

Lululemon Athletica, Inc.

NASDAQ: LULU

Analyst: Kara Carman

Sector: Consumer Goods

BUY

Price Target: \$71.40

Key Statistics as of 11/25/2016

Market Price: \$57.99
 Industry: Apparel and Accessories
 Market Cap: \$7.90B
 52-Week Range: \$44.62 - \$81.81
 Beta: 0.65
 P/E: 29.74

Catalysts:

- Fabric innovation
- Expanding retail footprint in Asia and Europe
- Further international expansion
- Holiday months
- Earnings call December 7th, 2016

Company Description:

Lululemon Athletica, Inc. designs, distributes, and retails fashionable, athletic apparel. Lululemon has business operations in two segments, including company-operated stores and direct to consumer. The company operates more than 350 stores located across the globe in countries such as the United States, Canada, New Zealand, Australia, Germany, and more. The direct to consumer segment includes the sale of products through the Lululemon and Iiviva websites. Lululemon's products are intended for athletic practices such as yoga and running, and consist of products such as pants, shorts, tops, jackets, and even yoga mats. Lululemon's competitors include Hanesbrands, Under Armour, Guess, Gap, and Express.



Thesis

Lululemon Athletica, Inc. is a designer, distributor, and retailer of technical, fashionable, innovative, athletic apparel. Lululemon, since its foundation, has developed an extremely distinctive corporate culture that allows it to be the best in its class. The company's mission is to produce and provide products to its consumers that create transformational experiences for them to live happy, healthy, and fun lives. Lululemon's core values include developing the absolute highest quality products, operating with integrity, leading a balanced and fun life, and nurturing entrepreneurial spirit. Its purpose is "elevating the world from mediocrity to greatness."

Lululemon is the best in its class, with positive margins that well surpass those of its competitors. As an innovative company, Lululemon is continuously setting the bar for the industry with new fabrics and products therefore it is continuously growing year after year. Historically, the company's ROIC/WACC has been 1.93, which proves that they are a value added company. With the holiday months ahead and expansion initiatives in the making, Lululemon will further its growth even more. The company's stock is currently priced towards the lower end of its 52-week range and with the upcoming months, the price is expected to converge closer to its 52-week high.

Industry Outlook

The retail apparel industry is very vulnerable to general seasonal trends. With that being said, the industry typically sees higher net revenues during the holiday season. Lululemon Athletica, along with other companies in its industry has annual net revenues weighted more heavily towards the holiday months of November and December. In Lululemon's case, its operating expenses are evenly distributed throughout the year, whereas a significant portion of its operating profit is generated in FY Q4. For example approximately 45% of Lululemon's full year operating profit for FY 2015 was generated during the fourth quarter. Competition within the industry is substantially on the basis of brand image and recognition, along with product quality, innovation, style, distribution, and price. Lululemon has a premium brand image and a large focus on technical product innovation.

Business Model

Lululemon Athletica primarily conducts business through its company-operated stores and direct to consumer. However, revenue is also generated from warehouse sales, sales to wholesale accounts, from the company's outlet stores and showrooms, and from license and supply agreements. Such revenues are combined in its other category. The company uses a community-based marketing strategy to build brand awareness and customer loyalty. This is done through the use of local ambassadors, social media, community boards throughout stores and a variety of other initiatives. Lululemon operates a vertical retail distribution strategy that differentiates it from its competitors. This allows the company to more effectively and efficiently control its brand image. Lululemon does not own or operate any manufacturing facilities. The company works with approximately 57 suppliers whom provide the fabrics for its products. Approximately 35 suppliers manufacture Lululemon's products, five of which manufactured 65% of them in fiscal 2015. Lululemon does not have any long-term contracts with the majority of its suppliers or manufacturers and it requires that all of which adhere to its vendor code of ethics.

People

Lululemon Athletica's current Chief Executive Officer is Laurent Potdevin. Mr. Potdevin was appointed CEO and a member of Lululemon's Board of Directors in December 2013. Prior to serving at Lululemon, Mr. Potdevin worked at Toms Shoes where he was President from 2011 to 2013. From 1995 to 2010, Mr. Potdevin worked at Burton Snowboards where he held various rolls over his career, including President and CEO. Stuart Haselden has served as Lululemon's Chief Financial Officer since February 2015 and became its Executive Vice President of Operations in October 2015. Mr. Haselden has more than 15 years of executive leadership experience. Prior to joining Lululemon's executive leadership, Mr. Haselden served as CFO and Executive VP of J. Crew for approximately 3 years. Prior to that he served as J. Crew's Senior Vice President of

Finance and Treasurer from 2009 to 2012 and from 2006 to 2009 served as its Vice President of Financial Planning and Analysis. From 1999 to 2005, Mr. Haselden held a variety of leadership positions at Saks. Miguel Almeida has served as Lululemon’s Executive Vice President, Digital since July 2015. Mr. Almeida’s 15 years of operational and senior leadership experiences have a substantial focus on digital strategies. Lee Holman has served as the company’s Executive Vice President, Creative Director since October 2015. Mr. Holman brings 20 years of design and leadership experience to Lululemon’s executive leadership team. Such experience includes senior positions at Nike.

