



Lululemon Athletica

SWS Stock Pitch - 12/10/19

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Lululemon Overview (NASDAQ: LULU)

- Luxury Athletic Apparel Retailer
- Founded in 1998 in Vancouver
- Calvin McDonald, CEO
- 440 stores worldwide
- Current share price: \$230.88¹
- \$3.58B in revenue
- 15,700 employees



Industry Analysis

Apparel, Accessories and Luxury Goods

- Very saturated and competitive market
- Macroevironment of healthy lifestyle and work-life balance
- Characterized by strong brand loyalty

Competitive Rivalry	<ul style="list-style-type: none"> • Medium • Increasing number of competitors • Key competitors are Nike and Athleta • Competes on price, quality, performance
Supplier Power	<ul style="list-style-type: none"> • Medium to High • 65 suppliers • Sources 30% of fabric use (the Luon fabric) from one Taiwanese manufacturer that also produces it for other companies (Nike, UA)
Buyer Power	<ul style="list-style-type: none"> • Low • Positioned as a higher-end product: offers less sales and discounts compared to competitors
Barriers to Entry	<ul style="list-style-type: none"> • Medium • Names its fabrics and trademarks them • Innovative fabrics
Threat of Substitutes	<ul style="list-style-type: none"> • Very high • Athleisure is more popular • Casual apparel and footwear industry competition • Many similar brands

Competition



- Direct Competition
- 73,000 employees
- “delivers innovative products, experiences and services to inspire athletes”
 - Broad products types
- Global recognition
- Revenue to increase by 7%



- Direct Competition
- Gap has 135,000 employees
- “designs clothing that integrates performance and technical features for active women and girls”
- New subsidiary of Gap since 2008
 - Started in 1998
- Revenue projected to increase

Income Statement

	Fiscal Year Ended				
	February 3, 2019	January 28, 2018	January 29, 2017	January 31, 2016	February 1, 2015
	<i>(In thousands, except per share data)</i>				
Consolidated statement of operations and comprehensive income data:					
Net revenue	\$ 3,288,319	\$ 2,649,181	\$ 2,344,392	\$ 2,060,523	\$ 1,797,213
Cost of goods sold	1,472,032	1,250,391	1,144,775	1,063,357	883,033
Gross profit	1,816,287	1,398,790	1,199,617	997,166	914,180
Selling, general and administrative expenses . . .	1,110,451	904,264	778,465	628,090	538,147
Asset impairment and restructuring costs	—	38,525	—	—	—
Income from operations	705,836	456,001	421,152	369,076	376,033
Other income (expense), net	9,414	3,997	1,577	(581)	7,102
Income before income tax expense	715,250	459,998	422,729	368,495	383,135
Income tax expense	231,449	201,336	119,348	102,448	144,102
Net income	\$ 483,801	\$ 258,662	\$ 303,381	\$ 266,047	\$ 239,033
Other comprehensive income (loss), net of tax:					
Foreign currency translation adjustment	(73,885)	58,577	36,703	(64,796)	(105,339)
Comprehensive income	\$ 409,916	\$ 317,239	\$ 340,084	\$ 201,251	\$ 133,694
Basic earnings per share	\$ 3.63	\$ 1.90	\$ 2.21	\$ 1.90	\$ 1.66
Diluted earnings per share	\$ 3.61	\$ 1.90	\$ 2.21	\$ 1.89	\$ 1.66
Basic weighted-average number of shares outstanding	133,413	135,988	137,086	140,365	143,935
Diluted weighted-average number of shares outstanding	133,971	136,198	137,302	140,610	144,298
	As of				
	February 3, 2019	January 28, 2018	January 29, 2017	January 31, 2016	February 1, 2015
	<i>(In thousands)</i>				
Consolidated balance sheet data:					
Cash and cash equivalents	\$ 881,320	\$ 990,501	\$ 734,846	\$ 501,482	\$ 664,479
Inventories	404,842	329,562	298,432	284,009	208,116
Total assets	2,084,711	1,998,483	1,657,541	1,314,077	1,296,213
Total stockholders' equity	1,445,975	1,596,960	1,359,973	1,027,482	1,089,568

Income Statement Analysis

Income statement metrics help us understand how the company is making their money

Growth Metrics → Useful to compare with multiple companies within an industry & over time

