

COMPUTERIZED THERMAL IMAGING INC  
Form 10-K  
September 29, 2003

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the Fiscal Year Ended June 30, 2003
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-16253

**COMPUTERIZED THERMAL IMAGING, INC.**

(Exact name of registrant as specified in its charter)

NEVADA

(State or other jurisdiction of incorporation  
or  
organization)

87-0458721

(I.R.S. Employer  
Identification No.)

1719 West 2800 South, Ogden, UT

(Address of principal executive offices)

84401

(Zip Code)

Registrant's telephone number including area code: (801) 776-4700

Securities registered under Section 12(b) of the Act:

None

Securities registered under Section 12(g) of the Act:

Common Stock

(Title of class)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

The aggregate market value of Common Stock held by non-affiliates of the registrant at September 2, 2003 was approximately \$36 million. Shares of Common Stock held by each officer and director and by each person who owns 5% or more of the outstanding Common Stock have been excluded from this computation in that such persons may be deemed to be affiliates.

As of September 2, 2003, there were 112,870,031 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

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**COMPUTERIZED THERMAL IMAGING, INC.**

**FORM 10-K**

**ANNUAL REPORT**

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**PART I**

*This document, and the documents incorporated by reference, including, but not limited to, certain statements contained in Item 1, Business and Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, contain forward-looking statements within the meaning of the Securities Act of 1933 and Securities Exchange Act of 1934. Forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied. When used in this document the words expects, anticipates, intends, plans, may, believes, seeks, estimates and similar expressions generally identify forward-looking statements. All forward-looking statements included in this document are based on information available to the Company on the date hereof, and we assume no obligation to update any forward-looking statements, except as otherwise required under applicable laws and regulations.*

*This document should be read in conjunction with our audited financial statements included in Part II and RISK FACTORS noted below.*

**ITEM 1. BUSINESS**

***Introduction***

Computerized Thermal Imaging, Inc. ( we , us , our , CTI , the Company ) designs, manufactures and markets thermal imaging and infrared devices and services used for clinical diagnosis, pain management and non-destructive testing of industrial products and materials. We market our products with an internal sales force and independent distributors.

Our research emphasizes applications for thermal imaging technology and the development of equipment and methods for producing, interpreting, and cataloging thermal images. We believe our products provide our customers with valuable and unique data for the detection of abnormalities. Our pain management products are used in the diagnosis and treatment of certain diseases and disorders. If ultimately approved by the U.S. Food and Drug Administration (the FDA ), we believe that our breast imaging system will be able to be used by radiologists to help distinguish between benign and malignant breast masses. Our industrial products are used for testing product quality and enabling more efficient designs.

We continue to develop enhancements for our existing products to improve their form, function and/or effectiveness. We are currently developing modifications and updates for our breast imaging system to reduce its size and weight and improve operator efficiency and clinical effectiveness. We developed an improved non-destructive turbine blade inspection system for Pratt and Whitney but, since April 2003, have suspended industrial product development to reduce expenses and conserve cash. We are developing various modest enhancements to our pain management products to improve manufacturability and quality.

We have applied for a pre-market approval ( PMA ) from the FDA for our breast imaging system: The BCS 2100 ( BCS 2100 ), a painless and non-invasive technique for acquiring physiological information from women recommended for breast biopsy. To receive PMA approval, we must establish the BCS 2100's ability to consistently distinguish between malignant and benign tissue and thereby reduce the number of benign breast biopsies performed. On December 10, 2002, an Advisory panel convened by the FDA to review our application held a public hearing on our PMA application and decided to recommend to the FDA, by a vote of 4-3, that the FDA not approve our application. On January 23, 2003, the FDA concurred with the recommendation of the panel and recommended additional data analysis, clinical trials and other steps that we might take to obtain FDA approval. We have contacted the FDA's ombudsman and are attempting to negotiate a reversal of the FDA's decision. We may formally appeal the FDA's non-approvable decision or avail ourselves of other remedies. As of the date of this document, we do not know whether our negotiations or any appeal we might file will be successful.

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We are not permitted to sell the BCS 2100 in the United States until after we receive an FDA approval, and lack of FDA approval hinders marketing of this product in international markets. Because FDA rules restrict marketing of unapproved products, CTI attends industry trade shows and professional conferences, where it can present product information in an educational format that is properly labeled to radiologists without risk of FDA censure.

Our pain management products have FDA clearance and are principally marketed in the United States to chiropractors and physical therapists who use them to locate soft tissue injuries or potential sources of pain, to verify the effect of treatment; or to treat the symptoms of soft tissue injuries and pain syndromes. Pain management products are shipped from inventory when ordered.

We market our pain management products with an internal sales force and independent distributors. We attend trade shows and conferences, make direct sales calls and sponsor clinics, where we introduce, demonstrate and educate customers about our BCS 2100, pain management and non-destructive testing products.

We have developed a product that uses our technology in an industrial setting. Our Turbine Blade Inspection System is a quality assurance tool and, using techniques similar to our BCS 2100, meets industrial requirements for non-destructive testing and examination of turbine blades used in aircraft and power generation, and other industrial components, composite materials and metals.

Our industrial systems do not require FDA approval and are marketed directly to end-user customers in the United States and Europe. Industrial products are built-to-order, require tailoring to the customer's specific requirements and require two to six months to complete. These products typically have long sales cycles and demand is directly impacted by economic conditions.

We manufacture our products (pain management, BCS 2100 and, as of April 2003, our industrial products) internally at our Ogden, Utah facility. The Ogden facilities certified to ISO 9000 quality standards.

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We are publicly traded on the American Stock Exchange under the symbol CIO. As of September 1, 2003, we had approximately 113 million shares of common stock outstanding; held by approximately 21 thousand shareholders. In addition to common stock, there are outstanding exercisable warrants and options to acquire approximately 10.4 million shares at exercise prices ranging from \$0.63 to \$5.00. Of the approximately 123 million fully-diluted common shares outstanding, 13.5 million are beneficially owned by insiders and affiliates. Other than our wholly-owned subsidiary, Bales Scientific, Inc., we have no interest in any other entity.

We use our capital to pay general corporate expenses, including salaries, manufacturing costs, professional fees, clinical study and technical support costs, and general and administrative expenses. We are a development stage company and, to date, we have funded our business activities with funds raised through the private placement of common stock, debt and warrants, and the exercise of warrants and options.

***Industry Overview & Trends***

The American Cancer Society estimates that 203,500 new cases of invasive breast cancer will be diagnosed among women and approximately 40 thousand women in the United States will die from the disease during 2002. Breast cancer is the most commonly diagnosed cancer among women, accounting for nearly one of every three new cancers diagnosed, and is the second leading cause of cancer death (after lung cancer). Each year, more than 20 million women in the United States have a mammogram to screen for breast cancer. Approximately two million of those mammograms require additional follow-up due to a suspicious finding, and approximately 1.3 million abnormal mammograms require a breast biopsy to characterize the suspicious tissue as benign or malignant. The American Cancer Society estimates that approximately 20%, or 203,500, of the suspicious tissues that are subjected to biopsies will turn out to be cancerous. In other words, more than 80% of these breast biopsies performed during 2002 are expected to yield benign results.

Of the 1.3 million breast biopsies performed in the United States each year, approximately 800 thousand are open surgical procedures where the patient is anesthetized or heavily sedated and a surgeon extracts the mass through an incision. The remaining approximately 500 thousand biopsies are less invasive core biopsies where a needle is guided to the region of interest and a sample is obtained without having to perform open surgery. The trend is toward less invasive biopsy methods to reduce scarring, cost and emotional trauma. The number of biopsies performed has doubled in the last 10 years and the trend toward less invasive biopsy techniques has accelerated.

If we receive FDA approval for our breast imaging system, we believe that, under prescribed circumstances, radiologists and surgeons will be able to use the physiological profile of the suspicious tissue produced by our BCS 2100 to determine whether breast masses are benign, without performing a biopsy. The target market for the BCS 2100 are the more than ten thousand certified mammography centers in the United States and more than ten thousand mammography centers throughout the rest of the world.

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Our target markets for the pain management products consists of over fifty thousand chiropractors, pain management practitioners, occupational therapists, physical therapists and major sports teams in the United States looking for ways to diagnose and treat injuries and pain conditions effectively and quickly. According to some reports, more than fifty million Americans suffer chronic pain and an additional twenty-five million suffer acute injury-related pain, costing the United States economy more than \$70 billion annually in missed work days, emergency room visits, medications and other costs.

The target markets for our industrial products are primarily manufacturers of complex castings, particularly in the aerospace and power generation markets.

***Our Products and Services***

Our imaging systems integrate third-party hardware, our proprietary software and heat-sensing camera to produce, interpret, and catalogue thermal images. These systems provide medical professionals with physiological information to assist in the evaluation of breast abnormalities and the management of chronic pain. These systems also have industrial applications in non-destructive testing and inspection of complex industrial products; e.g., turbine blades.

We have developed six significant proprietary technologies, four of which relate to the breast imaging system: 1) a climate-controlled examination unit to provide patient comfort and facilitate reproducible tests for the BCS 2100; 2) an imaging protocol that produces consistent results for the BCS 2100; 3) a statistical model that detects physiological irregularities for the BCS 2100; 4) infrared imaging and analysis hardware, including our proprietary heat-sensing camera, which is used in the BCS2100 as well as our pain management and industrial systems (collectively, we refer to items 2-4 as the Thermal Imaging Process ); 5) a system to treat pain and other symptoms of diseases that restrict blood flow (the Photonic Stimulator ); and 6) a system for non-destructive testing and examination of turbine blades and other industrial components (the Turbine Blade Inspection System ).

**Medical Products - Breast Cancer System 2100**

Our BCS 2100 provides a non-invasive, painless way to collect information that, if approved by the FDA, we believe could supplement the information provided by mammograms for the evaluation of suspicious breast lesions. To receive a breast scan on the BCS 2100, a patient will lie face down on our device and expose one breast at a time to the flow of cold air. The breast is then observed by our infrared imager as it cools. Because malignant tissue is more vascular and less likely to constrict upon contact with cool air than benign tissue, malignancies are measurably warmer than benign tissue. The BCS 2100 captures 103 dynamic images of each breast and analyzes over 8.3 million temperature values per breast to measure minute changes in physiological and metabolic activity. From these measurements, the system is able to compute a mathematical probability and indicate the likelihood that a suspicious breast lesion is benign or malignant. We believe that this data, when combined with diagnostic information from mammograms, will provide radiologists with additional information that can be useful in determining more precisely when a surgical biopsy is needed.

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Mammography and related imaging methods capture a snapshot of anatomical structure at a moment in time, but do not provide information about the behavior of the structures exposed. While mammography may detect the presence of an abnormality in the breast, a biopsy is required to determine whether the abnormality is benign or malignant. We believe our technology produces images that expose the physiology and function of breast tissue. If we receive FDA approval, we believe that this physiological information can provide health professionals with a tool for more accurately discriminating between those cases that require invasive biopsy and those that do not; furthermore, we believe our BCS 2100 will be able to provide physiological data that can lead to fewer biopsies, 80% of which have benign findings.

We believe the BCS 2100 provides a tool that could detect cancer in almost all types of abnormal breast lesions: masses, micro-calcifications and architectural distortions. In our clinical trials, where BCS 2100 findings were confirmed by biopsy, we detected malignancy 96.4% of the time cancer was present, and we believe we can improve this overall sensitivity with additional clinical research studies and statistical software development.

Our best sensitivity is with lesions classified as masses. According to our clinical trials, where BCS results were confirmed by biopsies our BCS 2100 detected cancer in lesions described as masses 99.3% of the time when cancer was present. This means that we have a false negative rate of less than 1%. Our PMA application addresses efficacy for all breast lesions, but later amendments and the panel presentation focused on lesions described as "masses," which represent about half of all anomalies noted on mammograms referred for biopsy, and where we had the best clinical sensitivity. If utilized as a decision tool, excluding all other factors, procedures and tests, we believe our system would have resulted in the deferral or avoidance of 19.2% of biopsies in women who had masses detected on their mammograms. The efficacy data presented shows a false positive rate, that is cases where results from the BCS 2100 indicated the possible presence of cancer when none existed, approximately 80% of the time when cancer was not present. We believe that ongoing clinical research and future developments in the software algorithms (statistical models), as part of the product maturation process and under FDA approved procedures, will enable the system to safely achieve significantly lower false positive rates, thereby leading to higher biopsy avoidance rates.

We view biopsy as the direct competition for the BCS 2100. According to the American College of Radiology, the average breast biopsy costs between one thousand and three thousand dollars per patient. We believe that a breast scan on the BCS 2100 should cost a fraction of the cost of a biopsy and avoid the pain, risk of infection and other complications arising from an invasive surgical procedure.

Medical device marketing and distribution efforts rely upon building relationships with other manufacturers (strategic alliances), equipment dealers, physicians and clinical investigators. Local distributors tend to have the essential relationships with hospitals that are difficult to duplicate with a captive sales force. While we cannot guarantee whether or when the FDA will approve our product, in anticipation of possible FDA approval we have initiated relationships with distributors who have established relationships in the radiology and medical imaging communities. Because FDA rules restrict marketing of unapproved products, we attend industry trade shows and professional conferences where we can present product information in an educational format to radiologists without risk of FDA censure.

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Medical Products - Pain Management

We market two FDA-cleared pain management devices used for diagnostic imaging and therapeutic treatment. The Thermal Image Processor ( TIP ), which uses the same infrared camera as the BCS 2100, measures body heat naturally radiated by the patient as he/she stands (or sits) before the camera, and develops a physiological profile to assist in the diagnosis and treatment of a wide range of physiological and circulatory abnormalities, principally soft-tissue related injuries and pain.

A complementary infrared light therapy device ( Photonic Stimulator ) is a hand-held device that emits infrared energy which penetrates the skin to stimulate blood flow, promote circulation, reduce pain and speed healing. The Photonic Stimulator is FDA-cleared to treat general aches and pains. However, anecdotal feedback from practitioners who use the Photonic Stimulator and published research reports indicate that infrared light therapy can reduce pain, promote circulation and speed healing.

The TIP system competes indirectly with x-ray, computed tomography, ultrasound and magnetic resonance imaging (MRI). Medical practitioners typically view imaging technologies as elements of a toolkit, each uniquely suited for the diagnosis of a specific problem or problems. The TIP also competes against infrared cameras available in the aftermarket and marketed by several small direct competitors. The Photonic Stimulator, also a non-invasive and painless modality, competes with therapeutic ultrasound, electrical stimulation and newly approved laser light therapy devices.

The recent outbreak of Sudden Acute Respiratory Syndrome (SARS) has provided a new opportunity for employing our Thermal Image Processor as a health screening device at international ports of entry and other public facilities; e.g., train stations and airports. Since the identification of SARS, we have sold cameras for screening use into the People's Republic of China, we are participating in a Canadian program to evaluate the use of infrared imaging for airport passenger screening and we are exploring other, similar, projects. While these activities appear exciting, we cannot guarantee the adoption of the methods we propose or the selection of our products by customers adopting infrared passenger screening.

The current suggested retail price for the TIP is \$55,000. Our average selling price for new equipment during Fiscal 2003 was \$43,800 and during 2002 was \$41,300. Our average selling price for reconditioned TIP system is \$28,000. Although we believe our TIP system competes favorably with aftermarket and other direct offerings in terms of capability and price, we expect TIP system prices to decline over time as a result of increased competition. The current suggested retail price of our Photonic Stimulator is \$4,500. Our average selling price during 2003 was \$2,130 and \$4,366 during 2002. We expect Photonic Stimulator resale prices to remain at its current price level as we continue our efforts to expand unit volume and compete with other light therapy devices as light therapy becomes more accepted.

The principal factors in growing the pain management segment will be increased market adoption of both technologies based on customer referral and testimonials, and published third-party research to build credibility of products and earn expanded indications for use of the devices from the FDA. The adoption of new products may be adversely affected by general economic conditions, changes in insurance coverage offered by private insurers in response to the general economy and new competitive offerings. We cannot guarantee that customers will accept our products, or that we will be able to profitably manufacture and sell these products.

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Pain management product marketing has relied upon trade advertising, word-of-mouth, public relations and media outreach, trade show attendance, direct and channel sales, and educational seminars, where products are demonstrated to groups of potential customers. We hold user group meetings and work with the current customer base to place articles and provide testimonials about how our pain management devices have impacted their practices and improved the condition of challenging patients.

CTI has a direct field and a small inside sales team. To build credibility and to obtain additional market exposure, we have developed relationships with pain management dealers in California, Texas, Florida, New England and Asia who have established relationships and reputations in these markets.

Industrial - Non-Destructive Testing Products

The Turbine Blade Inspection System ( TBIS ) provides customers with an effective, cost-efficient quality assurance tool. Using techniques similar to those employed by our BCS 2100 and the infrared camera used in the BCS 2100 and TIP products, our automated infrared inspection system creates thermal stress by rapidly heating a component, collecting a series of images as the component returns to ambient temperature, and then analyzing these images to determine the presence or absence of characteristics determined to correlate with certain manufacturing and usage-induced defects. The analysis identifies defects, abnormalities and flaws in the test material. This system can identify blockages in cooling holes as small as the diameter of a human hair.

The Company performs services for customers in connection with developing additional hardware, software to expand the type and number of components a customer can test, repairing previously installed equipment, and helping customers solve quality assurance or product design problems.

TBIS base systems are sold in a range between \$350,000 and \$450,000 and compete with industrial x-ray, ultrasound and other technological approaches. This system provides a safe, effective and hygienic approach to locating product defects, and requires no disposable supplies; i.e., x-ray film. We also market smaller, less expensive systems utilizing our TIP and an alternative thermal stimulus device costing approximately \$130,000. We market these products directly to engine and power system manufacturers and other industrial type customers. These products typically have long sales cycles and demand is directly impacted by the economic conditions.

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*Patents*

As of June 30, 2003, we had the following patents or patent applications pending before the United States Patent and Trademark Office:

Patent No. 5,999,842, dated December 7, 1999, acquired by assignment from TRW on a Functional Thermal Imaging Apparatus (our BCS 2100 Patient Positioning Table).

Patent No. 6,157,854, dated December 5, 2000, covering techniques designed to reduce or eliminate pain by the application of infrared therapy while monitoring the process as it is being conducted. The techniques involve the use of our Photonic Stimulator to apply infrared energy to a patient while using the Thermal Image Processor to monitor the patient's response to the therapy.

Patent No. 6,366,802, dated April 2, 2002, covering techniques designed to reduce or eliminate pain by the application of infrared therapy while monitoring the process as it is being conducted. The techniques involve the use of our Photonic Stimulator to apply infrared energy to a patient while using the Thermal Image Processor to monitor the patient's response to the therapy.

Patent application (Serial No. 09/425,042, dated October 19, 1999) for an algorithm used to analyze imaging data collected through our BCS 2100.

Patent application (Serial No. 10/062,638, dated January 31, 2002) for a turbine component inspection system, emphasizing the system's integration and ability to deliver precise thermal stimuli independent of the overall inspection cycle.

Patent application (Serial No. 10/062,862, dated January 31, 2002) for a heat exchanger for turbine component inspection system covering an improved convective heat exchanger design for use in the turbine component inspection system.

Patent application (Serial No. 10/062,631, dated January 31, 2002) for an infrared imaging arrangement for the turbine component inspection system covering the overall fixture and infrared imager arrangement.

Patent application (Serial No. 10/006,441, dated November 21, 2001) for software providing operator assistance during the use of an automated infrared inspection system of turbine components.

Patent application (Serial No. 10/006,436, dated November 21, 2001) for software performing automated analysis of the thermal response of a turbine component to application of thermal stimuli by an infrared inspection system.

Patent application (Serial No. 60/378,764, dated May 7, 2002) for the cold stimulus turbine component inspection system.

We expect to apply for additional patents in the future to cover other technologies or components of our products. We believe these patents and patent applications are valid and enforceable and provide some competitive protection for our products by requiring our competitors to either license intellectual property from the Company, invest in developing an alternative solution that would not infringe upon our patents or contest the validity of our patent in a legal proceeding.

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***Source of Supply***

Manufacture and assembly of our pain management and thermal imaging devices require standard electronic components, formed or machined metal and plastic parts, wiring harnesses, printed circuit boards and metal cases which are available from any number of suppliers with relatively short lead times. We single-source certain proprietary optical components and cooling equipment; these typically require 12 to 16 week lead times. To date, we have experienced no supply disruptions with these vendors. While there are alternative sources for these products, the loss of one of our current suppliers would require that we invest time developing and certifying a new supplier. Until the new vendor is certified we could experience a disruption in ability to supply TIP systems, which are a component of the BCS 2100 and our industrial products.

***Business Strategy and Markets***

We believe our products and technologies provide a unique collection of new and cost-effective diagnostic, pain management and product testing solutions for medical and industrial customers. Our target customers are hospital radiology departments, cancer research facilities and imaging centers, chiropractors and physical therapists, and manufacturers of products with complex cast components or processes.