Product Differentiation

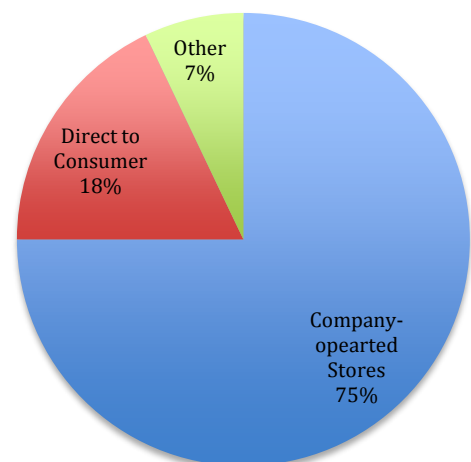
Lululemon Athletica has a team of designers based in Vancouver, British Columbia who partner with international designers in order to lead product design efforts. The team is comprised of not only users of Lululemon’s products but also dedicated athletes who are determined to produce products with premium quality. Trends are identified using market intelligence and research in order to deliver products with leading style, functionality, and technical superiority. The product design team also works extremely closely with Lululemon’s suppliers to ensure consumers are provided with the technically advanced fabrics that they are promised. Testing companies are also incorporated in the process and they conduct various tests on the fabrics the company uses to measure performance characteristics such as abrasion resistance, pilling, colorfastness, and shrinkage. One of Lululemon’s most recent fabric innovations is its “Nulu” line. Nulu is a new fabric incorporated in Lululemon’s bottoms assortment. It provides gentle compression while minimizing disruptions, and it offers quick drying, sweat-wicking, and lightweight coverage. Lululemon is a leader in the industry for craftsmanship and is raising the bar by utilizing highly technical processes that allow it to achieve a richer level of color and print detail without sacrificing the product function.

Financials

Lululemon Athletica experienced a 15% annual growth rate from fiscal 2014 to fiscal 2015 when its net revenue increased from \$1.8 billion to \$2.1 billion. This can primarily be attributed to the opening of 61 new company-operated stores and the growth of ecommerce

sales in its direct to consumer segment. The direct to consumer segment represented 19.5% of net revenue in fiscal year 2015 compared to 17.9% in the previous year. Direct to consumer sales are substantially increasing due to increased internet traffic and higher conversion rates. Lululemon experienced an increased in gross profit margin in fiscal year 2015 primarily due to an increase in fixed costs such as depreciation and a negative impact of foreign exchange rates. However, its profit margin is significantly higher than that of its competitors. In fiscal year 2015, its gross margin was 48.4% whereas the average of its competitors was about 39%. Similarly, Lululemon’s EBITDA margin is 20.34%, whereas the average of its competitors is 13.55%. Lululemon’s net income margin is 11.83% and the only competitor that has a margin remotely close to that is Hanesbrand, with a net income margin of 11.69%. The strength of Lululemon’s margins suggests that it is operating more efficiently than its competitors. Lululemon’s 15% sales growth year over year is nearly double that of its competitors’ average, which is 7.77%. Lululemon’s most recent ROIC/WACC was 2.39, which is more than double of that of its competitors, which is 1.12. This suggests that Lululemon is adding value more rapidly than its competitors and historically the same trend has occurred. Lululemon’s company-operated stores produced income from operations before general corporate expenses of \$346,802,000 for fiscal 2015. Its direct to consumer segment produced \$166,418,000 and the other category produced \$5,826,000.

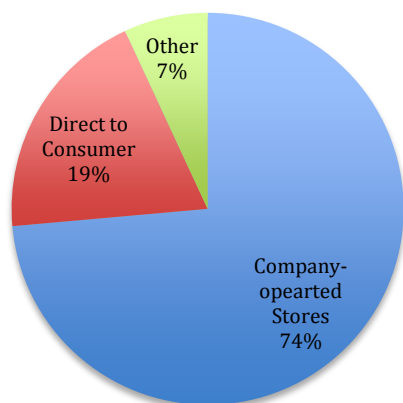
Income from Operations (before general expenses)



Net revenues produced by company-operated stores were \$1,516,323,000 for fiscal 2015 compared to \$1,348,225,000 in fiscal year 2014. . The direct to

consumer segment net revenue was \$401,525,000 compared to \$321,180,000 and net revenues for the other segment were \$127,808,000 for fiscal 2015.

