

lululemon athletica inc. (LULU)

Investment Thesis

Following the release of its March 21st Q4 earnings, LULU's share price has steadily dropped ~45% as investors weigh lululemon's ability to fight shrinking consumer demand within the Americas with continued product innovation and foreign market development. Currently, investor confidence remains slumped after a series of shortcomings within LULU's product lines, such as reduced sales numbers from their lack of product color and size variation, and the failure of the Breezethrough launch. The continued downturn in consumer and business sentiment paired with high household savings rates within China, one of LULU's largest foreign markets, has also led to further depressed investor confidence. However, the short-term uncertainty and subsequent price decline appears to be an overreaction. A reasonable growth case with stagnant North American growth, consistent international growth, and contributions from new store sales, yields a 2025E EPS of 15.13, using competitor Nike's 2025E P/E as a benchmark then yields our price target of \$356.

- **Growth within lululemon's Active Apparel and Athleisure industry provides a beneficial backdrop of growth.** Over recent years, the maintained prioritization of health and wellness has led consumers to adopt more active lifestyles, therefore allowing activewear and athleisure apparel to gain momentum within the fashion industry. For LULU specifically, this momentum has resulted in a total revenue CAGR of 23.9% over the five years ended Jan 28th, 2024. While current economic conditions may not allow for the continuation of such growth, projections from Euromonitor and Baird Research estimate a reasonable growth case for the sports apparel and footwear market to be 5.3% CAGR globally from 2023 to 2028 with a 3.8% CAGR in North America. This anticipated growth provides opportunities for multiple companies, including LULU, to flourish despite the recent consumer demand turndown.
- **Development of Menswear collections support lululemon's ability to remain competitive.** As part of their Power of Three x2 initiative, lululemon has sharpened their focus on expanding men's apparel sales. In an August 2nd report, Morningstar stated that "...men's clothing now accounts for about almost a fourth of its total revenue ... Lululemon generated \$2.25 billion in men's sales in 2023, up from \$527 million five years earlier." This previous growth of LULU's Menswear collections, which has outgrown the Women's collection CAGR since 2017, suggests that the brand resonates with men as well. Pairing this past success with LULU's continued focus on expanding Menswear through product innovation (Ex: Steady State and Soft Jersey) and dedicated televised marketing campaigns, highlights a significant opportunity to expand market share. This opportunity becomes greater when put into context with LULU's competitors. New brands such as Vuori and Athleta have become a point of apprehension for investors as this increased competition may slow growth. However, within the men's category, superior fabric quality and brand recognition continue build LULU's moat against these competitors.
- **Mainland China's market growth remains strong enough to support growth despite North American slowdown.** With China being the second largest activewear market globally and plans to open 25-35 new stores internationally in 2024, most of which in China, Lululemon can use its brand image and unique consumer experience to overcome stagnant growth within North America. While some concerns have been raised over China's modest cosmetics and clothing spending growth, sports apparel growth remains steady with 70% of consumers sighting increased or maintained spending within this category according to a McKinsey study. With 146 international stores outside of China and North America, Rest of World market growth also provides another layer of opportunity.

Valuation

Price target: \$356

Following a reasonable growth case, involving stable margins, sales growth in line with global market growth (5%/5.5% 2024/2025 CAGR), and annual revenue contributions from 30-35 new stores (mainly in China), provides a 2025E EPS of \$15.13 (~3% below consensus). Factoring this EPS into the current price assumes an overly conservative P/E of 17.55 (~28% below current industry average). Using Nike, one of LULU's main competitors, as a baseline provides a much more appropriate multiple as Nike and LULU face similar consumer challenges and international opportunities. Therefore, the price target of \$356 incorporates a P/E ratio of 23.5, which approximates Nasdaq's 2025 P/E estimate for Nike of 23.8, and falls 1.5 standard deviations below LULU's 15-year average.

Income Statement (\$ Millions)	2023	2024E	2025E
Net Sales	9,619	10,419	11,314
Cost of Goods Sold	3,986	4,376	4,752
Gross Margin	58.56%	58.00%	58.00%
Gross Profit	5,633	6,043	6,562
Selling, General & Administrative	3,402	3,647	3,960
Income from Operations Margin	23.19%	23.00%	23.00%
Income from Operations	2,231	2,396	2,602
Other income (expense)	43	47	51
Pretax Income	2,274	2,443	2,653
Income Tax Expense	652	733	796
Net Margin	16.87%	16.41%	16.41%
Net Income	1,622	1,710	1,857
EPS	12.77	13.67	15.13
Weighted Average Shares	127	125	123

New Store Revenue FY2023	
Stores opened	
China	28
Americas	19
Rest of World	9
Comp Growth	
China	39%
Americas	8%
Rest of World	32%
Revenue per new Store	
China	\$ 5.80
Americas	\$ 14.15
Rest of World	\$ 8.67

(\$ in Millions)

Store Count	711	748	788
Mainland China	127	145	165
Rest of World	146	156	170
Americas	438	447	453

EPS	P/E	Price Target
15.13	23.5	\$356

A history of strong marginal discipline despite international expansion economic conditions provides the basis for the valuation's consistent margins from 2024 to 2025. The drop-off between 2023 to 2024 is partially explained by the increased focus on promotional activity, particularly within the men's department, and partially explained by a want for more conservative estimates. However, management has reported their belief that these margins are unlikely to change. As a result, stable margins will contribute to a robust Free Cash Flow to fuel LULU's share repurchase program, explaining the annual decrease of 2 million within Weighted Average Shares.

Risks

- **Consumer Spending:** As a discretionary product provider, lululemon athletica's growth is significantly affected by consumer spending.
 - **Competition:** The development of multiple competitors such as Athleta and Vuori has created a competitive industry that could harm LULU's market share.
 - **Product Innovation:** After failing to maximize sales due to a lack of product variability, the departure of long-time Chief Product Officer, and the failure of the Breezethrough launch, much of LULU's growth depends on the successful continuation of product innovation.
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