To exploit the BCS 2100 and expand the market for our pain management products, the Company is pursuing FDA approvals and clearances. Our BCS 2100 qualifies as a medical device under federal law because of its intended use in the diagnosis of disease. We are pursuing FDA approval for our BCS 2100 and we believe that this approval will enhance our ability to market our products by: 1) allowing us to reference medical efficacy claims in connection with marketing our BCS 2100; 2) improving physician acceptance of our systems; and 3) facilitating the designation of insurance payment codes. We are in the process of conducting future clinical studies to expand the approved labeling and indications for use for our pain management products. We believe that expanding indications for use will improve physician acceptance of our products and increase pain management product revenues.

Our marketing efforts rely upon building relationships with manufacturers, local medical equipment dealers, physicians and clinical investigators. We established a medical advisory board to assist us in preparing for the FDA panel meeting and to help us devise programs and projects to facilitate acceptance in the market place. We also attend trade shows and conferences and make direct sales calls on industrial customers and sponsor clinics, where we introduce and demonstrate our breast imaging, pain management and non-destructive testing products. We believe marketing our medical products directly and through a dealer channel, augmented with trade shows, conference presentations, direct mail and inside sales, provides a cost-effective approach to diagnostic imaging and pain management practitioners. As of the date of this report, the medical advisory board is dormant, we have discontinued trade show participation and limited our marketing activities to user group meetings with current and potential customers and direct selling; however, if we are successful in securing additional capital, we plan to continue investing resources in these programs.

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As with all medical devices, it is important that our BCS 2100 customers receive adequate reimbursements from third-party payers: insurance companies, Medicare and Medicaid reimbursement agencies. We applied for a reimbursement code from the American Medical Association during December 2001 for our BCS 2100. Our application will not be acted upon unless and until we receive FDA approval for the BCS 2100.

Our pain management products qualify for insurance reimbursement in most states at rates that vary on a state-by-state basis. Generally insurance providers offer coverage if the state's workers compensation scheme recommends coverage. Currently only New York, Montana and Minnesota do not recommend coverage for treatments that include infrared imaging or infrared therapy. Average reimbursement for an infrared imaging procedure with our TIP camera, in states offering reimbursement, is \$198, with a high of \$375 and a low of \$96. Average reimbursement for an infrared treatment with the Photonic Stimulator is \$12, with a high of \$38 and a low of \$4 per treatment.

We plan to continue conducting clinical studies utilizing the BCS 2100 with institutions and practitioners to obtain user feedback, test product enhancements, secure technical papers, and for training and educational marketing purposes. Clinical studies are not the same as clinical trials, which we conducted for FDA PMA approval purposes, in that in clinical studies we are able to view the study results during the study and, therefore, cannot use study results as direct evidence in support of our PMA application. During 2002, we entered into a research relationship with McKay-Dee Hospital for a study of up to 70 patients referred for biopsy of a single mass after undergoing conventional diagnostic procedures. We conducted this study to acquire information about the effectiveness of the BCS 2100 for women age 60 and over presenting with a lesion described as a mass. We ended this study during the third quarter of fiscal 2003, without conclusion when it became apparent that the institution did not treat sufficient patients to complete the study in a timely fashion. A separate study at McKay-Dee Hospital involved 125 women to obtain baseline information regarding the characteristic thermal profile associated with normal breast tissue in women 21 and older. We concluded this study during March 2002 and are holding the data for further analysis if we receive FDA approval. We also initiated a study at Massachusetts General Hospital, Harvard Medical School's largest teaching hospital, for a clinical study involving up to 250 patients referred for biopsy of a single mass after undergoing conventional diagnostic procedures. This study is intended to acquire information to study the effectiveness of the BCS 2100 in women age 60 and under who present with a lesion described as a mass. This study is ongoing. In addition, these studies provide us with an opportunity to evaluate the form and function of the BCS 2100 and develop product enhancements for next generation products. We are currently conducting a study with the Photonic Stimulator, evaluating its effect on neck and shoulder pain. This study is not yet complete. We are not currently conducting clinical studies or trials for our Thermal Image Processor.

The legacy Bales Scientific subsidiary provided industrial test services and has designed and sold industrial test systems to customers who desire to perform their own testing for many years. Our industrial non-destructive testing product focus has been the analysis of turbine blade defects. Turbine blades are very complex cast parts used in aircraft, power generation, pumps and compressors. The TBIS analyzes turbine blades under conditions that mimic the extreme operating environment of a turbine by applying heat and measuring temperature changes as the part cools. We believe that this technology is uniquely capable of testing blades automatically, quickly, inexpensively and without destroying or compromising the blade part. During the third quarter of fiscal 2003, to reduce cash outlays, we relocated this activity to our Ogden, Utah facility and closed the Walnut Creek, California operation.

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The turbine blades tested using CTI's TBIS include aircraft turbines employed in military aircraft, and electrical power turbines. TBIS sales have long lead times and require significant integration into the customer's production systems. We address this market with a direct sales person, by attending trade shows and advertising in channel appropriate publications. TBIS sales have been infrequent, are dependent upon the health of the aerospace industry and general economic conditions and there may be relatively few customers for this device.

Although we have scaled back operations and staffing levels to conserve cash as we seek FDA approval, we continue to expend financial and technical resources improving and developing new applications for our medical products. We are continuing to develop enhancements for our existing products to improve their form, function and effectiveness. We are developing improvements for our BCS 2100 to reduce its size and weight and improve operator efficiency and clinical effectiveness. We developed an improved non-destructive TBIS for Pratt and Whitney, but have suspended additional industrial research until we secure additional funding. We have also delayed various small enhancements to our pain management products until future funding is obtained. While we cannot assure the success of any new product or regulatory approval of any proposed indication for use, we believe that improving product features and functions will expand the market for our products and increase revenues.

***Segment Sales***

We have two business segments medical and industrial. Medical products include the BCS 2100 and our pain management products, the TIP and Photonic Stimulator. Medical products share common infrastructure, sales and regulatory functions. Industrial Products includes our non-destructive testing products and services. The sales for our business units during the last three fiscal years ending June 30 were:

<u>Fiscal Year</u>	Percentage		Dollars		
	<u>Medical</u>	<u>Industrial</u>	<u>Medical</u>	<u>Industrial</u>	<u>Total</u>
2003	65%	35%	\$ 1,000,000	\$ 539,000	\$ 1,539,000
2002	85%	15%	750,000	128,000	878,000
2001	84%	16%	566,000	108,000	674,000

In 2003, NanDa Thermal Medical Technology, Inc. ( Nanda ) was our largest medical customer and represents 33% of total sales and 50% of medical sales for the year. Prior to 2003, medical sales were made to numerous customers, none of which was more than 10% of the business unit's sales. We fulfill our pain management sales as we receive orders and have no backlog.

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Medical sales by geographical location for the last three years ending June 30 were:

<u>Fiscal Year</u>	<u>Percentage</u>			<u>Dollars</u>			<u>Total</u>
	<u>USA</u>	<u>Canada</u>	<u>China</u>	<u>USA</u>	<u>Canada</u>	<u>China</u>	
2003	44%	1%	55%	\$ 441,000	\$ 8,000	\$ 551,000	\$ 1,000,000
2002	92%	8%	0%	692,000	58,000	--	750,000
2001	90%	10%	0%	507,000	59,000	--	566,000

Alstom Power UK, Ltd ( Alstom ) was our largest and primary industrial customer during fiscal 2001, 2002 and 2003, and provided 94%, 74% and 69% of all industrial sales respectively. During 2003, we recognized revenue of approximately \$318,000 from a TBIS we shipped and installed at Alstom's plant in the United Kingdom during 2002, which we deferred because of customer acceptance test requirements (which we have successfully completed) and multiple elements included in the sale including software and a warranty provision, which requires us to repair and correct all defects in material and workmanship started after the customer acceptance provisions. During fiscal 2003, we shipped a TBIS system to Pratt and Whitney and are in the process of obtaining final customer acceptance. We will recognize this sale as gain on the sale of fixed assets once the customer acceptance provisions have been completed. We also shipped a non-destructive test system to Dresser-Rand Company during the second quarter of fiscal 2003.

Industrial sales for the last three years ending June 30 were:

<u>Fiscal Year</u>	<u>Percentage</u>			<u>Dollars</u>			<u>Total</u>
	<u>Other</u>	<u>Dresser Rand</u>	<u>Alstom</u>	<u>Other</u>	<u>Dresser Rand</u>	<u>Alstom</u>	
2003	6%	25%	69%	\$ 30,000	\$ 135,000	\$ 374,000	\$ 539,000
2002	26%	0%	74%	33,000	--	95,000	128,000
2001	6%	0%	94%	6,000	--	102,000	108,000

Industrial sales by geographical location for the last three years ending June 30 were:

<u>Fiscal Year</u>	<u>Percentage</u>			<u>Dollars</u>			<u>Total</u>
	<u>USA</u>	<u>UK</u>	<u>Germany</u>	<u>USA</u>	<u>UK</u>	<u>Germany</u>	
2003	31%	69%	0%	\$ 165,000	\$ 374,000	\$ --	\$ 539,000
2002	16%	74%	10%	20,000	95,000	13,000	128,000
2001	0%	94%	6%	--	102,000	6,000	108,000

We fulfill industrial sales by building equipment to a customer's order and providing industrial thermal inspection services. We tailor our systems to meet our customers' needs and requirements because each customer has its own requirements for production equipment and their products are unique.

TBIS sales have a long sales cycle and are dependant upon, among other things, general economic conditions, and specifically the economic condition of the aerospace industry and demand for new or replacement power stations. We cannot guarantee that demand will be sufficient to ensure profitable operation of this business segment.



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***Backlog***

Unfulfilled orders as of June 30, 2003, 2002 and 2001 are \$0, \$425,000 and \$600,000 respectively. As of June 30, 2003, although we have not recognized the sale of the Pratt and Whitney TBIS, we are not including it in backlog. This order was shipped during Fiscal 2003 and will be recognized as a gain on sale of fixed assets when all of our sales commitments and obligations have been fulfilled. The 2002 backlog represents the Pratt and Whitney TBIS. The June 2001 backlog represents two TBIS ordered by Alstom. We shipped one system during the second quarter of Fiscal 2002, but have not recognized any revenue from that shipment because the terms of the sale did not meet our revenue recognition policy. Rather than purchase a second system, Alstom purchased fixtures and programming services to expand the application of the unit we delivered and cancelled its order for the second system, resulting in a net reduction in backlog of \$153,000.

We conduct research and development on medical and industrial products in our own facilities, conduct clinical studies and clinical trials at hospitals; however, we have no company sponsored or customer sponsored third-party or purchased research and development activities.

***Our Competition***

***Medical Imaging.*** The principal methods used to visualize internal human anatomy are x-ray, computed tomography, ultrasound and magnetic resonance imaging. Physicians view these technologies as elements of a toolkit, each uniquely suited to the diagnosis of a specific problem or problems.

Our BCS 2100 provides physiological information that supplements the anatomical information obtained from mammography and does not compete directly with x-ray, computed tomography, ultrasound or magnetic resonance imaging. Our system is painless, requires no radioactive materials and involves no invasive technology.

Our pain management products compete with ultra-sound, electrical stimulation, newly approved laser light therapy devices and infrared cameras purchased from competitors or in the aftermarket for infrared cameras.

Our industrial applications compete with industrial x-ray, and high pressure water and air techniques; which require skilled labor, are time consuming and may utilize dangerous radiation that requires special facilities. Our system provides additional defect analysis more quickly by using less skilled labor and no special environment; and may replace high pressure water and air or x-ray for certain applications.

The companies that supply diagnostic and industrial imaging equipment range from large manufacturers to smaller specialized companies. Large diversified manufacturers, for which imaging systems define only a portion of their total business, include General Electric, Siemens, Toshiba, Hitachi and Philips.

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**New Technologies.** Digital x-ray captures images electronically and may provide several important benefits relative to existing technologies: 1) reduced radiation dosage; 2) faster access to images, which is critical for emergency room use; 3) digital technology, which can be distributed and accessed through a computer, enables remote consultation; and 4) reductions in labor and radiographic film costs. Our BCS 2100 does not compete with digital x-ray equipment. In fact, as mammography technology improves more women are referred for biopsies. We believe this will create a greater demand for technologies, like our BCS 2100 that may be able to determine whether a patient's mass is benign without the use of an invasive surgical procedure.

Positron Emission Tomography ( PET ), an invasive, nuclear medicine-based diagnostic imaging technique for measuring the metabolic activity of human cells, may benefit patients suffering from certain types of cancer or certain conditions affecting the brain and heart. Many insurance carriers approve PET, but the technology is expensive and difficult to administer.

Optical imaging of the breast is based on laser transillumination. This technology is under investigation as a possible approach for medical imaging and at least one potential competitor is attempting to secure FDA approval for their version of this technology. Laser transillumination has been investigated for over 20 years and recent implementations of this technology use computed tomography to improve the results. We believe our BCS 2100 competes favorably with this technology.

**Procedures.** We view biopsies, either needle aspiration or open surgery, as direct competition for the BCS 2100. We believe that the BCS 2100, if approved by the FDA with the indications for use ( Labeling ) we have requested, will be adjunctive to mammography, and that every patient with an abnormal mammogram indicating a mass, who might be referred to biopsy under current protocols, will be a potential candidate for a BCS 2100 procedure. We believe that, through the product maturation process involving additional product development, we will be able to obtain expanded Labeling and effectively screen all patients referred for biopsy. To successfully market our product, which can occur only if we receive FDA approval, we will have to educate physicians about the BCS 2100 so that they will be able to recommend a BCS 2100 procedure to their patients, persuade hospitals and imaging centers to purchase the equipment and convince insurance carriers to provide reimbursement for the BCS 2100 procedure.

***Our Sales and Marketing Strategy***

**Overview.** We plan to market our products with a multi-channel strategy incorporating independent distributors, direct marketing, telemarketing, the internet and corporate marketing. We plan to address the industrial market with a direct sales force augmented by distributors and dealer representatives as appropriate.

**Distributors.** The Company has retained and will continue to seek the services of distributors. Our distributors usually focus their efforts on a specific channel in a specific region; e.g. chiropractors and physical therapists in Northern California. We believe that distributors provide intimate local market knowledge and contacts critical to accessing hospital imaging facilities, radiologists, chiropractors and physical therapists, and local service capability. Our agreements with these distributors allow the distributor to purchase products at a discount from list price, usually 30%, and provide extended terms for an initial order of demonstration equipment, which we do not recognize as a gain on sale of fixed assets until the distributor actually pays for the equipment. We retain the right to develop and service national accounts in the distributor's territory, but provide a period of limited exclusivity with regard to the distributor's own customers, which can be extended only if the distributor meets certain sales goals. To date, no distributor has met these goals. We also require the distributor to participate with us in certain marketing programs; e.g., user group meetings.

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**Telemarketing / Telesales.** We believe telemarketing/telesales provides important direct marketing, lead follow-up and customer service capability, particularly in the pain management segment. Telemarketing creates revenue through direct sales and generates leads for distributors.

**Internet.** We use the internet to provide information to current and potential customers.

**User Groups and Seminars.** We believe meeting with our customers and potential customers at informal user conferences and training sessions provides valuable market intelligence, product use information, and assists us in selling our products. We conduct user group meetings at various sites across the United States and by conference call.

**Trade Shows and Associations.** We attend medical and industrial trade shows and present papers at professional conferences. We believe attendance at trade shows and conferences allows us to build product awareness, demonstrate our products, educate customers and generate leads for future sales.

**Corporate Marketing.** We intend to develop product and company collateral materials, advertise in select trade journals, demonstrate our products and present papers, and research results at conferences and trade shows. We believe that these activities will build corporate and product awareness and support our sales efforts in selected vertical markets.

**Industrial Products.** The Company has a small internal team pursuing industrial opportunities. This team manages relationships with existing and potential customers in the turbine power market and is exploring potential relationships with industrial customers requiring non-destructive testing capabilities.

**Service Providers and Contractor Relationships**

**Overview.** As a development company, our business model relies upon contractors and suppliers to reduce our development risk and to provide necessary clinical resources. We continue to utilize some of these contractors to support our PMA application and clinical studies.

**Battelle Memorial Institute** assists us in the preparation of regulatory submissions and provides technical consulting services, on a time and materials basis, in connection with algorithm development and statistical consultation for interaction with the FDA.

**Quintiles, Inc.** is an independent consulting firm, authorized by the FDA to verify clinical examination results, provide clinical trial monitoring and FDA preparation support. Quintiles provides the Company services on a time and materials basis and continues to provide consulting support in connection with securing FDA approval.

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**Clinical Trials.** We contracted with six hospitals to conduct the clinical trials necessary for FDA approval of the BCS 2100. The Company continues to maintain relationships with these institutions in connection with completion of the PMA:

USC/Norris Comprehensive Cancer Center, Los Angeles;  
Los Angeles County Hospital, Los Angeles;  
Mt. Sinai Hospital, Miami;  
St. Agnes Hospital, Baltimore;  
Lahey Clinic, Boston; and  
Providence Hospital, Washington, D.C.

**Clinical Studies.** Clinical studies are clinical research conducted for purposes of developing expanded indications for use, testing product enhancements, identifying potential product issues and obtaining product trial by practitioners and patients. Clinical trials are experiments where patient results are withheld from the Company pursuant to experimental controls designed to ensure scientific accuracy and are conducted in connection with obtaining FDA PMA approval. We have relationships and agreements with two hospitals and plan to secure relationships with additional hospitals, clinics and practitioners, perhaps including the six hospitals previously mentioned in connection with our prior clinical trials, to conduct clinical studies on our BCS 2100 and other products. Clinical study agreements specify the number of patients studied, cost reimbursement, the study investigator, protocol, objectives and estimated time to complete the study. They also require the hospital to maintain professional and general liability insurance and comply with the protocol and all relevant FDA regulations. In some circumstances we may provide for the purchase of the equipment upon study completion. As of June 30, 2003, we had active clinical study relationships with McKay-Dee Hospital located in Ogden, Utah, and Massachusetts General Hospital in Boston, Massachusetts, for clinical studies with our BCS 2100. We are conducting these studies to acquire information about the effectiveness of the BCS 2100 for women presenting with a lesion described as a mass. During fiscal 2003, we terminated the McKay-Dee study because the hospital could not obtain sufficient patients to complete the study in a timely fashion. The Massachusetts General study is ongoing. In addition, we are using a third-party clinical research organization to conduct a study with our Photonic Stimulator to evaluate its effect on neck and shoulder pain after a limited course of treatment. We cannot guarantee customer acceptance, published results, expanded indications for use or the effectiveness of any product enhancement or protocol tested in connection with these efforts. However, we believe these efforts are important and plan to continue this activity. We have no clinical trials pending at this time. Depending on whether we receive FDA approval of our BCS 2100, and perhaps to obtain additional approvals for new indications for use, we may have to conduct additional clinical trials in the future.

We believe our relationships with these organizations and hospitals are good. Battelle continues to provide consultation and statistical analysis on an as needed basis. Quintiles and the hospitals that conducted our clinical trials have completed their work examining patients on the BCS 2100, but may be called upon in connection with FDA audits of clinical cases. While we believe that termination of any of these relationships, and the resultant loss of familiarity and know-how could result in delays in compiling information or preparing data in response to FDA inquiries, we believe that any such loss would not be material.

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***Government Regulation***

***Overview.*** Our BCS 2100 and pain management devices qualify as medical devices under federal law because they are intended for use in the diagnosis, cure, mitigation, treatment or prevention of disease but do not interact chemically with the body. Typically, low risk devices that are classified as Class I or Class II devices and are substantially similar to approved products already on the market obtain FDA clearance by the agency's pre-market notification known as a 510(k) filing. Our pain management products, the TIP and Photonic Stimulator, have these 510(k) clearances, have been listed with FDA and, accordingly, may be used by practitioners in accordance with the proposed indications and conditions for use without exception, monitoring, further approval, conditions or control, and without reporting obligations to any government entity. Each year more than four thousand new devices are cleared using this approach.

Sophisticated instruments that entail significant risk, or utilize unique or new technology and are classified as Class III devices, require manufacturers to submit a PMA to the FDA. More complex and time consuming to prepare than a 510(k) filing, a PMA typically contains significant clinical testing, manufacturing and other data, all of which are scrutinized by the FDA to demonstrate the product's safety, reliability and effectiveness, and that proposed indications and conditions for use are appropriate. Typically, less than 40 devices a year are granted PMA approval. Only companies that are registered with the FDA can submit a 510(k) or PMA for clearance or approval from the FDA for either a 510(k) or a PMA. As a registered company, we obtained the necessary clearance from the FDA prior to submitting the PMA.

