



LULULEMON ATHLETICA INC INVESTMENT RECOMMENDATION

TICKER: LULU



Overview

Current Price: \$296.36
52-week range: \$128.85 – 324.70
Market Cap: \$40.87 B
EV/EBITDA: 39.77
Target Price: \$325
Recommendation: LONG

Recommendation

We recommend to long LULU with a time horizon of 5 months. In the short term, we think there will be a pullback from the recent rally, with a new sideways trend arising. However, LULU's excellent business will return alpha by early Q4 2020.

Background

Lululemon Athletica Inc. is one of the leading designers and distributors in the retail trade industry, with a specific focus in retail of athletic apparel and accessories. It operates both through company-operated stores and direct to consumer business segments. Its Direct to Consumer business segment contains its mobile-app and also its e-commerce site, whilst its Company-Operated Stores business segment consists of the lululemon and ivivva brands: specialising in athletic wear for men, women and female youth.

Investment Thesis

In 2018, Lululemon announced a 5-year plan to double its menswear revenue by 2023, by widening product ranges in men's apparel and running accessories. With Lululemon's typical association with women's leisure wear, this expansion proves to be a viable growth opportunity, generating \$526.5 million in men's revenue in 2018, compared to \$933.8 million in 2019.

In this same 5-year growth plan, Lululemon also announced that it seeks to expand further into international markets, specifically Europe and Asia. The China market is a pivotal focus for the company's international expansion, with their sales in China jumping 70% in the first quarter of 2019, largely due to the use of local models to release specialised products for specific regions.

Nearly one third of Lululemon's total revenue is through e-commerce. In 2018, Lululemon saw a significant increase in digital sales following a website revamp for the North American market. With plans to launch new websites in Japan, Germany and France, their growing digital presence may be a reliable catalyst for a strong growth in earnings.

Lululemon has multiple competitor advantages including patented material and customer loyalty. The current coronavirus pandemic has seen a large shift to online shopping due to store closure which Lululemon have effectively capitalised on by offering digital classes and using other marketing techniques to build customer loyalty, retain current customers and attract new ones.

Catalysts

Hard

- Introduction of new products in men's apparel, running and accessories range.
- International expansion into markets such as Europe and Asia.

Soft

- Plans to launch new websites in Japan, Germany and France.
- Stores reopening due to easing lockdown measures as the coronavirus passes.



Contrarian & Risk

Despite Lululemon's e-commerce being strong, they reported a fiscal first quarter sales decline of 17% since 2019. This is due to its stores being shut due to the coronavirus pandemic and their digital business wasn't powerful enough to offset this loss.

As of June 10th, 295 of the 489 global stores have reopened, with the rest expected to follow by early July. However, a second wave of the coronavirus may be imminent which would prevent the reopening of stores and also trigger more closure, potentially inhibiting the appreciation of the stock price.

LULU has a beta value of 1.08 and is therefore fairly susceptible to market volatility. As of recent, the CBOE Volatility Index jumped up 50% on June 11th, highest since April 21-22, showing that the implied volatility in the market is returning peak corona levels thus, we could see a lot of sideways movement in LULU in the short term whilst markets recover.

Mitigation

- To mitigate potential short-term downside, we would use a short Iron Condor option strategy to hedge investment. This would mitigate expected sideways movements in the future
 - We made an option strategy model with options expiring 18th Dec, Break evens @ \$335.30 & \$274.40 with potential upside of \$1530, downside \$470
 - We would long put @ \$270 and long call @ \$360
 - We would short put @ \$290 and short call @ \$340
 - Making the Hedge would generate \$1530 in premiums
- We've attached graphs of our models for you to refer to in the appendix