- **Revenue Growth** = $(3,288,319/2,649,181)-1 = 24.1\%$
 - Company generating more money from sale of services/products
- **Operating Income (EBIT) Growth** = $(705,836/456,001)-1 = 54.8\%$
 - Whether company's effectively managing costs & generating revenues
- **Earnings Per Share (EPS) Growth** = $(3.63/1.90)-1 = 91.1\%$

Margin Metrics → How effective firm is in any given year at managing specific costs & line items

- **Gross Profit Margin** = $(1,816,287/3,288,319) = 55.2\%$
 - For every dollar generated in sales, Lululemon has ~55 cents left over to cover basic operating costs & profit
- **Operating Profit (EBIT) Margin** = $(705,836/3,288,319) = 21.5\%$
 - For every dollar generated in sales, Lululemon has ~22 cents left over to cover non-operating expenses & profit
- **Net Income Margin** = $(483,801/3,288,319) = 14.7\%$
 - For every dollar generated in sales, Lululemon has ~15 cents left over in profit

Balance Sheet

	<u>February 3, 2019</u>	<u>January 28, 2018</u>
ASSETS		
Current assets		
Cash and cash equivalents	\$ 881,320	\$ 990,501
Accounts receivable	35,786	19,173
Inventories	404,842	329,562
Prepaid and receivable income taxes	49,385	48,948
Other prepaid expenses and other current assets	57,949	48,098
	<u>1,429,282</u>	<u>1,436,282</u>
Property and equipment, net	567,237	473,642
Goodwill and intangible assets, net	24,239	24,679
Deferred income tax assets	26,549	32,491
Other non-current assets	<u>37,404</u>	31,389
	<u>\$ 2,084,711</u>	<u>\$ 1,998,483</u>

Balance Sheet

LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities			
Accounts payable	\$	95,533	\$ 24,646
Accrued inventory liabilities		16,241	13,027
Accrued compensation and related expenses		109,181	70,141
Current income taxes payable		67,412	15,700
Unredeemed gift card liability		99,412	82,668
Other current liabilities.		112,698	86,416
		500,477	292,598
Non-current income taxes payable		42,099	48,268
Deferred income tax liabilities		14,249	1,336
Other non-current liabilities		81,911	59,321
		638,736	401,523
Commitments and contingencies			
Stockholders' equity			
Undesignated preferred stock, \$0.01 par value: 5,000 shares authorized; none issued and outstanding		—	—
Exchangeable stock, no par value: 60,000 shares authorized; 9,332 and 9,781 issued and outstanding		—	—
Special voting stock, \$0.000005 par value: 60,000 shares authorized; 9,332 and 9,781 issued and outstanding		—	—
Common stock, \$0.005 par value: 400,000 shares authorized; 121,600 and 125,650 issued and outstanding		608	628
Additional paid-in capital.		315,285	284,253
Retained earnings.		1,346,890	1,455,002
Accumulated other comprehensive loss		(216,808)	(142,923)
		1,445,975	1,596,960
	\$	2,084,711	\$ 1,998,483

Balance Sheet Analysis

Balance sheet financial metrics help us determine the financial health of the company