For the past five years, we have pursued PMA approval for our BCS 2100 as an adjunct diagnostic tool to mammography in patients with suspicious breast lesions that include mass being considered for biopsy. We believe an approved PMA provides valuable benefits that enhance our ability to market the product, including: 1) an ability to reference medical efficacy claims in our marketing; 2) improved physician acceptance of our system; and 3) assistance in obtaining insurance reimbursement codes, which we believe will enhance the successful marketing of the BCS 2100. To date, as described below, we have not obtained FDA approval of our PMA application for the BCS 2100.

The FDA, in addition to clearing and approving medical devices, also regulates clinical trials and studies. Our clinical activities are subject to rules requiring that we adhere to specified clinical and investigational practices and procedures, obtain specified approvals from each study site, monitor clinical sites and data to assure adherence to protocol and report any adverse patient reactions that might occur in connection with our studies. The FDA may conduct an audit of clinical trials in connection with approving a PMA. During September 2002, the FDA conducted such an audit of our clinical trials at our Ogden, Utah, facility and concluded that our clinical trials were conducted in compliance with FDA regulations.

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The FDA also regulates products after they have received approval or clearance. Regulations require that we maintain manufacturing processes in accordance with the FDA's regulations and prescribed procedures regarding manufacturing processes, including a quality assurance system, document control, Medical Device Reporting relating to adverse events, maintenance of a corrective and preventative action program and appropriate design controls and process validation. The FDA also regulates export and import of any approved or non-approved device. In the event the Company is found out-of-compliance with any of these regulations, the FDA may require that we cease production and marketing until corrective measures have been implemented. The FDA also could require a product recall and could enforce civil and criminal penalties against the Company, its officers and others. Based on FDA actions to date, we believe we are in compliance with all applicable FDA regulations related to the design and manufacture of our products.

We submitted our PMA in five modules. Module 1 provided:

- An introduction of the use of infrared imaging, its safety and effectiveness;
- Summary of indications for use of infrared imaging as an adjunct to mammography and clinical examination in the detection of breast cancer;
- Summary of incidence, diagnosis and prognosis of breast cancer;
- Description of current modalities for detecting breast cancer;
- Description of our BCS 2100, including major components and the population for which our device has clinical utility;
- Description of our clinical trial and the population of the trial; and
- Statement of marketing of our device for its intended use.

Module 2 provided:

- A detailed description of our BCS 2100 and its component parts;
- Detailed discussion of the clinical evaluation system required to analyze and interpret the clinical data obtained through the clinical trial; and
- Documentation of all software used in our BCS 2100, including software used in the development of our system and the acquisition of data in our clinical trial.

Module 3 provided:

- Manufacturing information concerning our BCS 2100, including a detailed discussion of the facilities, personnel, equipment and controls used to manufacture our system;
- Information concerning the distribution and installation of our system; and
- A description of the procedures and record keeping associated with the manufacture, testing and installation of our device.

Module 4 reiterated certain information and provided additional information regarding:

- The safety of our system, including all non-clinical testing of the structural and functional components of our device; and
- The safety of materials used in manufacturing the device.

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Finally, Module 5 was an evaluation of our clinical trials, including the accumulation and analysis of all the clinical trials, efficacy data and an update to our indicated use as follows: The CTI BCS 2100 is a dynamic computerized infrared-based image acquisition device intended for use as an adjunct mammography in patients with suspicious breast lesions that include mass being considered for biopsy. The CTI BCS 2100 provides additional information to guide a breast biopsy recommendation .

On December 10, 2002, the FDA's Radiological Devices Panel, which is composed of independent experts, was convened by the FDA and held a public hearing to evaluate our application in order to make a recommendation to the FDA whether to approve or disapprove the BCS 2100 for its intended uses. The panel, by a vote of 4-3, recommended that the FDA not approve the BCS 2100. On January 23, 2003, the FDA concurred with that recommendation. We have contacted the FDA's ombudsman and are attempting to negotiate a reversal of the FDA's decision. We may formally appeal the FDA's non-approvable decision or avail ourselves of other remedies. As of the date of this document, we

dTYLE="BORDER-BOTTOM:1px solid #000000"> **Six Months Ended**

**November 30, (In millions) 2012 2011 2012 2011**

Net income

\$ 384 \$ 469 \$ 951 \$ 1,114

Other comprehensive income (loss), net of tax:

Foreign currency translation and other<sup>(1)</sup>

6 (146) 30 (133)

Net (loss) gain on cash flow hedges<sup>(2)</sup>

(14) 195 (49) 161

Net gain on net investment hedges<sup>(3)</sup>

- 31 - 25

Reclassification to net income of previously deferred (gains) losses related to hedge derivative instruments<sup>(4)</sup>

(47) 30 (74) 67

Release of cumulative translation loss related to Umbro<sup>(5)</sup> (Note 10)

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Total other comprehensive income (loss), net of tax

27 110 (11) 120

**TOTAL COMPREHENSIVE INCOME**

\$411 \$579 \$940 \$1,234

(1) Net of tax (expense) benefit of \$(16) million, \$68 million, \$(16) million and \$66 million, respectively.

(2) Net of tax (expense) benefit of \$(3) million, \$(14) million, \$2 million and \$(10) million, respectively.

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- (3) *Net of tax (expense) of \$0 million, \$(15) million, \$0 million and \$(12) million, respectively.*
- (4) *Net of tax (benefit) of \$(1) million, \$(5) million, \$(2) million and \$(12) million, respectively.*
- (5) *Net of tax (benefit) of \$(47) million, \$0 million, \$(47) million and \$0 million, respectively.*

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

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**Table of Contents****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

<i>(In millions)</i>	<b>Six Months Ended November 30,</b>	
	<b>2012</b>	<b>2011</b>
<b>Cash provided by operations:</b>		
Net income	\$ 951	\$ 1,114
Income charges (credits) not affecting cash:		
Depreciation	211	178
Deferred income taxes	(49)	(1)
Stock-based compensation	83	61
Amortization and other	55	20
Loss on sale of Umbro	107	-
Changes in certain working capital components and other assets and liabilities:		
Decrease (increase) in accounts receivable	22	(91)
(Increase) in inventories	(41)	(555)
(Increase) in prepaid expenses and other current assets	(33)	(55)
(Decrease) in accounts payable, accrued liabilities and income taxes payable	(61)	(74)
Cash provided by operations	1,245	597
<b>Cash provided by investing activities:</b>		
Purchases of short-term investments	(1,379)	(1,523)
Maturities of short-term investments	672	1,582
Sales of short-term investments	904	1,076
Additions to property, plant and equipment	(250)	(259)
Disposals of property, plant and equipment	-	1
Proceeds from the sale of Umbro	225	-
(Increase) in other assets, net of other liabilities	(12)	(37)
Settlement of net investment hedges	-	(8)
Cash provided by investing activities	160	832
<b>Cash used by financing activities:</b>		
Reductions in long-term debt, including current portion	(45)	(134)
(Decrease) in notes payable	(10)	(49)
Proceeds from exercise of stock options and other stock issuances	116	284
Excess tax benefits from share-based payment arrangements	14	59
Repurchase of common stock	(1,179)	(1,325)
Dividends common and preferred	(327)	(289)
Cash used by financing activities	(1,431)	(1,454)
Effect of exchange rate changes	-	(1)
Net decrease in cash and equivalents	(26)	(26)
Cash and equivalents, beginning of period	2,317	1,955
<b>CASH AND EQUIVALENTS, END OF PERIOD</b>	<b>\$ 2,291</b>	<b>\$ 1,929</b>
Supplemental disclosure of cash flow information:		
Dividends declared and not paid	\$ 188	\$ 165

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

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**Notes to Unaudited Condensed Consolidated Financial Statements**

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### **NOTE 1 Summary of Significant Accounting Policies**

#### **Basis of Presentation**

The accompanying unaudited Condensed Consolidated Financial Statements reflect all normal adjustments which are, in the opinion of management, necessary for a fair statement of the results of operations for the interim period. The year-end condensed consolidated balance sheet data as of May 31, 2012 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America ( U.S. GAAP ). The interim financial information and notes thereto should be read in conjunction with the Company's latest Annual Report on Form 10-K. The results of operations for the three and six months ended November 30, 2012 are not necessarily indicative of results to be expected for the entire year.

The Company entered into an agreement to sell Cole Haan and completed the sale of Umbro during the second quarter ended November 30, 2012. As a result, the Company reports the operating results of Cole Haan and Umbro in the net loss from discontinued operations line in the condensed consolidated statements of income for all periods presented. In addition, the assets and liabilities associated with these businesses are reported as assets of discontinued operations and liabilities of discontinued operations, as appropriate, in the condensed consolidated balance sheets (refer to Note 10 Discontinued Operations). Unless otherwise indicated, the disclosures accompanying the condensed consolidated financial statements reflect the Company's continuing operations.

On November 15, 2012 the Company announced a two-for-one split of both NIKE Class A and Class B Common shares. The stock split was a 100 percent stock dividend payable on December 24, 2012 to shareholders of record at the close of business December 10, 2012. Common stock began trading at the split-adjusted price on December 26, 2012. All share numbers and per share amounts presented reflect the stock split.

#### **Recently Adopted Accounting Standards**

In September 2011, the Financial Accounting Standards Board ( FASB ) issued updated guidance on the periodic testing of goodwill for impairment. This guidance will allow companies to assess qualitative factors to determine if it is more-likely-than-not that goodwill might be impaired and whether it is necessary to perform the two-step goodwill impairment test required under current accounting standards. This new guidance became effective for the Company beginning June 1, 2012. The adoption did not have a material effect on the Company's consolidated financial position or results of operations.

In June 2011, the FASB issued guidance on the presentation of comprehensive income. This new guidance eliminates the current option to report other comprehensive income and its components in the statement of shareholders' equity. Companies are now required to present the components of net income and other comprehensive income in either one continuous statement, referred to as the statement of comprehensive income, or in two separate, but consecutive statements. This guidance also originally required companies to present reclassification adjustments out of accumulated other comprehensive income by component in both the statement in which net income is presented and the statement in which other comprehensive income is presented. However, in December 2011, the FASB issued guidance which indefinitely defers the requirement related to the presentation of reclassification adjustments. Both issuances on the presentation of comprehensive income are effective for the Company beginning June 1, 2012. As this guidance only amends the presentation of the components of comprehensive income, the adoption did not have an impact on the Company's consolidated financial position or results of operations.

#### **Recently Issued Accounting Standards**

In July 2012, the FASB issued an accounting standard update intended to simplify how an entity tests indefinite-lived intangible assets other than goodwill for impairment by providing entities with an option to perform a qualitative assessment to determine whether further impairment testing is necessary. This accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2014, and early adoption is permitted. The Company does not anticipate the adoption will have an impact on its consolidated financial position or results of operations.

In December 2011, the FASB issued guidance enhancing disclosure requirements surrounding the nature of an entity's right to offset and related arrangements associated with its financial instruments and derivative instruments. This new guidance requires companies to disclose both gross and net information about instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to master netting arrangements. This new guidance is effective for the Company beginning June 1, 2013. As this guidance only requires expanded disclosures, the Company does not anticipate the adoption will have an impact on its consolidated financial position or results of operations.

### **NOTE 2 Inventories**

Inventory balances of \$3,318 million and \$3,222 million at November 30, 2012 and May 31, 2012, respectively, were substantially all finished goods.

**NOTE 3 Identifiable Intangible Assets and Goodwill**

The following table summarizes the Company's identifiable intangible asset balances at November 30, 2012 and May 31, 2012:

<i>(In millions)</i>	November 30, 2012			May 31, 2012		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortized intangible assets:						
Patents	\$ 107	\$ (32)	\$ 75	\$ 99	\$ (29)	\$ 70
Trademarks	42	(29)	13	40	(26)	14
Other	20	(17)	3	19	(16)	3
<b>TOTAL</b>	\$ 169	\$ (78)	\$ 91	\$ 158	\$ (71)	\$ 87
Unamortized intangible assets - Trademarks			283			283
<b>IDENTIFIABLE INTANGIBLE ASSETS, NET</b>			\$ 374			\$ 370

Amortization expense, which is included in selling and administrative expense, was \$3 million and \$4 million for each of the three month periods ended November 30, 2012 and 2011, respectively, and \$7 million for both the six month periods ended November 30, 2012 and 2011, respectively. The estimated amortization expense for intangible assets subject to amortization for the remainder of fiscal year 2013 and each of the years ending May 31, 2014 through May 31, 2017 are as follows: remainder of 2013: \$6 million; 2014: \$9 million; 2015: \$6 million; 2016: \$5 million; 2017: \$4 million.

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Goodwill was \$131 million at November 30, 2012 and May 31, 2012, respectively, and is included in the Company's Other Businesses categories for segment reporting purposes. There were no accumulated impairment balances for goodwill as of either period.

**NOTE 4 Accrued Liabilities**

Accrued liabilities included the following:

<i>(In millions)</i>	November 30, 2012	May 31, 2012
Compensation and benefits, excluding taxes	\$ 502	\$ 691
Taxes other than income taxes	238	169
Endorsement compensation	212	288
Dividends payable	188	165
Advertising and marketing	137	94
Import and logistics costs	124	133
Fair value of derivatives	83	55
Other <sup>(1)</sup>	395	346
<b>TOTAL ACCRUED LIABILITIES</b>	<b>\$ 1,879</b>	<b>\$ 1,941</b>

(1) Other consists of various accrued expenses with no individual item accounting for more than 5% of the balance at November 30, 2012 and May 31, 2012.

**NOTE 5 Fair Value Measurements**

The Company measures certain financial assets and liabilities at fair value on a recurring basis, including derivatives and available-for-sale securities. Fair value is the price the Company would receive to sell an asset or pay to transfer a liability in an orderly transaction with a market participant at the measurement date. The Company uses a three-level hierarchy established by the FASB that prioritizes fair value measurements based on the types of inputs used for the various valuation techniques (market approach, income approach, and cost approach).

The levels of hierarchy are described below:

Level 1: Observable inputs such as quoted prices in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly; these include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.

Level 3: Unobservable inputs for which there is little or no market data available, which require the reporting entity to develop its own assumptions. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability. Financial assets and liabilities are classified in their entirety based on the most conservative level of input that is significant to the fair value measurement.

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

The following table presents information about the Company's financial assets and liabilities measured at fair value on a recurring basis as of November 30, 2012 and May 31, 2012 and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value.

November 30, 2012

(In millions)	Fair Value			Assets / Liabilities at Fair Value	Balance Sheet Classification
	Level 1	Level 2	Level 3		
<b>ASSETS</b>					
Derivatives:					
Foreign exchange forwards and options	\$ -	\$ 116	\$ -	\$ 116	Other current assets and other long-term assets
Interest rate swap contracts	-	13	-	13	Other long-term assets
Total derivatives	-	129	-	129	
Available-for-sale securities:					
U.S. Treasury securities	510	-	-	510	Cash and equivalents
Commercial paper and bonds	-	212	-	212	Cash and equivalents
Money market funds	-	492	-	492	Cash and equivalents
U.S. Treasury securities	707	-	-	707	Short-term investments
U.S. Agency securities	-	223	-	223	Short-term investments
Commercial paper and bonds	-	304	-	304	Short-term investments
Non-marketable preferred stock	-	-	5	5	Other long-term assets
Total available-for-sale securities	1,217	1,231	5	2,453	
<b>TOTAL ASSETS</b>	<b>\$ 1,217</b>	<b>\$ 1,360</b>	<b>\$ 5</b>	<b>\$ 2,582</b>	
<b>LIABILITIES</b>					
Derivatives:					
Embedded derivatives	\$ -	\$ 1	\$ -	\$ 1	Accrued liabilities
Foreign exchange forwards and options	-	82	-	82	Accrued liabilities and other long-term liabilities
<b>TOTAL LIABILITIES</b>	<b>\$ -</b>	<b>\$ 83</b>	<b>\$ -</b>	<b>\$ 83</b>	

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(In millions)	Fair Value				May 31, 2012	
	Measurements Using			Assets / Liabilities at Fair Value	Balance Sheet Classification	
	Level 1	Level 2	Level 3			
<b>ASSETS</b>						
Derivatives:						
Foreign exchange forwards and options	\$ -	\$ 265	\$ -	\$ 265	Other current assets and other long-term assets	
Embedded derivatives	-	1	-	1	Other current assets	
Interest rate swap contracts	-	15	-	15	Other current assets and other long-term assets	
Total derivatives	-	281	-	281		
Available-for-sale securities:						
U.S. Treasury securities	226	-	-	226	Cash and equivalents	
U.S. Agency securities	-	254	-	254	Cash and equivalents	
Commercial paper and bonds	-	159	-	159	Cash and equivalents	
Money market funds	-	770	-	770	Cash and equivalents	
U.S. Treasury securities	927	-	-	927	Short-term investments	
U.S. Agency securities	-	230	-	230	Short-term investments	
Commercial paper and bonds	-	283	-	283	Short-term investments	
Non-marketable preferred stock	-	-	3	3	Other long-term assets	
Total available-for-sale securities	1,153	1,696	3	2,852		
<b>TOTAL ASSETS</b>	<b>\$ 1,153</b>	<b>\$ 1,977</b>	<b>\$ 3</b>	<b>\$ 3,133</b>		
<b>LIABILITIES</b>						
Derivatives:						
Foreign exchange forwards and options	\$ -	\$ 55	\$ -	\$ 55	Accrued liabilities and other long-term liabilities	
<b>TOTAL LIABILITIES</b>	<b>\$ -</b>	<b>\$ 55</b>	<b>\$ -</b>	<b>\$ 55</b>		

Derivative financial instruments include foreign exchange forwards, embedded derivatives and interest rate swap contracts. The fair value of derivative contracts is determined using observable market inputs such as the daily market foreign currency rates, forward pricing curves, currency volatilities, currency correlations and interest rates, and considers nonperformance risk of the Company and that of its counterparties. Adjustments relating to these nonperformance risks were not material at November 30, 2012 or May 31, 2012. Refer to Note 9 Risk Management and Derivatives for additional detail.

Available-for-sale securities comprise investments in U.S. Treasury and agency securities, money market funds, and corporate commercial paper and bonds. These securities are valued using market prices on both active markets (Level 1) and less active markets (Level 2).

The Company's Level 3 assets comprise investments in certain non-marketable preferred stock. These investments are valued using internally developed models with unobservable inputs. These Level 3 investments are an immaterial portion of our portfolio. Changes in Level 3 investment assets were immaterial during the six months ended November 30, 2012 and the year ended May 31, 2012.

No transfers among the levels within the fair value hierarchy occurred during the six months ended November 30, 2012 and the year ended May 31, 2012.

As of November 30, 2012 and May 31, 2012, the Company had no assets or liabilities that were required to be measured at fair value on a non-recurring basis.

**Short-Term Investments**

As of November 30, 2012 and May 31, 2012, short-term investments consisted of available-for-sale securities. As of November 30, 2012, the Company held \$937 million of available-for-sale securities with maturity dates within one year from purchase date and \$297 million with maturity dates over one year and less than five years from purchase date within short-term investments. As of May 31, 2012, the Company held \$1,129 million of available-for-sale securities with maturity dates within one year from purchase date and \$311 million with maturity dates over one year and less than five years from purchase date within short-term investments.

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

(In millions)	November 30, 2012	May 31, 2012
Available-for-sale investments:		
U.S. treasury and agencies	\$ 930	\$ 1,157
Commercial paper and bonds	304	283
<b>TOTAL AVAILABLE-FOR-SALE INVESTMENTS</b>	<b>\$ 1,234</b>	<b>\$ 1,440</b>

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Interest income related to cash and equivalents and short-term investments included within interest (income) expense, net was \$6 million and \$7 million for each of the three month periods ended November 30, 2012 and 2011, respectively, and \$14 million and \$15 million for each of the six month periods ended November 30, 2012 and 2011, respectively.

### **Fair Value of Long-Term Debt and Notes Payable**

The Company's long-term debt is recorded at adjusted cost, net of amortized premiums and discounts and interest rate swap fair value adjustments. The fair value of long-term debt is estimated based upon quoted prices for similar instruments (Level 2). The fair value of the Company's long-term debt, including the current portion, was approximately \$237 million at November 30, 2012 and \$283 million at May 31, 2012.

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

### **NOTE 6 Income Taxes**

The effective tax rate on continuing operations was 26.9% and 24.1% for the six months ended November 30, 2012 and 2011, respectively. The increase in the Company's effective tax rate was primarily driven by an increase in the effective tax rate on foreign operations and changes in uncertain tax positions.

As of November 30, 2012, total gross unrecognized tax benefits, excluding related interest and penalties, were \$374 million, \$191 million of which would affect the Company's effective tax rate if recognized in future periods. As of May 31, 2012, total gross unrecognized tax benefits, excluding interest and penalties, were \$285 million, \$150 million of which would affect the Company's effective tax rate if recognized in future periods. The gross liability for payment of interest and penalties increased \$26 million during the six months ended November 30, 2012. As of November 30, 2012, accrued interest and penalties related to uncertain tax positions was \$134 million (excluding federal benefit).