Numbers & Valuation

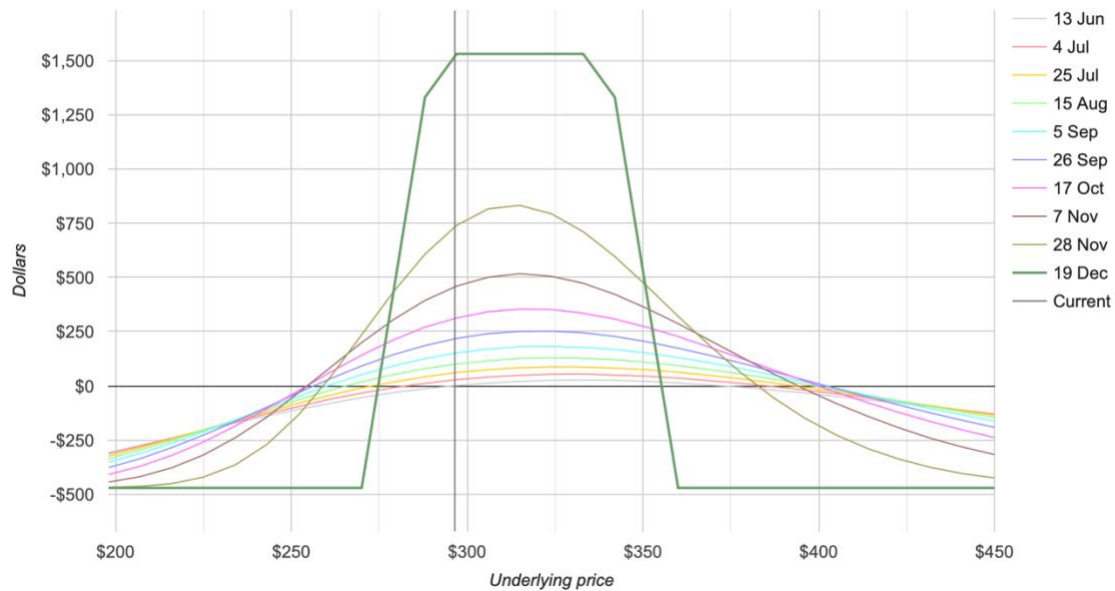
- Used a Discounted Cash Flow analysis to value LULU at **\$252**
- Overview of key assumptions in our DCF listed in our model
- For our forecast graphs, please see appendix
- LULU's balance sheet is very strong
 - \$1.094 Billion in cash and zero in debt
- P/E ratio of 59.23
- LULU seems to be overvalued given the following metrics
 - Intrinsic value by DCF 15% lower than current price
 - P/E ratio of 59.23, over twice the market average
 - PEG ratio of 4.31 (over 1 therefore suggests overvalued)
 - P/B ratio of 19.53 suggesting LULU is massively overvalued with respect to its assets and liabilities
- The combination of the overvaluation and the under par Q1 earnings has placed stress on the stock causing a consolidation, but we believe this will be good for LULU long term and will provide a base such that it can move sideways before steadily rising

Conclusion

We believe with Lululemon Athletica Inc will be a phenomenal growth investment with large upside due to the fantastic business model, strong brand, loyal customers & growth into new business areas.