Net Revenues by Segment



Important Dates and Catalysts

With expansion initiatives expected to produce results in fiscal 2017, Lululemon is expecting substantial growth within both of its business segments. In the more near term, Lululemon expects that more than 40% of its total net revenues to be produced in the time remaining left in November and in the months of December and January. Lululemon's next earnings call is December 7th, 2016.

Summary

Lululemon is a recognizable brand that continuously sets performance standards within the industry and amongst its competitors. As a value adding company, Lululemon will continue to grow and create and add value for its shareholders. With expansion initiatives expected to produce results in fiscal 2017, Lululemon is expecting substantial growth within both of its business segments. Through its innovative and functional products, Lululemon continuously motivates consumers to continue their happy, healthy lifestyles.

Lululemon Athletica Inc.
(LULU)

CENTER FOR GLOBAL FINANCIAL STUDIES

BULLISH

Analysis by Kara Carman
11/22/2016

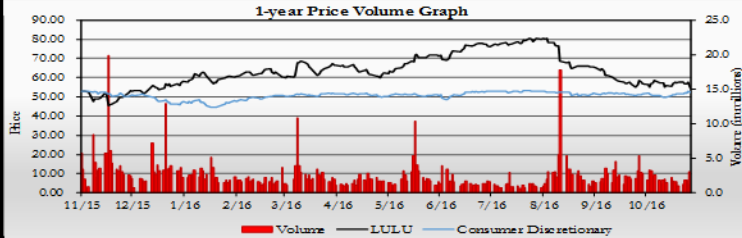
Current Price:
Divident Yield:

\$58.24
0.0%

Intrinsic Value
Target Price:

\$63.40
\$71.40

Target 1 year Return: 22.59%
Probability of Price Increase: 96.4%

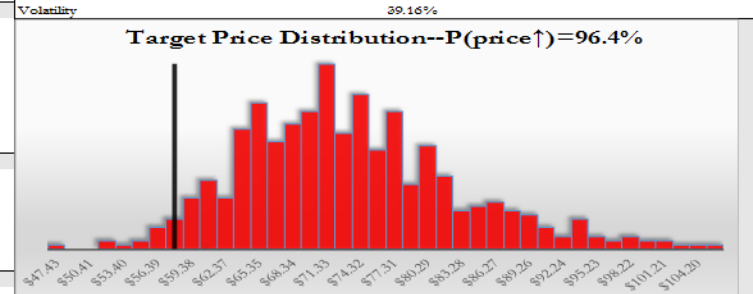


Description	
Lululemon athletica inc, an athletic apparel company, together with its subsidiaries, designs, distributes, and retails athletic apparel and accessories for women, men, and female youth.	
General Information	
Sector	Consumer Discretionary
Industry	Textiles, Apparel and Luxury Goods
Last Guidance	November 3, 2015
Next earnings date	December 9, 2016
Estimated Country Risk Premium	6.47%
Effective Tax rate	36%
Effective Operating Tax rate	36%

Market Data	
Market Capitalization	\$7,647.22
Daily volume (mil)	2.80
Shares outstanding (mil)	137.05
Diluted shares outstanding (mil)	138.28
% shares held by institutions	75%
% shares held by investments Managers	64%
% shares held by hedge funds	10%
% shares held by insiders	7.34%
Short interest	12.19%
Days to cover short interest	6.45
52 week high	\$81.81
52-week low	\$44.62
Levered Beta	0.78
Volatility	39.16%