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The Company is subject to taxation primarily in the United States, China, the Netherlands and Brazil as well as various other state and foreign jurisdictions. The Company has concluded substantially all U.S. federal income tax matters through fiscal year 2010, and is currently under examination by the Internal Revenue Service ( IRS ) for the fiscal 2011 and 2012 tax years. The Company's major foreign jurisdictions, China, the Netherlands, and Brazil have concluded substantially all income tax matters through calendar 2001, fiscal 2006, and calendar 2005, respectively. The Company estimates that it is reasonably possible that the total gross unrecognized tax benefits could decrease by up to \$78 million within the next 12 months as a result of resolutions of global tax examinations and the expiration of applicable statutes of limitations.

**NOTE 7 Stock-Based Compensation**

In 1990, the Board of Directors adopted, and the shareholders approved, the NIKE, Inc. 1990 Stock Incentive Plan (the 1990 Plan ). The 1990 Plan provides for the issuance of up to 326 million previously unissued shares of Class B Common Stock in connection with stock options and other awards granted under the plan. The 1990 Plan authorizes the grant of non-statutory stock options, incentive stock options, stock appreciation rights, restricted stock, restricted stock units, and performance-based awards. The exercise price for stock options and stock appreciation rights may not be less than the fair market value of the underlying shares on the date of grant. A committee of the Board of Directors administers the 1990 Plan. The committee has the authority to determine the employees to whom awards will be made, the amount of the awards, and the other terms and conditions of the awards. Substantially all stock option grants outstanding under the 1990 Plan were granted in the first quarter of each fiscal year, vest ratably over four years, and expire 10 years from the date of grant.

In addition to the 1990 Plan, the Company gives employees the right to purchase shares at a discount to the market price under employee stock purchase plans ( ESPPs ). Employees are eligible to participate through payroll deductions of up to 10% of their compensation. At the end of each six-month offering period, shares are purchased by the participants at 85% of the lower of the fair market value at the beginning or the end of the offering period.

The Company accounts for stock-based compensation by estimating the fair value of options granted under the 1990 Plan and employees' purchase rights under the ESPPs using the Black-Scholes option pricing model. The Company recognizes this fair value as operating overhead expense over the vesting period using the straight-line method.

The following table summarizes the Company's total stock-based compensation expense recognized in selling and administrative expense:

<i>(In millions)</i>	Three Months Ended November 30,		Six Months Ended November 30,	
	2012	2011	2012	2011
Stock options <sup>(1)</sup>	\$ 32	\$ 26	\$ 58	\$ 44
ESPPs	6	5	10	8
Restricted stock	8	5	15	9
<b>TOTAL STOCK-BASED COMPENSATION EXPENSE</b>	<b>\$ 46</b>	<b>\$ 36</b>	<b>\$ 83</b>	<b>\$ 61</b>

(1) Expense for stock options includes the expense associated with stock appreciation rights. Accelerated stock option expense is recorded for employees eligible for accelerated stock option vesting upon retirement. Accelerated stock option expense was \$6 million and \$4 million for the three month periods ended November 30, 2012 and 2011, respectively, and \$10 million and \$8 million for the six month periods ended November 30, 2012 and 2011, respectively.

As of November 30, 2012, the Company had \$264 million of unrecognized compensation costs from stock options, net of estimated forfeitures, to be recognized as selling and administrative expense over a weighted average period of 2.8 years.

The weighted average fair value per share of the options granted during the six months ended November 30, 2012 and 2011, as computed using the Black-Scholes pricing model, was \$12.71, and \$11.06, respectively. The weighted average assumptions used to estimate these fair values are as follows:

	Six Months Ended November 30,	
	2012	2011
Dividend yield	1.5%	1.4%
Expected volatility	35.0%	29.5%
Weighted average expected life (in years)	5.3	5.0
Risk-free interest rate	0.6%	1.5%

The Company estimates the expected volatility based on the implied volatility in market traded options on the Company's common stock with a term greater than one year, along with other factors. The weighted average expected life of options is based on an analysis of historical and expected future exercise patterns. The interest rate is based on the U.S. Treasury (constant maturity) risk-free rate in effect at the date of grant for periods corresponding with the expected term of the options.

## **NOTE 8 Earnings Per Share**

The following is a reconciliation from basic earnings per share to diluted earnings per share. Options to purchase an additional 27.4 million and 13.6 million shares of common stock were outstanding for the three month periods ended November 30, 2012 and 2011, respectively, and 27.4 million and 13.7 million shares of common stock were outstanding for the six month periods ended November 30, 2012 and 2011, respectively, but were not included in the computation of diluted earnings per share because the options were anti-dilutive.

On November 15, 2012 the Company announced a two-for-one stock split of both NIKE Class A and Class B Common shares. Common stock began trading at the split-adjusted price on December 26, 2012. All share numbers and per share amounts presented reflect the stock split.

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	Three Months Ended November 30,		Six Months Ended November 30,	
	2012	2011	2012	2011
<i>(In millions, except per share data)</i>				
Determination of shares:				
Weighted average common shares outstanding	897.0	918.5	901.4	924.2
Assumed conversion of dilutive stock options and awards	16.1	18.4	16.9	18.7
<b>DILUTED WEIGHTED AVERAGE COMMON SHARES OUTSTANDING</b>	<b>913.1</b>	<b>936.9</b>	<b>918.3</b>	<b>942.9</b>
Earnings per share from continuing operations:				
Basic earnings per common share	\$ 0.58	\$ 0.52	\$ 1.23	\$ 1.23
Diluted earnings per common share	\$ 0.57	\$ 0.51	\$ 1.20	\$ 1.21
Earnings per share from discontinued operations:				
Basic earnings per common share	\$ (0.15)	\$ (0.01)	\$ (0.18)	\$ (0.02)
Diluted earnings per common share	\$ (0.15)	\$ (0.01)	\$ (0.16)	\$ (0.03)
Basic earnings per common share for NIKE, Inc.	\$ 0.43	\$ 0.51	\$ 1.05	\$ 1.21
Diluted earnings per common share for NIKE, Inc.	\$ 0.42	\$ 0.50	\$ 1.04	\$ 1.18

**NOTE 9 Risk Management and Derivatives**

The Company is exposed to global market risks, including the effect of changes in foreign currency exchange rates and interest rates, and uses derivatives to manage financial exposures that occur in the normal course of business. The Company does not hold or issue derivatives for trading purposes.

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

The majority of derivatives outstanding as of November 30, 2012 are designated as cash flow or fair value hedges. All derivatives are recognized on the balance sheet at fair value and classified based on the instrument's maturity date. The total notional amount of outstanding derivatives as of November 30, 2012 was approximately \$8 billion, which is primarily comprised of cash flow hedges for Euro/U.S. Dollar, British Pound/Euro, and Japanese Yen/U.S. Dollar currency pairs.

The following table presents the fair values of derivative instruments included within the consolidated balance sheets as of November 30, 2012 and May 31, 2012:

	Balance Sheet Location	Asset Derivatives		Liability Derivatives	
		November 30, 2012	May 31, 2012	November 30, 2012	May 31, 2012
<i>(In millions)</i>					
Derivatives formally designated as hedging instruments:					
Foreign exchange forwards and options	Prepaid expenses and other current assets	\$ 69	\$ 203	Accrued liabilities	\$ 51
Foreign exchange forwards and options	Deferred income taxes and other long-term assets	21	7	Deferred income taxes and other long-term liabilities	-
Interest rate swap contracts	Deferred income taxes and other long-term assets	13	15	Deferred income taxes and other long-term liabilities	-
Total derivatives formally designated as hedging instruments		103	225		51
Derivatives not designated as hedging instruments:					
Foreign exchange forwards and options	Prepaid expenses and other current assets	26	55	Accrued liabilities	31
Embedded derivatives	Prepaid expenses and other current assets	-	1	Accrued liabilities	1
Total derivatives not designated as hedging instruments		26	56		32
<b>TOTAL DERIVATIVES</b>		<b>\$ 129</b>	<b>\$ 281</b>		<b>\$ 83</b>

The following tables present the amounts affecting the consolidated statements of income for the three and six months ended November 30, 2012 and 2011:

	Amount of Gain (Loss) Recognized in Other Comprehensive Income on Derivatives <sup>(1)</sup>		Amount of Gain (Loss) Reclassified From Accumulated Other Comprehensive Income into Income <sup>(1)</sup>		
	Three Months Ended November 30,	Six Months Ended November 30,	Location of Gain (Loss) Reclassified From Accumulated Other Comprehensive Income Into Income	Three Months Ended November 30,	Six Months Ended November 30,
	2012	2012		2012	2012
	(In millions)				
Derivatives designated as cash flow hedges:					
Foreign exchange forwards and options	\$ 13	\$ 4	Revenue	\$ (11)	\$ (25)
Foreign exchange forwards and options	(19)	(43)	Cost of sales	51	83
Foreign exchange forwards and options	(3)	(2)	Selling and administrative expense	1	1
Foreign exchange forwards and options	(2)	(10)	Other (income) expense, net	5	13
Total designated cash flow hedges	\$ (11)	\$ (51)		\$ 46	\$ 72
Derivatives designated as net investment hedges:					
Foreign exchange forwards and options	\$ -	\$ -	Other (income) expense, net	\$ -	\$ -

(1) For the three and six months ended November 30, 2012, the amounts recorded in other (income) expense, net as a result of hedge ineffectiveness and the discontinuance of cash flow hedges because the forecasted transactions were no longer probable of occurring were immaterial.

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	Amount of Gain (Loss) Recognized in Other Comprehensive Income on Derivatives <sup>(1)</sup>		Amount of Gain (Loss) Reclassified From Accumulated Other Comprehensive Income into Income <sup>(1)</sup>	
	Three Months		Location of Gain (Loss) Reclassified From Accumulated Other Comprehensive Income Into Income	Six Months Ended
	Ended November 30, 2011	Six Months Ended November 30, 2011		
<i>(In millions)</i>				
Derivatives designated as cash flow hedges:				
Foreign exchange forwards and options	\$ (4)	\$ 17	Revenue	\$ 7
Foreign exchange forwards and options	186	143	Cost of sales	(34)
Foreign exchange forwards and options	2	-	Selling and administrative expense	(1)
Foreign exchange forwards and options	25	11	Other (income) expense, net	(7)
Total designated cash flow hedges	\$ 209	\$ 171		\$ (35)
Derivatives designated as net investment hedges:				
Foreign exchange forwards and options	\$ 46	\$ 37	Other (income) expense, net	\$ -

(1) For the three and six months ended November 30, 2012 and 2011, the amounts recorded in other (income) expense, net as a result of hedge ineffectiveness and the discontinuance of cash flow hedges because the forecasted transactions were no longer probable of occurring were immaterial.

	Amount of Gain (Loss) Recognized in				Location of Gain (Loss) Recognized in Income on Derivatives
	Income on Derivatives				
	Three Months Ended November 30,		Six Months Ended November 30,		
<i>(In millions)</i>	2012	2011	2012	2011	
Derivatives designated as fair value hedges:					
Interest rate swaps <sup>(1)</sup>	\$ 1	\$ 2	\$ 3	\$ 4	Interest (income) expense, net
Derivatives not designated as hedging instruments:					
Foreign exchange forwards and options	\$ (22)	\$ 26	\$ (51)	\$ 3	Other (income) expense, net
Embedded derivatives	\$ (3)	\$ -	\$ (3)	\$ -	Other (income) expense, net

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

Refer to Note 4 Accrued Liabilities for derivative instruments recorded in accrued liabilities, and Note 5 Fair Value Measurements for a description of how the above financial instruments are valued.

**Cash Flow Hedges**

The purpose of the Company's foreign currency hedging activities is to protect the Company from the risk that the eventual cash flows resulting from transactions in foreign currencies will be adversely affected by changes in exchange rates. Foreign currency exposures that the Company may elect to hedge in this manner include product cost exposures, non-functional currency denominated external and intercompany revenues, selling and administrative expenses, investments in U.S. Dollar-denominated available-for-sale debt securities and certain other intercompany transactions.

Product cost exposures are primarily generated through non-functional currency denominated product purchases and the foreign currency adjustment program described below. NIKE entities primarily purchase products in two ways: 1) Certain NIKE entities purchase product from the NIKE Trading Company (NTC), a wholly-owned centralized sourcing hub that buys NIKE branded products from external factories, predominantly in U.S. Dollars. The NTC, whose functional

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currency is the U.S. Dollar, then sells the products to NIKE entities in their respective functional currencies. When the NTC sells to a NIKE entity with a different functional currency, the result is a foreign currency exposure for the NTC; and 2) Other NIKE entities purchase product directly from external factories in U.S. Dollars. These purchases generate a foreign currency exposure for those NIKE entities with a functional currency other than the U.S. Dollar.

In January 2012, the Company implemented a foreign currency adjustment program with certain factories. The program is designed to more effectively manage foreign currency risk by assuming certain of the factories' foreign currency exposures, some of which are natural offsets to our existing foreign currency exposures. Under this program, the Company's payments to these factories are adjusted for rate fluctuations in the basket of currencies ( factory currency exposure index ) in which the labor, materials and overhead costs incurred by the factories in the production of NIKE branded products ( factory input costs ) are denominated. For the portion of the indices denominated in the local or functional currency of the factory, the Company may elect to place formally designated cash flow hedges. For all currencies within the indices, excluding the U.S. Dollar and the local or functional currency of the factory, an embedded derivative is created upon the factory's acceptance of NIKE's purchase order. Embedded derivatives are separated from the related purchase order and their accounting treatment is described further below.

The Company's policy permits the utilization of derivatives to reduce its foreign currency exposures where internal netting or other strategies cannot be effectively employed. Hedged transactions are denominated primarily in Euros, British Pounds and Japanese Yen. The Company may enter into hedge contracts typically starting 12 to 18 months in advance of the forecasted transaction and may place incremental hedges for up to 100% of the exposure by the time the forecasted transaction occurs.

All changes in fair value of derivatives designated as cash flow hedges, excluding any ineffective portion, are recorded in other comprehensive income until net income is affected by the variability of cash flows of the hedged transaction. In most cases, amounts recorded in other comprehensive income will be released to net income some time after the maturity of the related derivative. Effective hedge results are classified within the consolidated statements of income in the same manner as the underlying exposure, with the results of hedges of non-functional currency denominated revenues and product cost exposures, excluding embedded derivatives as described below, recorded in revenues or cost of sales, when the underlying hedged transaction affects consolidated net income. Results of hedges of selling and administrative expense are recorded together with those costs when the related expense is recorded. Results of hedges of anticipated purchases and sales of U.S. Dollar-denominated available-for-sale securities are recorded in other (income) expense, net when the securities are sold. Results of hedges of certain anticipated intercompany transactions are recorded in other (income) expense, net when the transaction occurs. The Company classifies the cash flows at settlement from these designated cash flow hedge derivatives in the same category as the cash flows from the related hedged items, generally within the cash provided by operations component of the cash flow statement.

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Premiums paid on options are initially recorded as deferred charges. The Company assesses the effectiveness of options based on the total cash flows method and records total changes in the options' fair value to other comprehensive income to the degree they are effective.

The Company formally assesses, both at a hedge's inception and on an ongoing basis, whether the derivatives that are used in the hedging transaction have been highly effective in offsetting changes in the cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. Effectiveness for cash flow hedges is assessed based on forward rates. Ineffectiveness was not material for the three and six month periods ended November 30, 2012 and 2011.

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

When the Company discontinues hedge accounting because it is no longer probable that the forecasted transaction will occur in the originally expected period, but is expected to occur within an additional two-month period of time thereafter, the gain or loss on the derivative remains in accumulated other comprehensive income and is reclassified to net income when the forecasted transaction affects consolidated net income. However, if it is probable that a forecasted transaction will not occur by the end of the originally specified time period or within an additional two-month period of time thereafter, the gains and losses that were accumulated in other comprehensive income will be recognized immediately in other (income) expense, net. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, the Company will carry the derivative at its fair value on the balance sheet, recognizing future changes in the fair value in other (income) expense, net. For the three and six month periods ended November 30, 2012 and 2011, the amounts recorded in other (income) expense, net as a result of the discontinuance of cash flow hedging because the forecasted transaction was no longer probable of occurring were immaterial.

As of November 30, 2012, \$36 million of deferred net gains (net of tax) on both outstanding and matured derivatives accumulated in other comprehensive income are expected to be reclassified to net income during the next 12 months concurrent with the underlying hedged transactions also being recorded in net income. Actual amounts ultimately reclassified to net income are dependent on the exchange rates in effect when derivative contracts that are currently outstanding mature. As of November 30, 2012, the maximum term over which the Company is hedging exposures to the variability of cash flows for its forecasted transactions is 30 months.

### **Fair Value Hedges**

The Company is also exposed to the risk of changes in the fair value of certain fixed-rate debt attributable to changes in interest rates. Derivatives currently used by the Company to hedge this risk are receive-fixed, pay-variable interest rate swaps. As of November 30, 2012, all interest rate swap agreements are designated as fair value hedges of the related long-term debt and meet the shortcut method requirements under the accounting standards for derivatives and hedging. Accordingly, changes in the fair values of the interest rate swap agreements are considered to exactly offset changes in the fair value of the underlying long-term debt. The cash flows associated with the Company's fair value hedges are periodic interest payments while the swaps are outstanding, which are reflected within the cash provided by operations component of the cash flow statement. The Company recorded no ineffectiveness from its interest rate swaps designated as fair value hedges for the three and six month period ended November 30, 2012 or 2011.

### **Net Investment Hedges**

The Company has hedged and may, in the future, hedge the risk of variability in foreign-currency-denominated net investments in wholly-owned international operations. All changes in fair value of the derivatives designated as net investment hedges, except ineffective portions, are reported in the cumulative translation adjustment component of other comprehensive income along with the foreign currency translation adjustments on those investments. The Company classifies the cash flows at settlement of its net investment hedges within the cash provided or used by investing component of the cash flow statement. The Company assesses hedge effectiveness based on changes in forward rates. The Company recorded no ineffectiveness from its net investment hedges for the three and six months ended November 30, 2012 or 2011.

### **Embedded Derivatives**

As described above, for currencies within the factory currency exposure indices that are neither the U.S. Dollar nor the local or functional currency of the factory, an embedded derivative is created upon the factory's acceptance of NIKE's purchase order. Embedded derivatives are treated as foreign currency forward contracts that are bifurcated from the related purchase order and recorded at fair value as a derivative asset or liability on the balance sheet with their corresponding change in fair value recognized in other (income) expense, net from the date a purchase order is accepted by a factory through the date the purchase price is no longer subject to foreign currency fluctuations. At November 30, 2012, the notional amount of embedded derivatives was approximately \$129 million.

### **Undesignated Derivative Instruments**

The Company may elect to enter into foreign exchange forwards to mitigate the change in fair value of specific assets and liabilities on the balance sheet and/or the embedded derivative contracts explained above. These forwards are not designated as hedging instruments under the accounting standards for derivatives and hedging. Accordingly, these undesignated instruments are recorded at fair value as a derivative asset or liability on the balance sheet with their corresponding change in fair value recognized in other (income) expense, net, together with the re-measurement gain or loss from the hedged balance sheet position or embedded

derivative contract. The Company classifies the cash flows at settlement from undesignated instruments in the same category as the cash flows from the related hedged items, generally within the cash provided by operations component of the cash flow statement.

### Credit Risk

The Company is exposed to credit-related losses in the event of non-performance by counterparties to hedging instruments. The counterparties to all derivative transactions are major financial institutions with investment grade credit ratings. However, this does not eliminate the Company's exposure to credit risk with these institutions. This credit risk is limited to the unrealized gains in such contracts should any of these counterparties fail to perform as contracted. To manage this risk, the Company has established strict counterparty credit guidelines that are continually monitored and managed according to prescribed guidelines. The Company also utilizes a portfolio of financial institutions either headquartered or operating in the same countries in which the Company conducts its business.

The Company's derivative contracts contain credit risk related contingent features designed to protect against significant deterioration in counterparties creditworthiness and their ultimate ability to settle outstanding derivative contracts in the normal course of business. The Company's bilateral credit related contingent features require the owing entity, either the Company or the derivative counterparty, to post collateral for the portion of the fair value in excess of \$50 million should the fair value of outstanding derivatives per counterparty be greater than \$50 million. Additionally, a certain level of decline in credit rating of either the Company or the counterparty could also trigger collateral requirements. As of November 30, 2012, the Company was in compliance with all credit risk related contingent features and the aggregate fair value of derivative instruments with credit risk related contingent features that were in a net liability position was \$33 million. Accordingly, the Company was not required to post any collateral as a result of these contingent features. Given the considerations described above, the Company considers the impact of the risk of counterparty default to be immaterial.