Appendix

Graph showing P&L for Iron Condon
option hedging strategy



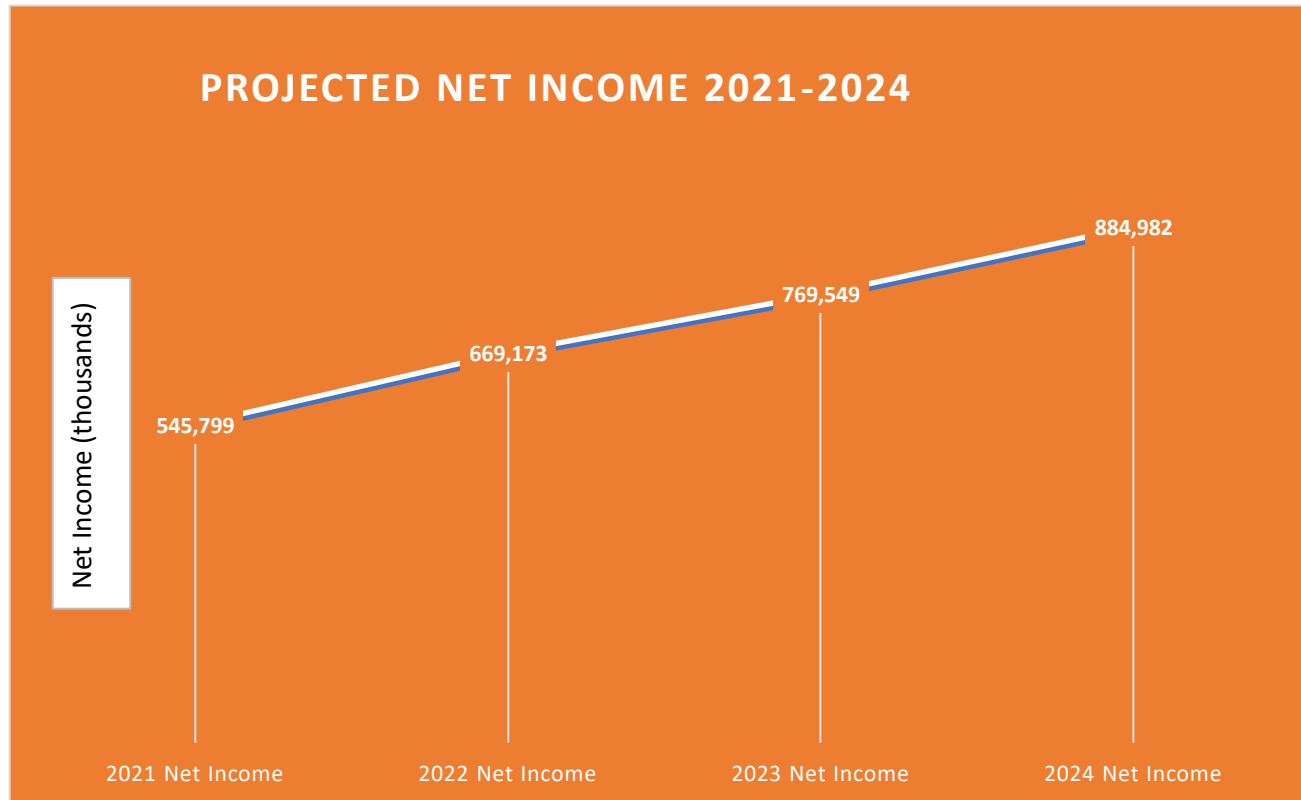
Estimated returns- LULU at \$296.48 on 12th Jun 2020

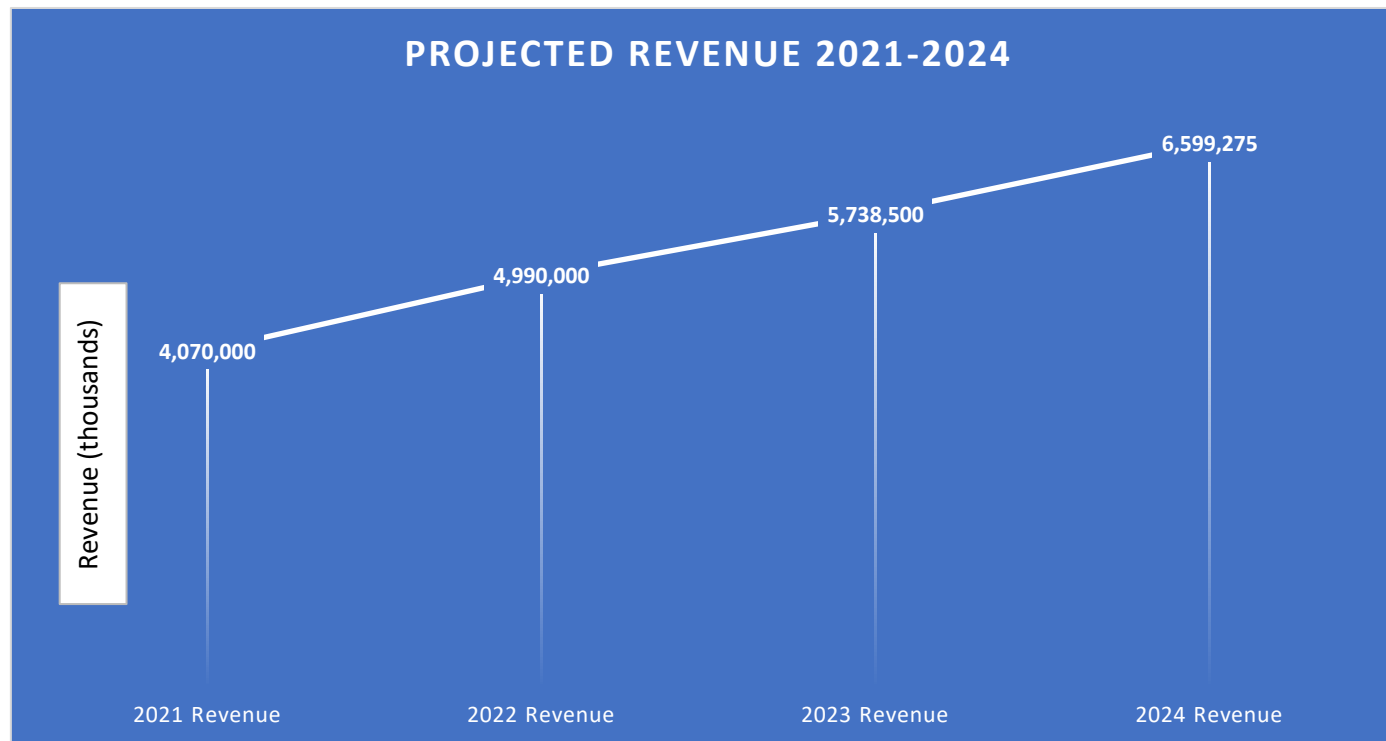
Entry cost: **\$1530** (net credit) [see details](#)