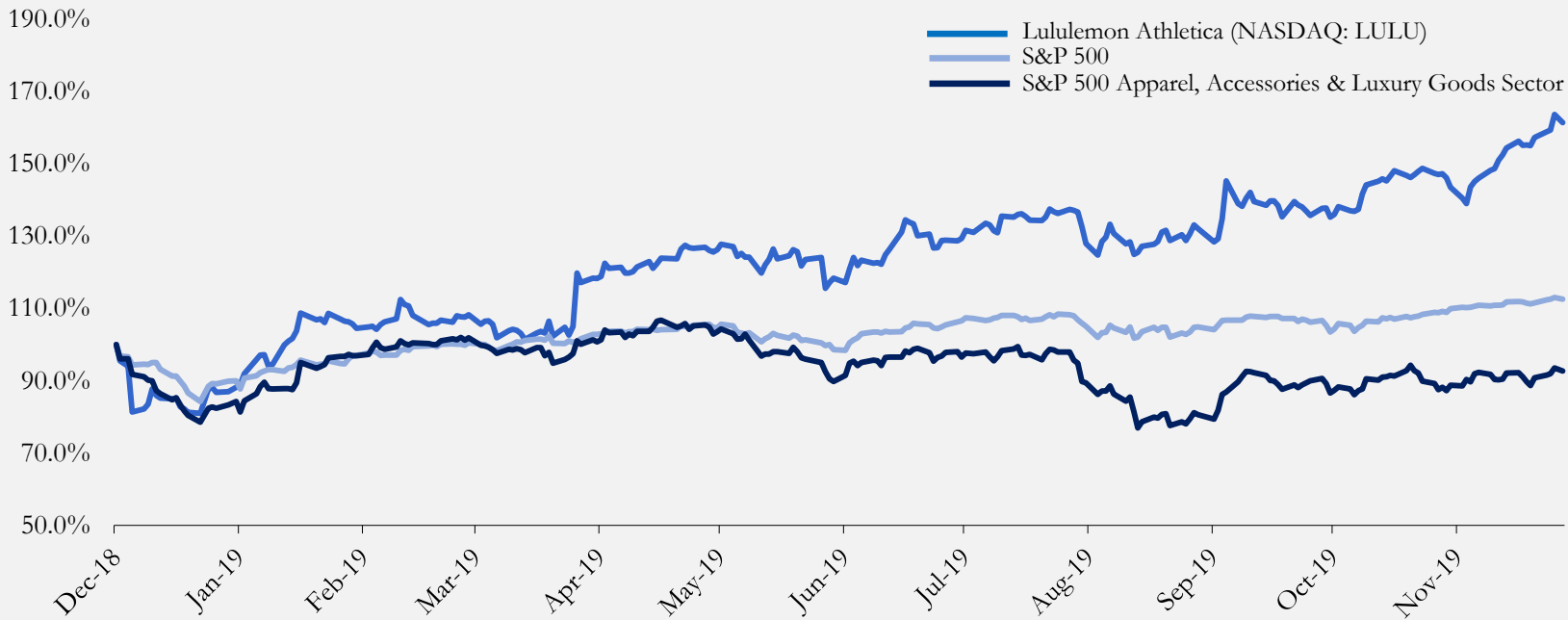
- **Current Ratio** = $CA/CL = 1,429,282 / 500,477 = 2.86$
 - How easily a company can cover current expenses with assets on hand
 - Lululemon can easily fund its CL, but may be keeping cash for other purposes
- **Return On Equity (ROE)** = $\text{Net Income}/\text{Shareholder's Equity} = 483,801 / 1,445,975 = 3.3\%$
 - Measure of efficiency with which a company employs its shareholders' capital
- **Return On Assets (ROA)** = $\text{Net Income}/\text{Total Assets} = 483,801 / 2,084,711 = 2.3\%$
 - Measure of company's profitability
- **Debt-to-Equity** = $\text{Total Liabilities}/\text{Shareholder's Equity} = 638,736 / 1,445,975 = 0.44$
 - Measures the amount of LT debt financing relative to equity in a firm's capital structure
 - $D/E < 1$, assets financed more with equity instead of debt

Valuation

Key Statistics

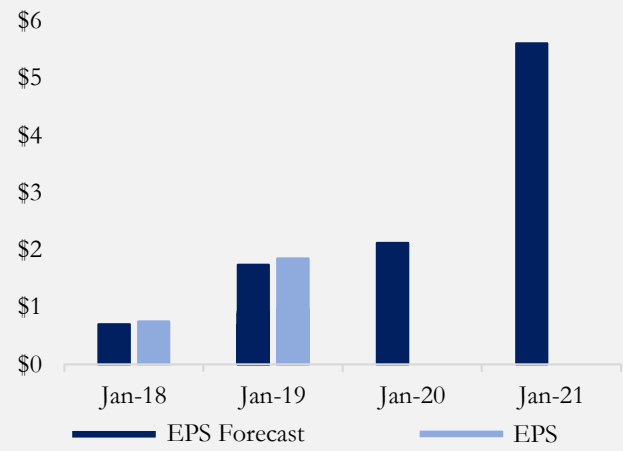
- 10-year average annual shareholder return of 34% compared to industry average of 14%
- Company experienced 20% revenue growth in company-operated stores
- EPS grew 90% over the past year