**Table of Contents****NOTE 10 Discontinued Operations**

The Company continually evaluates its existing portfolio of businesses to ensure resources are invested in those businesses that are accretive to the NIKE Brand, and represent the largest growth potential and highest returns. On May 31, 2012, the Company announced its intention to divest of Umbro and Cole Haan, which allows it to focus its resources on driving growth in the NIKE, Jordan, Converse and Hurley brands.

On November 30, 2012, the Company completed the sale of certain assets of Umbro to Iconix Brand Group (Iconix) for \$225 million. The Umbro disposal group was classified as held-for-sale as of November 30, 2012 and the results of Umbro's operations are presented in the net loss from discontinued operations line item on the condensed consolidated statements of income. The remaining assets and liabilities of Umbro are recorded in the assets of discontinued operations and liabilities of discontinued operations line items on the condensed consolidated balance sheets, respectively. Previously, these amounts were reported in the Company's segment presentation as Businesses to be Divested. Upon meeting the held-for-sale criteria, the Company recorded a loss of \$107 million, net of tax, on the sale of Umbro and the loss is included in the net loss from discontinued operations line item on the condensed consolidated statements of income. The loss on sale was calculated as the net sales price less Umbro assets of \$248 million, including intangibles, goodwill, and fixed assets, other miscellaneous charges of \$22 million, and the release of the associated cumulative translation adjustment of \$129 million. The tax benefit on the loss was \$67 million.

Under the sale agreement, the Company will provide transition services to Iconix while certain markets are converted and transitioned to Iconix-designated licensees. These transition services are expected to be completed by May 31, 2013. The Company expects to substantially wind down the remaining operations of Umbro over the remainder of fiscal 2013. The continuing operating cash flows are not expected to be significant to the Umbro business and the Company will have no significant continuing involvement with Umbro beyond the transition period.

On November 16, 2012, the Company reached a definitive agreement to sell Cole Haan to Apax Partners for \$570 million. The transaction is expected to be completed in the third fiscal quarter of 2013. At November 30, 2012, the Company has classified the Cole Haan disposal group as held-for-sale and presented the results of Cole Haan's operations in the net loss from discontinued operations line item on the condensed consolidated statements of income. The assets and liabilities of Cole Haan are recorded in the assets of discontinued operations and liabilities of discontinued operations line items on the condensed consolidated balance sheets, respectively. Previously, these amounts were reported in the Company's segment presentation as Businesses to be Divested. The Company is expecting to record a gain on the sale of Cole Haan that will be recognized when the transaction closes. The transition services associated with this transaction are immaterial.

Summarized results of the Company's results from discontinued operations are as follows:

<i>(In millions)</i>	Three Months Ended November 30,		Six Months Ended November 30,	
	2012	2011	2012	2011
Revenues	\$ 186	\$ 185	\$ 381	\$ 373
Loss before income taxes	(220)	(14)	(238)	(33)
Income tax benefit	83	3	83	6
Net loss from discontinued operations	\$ (137)	\$ (11)	\$ (155)	\$ (27)

As of November 30, 2012 and May 31, 2012, the aggregate components of assets and liabilities classified as discontinued operations and included in current assets and current liabilities consisted of the following:

<i>(In millions)</i>	November 30, 2012	May 31, 2012
Accounts Receivable, net	\$ 129	\$ 148
Inventories	130	128
Deferred income taxes and other assets	32	35
Property, plant and equipment, net	53	70
Identifiable intangible assets, net	-	234
<b>TOTAL ASSETS</b>	<b>\$ 344</b>	<b>\$ 615</b>
Accounts Payable	39	42
Accrued liabilities	127	112
Deferred income taxes and other liabilities	32	33
<b>TOTAL LIABILITIES</b>	<b>\$ 198</b>	<b>\$ 187</b>

**NOTE 11 Operating Segments**

The Company's operating segments are evidence of the structure of the Company's internal organization. The major segments are defined by geographic regions for operations participating in NIKE Brand sales activity excluding NIKE Golf. Each NIKE Brand geographic segment operates predominantly in one industry: the design, development, marketing and selling of athletic footwear, apparel, and equipment. The Company's reportable operating segments for the NIKE Brand are: North America, Western Europe, Central & Eastern Europe, Greater China, Japan, and Emerging Markets. The Company's NIKE Brand Direct to Consumer operations are managed within each geographic segment.

The Company's Other category is broken into two components for presentation purposes to align with the way management views the Company. The Global Brand Divisions category primarily represents NIKE Brand licensing businesses that are not part of a geographic operating segment, demand creation and operating overhead expenses that are centrally managed for the NIKE Brand, and costs associated with product development and supply chain operations. The Other Businesses category consists of the activities of Converse Inc., Hurley International LLC, and NIKE Golf. Activities represented in the Other category are considered immaterial for individual disclosure.

Corporate consists of unallocated general and administrative expenses, including expenses associated with centrally managed departments; depreciation and amortization related to the Company's headquarters; unallocated insurance, benefit and compensation programs, including stock-based compensation; certain foreign currency gains and losses, including certain hedge gains and losses; corporate eliminations and other items.

The primary financial measure used by the Company to evaluate performance of individual operating segments is earnings before interest and taxes (commonly referred to as EBIT), which represents net income before interest (income) expense, net and income taxes in the consolidated statements of income. Reconciling items for EBIT represent corporate expense items that are not allocated to the operating segments for management reporting.

As part of the Company's centrally managed foreign exchange risk management program, standard foreign currency rates are assigned twice per year to each NIKE Brand entity in our geographic operating segments and certain Other Businesses. These rates are set approximately nine months in advance of the future selling season based on average market spot rates in the calendar month preceding the date they are established. Inventories and cost of sales for geographic operating segments and certain Other Businesses reflect use of these standard rates to record non-functional currency product purchases in the entity's functional currency. Differences between assigned standard foreign currency rates and actual market rates are included in Corporate, together with foreign currency hedge gains and losses generated from the Company's centrally managed foreign exchange risk management program and other conversion gains and losses.

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Accounts receivable, inventories and property, plant and equipment for operating segments are regularly reviewed by management and are therefore provided below.

Certain prior year amounts have been reclassified to conform to fiscal 2013 presentation.

<i>(In millions)</i>	Three Months Ended November 30,		Six Months Ended November 30,	
	2012	2011	2012	2011
<b>REVENUE</b>				
North America	\$ 2,421	\$ 2,066	\$ 5,127	\$ 4,266
Western Europe	897	915	2,064	2,143
Central & Eastern Europe	266	261	608	595
Greater China	577	650	1,149	1,178
Japan	219	198	402	392
Emerging Markets	1,052	948	1,919	1,748
Global Brand Divisions	27	25	54	57
Total NIKE Brand	5,459	5,063	11,323	10,379
Other Businesses	518	488	1,153	1,073
Corporate	(22)	(5)	(47)	(13)
<b>TOTAL NIKE CONSOLIDATED REVENUES</b>	<b>\$ 5,955</b>	<b>\$ 5,546</b>	<b>\$ 12,429</b>	<b>\$ 11,439</b>
<b>EARNINGS BEFORE INTEREST AND TAXES</b>				
North America	\$ 556	\$ 426	\$ 1,186	\$ 965
Western Europe	113	92	327	315
Central & Eastern Europe	43	33	104	103
Greater China	185	220	349	391
Japan	43	35	67	69
Emerging Markets	305	247	528	437
Global Brand Divisions	(324)	(281)	(699)	(547)
Total NIKE Brand	921	772	1,862	1,733
Other Businesses	80	71	201	176
Corporate	(290)	(208)	(555)	(403)
Total NIKE Consolidated Earnings Before Interest and Taxes	711	635	1,508	1,506
Interest (income) expense, net	(1)	3	(4)	3
<b>TOTAL NIKE CONSOLIDATED EARNINGS BEFORE TAXES</b>	<b>\$ 712</b>	<b>\$ 632</b>	<b>\$ 1,512</b>	<b>\$ 1,503</b>

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<i>(In millions)</i>	November 30, 2012	May 31, 2012
<b>ACCOUNTS RECEIVABLE, NET</b>		
North America	\$ 1,286	\$ 1,149
Western Europe	362	420
Central & Eastern Europe	273	261
Greater China	102	221
Japan	139	152
Emerging Markets	639	476
Global Brand Divisions	28	30
Total NIKE Brand	2,829	2,709
Other Businesses	329	401
Corporate	30	22
<b>TOTAL ACCOUNTS RECEIVABLE, NET</b>	<b>\$ 3,188</b>	<b>\$ 3,132</b>
<b>INVENTORIES</b>		
North America	\$ 1,328	\$ 1,272
Western Europe	510	488
Central & Eastern Europe	161	180
Greater China	260	217
Japan	87	83
Emerging Markets	530	521
Global Brand Divisions	43	35
Total NIKE Brand	2,919	2,796
Other Businesses	382	384
Corporate	17	42
<b>TOTAL INVENTORIES</b>	<b>\$ 3,318</b>	<b>\$ 3,222</b>
<b>PROPERTY, PLANT AND EQUIPMENT, NET</b>		
North America	\$ 383	\$ 378
Western Europe	323	314
Central & Eastern Europe	38	30
Greater China	204	191
Japan	336	359
Emerging Markets	74	59
Global Brand Divisions	220	205
Total NIKE Brand	1,578	1,536
Other Businesses	74	76
Corporate	606	597
<b>TOTAL PROPERTY, PLANT AND EQUIPMENT, NET</b>	<b>\$ 2,258</b>	<b>\$ 2,209</b>

**NOTE 12 Commitments and Contingencies**

At November 30, 2012, the Company had letters of credit outstanding totaling \$114 million. These letters of credit were issued primarily for the purchase of inventory and guarantees of the Company's performance under certain self-insurance and other programs.

There have been no other significant subsequent developments relating to the commitments and contingencies reported on the Company's latest Annual Report on Form 10-K.

**Table of Contents****ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

On November 15, 2012, we announced a two-for-one split of both NIKE Class A and Class B Common shares. The stock split was in the form of a 100 percent stock dividend payable on December 24, 2012 to shareholders of record at the close of business December 10, 2012. Common stock began trading at the split-adjusted price on December 26, 2012. All share numbers and per share amounts presented reflect the stock split.

In the second quarter of fiscal 2013, our revenues from continuing operations increased 7% to \$6.0 billion. Excluding the impact of currency exchange rates, revenues from continuing operations would have grown 10%. We delivered net income from continuing operations of \$521 million and diluted earnings per share from continuing operations of \$0.57, 9% and 12% above the second quarter of fiscal 2012, respectively.

Income before income taxes from continuing operations increased 13% compared to the second quarter of the prior year due to an increase in revenues, selling and administrative expense leverage, and an increase in other (income) expense, net, that more than offset the decline in gross margin. The decline in gross margin was primarily driven by higher product costs, unfavorable currency exchange rates, and an increase in third party royalties, which more than offset the positive impact of higher average product selling prices. The NIKE Brand, which represents over 90% of NIKE, Inc. revenues, delivered constant currency revenue growth in all geographies except China and across all product types and categories. Brand strength, innovative products and strong category retail presentation continue to fuel the demand for NIKE Brand products. Revenue from our Other Businesses also grew, reflecting growth in every business, led by Converse and NIKE Golf.

Our second quarter net income and diluted earnings per share from continuing operations were negatively impacted by a year-on-year increase in our effective tax rate of 270 basis points; however diluted earnings per share benefited from a decline in the weighted average number of diluted common shares outstanding, driven by our share repurchase program.

We continually evaluate our existing portfolio of businesses to ensure resources are invested in those businesses that are accretive to the NIKE Brand, and have the greatest potential to deliver profitable growth and high returns on capital. During the fourth quarter of fiscal 2012, we announced our intention to divest of Cole Haan and Umbro, allowing us to focus our resources on driving growth in the NIKE, Jordan, Converse and Hurley brands. On November 30, 2012, we completed the sale of Umbro to Iconix Brand Group for \$225 million, recognizing an after tax loss on sale of \$107 million. For the second quarter ended November 30, 2012 the results of Umbro's operations and financial position are presented as discontinued operations.

On November 16, 2012, we reached a definitive agreement to sell Cole Haan to Apex Partners for \$570 million. For the quarter ended November 30, 2012, the Company has classified Cole Haan as held-for-sale and presented the results of Cole Haan's operations and financial position as discontinued operations. We expect to recognize a gain on the sale of Cole Haan when the transaction closes.

**Results of Operations**

<i>(Dollars in millions, except per share data)</i>	<b>Six Months Ended</b>					
	<b>Three Months Ended November 30,</b>			<b>November 30,</b>		
	<b>2012</b>	<b>2011</b>	<b>% Change</b>	<b>2012</b>	<b>2011</b>	<b>% Change</b>
Revenues	\$ 5,955	\$ 5,546	7%	\$ 12,429	\$ 11,439	9%
Cost of sales	3,425	3,170	8%	7,071	6,445	10%
Gross profit	2,530	2,376	6%	5,358	4,994	7%
Gross margin %	42.5%	42.8%		43.1%	43.7%	
Demand creation expense	613	616	0%	1,484	1,280	16%
Operating overhead expense	1,223	1,115	10%	2,411	2,181	11%
Total selling and administrative expense	1,836	1,731	6%	3,895	3,461	13%
% of Revenues	30.8%	31.2%		31.3%	30.3%	
Income before income taxes	712	632	13%	1,512	1,503	1%
Net income from continuing operations	521	480	9%	1,106	1,141	-3%
Net loss from discontinued operations	(137)	(11)	-	(155)	(27)	-
Net income	\$ 384	\$ 469	-18%	\$ 951	\$ 1,114	-15%
Diluted earnings per share Continuing Operations	\$ 0.57	\$ 0.51	12%	\$ 1.20	\$ 1.21	-1%
Diluted earnings per share Discontinued Operations	\$ (0.15)	\$ (0.01)	-	\$ (0.16)	\$ (0.03)	-

**Consolidated Operating Results****Revenues**

	Three Months Ended November 30,				Six Months Ended November 30,			
			% Change	% Change			% Change	% Change
(Dollars in millions)	2012	2011	Excluding	Excluding	2012	2011	Excluding	Excluding
			Currency	Currency			Currency	Currency
			Changes <sup>(1)</sup>	Changes <sup>(1)</sup>			Changes <sup>(1)</sup>	Changes <sup>(1)</sup>
<b>NIKE Brand Revenues by:</b>								
Footwear	\$ 3,299	\$ 3,091	7%	10%	\$ 6,989	\$ 6,430	9%	13%
Apparel	1,801	1,680	7%	10%	3,562	3,282	9%	12%
Equipment	332	267	24%	27%	718	610	18%	22%
Global Brand Divisions	27	25	8%	15%	54	57	-5%	2%
<b>Total NIKE Brand</b>	<b>5,459</b>	<b>5,063</b>	<b>8%</b>	<b>11%</b>	<b>11,323</b>	<b>10,379</b>	<b>9%</b>	<b>13%</b>
Other Businesses	518	488	6%	6%	1,153	1,073	7%	8%
Corporate <sup>(2)</sup>	(22)	(5)	-	-	(47)	(13)	-	-
<b>TOTAL NIKE, INC. REVENUES FROM CONTINUING OPERATIONS</b>	<b>\$ 5,955</b>	<b>\$ 5,546</b>	<b>7%</b>	<b>10%</b>	<b>\$ 12,429</b>	<b>\$ 11,439</b>	<b>9%</b>	<b>13%</b>
<b>Supplemental NIKE Brand Revenues Details by:</b>								
Sales to Wholesale Customers	\$ 4,467	\$ 4,263	5%	8%	\$ 9,207	\$ 8,638	7%	11%
Sales Direct to Consumer	965	775	25%	27%	2,062	1,684	22%	25%
Global Brand Divisions	27	25	8%	15%	54	57	-5%	2%
<b>TOTAL NIKE BRAND REVENUES</b>	<b>\$ 5,459</b>	<b>\$ 5,063</b>	<b>8%</b>	<b>11%</b>	<b>\$ 11,323</b>	<b>\$ 10,379</b>	<b>9%</b>	<b>13%</b>

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(1) *Results have been restated using actual currency exchange rates in use during the comparative period to enhance the visibility of the underlying business trends by excluding the impact of translation arising from foreign currency exchange rate fluctuations.*

(2) *Corporate revenues primarily consist of intercompany revenue eliminations and foreign currency revenue-related hedge gains and losses generated by entities within the NIKE Brand geographic operating segments and certain Other Businesses through our centrally managed foreign exchange risk management program.*

Excluding the effects of changes in currency exchange rates, revenues for NIKE, Inc.'s continuing operations increased 10% for the second quarter and 13% for the first six months of fiscal 2013, driven by increases in both the NIKE Brand and our Other Businesses. On a currency neutral basis, revenues for the NIKE Brand increased 11% and 13% for the second quarter and year to date period, respectively, while revenues for our Other Businesses increased 6% and 8% for the same periods, respectively. For both the second quarter and first six months of fiscal 2013, every NIKE Brand geography except Greater China delivered higher revenues. North America contributed approximately 7 and 8 percentage points to the NIKE Brand revenue increase for the second quarter and first six months of fiscal 2013, respectively, while Emerging Markets contributed approximately 3 percentage points for both respective periods. China's results negatively impacted NIKE Brand revenue growth by approximately 2 percentage points for the second quarter and by less than 1 percentage point for the year to date period, respectively.

Excluding the effects of changes in currency exchange rates, NIKE Brand footwear and apparel revenues each increased 10% for the second quarter, while NIKE Brand equipment revenues increased 27%. For the first six months of fiscal 2013, NIKE Brand footwear and apparel revenues increased 13% and 12%, respectively, while NIKE Brand equipment revenues increased 22%. The increase in footwear revenue for both the second quarter and first six months of fiscal 2013 was attributable to growth across our Running, Basketball, and Sportswear categories, primarily reflective of increased demand for our performance products, most notably those utilizing NIKE Free and Lunar technologies. For the second quarter of fiscal 2013, unit sales increased approximately 6% and average selling price per pair increased approximately 4%. For the first half of fiscal 2013, unit sales increased approximately 8% and the average selling price per pair increased approximately 5%. The growth in average selling price per pair for the second quarter and year to date period primarily reflected the impact of product price increases.

The increase in NIKE Brand apparel revenue for both the second quarter and year to date period of fiscal 2013 was driven primarily by our Men's Training category, which includes our new NFL licensed business, while strong demand for Football (Soccer), Running, and Basketball products also contributed positively. For the second quarter of fiscal 2013, average selling price per unit increased approximately 11% and unit sales decreased approximately 1%. The decrease in unit sales for the second quarter was primarily driven by lower unit sales in Sportswear, largely offset by higher unit sales in Men's Training, Basketball, and Running. For the year to date period, average selling price increased approximately 9%, while units sold increased approximately 3%. The increase in average selling price per unit for the second quarter and year to date period was driven approximately equally by product price increases and a shift in mix to higher priced products such as our performance Running, Basketball and NFL licensed apparel.

While wholesale revenues remain the largest component of overall NIKE Brand revenues, we continue to expand Direct to Consumer revenues through a growing network of NIKE owned in-line and factory stores, as well as online sales through NIKE owned websites. For both the second quarter and first six months of fiscal 2013, Direct to Consumer revenues represented approximately 18% of our total NIKE Brand revenues, compared to 15% and 16% for the second quarter and first half of fiscal 2012, respectively. Excluding changes in currency exchange rates, Direct to Consumer revenues increased 27% and 25% for the second quarter and first six months of fiscal 2013, respectively, as comparable store sales increased 16% and 15% over the same respective periods. Comparable store sales include revenues from NIKE owned in-line and factory stores for which all three of the following requirements have been met: the store has been open at least one year, square footage has not changed by more than 15% within the past year, and the store has not been permanently repositioned within the past year.

Revenues for our Other Businesses consist of results from Converse, Hurley and NIKE Golf. Excluding the impact of currency changes, total revenues for these businesses increased by 6% and 8% in the second quarter and first half of fiscal 2013, respectively, reflecting growth across all businesses.

**Futures Orders**

Futures orders for NIKE Brand footwear and apparel scheduled for delivery from December 2012 through April 2013 were 6% higher than the orders reported for the comparable prior year period. The U.S. Dollar futures order amount is calculated based upon our internal forecast of the currency exchange rates under which our revenues will be translated during this period. Excluding the impact of currency changes, futures orders increased 7%, as unit orders contributed approximately 4 percentage points of the growth and average selling price per unit contributed approximately 3 percentage points.

