

Lululemon Athletica

David Gardner | December 22, 2010

CURRENT PRICE: [LULU](#) \$ 295.13  -\$ 0.09 (-0.0%) ČvàG! Ýi B~ĀOG"Ām"ĀAĀl v iN b

 This clothing retailer is our 23rd stock of 2010.

Some of my favorite companies — and some of my best recommendations — sell consumer goods. While selling expensive, high-tech items to a limited number of customers is great, I love products that legions of loyal customers return to again and again. Think of a **Chipotle Mexican Grill** ([NYSE: CMG](#)) burrito or **Green Mountain Coffee Roasters** ([NASDAQ: GMCR](#)) K-cups. That's why strong consumer appeal is one of our six signs of a Rule Breaker. Better yet is a brand that becomes part of a customer's regular habits or personal identity. Brands become their own sustainable advantage, and certain "lifestyle" brands — think Starbucks or Apple — can long hold sway over imitators without relying on patents or huge marketing budgets.

This is what's happening with **Lululemon Athletica** ([NASDAQ: LULU](#)), a company that makes yoga-inspired clothing sold at 130 retail locations in the U.S. and Canada, online, and in yoga studios and small showrooms. In a relatively short time, Lululemon has become an admired brand and is growing at a stunning rate. And with the economy rebounding from the recession, consumers are once again spending money on nonessentials like yoga classes — or just the clothes that make them look like they take yoga.

A Zen Concept

Lululemon was founded in 1998 by Dennis "Chip" Wilson, who spent 20 years in the surf, skate, and snowboard business before becoming a yoga enthusiast. Wilson recognized the growing popularity of women's athletics, particularly yoga, and a need for apparel tailored for active women. (The company has since expanded its line to include running apparel and clothes for men and girls.) Wilson's vision also included a desire for clothing that not only offers comfort and performance but also projects an image of eco-awareness — the clothes are often made from exotic or unusual materials, such as bamboo, hemp, seaweed, and soybeans. Customers are also encouraged to use cold water to wash their garments and air dry them, rather than use a dryer, to save energy.

The company has a commitment to health, fitness, and (of course) yoga and is well known for its manifesto — [a red and white collage of inspirational catchphrases and mantras](#) — which is reprinted on posters and shopping bags. This focus on a healthy lifestyle extends to its salespeople (aka "educators") who are encouraged to walk, run, or bike to work. Each store also has a "community coordinator" who organizes fitness and philanthropic events.

A (Money) Tree Pose

Lululemon's eco-friendly and fitness-focused approach to apparel has made for a winning combination. The company went public in July 2007, its stock quickly rising from its debut price of \$18 to more than \$60 per share. Then the recession took hold, and the stock dropped to less than \$5 as investors shunned anything that smacked of luxury (as well as just about everything else). But all that while, Lululemon kept

Lululemon Athletica designs and sells athletic apparel.

WHY BUY?

- Lululemon benefits from resurging consumer confidence, a rising interest in yoga, and a feel-good, health-conscious image.
- After slow but positive growth during the recession, Lululemon has reaccelerated with 31% comparable-store growth so far in 2010.
- Its innovative grassroots promotion strategy is building a powerhouse brand that staves off the competition.

KEY COMPANY DATA

Headquarters: Vancouver, British Columbia

Website: [www.lululemon.com](#)

Sign of a Breaker: Consumer Appeal

CAPS Rating: 1 star (14.15 out of 100)

Market Cap: \$5,204

Cash/Debt: \$225 / \$0

Revenue (TTM): \$627

Earnings (TTM): \$96

Revenue (2007/08/09): \$270 / \$354 / \$453

Earnings (2007/08/09): \$31 / \$39 / \$58

Recent Price: \$73.29

Data as of 12/17/10

Dollar amounts in millions except recent price.

growing. While revenue growth slowed to "only" 31% and 28% in 2008 and 2009 performance was quick to reaccelerate with the economy. Revenue is up 58% during the past 12 months. Perhaps more impressive, comparable-store sales — which held steady in 2008 and grew 9% in 2009 — were up an eye-opening 31% for the first three quarters of 2010.

Store-level economics are also remarkable. The company averaged annual sales of \$1,318 per square foot in fiscal 2009 — more than twice the figure you'll find at apparel stores such as **Aeropostale** ([NYSE: ARO](#)) and **J. Crew** ([NYSE: JCG](#)). That's even more notable when you consider that Lululemon maintains space in many of its retail locations for free yoga lessons — another brand-building piece of brilliance.

Lululemon hits another Rule Breaker criterion: It's been derided as overvalued in the financial press. At \$73, the stock trades at about 53 times this year's estimated earnings. The cash flow picture is somewhat better than reported earnings and implies that the current value of the stock is based on the assumption of 25% annual growth in the next five years, after which Lululemon won't need to grow beyond a baseline 3%. I don't believe this growth story will be all sewn up in just five years, with much of the company's U.S. expansion still ahead of it and international expansion still in the planning phase.

Risks and When We'd Sell

Still, Lululemon's stock isn't cheap at \$73, and the valuation presents a risk if there are any stumbles. So far the company has executed its expansion plans well, but I'll be keeping an eye on store economics as the chain grows. Lululemon had much of its early growth in Canada, which accounted for 60% of sales in 2009 and where sales per square foot are particularly strong. But much of the expansion — it plans to open 300 retail location in North America — will be in the U.S. Today, U.S. stores significantly underperform their Canadian counterparts. If sinking sales per square foot translate to declining margins, we may stretch out our yoga mat elsewhere.

A brand is also only as good as its image, and Lululemon's has been dented before. The company used to make health claims about its VitaSea fabric, which it said contained seaweed. Then, in 2007, a reporter with the *New York Times* took the material to laboratory that didn't find a trace of seaweed in the fabric. Lululemon, which doesn't make the fabric, came out with a lab test finding a different conclusion. Nevertheless, it stopped making claims about the fabric. Given the company's subsequent performance, the controversy doesn't seem to have done it any lasting harm, but if we think this brand is losing its luster, we'll jog on.

The Foolish Bottom Line

Consumers are feeling more confident about spending their paychecks on nonessential items. A growing number of them are putting Lululemon athletic wear in their closets and gym bags — which is why you should put some of this stock in your portfolio today.

David owns shares of Apple, Chipotle Mexican Grill, and Starbucks. The Motley Fool owns shares of Aeropostale, Apple, and Chipotle Mexican Grill.

Is Lululemon the right fit for your portfolio? Add it to [MyScorecard!](#)

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- Is Lululemon Athletica the right fit for your portfolio? Tell us on our [discussion board](#) and add it to [My Scorecard](#).

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Market data provided by FactSet and Web Financial Group.