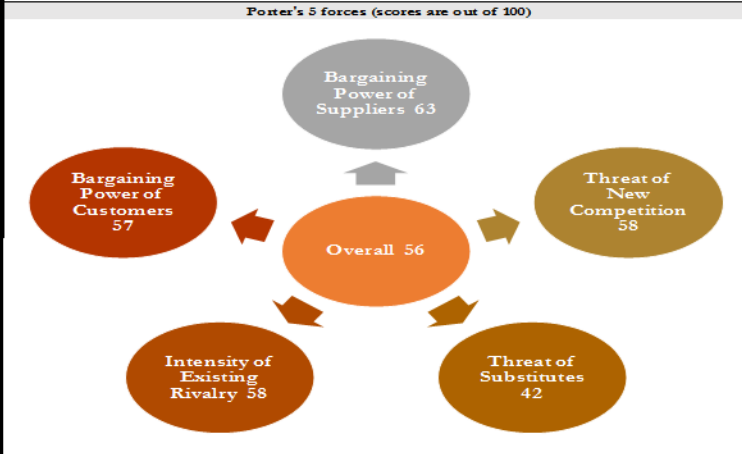
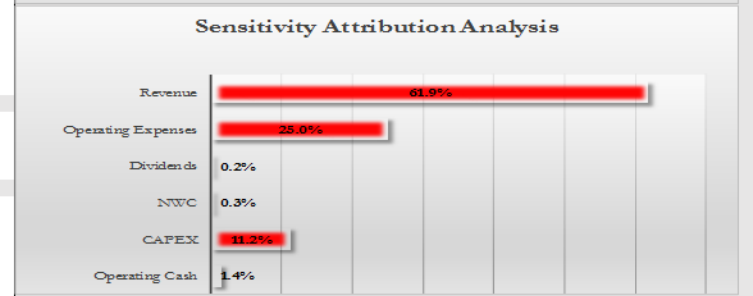
Past Earning Surprises	
Quarter ending	Revenue
8/2/2015	-0.20%
11/1/2015	-4.31%
1/31/2016	1.15%
5/1/2016	-0.36%
7/31/2016	-3.76%
Mean	-1.50%
Standard error	1.1%

EBITDA	
8/2/2015	-9.48%
11/1/2015	-6.51%
1/31/2016	-4.26%
5/1/2016	7.65%
7/31/2016	-9.83%
Mean	-4.49%
Standard error	3.2%



Management	
Fordevin, Laurent	Position
Haselden, Stuart	Chief Executive Officer and Chief Financial Officer
Stump, Scott	Executive Vice President of
Almeida, Miguel	Executive Vice President of
Holman, Lee	Executive Vice President and
Warren, Gina	Executive Vice President of
Profitability	
LULU (LTM)	LULU (5 years historical average)
ROIC	14.6%
NOPAT Margin	17%
Revenue/Invested Capital	0.85
ROE	22.0%
Adjusted net margin	17%
Revenue/Adjusted Book Value	1.32
Invested Funds	
LULU (LTM)	LULU (5 years historical average)
Total Cash/Total Capital	17.7%
Estimated Operating Cash/Total Capital	7.6%
Non-cash working Capital/Total Capital	100.0%
Capital Structure	
LULU (LTM)	LULU (5 years historical average)
Total Debt/Common Equity (LTM)	0.11
Cost of Existing Debt	1.52%
Estimated Cost of new Borrowing	1.00%
CGFS Risk Rating	AAA
Unlevered Beta (LTM)	0.73
WACC	8.35%

Peers	
Under Armour, Inc.	16.55% per annum over 2y
Columbia Sportswear Company	0% per annum over 0y
Coach, Inc.	-6.3% per annum over 1y
G-III Apparel Group, Ltd.	0% per annum over 0y
Urban Outfitters Inc.	0% per annum over 0y
Chico's FAS Inc.	0% per annum over 0y
Express Inc.	N/M
Hanesbrands Inc.	N/M
Total compensations growth	
-100% per annum over 2y	
N/M	
-100% per annum over 1y	
N/M	
N/M	
N/M	
N/M	
Total return to shareholders	
16.55% per annum over 2y	
0% per annum over 0y	
-6.3% per annum over 1y	
0% per annum over 0y	
0% per annum over 0y	
N/M	



Revenue growth	
Base Year	15.6%
7/31/2017	10.8%
7/31/2018	8.3%
7/31/2019	13.3%
7/31/2020	21.5%
7/31/2021	19.0%
7/31/2022	16.5%
7/31/2023	14.0%
7/31/2024	11.5%
7/31/2025	9.1%
7/31/2026	6.6%
Continuing Period	4.1%
Invested Capital	
Base Year	\$1,284.55
7/31/2017	\$1,654.47
7/31/2018	\$2,112.56
7/31/2019	\$2,349.90
7/31/2020	\$2,576.21
7/31/2021	\$3,029.82
7/31/2022	\$3,543.72
7/31/2023	\$3,658.79
7/31/2024	\$4,062.01
7/31/2025	\$4,760.34
7/31/2026	\$5,706.46
Continuing Period	

Valuation	
NOPAT margin	17.1%
ROIC/WACC	1.75
Net Claims	\$62.10
Price per share	\$69.51
	\$77.52
	\$86.08
	\$95.55
	\$106.05
	\$117.64
	\$130.15
	\$143.47
	\$157.53
	\$172.13