By geography, futures orders growth was as follows:

	Reported Futures Orders	Futures Orders Excluding
	Growth	Currency Changes <sup>(1)</sup>
North America	14%	14%
Western Europe	-1%	0%

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Central & Eastern Europe	10%	11%
Greater China	-6%	-7%
Japan	-3%	4%
Emerging Markets	7%	11%
<b>TOTAL NIKE BRAND FUTURES ORDERS</b>	<b>6%</b>	<b>7%</b>

(1) Growth rates have been restated using constant currency exchange rates for the comparative period to enhance the visibility of the underlying business trends excluding changes in foreign currency exchange rates.

The reported futures orders growth is not necessarily indicative of our expectation of revenue growth during this period. This is due to year-over-year changes in shipment timing, the mix of orders which can shift between futures and at-once orders, and the fulfillment of certain orders may fall outside of the schedule noted above. In addition, currency exchange rate fluctuations as well as differing levels of order cancellations, discounts and returns can cause differences in the comparisons between futures orders and actual revenues. Moreover, a significant portion of our revenue is not derived from futures orders, including at-once and close-out sales of NIKE Brand footwear and apparel, sales of NIKE Brand equipment, sales from our Direct to Consumer operations, and sales from our Other Businesses.

### Gross Margin

<i>(Dollars in millions)</i>	Three Months Ended November 30,			Six Months Ended November 30,		
	2012	2011	% Change	2012	2011	% Change
Gross Profit	\$ 2,530	\$ 2,376	6%	\$ 5,358	\$ 4,994	7%
Gross Margin %	42.5%	42.8%	(30) bps	43.1%	43.7%	(60) bps

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For the second quarter and first six months of fiscal 2013, our consolidated gross margin was 30 and 60 basis points lower than the respective prior year periods. For the second quarter, the decrease in margin was largely attributable to the following:

Higher product costs, driven mainly by factory labor cost increases at our manufacturers, decreased our gross margin approximately 110 basis points;

Unfavorable foreign currency exchange rates decreased our gross margin approximately 70 basis points;

Higher third party royalties, primarily resulting from NFL licensed product sales in North America, decreased our gross margin approximately 50 basis points;

Other less significant factors, primarily due to additional investments in digital products and capabilities and higher inventory obsolescence, contributed another approximate 60 basis point decline to our gross margin.

These factors more than offset the favorable 260 basis point impact to gross margin due to higher net average selling price per unit, driven primarily by product price increases.

In addition, we have seen significant shifts in the mix of revenues from higher to lower margin segments of our business. While growth in these lower gross margin segments delivers incremental revenue and profits, it has a downward effect on our consolidated gross margin.

For the first six months of fiscal 2013, increases in selling prices contributed a benefit of 280 basis points to our gross margin, which were more than offset by higher product costs that negatively impacted gross margin by approximately 260 basis points, higher third party royalties negatively impacting gross margin by approximately 40 basis points, and unfavorable foreign currency exchange rates, reducing our year to date gross margin by approximately 40 basis points.

We expect that full year gross margin will be essentially flat compared to the prior year as currency headwinds and actions to clear inventory in China will offset gross margin expansion.

**Selling and Administrative Expense**

	Three Months Ended			Six Months Ended		
	November 30,			November 30,		
(Dollars in millions)	2012	2011	% Change	2012	2011	% Change
Demand creation expense <sup>(1)</sup>	\$ 613	\$ 616	0%	\$ 1,484	\$ 1,280	16%
Operating overhead expense	1,223	1,115	10%	2,411	2,181	11%
Selling and administrative expense	\$ 1,836	\$ 1,731	6%	\$ 3,895	\$ 3,461	13%
% of Revenues	30.8%	31.2%	(40) bps	31.3%	30.3%	100 bps

(1) Demand creation consists of advertising and promotion expenses, including costs of endorsement contracts.

Demand creation expense was flat in the second quarter and increased 16% during the first six months of fiscal 2013 compared to the same periods in the prior year. Excluding the effects of changes in currency exchange rates, demand creation for the second quarter of fiscal 2013 increased 3% primarily attributable to higher sports marketing expense, as we spent less on advertising and other marketing activities in the second quarter following our high level of brand event investments in the first quarter of fiscal 2013. For the six months ended November 30, 2012, demand creation expense was 21% higher than the prior year on a currency neutral basis, largely driven by higher spending around the Olympics and European Football Championships in the first quarter of fiscal 2013.

Operating overhead expense increased 10% and 11% during the second quarter and first six months of fiscal 2013, respectively. Changes in currency exchange rates decreased the growth in operating overhead expense by 2 percentage points for both periods. The increase for both the quarter and year to date periods was primarily attributable to higher wage related costs and performance-based compensation to support the growth of our overall business as well as increased investments in our expanding Direct to Consumer business.

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For the full fiscal year, we anticipate selling and administrative expense to grow at a high-single to low-double-digit rate as we continue to make investments in our brands and growth initiatives while we anniversary demand creation investments made in the fourth quarter of fiscal 2012 for the Olympics and European Football Championships.

### Other (Income) Expense, net

<i>(Dollars in millions)</i>	Three Months Ended		Six Months Ended	
	November 30,		November 30,	
	2012	2011	2012	2011
Other (income) expense, net	\$ (17)	\$ 10	\$ (45)	\$ 27

Other (income) expense, net comprises foreign currency conversion gains and losses from the re-measurement of monetary assets and liabilities denominated in non-functional currencies, the impact of certain foreign currency derivative instruments, as well as unusual or non-operating transactions that are outside the normal course of business.

For the second quarter of fiscal 2013, other (income) expense, net increased \$27 million compared to the prior year. This change was primarily driven by a \$39 million change from foreign currency net losses in the prior year to net gains in the current year. These impacts were partially offset by changes in other non-operating net gains and losses. For the first six months of fiscal 2013, other (income) expense, net increased \$72 million compared to the prior year, primarily due to a \$75 million change from foreign currency net losses in the prior year to net gains in the current year.

We estimate the combination of translation of foreign currency-denominated profits from our international businesses and the year-over-year change in foreign currency related gains and losses included in other (income) expense, net had a favorable impact of approximately \$10 million on our income before income taxes for the second quarter of fiscal 2013, and an unfavorable impact of \$19 million for the first six months of fiscal 2013.

### Income Taxes

	Three Months Ended November			Six Months Ended		
	30,			November 30,		
	2012	2011	% Change	2012	2011	% Change
Effective tax rate	26.8%	24.1%	270 bps	26.9%	24.1%	280 bps

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Our effective tax rate on continuing operations for the second quarter and first six months of fiscal 2013 was 270 and 280 basis points higher than the effective tax rate on continuing operations for the respective prior year periods. The increase in our effective tax rate was primarily driven by changes in uncertain tax positions and an increase in the effective tax rate on foreign operations.

We anticipate the effective tax rate for the full fiscal year will be approximately 26.5%.

## Discontinued Operations

On November 30, 2012, we completed the sale of certain assets of Umbro to Iconix Brand Group (Iconix) for \$225 million. The results of Umbro's operations and Umbro's financial position are presented as discontinued operations on the condensed consolidated statements of income and balance sheets, respectively. Previously, these amounts were reported in our segment presentation as Businesses to be Divested. Upon meeting the held-for-sale criteria, we recorded a loss of \$107 million, net of tax, on the sale of Umbro. The loss on sale was calculated as the net sales price less the Umbro assets of \$248 million, including intangibles, goodwill, and fixed assets, other miscellaneous charges of \$22 million, the release of the associated cumulative translation adjustment of \$129 million, offset by a tax benefit on the loss of \$67 million. Previously, we disclosed the potential for certain tax balances to be written off as a result of the sale of Umbro. However, upon determining the final transaction structure, we determined that those amounts remain realizable and therefore were not part of the loss on sale of Umbro.

Under the sale agreement, we will provide transition services to Iconix while certain markets are converted and transitioned to Iconix-designated licensees. These transition services are expected to be completed by May 31, 2013. We also expect to wind down the remaining operations of Umbro over the remainder of fiscal 2013 and incur approximately \$30 million of additional exit and disposal costs related to this transaction. The continuing operating cash flows are not expected to be significant to the Umbro business and we will have no significant continuing involvement with Umbro beyond the transition period.

On November 16, 2012, we reached a definitive agreement to sell Cole Haan to Apax Partners for \$570 million. The transaction is expected to be completed in the third fiscal quarter of 2013. At November 30, 2012, we classified the Cole Haan disposal group as held-for-sale and presented the results of Cole Haan's operations in the net loss from discontinued operations line item on the condensed consolidated statements of income. Previously, these amounts were reported in our segment presentation as Businesses to be Divested. We are expecting a gain on the sale of Cole Haan that will be recognized when the transaction closes. The transition services associated with this transaction are immaterial.

## Operating Segments

Reportable operating segments are based on our internal geographic organization. Each of the NIKE Brand geographies operate predominantly in one industry: the design, development, marketing and selling of athletic footwear, apparel, and equipment. Our reportable operating segments for the NIKE Brand are: North America, Western Europe, Central & Eastern Europe, Greater China, Japan, and Emerging Markets. Our NIKE Brand Direct to Consumer operations are managed within each geographic segment.

As part of our centrally managed foreign exchange risk management program, standard foreign currency exchange rates are assigned twice per year to each NIKE Brand entity in our geographic operating segments and certain Other Businesses. These rates are set approximately nine months in advance of the future selling season based on average market spot rates in the calendar month preceding the date they are established. Inventories and cost of sales for geographic operating segments and certain Other Businesses reflect use of these standard foreign currency exchange rates to record non-functional currency product purchases into the entity's functional currency. Differences between assigned standard foreign currency exchange rates and actual market rates are included in Corporate together with foreign currency hedge gains and losses generated from our centrally managed foreign exchange risk management program.

The breakdown of revenues follows:

(Dollars in millions)	Three Months Ended November 30,				Six Months Ended November 30,			
	2012	2011 <sup>(1)</sup>	% Change	% Change Excluding Currency Changes <sup>(2)</sup>	2012	2011 <sup>(1)</sup>	% Change	% Change Excluding Currency Changes <sup>(2)</sup>
North America	\$ 2,421	\$ 2,066	17%	17%	\$ 5,127	\$ 4,266	20%	20%
Western Europe	897	915	-2%	4%	2,064	2,143	-4%	6%
Central & Eastern Europe	266	261	2%	7%	608	595	2%	12%
Greater China	577	650	-11%	-12%	1,149	1,178	-2%	-4%
Japan	219	198	11%	13%	402	392	3%	3%
Emerging Markets	1,052	948	11%	18%	1,919	1,748	10%	20%
Global Brand Divisions	27	25	8%	15%	54	57	-5%	2%
<b>Total NIKE Brand Revenues</b>	<b>5,459</b>	<b>5,063</b>	<b>8%</b>	<b>11%</b>	<b>11,323</b>	<b>10,379</b>	<b>9%</b>	<b>13%</b>

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Other Businesses	518	488	6%	6%	1,153	1,073	7%	8%
Corporate <sup>(3)</sup>	(22)	(5)	-	-	(47)	(13)	-	-
<b>TOTAL NIKE, INC.</b>								
<b>REVENUES</b>	\$ 5,955	\$ 5,546	7%	10%	\$ 12,429	\$ 11,439	9%	13%

(1) Certain prior year amounts have been reclassified to conform to fiscal 2013 presentation. These changes had no impact on previously reported results of operations or shareholders' equity.

(2) Results have been restated using actual currency exchange rates in use during the comparative period to enhance the visibility of the underlying business trends by excluding the impact of translation arising from foreign currency exchange rate fluctuations.

(3) Corporate revenues primarily consist of certain intercompany revenue eliminations and foreign currency hedge gains and losses related to revenues generated by entities within the NIKE Brand geographic operating segments and certain Other Businesses but managed through our central foreign exchange risk management program.

The primary financial measure we use to evaluate the performance of individual operating segments is earnings before interest and taxes (commonly referred to as EBIT) which represents net income before interest (income) expense, net and income taxes in the Condensed consolidated statements of income. As discussed in Note 11 Operating Segments in the accompanying notes to unaudited condensed consolidated financial statements, certain corporate costs are not included in EBIT of our operating segments.

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The breakdown of earnings before interest and taxes is as follows:

(Dollars in millions)	Three Months Ended			Six Months Ended		
	November 30,			November 30,		
	2012	2011 <sup>(1)</sup>	% Change	2012	2011 <sup>(1)</sup>	% Change
North America	\$ 556	\$ 426	31%	\$ 1,186	\$ 965	23%
Western Europe	113	92	23%	327	315	4%
Central & Eastern Europe	43	33	30%	104	103	1%
Greater China	185	220	-16%	349	391	-11%
Japan	43	35	23%	67	69	-3%
Emerging Markets	305	247	23%	528	437	21%
Global Brand Divisions	(324)	(281)	-15%	(699)	(547)	-28%
<b>Total NIKE Brand</b>	<b>921</b>	<b>772</b>	<b>19%</b>	<b>1,862</b>	<b>1,733</b>	<b>7%</b>
Other Businesses	80	71	13%	201	176	14%
Corporate	(290)	(208)	-39%	(555)	(403)	-38%
<b>TOTAL CONSOLIDATED EARNINGS BEFORE INTEREST AND TAXES</b>	<b>\$ 711</b>	<b>\$ 635</b>	<b>12%</b>	<b>\$ 1,508</b>	<b>\$ 1,506</b>	<b>0%</b>
Interest (income) expense, net	(1)	3	-	(4)	3	-
<b>TOTAL CONSOLIDATED INCOME BEFORE INCOME TAXES</b>	<b>\$ 712</b>	<b>\$ 632</b>	<b>13%</b>	<b>\$ 1,512</b>	<b>\$ 1,503</b>	<b>1%</b>

(1) Certain prior year amounts have been reclassified to conform to fiscal 2013 presentation. These changes had no impact on previously reported results of operations or shareholders' equity.

**North America**

(Dollars in millions)	Three Months Ended				Six Months Ended			
	November 30,			% Change Excluding Currency Changes	November 30,			% Change Excluding Currency Changes
	2012	2011	% Change		2012	2011	% Change	
Revenues by:								
Footwear	\$ 1,471	\$ 1,305	13%	13%	\$ 3,203	\$ 2,749	17%	17%
Apparel	788	661	19%	19%	1,583	1,293	22%	23%
Equipment	162	100	62%	61%	341	224	52%	52%
<b>TOTAL REVENUES</b>	<b>\$ 2,421</b>	<b>\$ 2,066</b>	<b>17%</b>	<b>17%</b>	<b>\$ 5,127</b>	<b>\$ 4,266</b>	<b>20%</b>	<b>20%</b>
Revenues by:								
Sales to Wholesale Customers	\$ 1,866	\$ 1,616	15%	15%	\$ 3,878	\$ 3,252	19%	19%
Sales Direct to Consumer	555	450	23%	23%	1,249	1,014	23%	23%
<b>TOTAL REVENUES</b>	<b>\$ 2,421</b>	<b>\$ 2,066</b>	<b>17%</b>	<b>17%</b>	<b>\$ 5,127</b>	<b>\$ 4,266</b>	<b>20%</b>	<b>20%</b>
<b>EARNINGS BEFORE INTEREST AND TAXES</b>	<b>\$ 556</b>	<b>\$ 426</b>	<b>31%</b>		<b>\$ 1,186</b>	<b>\$ 965</b>	<b>23%</b>	

Revenues for North America increased 17% for the second quarter and 20% for the first six months of fiscal 2013, driven by growth in both wholesale and Direct to Consumer channels. Our category offense continued to deliver innovative products, deep brand connections and compelling retail experiences to consumers, driving demand for NIKE Brand products across most key categories, most notably Men's Training, Basketball, and Running. Comparable store sales in our Direct to Consumer stores increased 18% for both the second quarter and year to date periods.

For the second quarter and first six months of fiscal 2013, footwear revenue in North America increased 13% and 17%, respectively, driven by higher demand in most key categories, most notably Running, Basketball and Sportswear. For the second quarter and first half of fiscal 2013, unit sales increased 7% and 10%, respectively, and average selling price per pair increased 6% and 7%, respectively, driven primarily by product price increases.

Apparel revenue in North America for the second quarter and first six months of fiscal 2013 increased 19% and 22%, respectively, driven by growth in Men's Training, reflecting the addition of our new NFL licensed business, as well as Basketball, Women's Training, and Running. Average selling price per unit for the second quarter and first half of fiscal 2013 increased 21% and 19%, respectively. Approximately 16% of the increase in both periods was primarily due to a larger

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mix of higher price-point products, specifically within Men's Training, Basketball, and Brand Jordan, with the remaining increase due to an increase in average selling prices to offset higher product costs. Unit sales for the second quarter decreased 2%, largely driven by a decline in our Sportswear category, which more than offset growth in other categories. For the year to date period, units sold increased 3%.

North America EBIT increased 31% in the second quarter as revenue growth of 17%, gross margin improvement, and selling and administrative expense leverage all contributed to increased profitability. Gross margin increased 120 basis points, as the favorable impacts from product price increases and a lower mix of off-price sales more than offset higher product costs and higher royalties related to our NFL business. Compared to the same period last year, selling and administrative expense was a lower percentage of revenues despite increased demand creation spending and higher operating overhead costs to support the expansion of our Direct to Consumer business and overall growth of the business. For the year to date period, EBIT increased 23% as higher revenues and a 70 basis point expansion in gross margin were partially offset by an increase in selling and administrative expense. The gross margin increase for the first half of fiscal 2013 reflects the favorable impact of price increases, which more than offset higher product costs and royalties for our NFL business. The increase in selling and administrative expense was largely driven by higher demand creation expense supporting key product initiatives and the Olympics in the first quarter of fiscal 2013.

**Table of Contents****Western Europe**

<i>(Dollars in millions)</i>	Three Months Ended				Six Months Ended			
	November 30,				November 30,			
	2012	2011	% Change	% Change Excluding Currency Changes	2012	2011	% Change	% Change Excluding Currency Changes
Revenues by:								
Footwear	\$ 545	\$ 538	1%	8%	\$ 1,259	\$ 1,269	-1%	9%
Apparel	301	324	-7%	-1%	683	740	-8%	1%
Equipment	51	53	-4%	4%	122	134	-9%	-1%
<b>TOTAL REVENUES</b>	<b>\$ 897</b>	<b>\$ 915</b>	<b>-2%</b>	<b>4%</b>	<b>\$ 2,064</b>	<b>\$ 2,143</b>	<b>-4%</b>	<b>6%</b>
Revenues by:								
Sales to Wholesale Customers	\$ 739	\$ 780	-5%	1%	\$ 1,737	\$ 1,850	-6%	3%
Sales Direct to Consumer	158	135	17%	26%	327	293	12%	22%
<b>TOTAL REVENUES</b>	<b>\$ 897</b>	<b>\$ 915</b>	<b>-2%</b>	<b>4%</b>	<b>\$ 2,064</b>	<b>\$ 2,143</b>	<b>-4%</b>	<b>6%</b>
<b>EARNINGS BEFORE INTEREST AND TAXES</b>	<b>\$ 113</b>	<b>\$ 92</b>	<b>23%</b>		<b>\$ 327</b>	<b>\$ 315</b>	<b>4%</b>	

On a currency neutral basis, revenues for Western Europe increased 4% for the second quarter of fiscal 2013 and 6% for the first half of the year, despite poor economic conditions impacting our Southern European businesses. Most territories reported revenue growth for the quarter and year to date periods, which more than offset revenue declines of 9% and 14% in Italy and 23% and 11% in Iberia, respectively. Revenues for the United Kingdom & Ireland, the largest market in Western Europe, increased 5% for the second quarter and 8% for the first half of fiscal 2013. Western Europe's Direct to Consumer revenues on a constant currency basis increased 26% for the second quarter and 22% for the first half of fiscal 2013, primarily driven by an increase in comparable store sales. On a category basis, Western Europe revenue growth for the second quarter and year to date period was driven largely by growth in our Running, Football (Soccer), and Basketball categories.

Excluding changes in currency exchange rates, footwear revenue in Western Europe increased 8% for the second quarter and 9% for the year to date period. The footwear revenue increase in the second quarter and first half of fiscal 2013 was primarily driven by growth in Running, Sportswear, and Basketball. Both unit sales and average selling price per pair increased 4% in the second quarter, the latter primarily the result of product price increases. For the first half of fiscal 2013, unit sales increased 5% and average selling price per pair increased 4%, primarily due to product price increases.

Excluding changes in currency exchange rates, apparel revenue in Western Europe decreased 1% for the second quarter of fiscal 2013. The overall decrease in apparel revenues for the second quarter was due to a decline in Sportswear, partially offset by growth in Football (Soccer) and Running. Year-over-year, second quarter unit sales decreased 6% and average selling price per unit increased 5%, primarily attributable to product price increases. For the first six months of fiscal 2013, apparel revenues in Western Europe increased 1% excluding changes in currency exchange rates, attributable to growth in Football (Soccer) and Running, which was partially offset by a decrease in Sportswear. For the year to date period, unit sales decreased 3% and average selling price per unit increased 4%, attributable to pricing actions.

