

ICR Conference

Company Participants

- Laurent Potdevin, CEO
- Stuart Haselden, CFO

Other Participants

- Unidentified Participant, Analyst, Unknown

Presentation

Unidentified Participant

It is my great pleasure to introduce the senior management at lululemon, one of the iconic brands in the outdoor space and in the athletic space. We're going to have Laurent Potdevin come up and Stuart Haselden. And if history is a guide, we're probably going to get a little bit of a show as well. So welcome, everyone. And thank you very much.

Laurent Potdevin {BIO 18481730 <GO>}

All right. Good afternoon. We realized it's late in the day and we also know that you guys are all here for the function show. So Stuart and I will be relatively brief. But we are thrilled to be here. So before I forget, you guys know the drill, we will be making forward-looking statements.

So with that out of the way, I'm going to give you a brief update on the business on our holiday season and then, Stuart will come and get into a little bit more detail with our financials. So obviously, we are thrilled with the way holidays went for us. Numbers have been exceptional. We were conservative with guidance. Back in November, after seeing two weeks of a trend that had changed, it turned out that that change was actually fairly short-lived and mid-November, we resumed our positive traffic number and high single-digit comps. So all from holiday season and what we're more proud is the quantity of the business that we generated during the period.

So if you think about our revenue between Cyber Monday and Christmas Day, we did 90% of our business at full retail and quarter up to-date, including Black Friday, Cyber Monday, that number hovered around 85%. So obviously, very high quality business during a very key period of the year. What's most important in that is it speaks to how well our product is resonating with our guests, it speaks to our store managers and our educators, who all the heartbeat of the brand and deliver exceptional experience that are very unique in the retail landscape today. And it

speaks to the fact that our go-to-market strategy, which is grassroots driven, which is about creating authentic relationship in the communities that we live in; it's a very powerful, sustainable, efficient way to build our business.

So we've got the question a couple times today about why don't you do more traditional marketing? And I answered that why would we? What we're doing is incredibly efficient. It actually speaks to our (inaudible) in a far stronger, powerful way than traditional marketing and actually, we see that strategy work around the world. So we're going to stick with what we do and do it really well.

What you're going to see in the future is as we build a digital culture at lululemon, you're going to see us amplify our grassroots messaging in a more powerful way. So what do we stand for? Well first and foremost, I mentioned our store managers or educators, I mean 9,000 of them around the world creating amazing experiences everyday.

Moving forward, what I'm most excited about is I finally have a full management team as of next week with Gina Warren joining us as our Head of People Potential. So it's really the completion of evolving from being a founder-led organization to building a high-performance culture. In every single one of the function, we have an amazing strong global developed leadership team. I am very excited to have all of that horsepower as we enter 2016.

Our brand operating model remains very much the same. I mean if you guys have heard me talk about the triangle of product, guest experience, brand and community, when we balance that triangle, we win. So the chances that we've made from an organizational standpoint to a point Lee Holman as our Creative Director and Tom Waller as our Head of Innovation really solidifies that triangle and allow us to continue to build the business that's (inaudible) building globally across men's and women's. Then, from a brand and community, it's really continuing to build resonance and relevance in our communities one relationship at a time.

So from a digital standpoint, it's about building CRM, it's about understanding our guests better and obviously, at the store level, continuing to do what we do so well. So our brand operating model is very, very solid, very powerful and relevant around the world. Then, obviously, we've talked a lot about our international expansion and we're continuing to be very focused on key major cities around the world. We've gone up to Asia, we've gone up to Europe. Asia is far exceeding our expectations so far. We've had a brand presence in Asia before we had a brand presence in Europe. So that's part of it. And Europe is on track with our expectations.

And I think when you compare the Asian guest to the European guest, I mean European guest probably takes a little bit longer to accept and embrace a new brand, especially at the premium level. So we're going to be a little bit more patient in Europe and really use different ways of going to market to build a brand awareness quickly and efficiently and we're going to leverage the momentum that we're seeing in Asia.

