIBIT 1.32

Excerpts from Notes to Consolidated Financial Statements for Nike (amounts in millions) (Case 1.2)

Summary of Significant Accounting Policies

Recognition of Revenues: Nike recognizes revenue at time of sale to its customers and as it earns fees on sales by licensees. Provisions for sales discounts and returns are made at the time of sale.

Inventory Valuation: Inventories appear at lower of cost or market. Nike determines cost using the first-in, first-out (FIFO) method.

Property, Plant, and Equipment and Depreciation: Property, plant, and equipment appear at acquisition cost. Nike computes depreciation using the straight-line method for buildings and leasehold improvements and a declining-balance method for machinery and equipment, based on estimated useful lives ranging from 3 to 32 years.

Identifiable Intangible Assets and Goodwill: This account represents the excess of the purchase price of acquired businesses over the market values of identifiable net assets, net of amortization to date on assets with limited lives.

Foreign Currency Translation: Adjustments resulting from translating foreign functional currency financial statements into U.S. dollars and gains and losses from derivatives that Nike uses to hedge changes in exchange rate are included in accumulated other comprehensive income.

Income Taxes: Nike provides deferred income taxes for temporary differences between income before taxes for financial reporting and tax reporting. Income tax expense includes the following:

	Year 4	Year 3	Year 2
Currently Payable	$495	$349	$336
Deferred	9	34	3
Income Tax Expense	$504	$383	$349

Stock Repurchases: Nike repurchases outstanding shares of its common stock each year and retires them. Any difference between the price paid and the book value of the shares appears as an adjustment of retained earnings.

f. Why does Nike add increases in accounts payable and other current liabilities to net income when calculating cash flow from operations for Year 4?

g. Given that firms often sell property, plant, and equipment at a gain or loss, why does Nike include the proceeds of disposal of these assets as an investing activity instead of as an operating activity?

h. Given that notes payable appear on the balance sheet as a current liability, why does Nike include changes in this liability as a financing activity instead of as an operating activity?

Relations between Financial Statement Items

a. Compute the amount of cash collected from customers during Year 4.

b. Compute the amount of cash payments made to suppliers of merchandise during Year 4.

EXHIBIT 1.33

Common-Size and Percentage Change Income Statements for Nike (Case 1.2)

	Common-Size Income Statements			Percentage Change Income Statements	
Fiscal Year Ended May 31:	**Year 4**	**Year 3**	**Year 2**	**Year 4**	**Year 3**
Nike					
Sales Revenues	100.0%	100.0%	100.0%	14.5%	8.1%
Cost of Goods Sold	(57.2)	(59.0)	(60.7)	10.9%	5.1%
Selling and Administrative Expenses	(30.2)	(29.5)	(28.7)	17.4%	11.2%
Interest Expense	(.2)	(.3)	(.3)	(13.8%)	(14.7%)
Other Income (Expense)	(.6)	(.7)	—	(2.6%)	—
Income before Taxes	11.8%	10.5%	10.3%	29.1%	10.4%
Income Taxes	(4.1)	(3.6)	(3.5)	31.6%	9.7%
Net Income	7.7%	6.9%	6.8%	27.8%	10.8%

c. Prepare an analysis that accounts for the change in the property, plant, and equipment account and the accumulated depreciation account during Year 4. Calculate the gain or loss that Nike recognized on the disposal of property, plant, and equipment during Year 4.

d. Identify the reasons for the change in retained earnings during Year 4.

Interpreting Financial Statement Relationships

a. Exhibit 1.33 presents common-size and percentage change income statements for Nike for Year 2, Year 3, and Year 4. What are the likely reasons for the higher net income/sales revenue percentages for Nike between Year 2 and Year 4?

b. What are the likely reasons for the decrease in the cost of goods sold to sales percentages between Year 2 and Year 4?

c. What are the likely reasons for the increase in the selling and administrative expenses to sales percentages between Year 2 and Year 4?

d. Exhibit 1.34 presents common-size and percentage change balance sheets for Nike at the end Year 2, Year 3, and Year 4. What is the likely explanation for the relatively small percentages for property, plant, and equipment?

e. What is the likely explanation for the relatively small percentages for long-term debt?

f. What is the likely explanation for the small percentage increase for property, plant, and equipment for Nike for Year 3 and the small decrease in Year 4?

g. Refer to the statement of cash flows for Nike in Exhibit 1.31. Net income increased between Year 2 and Year 3, but cash flow from operations decreased. What is the likely reason for the different direction of these changes?

EXHIBIT 1.34

Common-Size and Percentage Change Balance Sheets for Nike (Case 1.2)

	Common-Size Balance Sheets			Percentage Change Balance Sheets	
	Year 4	Year 3	Year 2	Year 4	Year 3
Assets					
Cash	15.6%	9.3%	8.9%	93.8%	10.1%
Accounts Receivable	26.9	30.6	28.0	1.7%	15.5%
Inventories	20.7	22.2	21.3	7.9%	10.3%
Prepayments	6.7	8.1	6.3	(4.5%)	38.2%
Total Current Assets	69.9%	70.2%	64.5%	15.1%	15.2%
Property, Plant, and Equipment, net	20.1	23.7	25.1	(2.1%)	0.4%
Other Noncurrent Assets	10.0	6.1	10.4	92.0%	(38.5%)
Total Assets	100.0%	100.0%	100.0%	15.7%	5.9%
Liabilities and Shareholders' Equity					
Accounts Payable	9.7%	8.4%	7.8%	33.3%	13.7%
Notes Payable	1.8	1.1	6.6	94.7%	(82.4%)
Current Portion of Long-Term Debt	0.1	3.0	0.9	(96.6%)	274.5%
Other Current Liabilities	13.8	17.1	13.2	(6.4%)	37.6%
Total Current Liabilities	25.4%	29.6%	28.5%	(0.6%)	10.3%
Long-Term Debt	8.7	8.1	9.7	24.0%	(12.0%)
Deferred Income Taxes and Other Liabilities	5.3	3.8	2.2	(62.0%)	81.7%
Total Liabilities	39.4%	41.5%	40.4%	9.9%	8.8%
Minority Interest	—	—	—	—	—
Common Stock	—	—	—	—	—
Additional Paid-In Capital	11.3%	8.6%	8.4%	50.8%	9.3%
Retained Earnings	50.4	53.3	54.2	9.3%	4.3%
Accumulated Other Comprehensive Income	(1.1)	(3.4)	(3.0)	(62.2%)	25.0%
Treasury Stock	—	—	—	—	—
Total Shareholders' Equity	60.6%	58.5%	59.6%	19.8%	3.9%
Total Liabilities and Shareholders' Equity	100.0%	100.0%	100.0%	15.7%	5.9%

h. Cash flow from operations exceeded net income during all three years. Why is this the case?

i. How has Nike primarily financed its acquisitions of property, plant, and equipment during the three years?

j. What are the likely reasons for the repurchases of common stock during the three years?

k. The dividends paid by Nike increased each year ($129 million in Year 2, $138 million in Year 3, and $179 million in Year 4). Given that Nike repurchased its stock each year, what is the likely explanation for the increasing amount of dividends?