On a reported basis, revenues for the second quarter and first half of fiscal 2013 for Western Europe decreased 2% and 4%, respectively, while EBIT increased 23% and 4%, respectively. Western Europe's EBIT growth for the second quarter was primarily the result of higher gross margin and lower selling and administrative expense. Gross margin increased 240 basis points for both the second quarter and the first six months of fiscal 2013 primarily due to more favorable standard foreign currency exchange rates; higher selling prices were mostly offset by higher product costs. In the second quarter, selling and administrative expense declined due to lower personnel costs. For the year to date period, EBIT growth was primarily due to gross margin improvement, offset by higher selling and administrative expense largely as a result of demand creation spending for the Olympics and European Football Championships in the first quarter of fiscal 2013.

**Central & Eastern Europe**

<i>(Dollars in millions)</i>	Three Months Ended				Six Months Ended			
	November 30,				November 30,			
	2012	2011	% Change	% Change Excluding Currency Changes	2012	2011	% Change	% Change Excluding Currency Changes

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Revenues by:												
Footwear	\$	134	\$	135	-1%	4%	\$	312	\$	315	-1%	9%
Apparel		117		111	5%	10%		251		234	7%	17%
Equipment		15		15	0%	5%		45		46	-2%	9%
<b>TOTAL REVENUES</b>	<b>\$</b>	<b>266</b>	<b>\$</b>	<b>261</b>	<b>2%</b>	<b>7%</b>	<b>\$</b>	<b>608</b>	<b>\$</b>	<b>595</b>	<b>2%</b>	<b>12%</b>
<b>EARNINGS BEFORE INTEREST AND TAXES</b>	<b>\$</b>	<b>43</b>	<b>\$</b>	<b>33</b>	<b>30%</b>		<b>\$</b>	<b>104</b>	<b>\$</b>	<b>103</b>	<b>1%</b>	

Excluding changes in currency exchange rates, revenues for Central & Eastern Europe increased 7% for the second quarter and 12% for the first half of fiscal 2013, driven by growth across most territories, particularly in Russia and Turkey, which more than offset lower revenues in Greece. Overall revenue growth in Central and Eastern Europe for the second quarter and year to date period was driven by growth in most key categories, most notably Running, Football (Soccer), and Sportswear.

Excluding changes in currency exchange rates, Central & Eastern Europe's footwear revenue increased 4% and 9% for the second quarter year to date period, respectively. The overall increase in footwear revenues for both periods was primarily driven by growth in Running, partially off-set by lower revenues for Sportswear and Football (Soccer). In the second quarter, unit sales decreased 3% and average selling price per pair increased 7%, primarily reflective of product price increases. For the first six months of fiscal 2013, unit sales increased 4% and average selling price per pair increased 5%, attributable to product price increases.

Excluding changes in currency exchange rates, Central & Eastern Europe's apparel revenues increased 10% for the second quarter mainly driven by growth in Football (Soccer) and Sportswear. In the second quarter of fiscal 2013, unit sales increased 6% and average selling price per unit increased 4%, reflective of product price increases. For the year to date period, apparel revenues increased 17%, driven by growth in most key categories, most notably Football (Soccer), Sportswear, and Running. For the first half of fiscal 2013, unit sales increased 13% and average selling price per unit increased 4%, reflective of product price increases.

On a reported basis, revenues for Central & Eastern Europe increased 2% for both the second quarter and first half of fiscal 2013, while EBIT grew 30% and 1%, respectively. The EBIT growth for the second quarter was primarily the result of higher revenues, gross margin improvement, and significant selling and administrative expense leverage. Gross margin for the second quarter and first half of fiscal 2013 increased 150 basis points and 120 basis points, respectively, primarily due to product price increases that more than offset higher product costs and more favorable standard foreign currency exchange rates. Selling and administrative expense decreased as a percentage of revenues for the second quarter, mainly due to higher advertising spending in the prior year, but increased for the first half of fiscal 2013 due to higher demand creation spending related to the Olympics and European Football Championships in the first quarter of fiscal 2013.

**Table of Contents****Greater China**

(Dollars in millions)	Three Months Ended				Six Months Ended			
	November 30,			% Change Excluding Currency Changes	November 30,			% Change Excluding Currency Changes
	2012	2011	% Change		2012	2011	% Change	
Revenues by:								
Footwear	\$ 324	\$ 353	-8%	-9%	\$ 680	\$ 667	2%	1%
Apparel	224	268	-16%	-17%	402	445	-10%	-11%
Equipment	29	29	0%	-2%	67	66	2%	-1%
<b>TOTAL REVENUES</b>	<b>\$ 577</b>	<b>\$ 650</b>	<b>-11%</b>	<b>-12%</b>	<b>\$ 1,149</b>	<b>\$ 1,178</b>	<b>-2%</b>	<b>-4%</b>
<b>EARNINGS BEFORE INTEREST AND TAXES</b>	<b>\$ 185</b>	<b>\$ 220</b>	<b>-16%</b>		<b>\$ 349</b>	<b>\$ 391</b>	<b>-11%</b>	

Excluding changes in currency exchange rates, Greater China revenues decreased 12% and 4% for the second quarter and first half of fiscal 2013, respectively, driven by lower futures orders and proactive order cancellations to manage the amount of new product flowing into the market, as well as increased sales related reserves for product returns and discounts. These drivers were partially offset by growth in our Direct to Consumer revenues, driven by comparable store sales growth of 10% and 8% for the second quarter and first six months of fiscal 2013, respectively. For both the second quarter and year to date period, revenues in most key categories were lower.

Excluding changes in currency exchange rates, Greater China footwear revenue declined 9% for the second quarter, primarily driven by lower sales across most key categories, most notably Sportswear, Basketball, and Men's Training, and increased reserves for product returns and retailer discounts to help clear excess inventory at retail. For the second quarter of fiscal 2013, unit sales decreased 10% while the average selling price per pair increased 1%, primarily reflecting a favorable mix of higher priced products. For the year to date period, footwear revenues increased 1%, primarily driven by growth in Running, largely offset by lower revenues in Sportswear and Women's Training. Average selling price per pair for the first six months of fiscal 2013 increased 3%, while unit sales were 2% lower. The increase in average selling price per pair for the first half of fiscal 2013 is reflective of product price increases, primarily benefitting the first quarter of fiscal 2013.

Excluding changes in currency exchange rates, apparel revenues for Greater China were 17% lower for the second quarter, largely driven by a decrease in Sportswear and Men's Training revenues. Unit sales were 22% lower in the second quarter of fiscal 2013, due to lower demand and increased reserves for product returns and retailer discounts to clear excess inventory at retail, while the average selling price per unit increased 5%, primarily reflecting a favorable mix of higher priced performance products. Year to date apparel revenues declined 11%, primarily attributable to decreased Sportswear, Men's Training, and Women's Training revenues, partially offset by growth in Basketball. For the first six months of fiscal 2013, unit sales were 13% lower than the prior year period and average selling price per unit increased 2%, reflecting a favorable product mix.

On a reported basis, revenues for Greater China decreased 11% for the second quarter, while EBIT fell 16%, primarily driven by lower revenues and an increase in selling and administrative expense, partially offset by higher gross margin. Selling and administrative expense increased as a percentage of revenues, primarily driven by increased investment in our Direct to Consumer business and the decrease in revenues. Gross margin improved 90 basis points in the second quarter due to more favorable standard foreign currency exchange rates, partially offset by a higher mix of close-out sales.

For the first six months of fiscal 2013, revenues on a reported basis decreased 2% while EBIT decreased 11%, primarily driven by lower revenues and higher selling and administrative expense, offset partially by an increase in gross margin. Selling and administrative expense increased as a percentage of revenues, primarily driven by higher operational overhead reflecting investments in both wholesale and Direct to Consumer operations. Gross margin improved 50 basis points for the year to date period, due to more favorable standard foreign currency exchange rates, partially offset by a higher mix of close-out sales.

Despite the challenges we've seen in China, there are early indications that our strategies are taking hold in the marketplace. Comparable store sales are growing in both NIKE-owned Direct to Consumer and wholesale customer doors, inventory levels in the marketplace are beginning to decline, and apparel product sell-through is improving. However, we still expect lower year-on-year revenue and EBIT from Greater China over the next few quarters as we work to position this market to capture the tremendous long-term growth potential.

**Japan****Three Months Ended****Six Months Ended**

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<i>(Dollars in millions)</i>	November 30,			% Change Excluding Currency Changes	November 30,			% Change Excluding Currency Changes
	2012	2011	% Change		2012	2011	% Change	
Revenues by:								
Footwear	\$ 107	\$ 100	7%	10%	\$ 213	\$ 203	5%	6%
Apparel	98	83	18%	19%	159	155	3%	3%
Equipment	14	15	-7%	-6%	30	34	-12%	-12%
<b>TOTAL REVENUES</b>	<b>\$ 219</b>	<b>\$ 198</b>	<b>11%</b>	<b>13%</b>	<b>\$ 402</b>	<b>\$ 392</b>	<b>3%</b>	<b>3%</b>
<b>EARNINGS BEFORE INTEREST AND TAXES</b>	<b>\$ 43</b>	<b>\$ 35</b>	<b>23%</b>		<b>\$ 67</b>	<b>\$ 69</b>	<b>-3%</b>	

Excluding changes in currency exchange rates, revenues for Japan increased 13% for the second quarter driven by higher revenues in all but one category, including strong growth in Running, Men's Training, and Football (Soccer). For the year to date period, constant currency growth of 3% was driven by higher revenues in Running and Football (Soccer).

On a reported basis, second quarter revenues for Japan increased 11% while EBIT increased 23% as a result of higher revenues and selling and administrative expense leverage. The decrease in selling and administrative expense as a percentage of revenues was primarily driven by lower sports marketing and digital demand creation spending. For the first half of fiscal 2013, reported revenue increased 3% while EBIT declined 3%. The decrease in EBIT was largely due to higher selling and administrative expense as a percentage of revenue due to higher demand creation spending around the Olympics in the first quarter of fiscal 2013.

**Table of Contents****Emerging Markets**

<i>(Dollars in millions)</i>	Three Months Ended				Six Months Ended			
	November 30,			% Change Excluding Currency Changes	November 30,			% Change Excluding Currency Changes
	2012	2011	% Change		2012	2011	% Change	
Revenues by:								
Footwear	\$ 718	\$ 660	9%	16%	\$ 1,322	\$ 1,227	8%	18%
Apparel	273	233	17%	24%	484	415	17%	27%
Equipment	61	55	11%	16%	113	106	7%	16%
<b>TOTAL REVENUES</b>	<b>\$ 1,052</b>	<b>\$ 948</b>	<b>11%</b>	<b>18%</b>	<b>\$ 1,919</b>	<b>\$ 1,748</b>	<b>10%</b>	<b>20%</b>
<b>EARNINGS BEFORE INTEREST AND TAXES</b>	<b>\$ 305</b>	<b>\$ 247</b>	<b>23%</b>		<b>\$ 528</b>	<b>\$ 437</b>	<b>21%</b>	

Excluding changes in currency exchange rates, revenues for the Emerging Markets increased 18% for the second quarter and 20% for the first half of fiscal 2013. For both periods, revenues were higher for every key category and territory, led by Brazil, Argentina, and Mexico.

Excluding changes in currency exchange rates, Emerging Markets footwear revenues grew 16% and 18% for the second quarter and first half of fiscal 2013, respectively, led by Running, Football (Soccer) and Men's and Women's Training. Unit sales increased approximately 11% and 13% for the second quarter and first half of fiscal 2013, respectively, while average selling price per pair increased approximately 5% for both periods, primarily reflective of product price increases.

Excluding changes in currency exchange rates, apparel revenues for the second quarter and year to date period were 24% and 27%, respectively, led by Football (Soccer), Running, and Sportswear. For the second quarter and first six months of fiscal 2013, apparel revenue was driven by approximately 14% and 20% growth in unit sales and approximately 10% and 7% growth in average selling price per unit, respectively. The increase in average selling price per unit for both periods was driven primarily by product price increases and to a lesser extent, a favorable mix of higher priced products.

On a reported basis, revenues for the Emerging Markets increased 11% and 10% for the second quarter and first half of fiscal 2013, respectively, while EBIT grew 23% and 21%, respectively, due largely to improved gross margins. Gross margin increased 300 basis points and 250 basis points for the second quarter and first half of fiscal 2013, primarily due to changes in standard foreign currency exchange rates, as well as the favorable impact from product price increases which more than offset higher product costs. As a percentage of revenues, selling and administrative expense was flat for both the second quarter and year to date period.

**Global Brand Divisions**

<i>(Dollars in millions)</i>	Three Months Ended				Six Months Ended			
	November 30,			% Change Excluding Currency Changes	November 30,			% Change Excluding Currency Changes
	2012	2011	% Change		2012	2011	% Change	
Revenues	\$ 27	\$ 25	8%	15%	\$ 54	\$ 57	-5%	2%
(Loss) Before Interest and Taxes	\$ (324)	\$ (281)	15%		\$ (699)	\$ (547)	28%	

Global Brand Divisions primarily represent demand creation and operating overhead expenses that are centrally managed for the NIKE Brand. Revenues for the Global Brand Divisions are attributable to NIKE Brand licensing businesses that are not part of a geographic operating segment.

The increase in the loss for the second quarter and year to date period was primarily driven by increased investments and marketing support for our digital business and product creation initiatives. For the year to date period, a higher level of first quarter demand creation spending around the Olympics and European Football Championships also contributed to the increase.

**Other Businesses**

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<i>(Dollars in millions)</i>	Three Months Ended				Six Months Ended			
	November 30,			% Change Excluding Currency Changes	November 30,			% Change Excluding Currency Changes
	2012	2011	% Change		2012	2011	% Change	
Revenues	\$ 518	\$ 488	6%	6%	\$ 1,153	\$ 1,073	7%	8%
Earnings Before Interest and Taxes	\$ 80	\$ 71	13%		\$ 201	\$ 176	14%	

Our Other Businesses comprise Converse, Hurley and NIKE Golf.

Excluding changes in currency exchange rates, revenues for our Other Businesses increased 6% in the second quarter, and 8% for the first half of fiscal 2013, reflecting growth across all businesses. Converse revenues grew 5% for the second quarter and 8% year to date, driven primarily by increased sales in the United Kingdom and China, as well as our North America Direct to Consumer business. NIKE Golf grew 10% for the second quarter and 8% for the first half of fiscal 2013.

On a reported basis, EBIT for our Other Businesses increased 13% for the second quarter and 14% year to date, driven by improved profits at Converse, NIKE Golf, and Hurley.

### Corporate

<i>(Dollars in millions)</i>	Three Months Ended			Six Months Ended		
	November 30,			November 30,		
	2012	2011	% Change	2012	2011	% Change
Revenues	\$ (22)	\$ (5)	-	\$ (47)	\$ (13)	-
(Loss) Before Interest and Taxes	\$ (290)	\$ (208)	39%	\$ (555)	\$ (403)	38%

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Corporate consists largely of unallocated general and administrative expenses, including expenses associated with centrally managed departments; depreciation and amortization related to our corporate headquarters; unallocated insurance, benefit and compensation programs, including stock-based compensation; certain foreign currency gains and losses, including certain hedge gains and losses; intercompany eliminations; and other items.

Corporate revenues primarily consist of certain intercompany revenue eliminations and foreign currency hedge gains and losses related to revenues generated by entities within the NIKE Brand geographic operating segments and Other Businesses but managed through our central foreign exchange risk management program.

In addition to the foreign currency gains and losses recognized in Corporate revenues, foreign currency results include all other foreign currency hedge gains and losses generated through our centrally managed foreign exchange risk management program, other conversion gains and losses arising from re-measurement of monetary assets and liabilities in non-functional currencies, and gains and losses resulting from the difference between actual foreign currency exchange rates and standard foreign currency exchange rates used to record non-functional currency denominated product purchases within the NIKE Brand geographic operating segments and Other Businesses.

Corporate loss increased by \$82 million and \$152 million for the second quarter and first six months of fiscal 2013, respectively. The increase is primarily comprised of the following:

Higher foreign exchange losses included in gross margin of \$86 million for the second quarter and \$161 million for the first six months of fiscal 2013 related to the difference between actual foreign currency exchange rates and standard foreign currency exchange rates assigned to the NIKE Brand geographic operating segments and Other Businesses, net of hedge gains,

Change in other foreign currency related results included in other (income) expense, net from net losses in the prior year to net gains in the current year of \$39 million for the second quarter and \$75 million for the first six months of fiscal 2013, and

Higher corporate overhead expense of \$32 million and \$69 million for the second quarter and first six months of fiscal 2013, respectively, primarily due to higher wage related expense.

## **Foreign Currency Exposures and Hedging Practices**

### **Overview**

As a global company with significant operations outside the United States, in the normal course of business we are exposed to risk arising from changes in currency exchange rates. Our primary foreign currency exposures arise from the recording of transactions denominated in non-functional currencies and the translation of foreign currency denominated results of operations, financial position and cash flows, such as the Euro and Chinese Renminbi, into U.S. Dollars.

Our foreign exchange risk management program is intended to lessen both the positive and negative effects of currency fluctuations on our reported consolidated results of operations, financial position and cash flows. We manage global foreign exchange risk centrally on a portfolio basis to address those risks that are material to NIKE, Inc. We manage these exposures by taking advantage of natural offsets and currency correlations that exist within the portfolio, and where practical, by hedging a portion of the remaining material exposures using derivative instruments such as forward contracts and options. As described below, the implementation of our foreign currency adjustment program enhanced our ability to manage our foreign exchange risk on a portfolio basis by increasing the natural offsets and currency correlation benefits that exist within our portfolio of aggregate foreign exchange exposure. Our hedging policy is designed to partially or entirely offset the impact of exchange rate changes on the underlying net exposures being hedged. Where hedged, our program has the effect of delaying the impact of current market rates on our consolidated financial statements; the length of the delay is dependent upon hedge horizons. We do not hold or issue derivative instruments for trading purposes.

### **Transactional exposures**

We conduct business in various currencies and have transactions which subject us to foreign currency risk. Our most significant transactional foreign currency exposures are:

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**Product Costs** NIKE's product costs are exposed to fluctuations in foreign currencies in the following ways:

1. Non-functional currency denominated product purchases:
  - a. Certain NIKE entities purchase product from the NIKE Trading Company ( NTC ), a wholly-owned centralized sourcing hub that buys NIKE branded products from external factories, predominantly in U.S. Dollars. The NTC, whose functional currency is the U.S. Dollar, then sells the products to NIKE entities in their respective functional currencies. When the NTC sells to a NIKE entity with a different functional currency, the result is a foreign currency exposure for the NTC.
  - b. Other NIKE entities purchase product directly from external factories in U.S. Dollars. These purchases generate a foreign currency exposure for those NIKE entities with a functional currency other than the U.S. Dollar.

In both purchasing scenarios, a weaker U.S. Dollar reduces the inventory cost incurred by NIKE whereas a stronger U.S. Dollar increases its cost.

2. **Factory input costs:** In January 2012, NIKE implemented a foreign currency adjustment program with certain factories. The program is designed to more effectively manage foreign currency risk by assuming certain of the factories' foreign currency exposures, some of which are natural offsets to our existing foreign currency exposures. Under this program, our payments to these factories are adjusted for rate fluctuations in the basket of currencies ( factory currency exposure index ) in which the labor, materials and overhead costs incurred by the factories in the production of NIKE branded products ( factory input costs ) are denominated.

For the currency within the factory currency exposure indices that is the local or functional currency of the factory, the currency rate fluctuation affecting the product cost is recorded within inventories and is recognized in cost of sales when the related product is sold to a third-party. All currencies within the indices, excluding the U.S. Dollar and the local or functional currency of the factory are recognized as embedded derivatives and are recorded at fair value through other (income) expense, net. Refer to Note 9 Risk Management and Derivatives for additional detail.

As an offset to the impacts of the fluctuating U.S. Dollar on our non-functional currency denominated product purchases described above, a strengthening U.S. Dollar against the foreign currencies within the factory currency exposure indices decreases NIKE's U.S. Dollar inventory cost. Conversely, a weakening U.S. Dollar against the indexed foreign currencies increases our inventory cost.

**Non-Functional Currency Denominated External Sales** A portion of our Western Europe and Central & Eastern Europe geography revenues are earned in currencies other than the Euro (e.g. British Pound, Polish Zloty) but are recognized at a subsidiary that uses the Euro as its functional currency. These sales generate a foreign currency exposure.

**Other Costs** Non-functional currency denominated costs, such as endorsement contracts, intercompany royalties and other intercompany charges generate foreign currency risk to a lesser extent.

**Non-Functional Currency Denominated Monetary Assets and Liabilities** Our global subsidiaries have various assets and liabilities, primarily receivables and payables, denominated in currencies other than their functional currencies. These balance sheet items are subject to re-measurement, which may create fluctuations in other (income) expense, net within our consolidated results of operations.