Company Performance



2018 EPS: \$1.19
2019 EPS: \$3.61

EPS Growth



Lululemon has consistently outperformed the S&P over the past year

Lululemon Public Comparables

Company Name	Ticker	Latest Close Price	Market Cap \$MM	Enterprise Value \$MM	EV/Revenue		EV/EBITDA		Price/Earnings
					LTM	NTM	LTM	NTM	NTM
Columbia Sportswear									
Company	COLM	\$92.50	\$6,246	\$6,435	2.1x	2.0x	12.6x	12.3x	18.9x
Hanesbrands Inc	HBI	15.07	5451	9475	1.4x	1.4x	8.8x	8.7x	8.6x
Under Armour, Inc	UAA	18.89	8166	9049	1.7x	1.7x	23.2x	19.5x	44.1x
PUMA	PUM	75.14	11235	11883	2.1x	1.8x	21.1x	14.7x	33.7x
Adidas	ADS	311.54	60789	63052	2.5x	2.3x	16.5x	15.1x	26.2x
NIKE, Inc	NKE	93.49	145943	149120	3.7x	3.5x	26.2x	26.0x	30.6x
75th Percentile			\$48,400	\$50,260	2.4x	2.2x	22.8x	18.4x	32.9x
Mean			39,638	41,502	2.3x	2.1x	18.1x	16.1x	27.0x
Median			9,701	10,679	2.1x	1.9x	18.8x	14.9x	28.4x
25th Percentile			6,726	9,156	1.8x	1.7x	13.6x	13.0x	20.7x
Lululemon Athletica	LULU	\$225.69	\$29,402	\$29,477	8.2x	7.16x	32.8x	27.83x	44.93x

Company Name	Ticker	Revenue (\$MM)		EBITA (\$MM)		Revenue Growth		EBITDA Growth		Margins
		LTM	NTM	LTM	NTM	LTM	NTM	LTM	NTM	EBITDA
Columbia Sportswear										
Company	COLM	\$3,005	\$3,170	\$510	\$522	13.0%		42.1%		17.0%
Hanesbrands Inc	HBI	6984	6846	1082	1085	4.5%		0.5%		15.5%
Under Armour, Inc	UAA	5216	5481	395	464	0.8%		22.0%		7.6%
PUMA	PUM	5784	6475	564	807	17.7%		25.6%		9.7%
Adidas	ADS	25380	27564	3831	4177	6.0%		26.0%		15.1%
NIKE, Inc	NKE	39829	43003	5695	6466	6.9%		4.6%		14.3%
75th Percentile		\$20,781	\$22,384	\$3,144	\$3,404	11.4%		25.9%		15.4%
Mean		14,366	15,423	2,013	2253	8.1%		20.1%		13.2%
Median		6,384	6,660	823	946	6.4%		23.8%		14.7%
25th Percentile		5,358	5,729	524	593	4.9%		9.0%		10.9%
Lululemon Athletica	LULU	\$3,581	\$4,116	\$876	\$1,059	22.6%		25.6%		25.1%

Lululemon 2019E Implied Valuation			
	P/E	EV/EBITDA	EV
75th	32.9x	22.8x	\$22,646
Median	28.4x	18.8x	\$18,673
Average	27.0x	18.1x	\$17,978
25th	20.7x	13.6x	\$13,508

Fair Value	Current Price
\$143	\$231

Investment Opportunities

Self-Care Product Line

- Expand upon current offerings
- Establish Lululemon as a major player in the self-care industry

Professional Clothing Line

- Develop new clothing line for the modern workplace
- Suits, Blazers, Slacks, and Blouses

Athletic Event Sponsorship

- Partner with major athletic contests around the world
- Marathons, Yoga Retreats, Cycling Races



Investment Opportunities

Net Revenue:

	Fiscal Year Ended		
	February 3, 2019	January 28, 2018	January 29, 2017
	<i>(In thousands)</i>		
United States	\$ 2,363,374	\$ 1,911,763	\$ 1,726,076
Canada	565,105	491,779	447,167
Outside of North America	359,840	245,639	171,149
	\$ 3,288,319	\$ 2,649,181	\$ 2,344,392

Expand Outside of North America

- 349 stores in NA
 - 89% of total revenue
- 91 stores outside of NA
 - 11% of total revenue
- Many competitors have large international distribution networks

Investment Risks

- Potential risks surrounding brand name
- Technical athletic apparel industry is highly competitive
- Business model is very dependent on economic activity
- Potential failure in accurately predicting customer trends and innovation opportunities
- Material and designs are not protected through patents

Investment Recommendation

We recommend selling the stock within the next year

Target Price: \$162.20

- Current P/E: 44.93x
- EPS x P/E: \$3.61 x 44.93 = **\$162.20**
- Current Stock Price: \$230.88
- Overvalued: ~42%

We believe the stock's performance may begin to decline due to slow expansion into European markets, direct competition with Nike in the running and training categories, and low brand awareness among male consumers