And obviously, we had a lot of questions on gross margin and inventory. Operational excellence has been very much top of mind and with tools, with processes, with the leadership in place, we're finally in a place where we can deliver margin inflection and go back to levels that you guys will enjoy more than you've enjoyed them in the past couple of years. So people, as I said, I mean as we enter 2016, I'm thrilled about the quality of the team, not only from the standpoint of the people and how aligned they are with our culture. But how strong they are in their own field. So should have got Whitespace and the Creative Director. That is all driven by innovation and design. And so, we've got this right brain function-focused group of two people that are very much inventing the future that we will be living into.

From an operational excellence, we've got IT, operations and finance led by Stuart, who will speak in a little bit. And digital was never a huge area of focus for the organization. The digital function reported into the stores and we've actually built -- we've got six months of center of excellence for digital and we're building a digital culture, we're building a digital muscle led by Miguel Almeida, who joined us about six months ago from Walgreens and prior to Walgreens, Apple.

We've had a tremendous online business and we haven't even started to scratch the surface on how much we can optimize that business. So in Q4, we started to dial up digital marketing and we've been able to drive amazing highly-qualified traffic that had no impact on conversion. Our regional GMs, we've got Ken in Asia, Kristy in Europe, Celeste in North America doing an outstanding job and being experts in their own market.

Brand and Community led by Duke, which is an amazing balance. Duke is not a digital native; Miguel is a digital native; and Duke is all about brand, having begun at Nike and Seventh Generation. And so, the combination of Duke and Miguel is really the best of both worlds. And last but not least, certainly as far as we are concerned is Gina Warren joining us next week to lead Culture & People. So it's taken a while to build this group. But again when you think about evolving from a founder-led organization to a high-performance culture, I've got a team that I'm thrilled to be working with moving forward.

All right. So from a product standpoint, I mentioned Lee being appointed as Creative Director. As a brand that is succeeding by creating a market driven by innovation and design, Lee is the guy with the background at Nike and Burberry that he is perfectly suited to understand how to solve problems for the athletes and bring craftsmanship and design on the product. So the relaunch of the pant wall is actually a really good example of some things we do really well and that's when we are courageous. When we bring innovation to the market, our guests respond instantly with a very little price resistance.

From a guest experience standpoint, we've had for a long time a very successful formula of rolling out 3,000 square foot stores that was square with a certain amount of window and it's been very powerful for a long time. What we're doing now is that we're actually playing with different formats. And I want to be clear that when we talk about different formats and when we talk about flagship, we're actually not talking

about a marketing investment that's going to lose money, we're looking at all of these formats having the same level of profitability that we're going to expect. But it could be an 1,100 square foot store in Hong Kong at IFC across the Apple store that's tracking to about \$8 million or it could be our most recent Flatiron store in New York at 10,000 square feet.

What we're most excited and where we see most success in the mid-term in this is in those expanded square footage. So we're not so much focused about the store count. But we are very focused on expanded square footage in communities where we already have a lot of success. So think about what we've done in Vancouver, in Santa Monica, in Miami or in New York, we've actually seen sales growth outpacing the growth in square footage. So from a store standpoint, we're really having the options to play with different formats and allow us to be in smaller communities, whether it's at the beach or the mountain. And have larger format stores like Flatiron that will obviously serve the New York Community as well as being an incredible platform to put more eyeballs on the brand as we grow our international business.

Then, obviously, from a digital standpoint, I mentioned that we're starting to build a digital culture. Miguel is leading this. What we've done with digital marketing for the past two months has been very, very successful. And so, when people ask us about traditional marketing and we talk about grassroots, there is whole spectrum of things that we can do. And so, we're not stuck with grassroots at the local level. But we're going to use tools that actually allow us to very effectively amplify what we do at the community level. So it's also allowing us mid-term to have very localized assortment of products at the store level, knowing that our educators have access to the entire pool of inventory that sits online. So creating seamless omnichannel experience and we've got the foundation to do that, having rolled out our (inaudible). Brand and community, again it's all about building relevance and resonance with our guests and do that from a very grassroots level. So Seawheeze is an outstanding example of how we do that. I mean if 10,000 people are running, it sells out in less than an hour and it was just voted the best half marathon in the world.