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### **Managing transactional exposures**

Transactional exposures are managed on a portfolio basis within our foreign currency risk management program. We manage these exposures by taking advantage of natural offsets and currency correlations that exist within the portfolio and may also elect to use currency forward and option contracts to hedge the remaining effect of exchange rate fluctuations on probable forecasted future cash flows, including certain product cost exposures, non-functional currency denominated external sales and other costs described above. These are accounted for as cash flow hedges in accordance with the accounting standards for derivatives and hedging, except for hedges of the embedded derivatives component of the product cost exposure as discussed below. As of November 30, 2012, there were outstanding currency forward contracts with maturities up to 30 months. The fair value of outstanding currency forward contracts at November 30, 2012 and May 31, 2012 was \$78 million and \$183 million in assets and \$39 million and \$32 million in liabilities, respectively. The effective portion of the changes in fair value of these instruments is reported in other comprehensive income (OCI), a component of shareholders' equity, and reclassified into earnings in the same financial statement line item and in the same period or periods during which the related hedged transactions affect consolidated earnings. The ineffective portion is immediately recognized in earnings as a component of other (income) expense, net. Ineffectiveness was not material for the three and six months ended November 30, 2012 and 2011.

Certain currency forward contracts used to manage the foreign exchange exposure of non-functional currency denominated monetary assets and liabilities subject to re-measurement and the embedded derivative contracts discussed above are not formally designated as hedging instruments under the accounting standards for derivatives and hedging. Accordingly, changes in fair value of these instruments are immediately recognized in other (income) expense, net and are intended to offset the foreign currency impact of the re-measurement of the related non-functional currency denominated asset or liability or the embedded derivative contract being hedged. The fair value of undesignated instruments was \$26 million and \$55 million in assets and \$31 million and \$20 million in liabilities at November 30, 2012 and May 31, 2012, respectively.

Refer to Note 5 Fair Value Measurements and Note 9 Risk Management and Derivatives in the accompanying notes to unaudited condensed consolidated financial statements for additional description of how the above financial instruments are valued and recorded.

### **Translational exposures**

Many of our foreign subsidiaries operate in functional currencies other than the U.S. Dollar. Fluctuations in currency exchange rates create volatility in our reported results as we are required to translate the balance sheets, operational results and cash flows of these subsidiaries into U.S. Dollars for consolidated reporting. The translation of foreign subsidiaries' non-U.S. Dollar denominated balance sheets into U.S. Dollars for consolidated reporting results in a cumulative translation adjustment to OCI within shareholders' equity. In the translation of our consolidated statements of income, a weaker U.S. Dollar in relation to foreign functional currencies benefits our consolidated earnings whereas a stronger U.S. Dollar reduces our consolidated earnings. The impact of foreign exchange rate fluctuations on the translation of our consolidated revenues and income before income taxes was a net translation benefit (detriment) of approximately \$(165) million and \$(28) million, respectively, for the three months ended November 30, 2012 and approximately \$98 million and \$23 million, respectively, for the three months ended November 30, 2011. The impact of foreign exchange rate fluctuations on the translation of our consolidated revenues and income before income taxes was a net translation benefit (detriment) of approximately \$(488) million and \$(93) million, respectively, for the six months ended November 30, 2012 and approximately \$416 million and \$86 million, respectively, for the six months ended November 30, 2011.

### **Managing translational exposures**

To minimize the impact of translating foreign currency denominated revenues and expenses into U.S. Dollars for consolidated reporting, certain foreign subsidiaries use excess cash to purchase U.S. Dollar denominated available-for-sale investments. The variable future cash flows associated with the purchase and subsequent sale of these U.S. Dollar denominated securities at non-U.S. Dollar functional currency subsidiaries creates a foreign currency exposure that qualifies for hedge accounting under the accounting standards for derivatives and hedging. We utilize forward contracts and/or options to mitigate the variability of the forecasted future purchases and sales of these U.S. Dollar investments. The combination of the purchase and sale of the U.S. Dollar investment and the hedging instrument has the effect of partially offsetting the year-over-year foreign currency translation impact on net earnings in the period the investments are sold. Hedges of available-for-sale investments are accounted for as cash flow hedges. The fair value of instruments used in this manner at November 30, 2012 and May 31, 2012 was \$12 million and \$27 million in assets and \$12 million and \$3 million in liabilities, respectively. The effective portion of the changes in fair value of these instruments is reported in OCI and reclassified into earnings in other (income) expense, net in the period during which the hedged available-for-sale investment is sold and affects earnings. Any ineffective portion is immediately recognized in earnings as a component of other (income) expense, net. The impact of ineffective hedges was not material for any period presented.

The combination of translation of foreign currency-denominated profits from our international businesses and the year-over-year change in foreign currency related gains and losses included in other (income) expense, net had a favorable impact on our income before income taxes of approximately \$10 million for the three months ended November 30, 2012 and had an unfavorable impact of approximately \$19 million for the six months ended November 30, 2012.

Refer to Note 5 Fair Value Measurements and Note 9 Risk Management and Derivatives in the accompanying notes to unaudited condensed consolidated financial statements for additional description of how the above financial instruments are valued and recorded.

### **Net investments in foreign subsidiaries**

We are also exposed to the impact of foreign exchange fluctuations on our investments in wholly-owned foreign subsidiaries denominated in a currency other than the U.S. Dollar, which could adversely impact the U.S. Dollar value of these investments and therefore the value of future repatriated earnings. We have hedged and may, in the future, hedge net investment positions in certain foreign subsidiaries to mitigate the effects of foreign exchange fluctuations on these net investments. In accordance with the accounting standards for derivatives and hedging, the effective portion of the change in fair value of the forward contracts designated as net investment hedges is recorded in the cumulative translation adjustment component of accumulated other comprehensive income. Any ineffective portion is immediately recognized in earnings as a component of other (income) expense, net. The impact of ineffective hedges was not material for any period presented. To minimize credit risk, we have structured these net investment hedges to be generally less than six months in duration. Upon maturity, the hedges are settled based on the current fair value of the forward contracts with the realized gain or loss remaining in OCI. As of November 30, 2012 and May 31, 2012 there were no outstanding net investment hedges. There were no cash flows from net investment hedge settlements for the six month period ended November 30, 2012. Cash flows from net investment hedge settlements totaled \$(8) million for the six month period ended November 30, 2011.

## Liquidity and Capital Resources

### Cash Flow Activity

Our primary source of operating cash flow for the first six months of fiscal 2013 was net income of \$951 million. Cash provided by operations was \$1,245 million for the first six months of fiscal 2013 compared to \$597 million for the first six months of fiscal 2012, driven largely by significantly smaller increases in working capital in the current year. For the first six months of fiscal 2013 changes in working capital resulted in a net cash outflow of \$113 million compared to a net cash outflow of \$775 million for the same period in fiscal 2012. This year-over-year change in cash invested in working capital was primarily driven by our continued focus on inventory management.

Cash provided by investing activities was \$160 million during the first six months of fiscal 2013, compared to \$832 million for the first six months of fiscal 2012. The year-over-year decrease was primarily due to lower net proceeds from short-term investments (sales and maturities, less purchases); net proceeds were \$197 million in the first half of fiscal 2013 compared to net proceeds of \$1,135 million in the first half of fiscal 2012. In fiscal 2013, the lower net proceeds from short-term investments were partially offset by \$225 million in proceeds from the sale of Umbro.

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Cash used by financing activities was \$1,431 million for the first six months of fiscal 2013 compared to \$1,454 million for the first six months of fiscal 2012. The decrease in cash used by financing activities was primarily due to lower common stock repurchases combined with a decrease in long-term debt maturities, which together more than offset lower proceeds from stock option exercises compared to the same prior year period.

In the first six months of fiscal 2013, we purchased 24.4 million shares of NIKE's class B common stock for \$1,162 million and concluded the Company's four-year, \$5 billion share repurchase program approved by the Board of Directors in September 2008. Under this program the Company purchased a total of 118.8 million shares at an average price of \$42.08. Following the completion of this program, the Company began repurchases under a four-year, \$8 billion program approved by the NIKE, Inc. Board of Directors in September 2012. Of the total shares repurchased during the second quarter, 6.2 million shares were purchased under this program at a cost of approximately \$294 million. We continue to expect funding of share repurchases will come from operating cash flow, excess cash, and/or debt. The timing and the amount of shares purchased will be dictated by our capital needs and stock market conditions.

## **Capital Resources**

On November 1, 2011, we entered into a committed credit facility agreement with a syndicate of banks which provides for up to \$1 billion of borrowings with the option to increase borrowings to \$1.5 billion with lender approval. The facility matures November 1, 2016, with a one-year extension option prior to both the second and third anniversary of the closing date, provided that extensions shall not extend beyond November 1, 2018. As of and for the quarter ended November 30, 2012, we had no amounts outstanding under our committed credit facility.

We currently have long-term debt ratings of A+ and A1 from Standard and Poor's Corporation and Moody's Investor Services, respectively. If our long-term debt rating were to decline, the facility fee and interest rate under our committed credit facility would increase. Conversely, if our long-term debt rating were to improve, the facility fee and interest rate would decrease. Changes in our long-term debt rating would not trigger acceleration of maturity of any then-outstanding borrowings or any future borrowings under the committed credit facility. Under this committed revolving credit facility, we have agreed to various covenants. These covenants include limits on our disposal of fixed assets, the amount of debt secured by liens we may incur, as well as a minimum capitalization ratio. In the event we were to have any borrowings outstanding under this facility and failed to meet any covenant, and were unable to obtain a waiver from a majority of the banks in the syndicate, any borrowings would become immediately due and payable. As of November 30, 2012, we were in full compliance with each of these covenants and believe it is unlikely we will fail to meet any of these covenants in the foreseeable future.

Liquidity is also provided by our \$1 billion commercial paper program. During the three months ended November 30, 2012, we issued commercial paper and repaid borrowings totaling \$305 million. As of November 30, 2012, no amounts were outstanding under this program. We may continue to issue commercial paper from time to time during fiscal 2013 depending on general corporate needs. We currently have short-term debt ratings of A1 and P1 from Standard and Poor's Corporation and Moody's Investor Services, respectively.

As of November 30, 2012, we had cash, cash equivalents and short-term investments totaling \$3.5 billion, of which \$3.0 billion was held by our foreign subsidiaries. Cash equivalents and short-term investments consist primarily of deposits held at major banks, money market funds, Tier-1 commercial paper, corporate notes, U.S. Treasury obligations, U.S. government sponsored enterprise obligations, and other investment grade fixed income securities. Our fixed income investments are exposed to both credit and interest rate risk. All of our investments are investment grade to minimize our credit risk. While individual securities have varying durations, the average duration of our entire cash equivalents and short-term investment portfolio is less than 116 days as of November 30, 2012.

Despite recent uncertainties in the financial markets, to date we have not experienced difficulty accessing the credit markets or incurred higher interest costs. Future volatility in the capital markets, however, may increase costs associated with issuing commercial paper or other debt instruments or affect our ability to access those markets. We believe that existing cash, cash equivalents, short-term investments and cash generated by operations, together with access to external sources of funds as described above, will be sufficient to meet our domestic and foreign capital needs in the foreseeable future.

We utilize a variety of tax planning and financing strategies to manage our worldwide cash and deploy funds to locations where they are needed. We routinely repatriate a portion of our foreign earnings for which U.S. taxes have previously been provided. We also indefinitely reinvest a significant portion of our foreign earnings, and our current plans do not demonstrate a need to repatriate these earnings. Should we require additional capital in the U.S., we may elect to repatriate indefinitely reinvested foreign funds or raise capital in the U.S. through debt. If we were to repatriate indefinitely reinvested foreign funds, we would be required to accrue and pay additional U.S. taxes less applicable foreign tax credits. If we elect to raise capital in the U.S. through debt, we would incur additional interest expense.

## **Contractual Obligations**

There have been no significant changes to the contractual obligations reported in our Annual Report on Form 10-K for the fiscal year ended May 31, 2012.

The total liability for uncertain tax positions was \$374 million, excluding related interest and penalties, at November 30, 2012. We estimate that it is reasonably possible that the total gross unrecognized tax benefits could decrease by up to \$78 million within the next 12 months as a result of resolutions of global tax examinations and the expiration of applicable statutes of limitations.

## **Recently Adopted Accounting Standards**

In September 2011, the FASB issued updated guidance on the periodic testing of goodwill for impairment. This guidance will allow companies to assess qualitative factors to determine if it is more-likely-than-not that goodwill might be impaired and whether it is necessary to perform the two-step goodwill impairment test required under current accounting standards. This new guidance became effective for us beginning June 1, 2012. The adoption did not have a material effect on our consolidated financial position or results of operations.

In June 2011, the FASB issued guidance on the presentation of comprehensive income. This new guidance eliminates the current option to report other comprehensive income and its components in the statement of shareholders' equity. Companies will now be required to present the components of net income and other comprehensive income in either one continuous statement, referred to as the statement of comprehensive income, or in two separate, but consecutive statements. This guidance originally also required companies to present reclassification adjustments out of accumulated other comprehensive income by component in both the statement in which net income is presented and the statement in which other comprehensive income is presented. However, in December 2011, the FASB issued guidance which indefinitely defers the requirement related to the presentation of reclassification adjustments. Both issuances on the presentation of comprehensive income became effective for us beginning June 1, 2012. As this guidance only amends the presentation of the components of comprehensive income, the adoption did not have an impact on our consolidated financial position or results of operations.

### **Recently Issued Accounting Standards**

In July 2012, the FASB issued an accounting standard update intended to simplify how an entity tests indefinite-lived intangible assets other than goodwill for impairment by providing entities with an option to perform a qualitative assessment to determine whether further impairment testing is necessary. This accounting standard update will be effective for us beginning in the first quarter of fiscal 2014, and early adoption is permitted. We do not anticipate the adoption will have an impact on our consolidated financial position or results of operations.

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In December 2011, the FASB issued guidance enhancing disclosure requirements surrounding the nature of an entity's right to offset and related arrangements associated with its financial instruments and derivative instruments. This new guidance requires companies to disclose both gross and net information about instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to master netting arrangements. This new guidance is effective for us beginning June 1, 2013. As this guidance only requires expanded disclosures, we do not anticipate the adoption will have an impact on our consolidated financial position or results of operations.

## **Critical Accounting Policies**

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities.

We believe that the estimates, assumptions and judgments involved in the accounting policies described in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of our most recent Annual Report on Form 10-K have the greatest potential impact on our financial statements, so we consider these to be our critical accounting policies. Actual results could differ from the estimates we use in applying our critical accounting policies. We are not currently aware of any reasonably likely events or circumstances that would result in materially different amounts being reported.

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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There have been no material changes from the information previously reported under Item 7A of our Annual Report on Form 10-K for the fiscal year ended May 31, 2012.

**ITEM 4. CONTROLS AND PROCEDURES**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act of 1934, as amended ( the Exchange Act ) reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

We carry out a variety of on-going procedures under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, to evaluate the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of November 30, 2012.

There has been no change in our internal control over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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**Special Note Regarding Forward-Looking**

**Statements and Analyst Reports**

Certain written and oral statements, other than purely historical information, including estimates, projections, statements relating to NIKE's business plans, objectives and expected operating results, and the assumptions upon which those statements are based, made or incorporated by reference from time to time by NIKE or its representatives in this report, other reports, filings with the Securities and Exchange Commission, press releases, conferences, or otherwise, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and Section 21E of the Exchange Act. Forward-looking statements include, without limitation, any statement that may predict, forecast, indicate, or imply future results, performance, or achievements, and may contain the words believe, anticipate, expect, estimate, project, will be, will continue, will likely result, or words or phrases of similar meaning. Forward-looking statements involve risks and uncertainties which may cause actual results to differ materially from the forward-looking statements. The risks and uncertainties are detailed from time to time in reports filed by NIKE with the Securities and Exchange Commission, including Forms 8-K, 10-Q, and 10-K, and include, among others, the following: international, national and local general economic and market conditions; the size and growth of the overall athletic footwear, apparel, and equipment markets; intense competition among designers, marketers, distributors and sellers of athletic footwear, apparel, and equipment for consumers and endorsers; demographic changes; changes in consumer preferences; popularity of particular designs, categories of products, and sports; seasonal and geographic demand for NIKE products; difficulties in anticipating or forecasting changes in consumer preferences, consumer demand for NIKE products, and the various market factors described above; difficulties in implementing, operating, and maintaining NIKE's increasingly complex information systems and controls, including, without limitation, the systems related to demand and supply planning, and inventory control; interruptions in data and information technology systems; data security; fluctuations and difficulty in forecasting operating results, including, without limitation, the fact that advance futures orders may not be indicative of future revenues due to changes in shipment timing, the changing mix of futures and at-once orders, and discounts, order cancellations, and returns; the ability of NIKE to sustain, manage or forecast its growth and inventories; the size, timing and mix of purchases of NIKE's products; increases in the cost of materials and energy used to manufacture products, new product development and introduction; the ability to secure and protect trademarks, patents, and other intellectual property; performance and reliability of products; customer service; adverse publicity; the loss of significant customers or suppliers; dependence on distributors and licensees; business disruptions; increased costs of freight and transportation to meet delivery deadlines; increases in borrowing costs due to any decline in our debt ratings; changes in business strategy or development plans; general risks associated with doing business outside the United States, including, without limitation, exchange rate fluctuations, import duties, tariffs, quotas, political and economic instability, and terrorism; changes in government regulations; the impact of, including business and legal developments relating to, climate change; liability and other claims asserted against NIKE; the ability to attract and retain qualified personnel; the effects of our decision to divest of the Cole Haan and Umbro businesses; and other factors referenced or incorporated by reference in this report and other reports.

The risks included here are not exhaustive. Other sections of this report may include additional factors which could adversely affect NIKE's business and financial performance. Moreover, NIKE operates in a very competitive and rapidly changing environment. New risk factors emerge from time to time and it is not possible for management to predict all such risk factors, nor can it assess the impact of all such risk factors on NIKE's business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results. We do not undertake to update our forward-looking statements unless required by law.

Investors should also be aware that while NIKE does, from time to time, communicate with securities analysts, it is against NIKE's policy to disclose to them any material non-public information or other confidential commercial information. Accordingly, shareholders should not assume that NIKE agrees with any statement or report issued by any analyst irrespective of the content of the statement or report. Furthermore, NIKE has a policy against issuing or confirming financial forecasts or projections issued by others. Thus, to the extent that reports issued by securities analysts contain any projections, forecasts or opinions, such reports are not the responsibility of NIKE.

**Table of Contents****PART II OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

There have been no material developments with respect to the information previously reported under Part I, Item 3 of our Annual Report on Form 10-K for the fiscal year ended May 31, 2012.

**ITEM 1A. RISK FACTORS**

There have been no material changes in our risk factors from those disclosed in Part I, Item 1A, of our Annual Report on Form 10-K for the fiscal year ended May 31, 2012.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

During the three months ended November 30, 2012, the Company concluded the previous four-year, \$5 billion share repurchase program approved by the Board of Directors in September 2008. During this program the Company purchased a total of 118.8 million shares at an average price of \$42.08 per share. Following the completion of this program, the Company began repurchases under the new four-year, \$8 billion program approved by the Board of Directors in September 2012.

The following table presents a summary of share repurchases made by NIKE under the purchase programs during the quarter ended November 30, 2012.

Period		Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs <i>(In Millions)</i>
September 1	September 30, 2012	2,815,400	\$ 48.74	2,815,400	\$ 7,952
October 1	October 31, 2012	2,854,956	\$ 47.27	2,854,956	\$ 7,817
November 1	November 30, 2012	2,368,718	\$ 47.00	2,368,718	\$ 7,706
		8,039,074	\$ 47.71	8,039,074	

**ITEM 6. EXHIBITS**

(a) EXHIBITS:

3.1	Restated Articles of Incorporation, as amended.
3.2	Third Restated Bylaws, as amended (incorporated by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K filed February 16, 2007).
4.1	Restated Articles of Incorporation, as amended (see Exhibit 3.1).
4.2	Third Restated Bylaws, as amended (see Exhibit 3.2).
10.8*	NIKE, Inc. Long-Term Incentive Plan (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed September 25, 2012).
31.1	Rule 13(a)-14(a) Certification of Chief Executive Officer.
31.2	Rule 13(a)-14(a) Certification of Chief Financial Officer.
32.1	Section 1350 Certificate of Chief Executive Officer.
32.2	Section 1350 Certificate of Chief Financial Officer.
101.INS	XBRL Instance Document.

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101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

*Furnished herewith*

\* *Management contract or compensatory plan or arrangement.*

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**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NIKE, Inc.

an Oregon Corporation

/s/ DONALD W. BLAIR  
**Donald W. Blair**

**Chief Financial Officer**

DATED: January 9, 2013