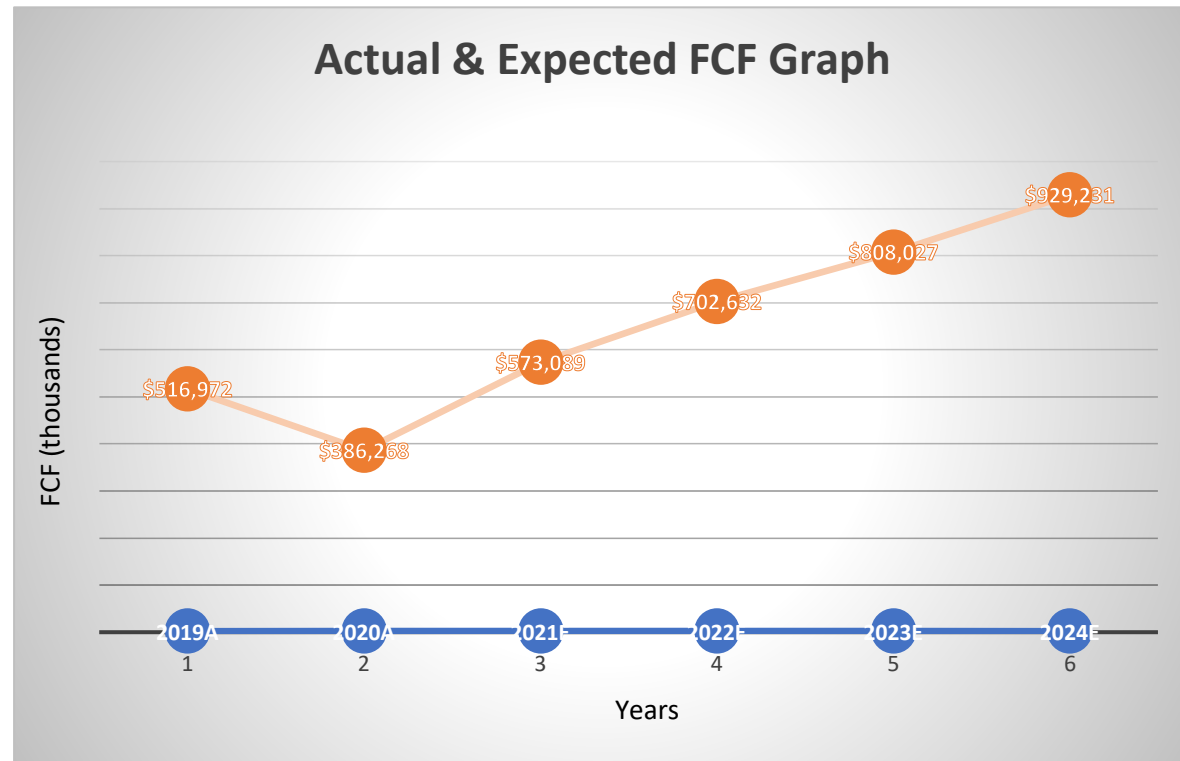
Maximum risk: \$470 at a price of \$270 at expiry

Maximum return: \$1530 at a price of \$290 at expiry

Breakevens at expiry: \$355.30, \$274.70









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