And when you think about the quality of the engagement, in the sport and the athletic world, we were recently voted in the Top 3 brands of engagement and impact on social platforms and Number 1 from a responsiveness standpoint. So when we engage with our community, we see a really strong dialog going on.

From an international standpoint, I touched on that a little bit earlier. Asia is exceeding our expectation. We opened two stores in Singapore; two stores in Hong Kong. We've got two showrooms in South Korea that are performing well above expectations; that will trigger a full rollout. We opened our presence on Tmall, which obviously allowed us to put a lot of eyeballs on the brand. So still very, very focused on key major cities and not sort of getting distracted by going into more infill markets. But very happy with what we're seeing so far.

In Europe, we're on plan. So we're not seeing the same level of success and that's certainly doesn't mean that Europe is not working. We're just on plan and it will take

a little bit longer to build brand awareness in Europe. And as I said earlier, we're looking at different ways of going to market that will allow us to accelerate a building brand awareness. But we're very disciplined. But not getting the store count get ahead of brand awareness. I mean that would be the worst thing that we could do. I mean we kill it, we win when the stores roll out like a little bit behind the excitement in the community.

And so, the start -- two years, I mean we've been very, very focused on coming to an environment, where we had negative store counts, we had PR that was not the greatest, you guys know that. We had product issues. I mean we've been incredibly focused on being guest centric, on bringing product to life back where that; that is design led, that is obviously from a quality standpoint second to none. We've done that really well. It shows in our store counts, it shows in our international expansion and in the background, we have built the processes, the tools and the team to really have the discipline to run a very efficient business. And now, we're positioned with a momentum that we have to really deliver on the margin expansion that we've been talking to you about. So I feel very good that we've got a very, very solid plan with a very clear accountability in each and every bucket that will drive margin expansion and you'll see that happening as we enter 2016.

So with that said, thank you very for listening to us today. And I'll pass it onto Stuart.

Stuart Haselden {BIO 17615686 <GO>}

Great. Thanks, Laurent. So just a few slides on the financials. So thought I would start with a recap of the guidance update that we provided in the press release that we issued yesterday. So very pleased with the holiday sales results and I think, as Laurent mentioned, very strong full-price business in December.

As we look at the upside and the outlook now in the Fourth Quarter and we look at the underlying drivers of that upside, certainly the trends that we saw in traffic and conversion stabilizing into December is a big part of that story as well as the strong positive AURs that we saw continuing in the month. So we saw those trends both across our e-commerce business as well as our store business. And we saw a nice flow-through on that revenue and we included comments in the press release describing how our gross margin rates will -- at the outlook where our gross margin rates remain consistent with the guidance that we've given earlier in December.

And the intent of that was just to communicate that this sales upside does not come from higher markdowns or markdown sales. It was a full-price business that is flowing through and accounting for the upside and the EPS guidance as well. Then, we also provide here just the updated full-year outlook. We expect to post sales this year above [ph] \$2 billion and again, very pleased with the momentum in the business currently.

This next slide, really just -- it provides a chance for us to step back and look at what were the topline drivers in 2015 and it really speaks to the power of the model, both across our channels as well as key categories. And as you look at what drove that

revenue number above \$2 billion or we expect to drive above \$2 billion for the fiscal year, certainly high single-digit comps, square footage growth north of 20%, e-commerce growth in the mid-20s, men's growth north of 20% and a solid women's comp in the mid-single digit driven largely by the outperformance in our pants business, we believe paints a pretty compelling picture for the momentum in our business model broadly and we're excited at the prospects of how we will be able to extend this performance into next year.

Inventory. So couldn't get out the room without talking about inventory. So certainly, the headlines and the overall pictures that we see now is pretty consistent with what we saw when we reported in December. Certainly, we've been able to chip away at on-hand inventory as a result of the improved sales trend. The in-transit elements are largely unchanged. So the net impact of the Fourth Quarter will be some improvement in on-hand inventory, some improvement in the overall number. But still elevates, it's still above where we like it to be. I will be into Q1 before we're able to fully align inventories with our forward sales trend and I'm excited that by Q1, we can stop talking about inventory overhang. So in the bottom line here, we're very confident that the excess inventory is contained and that we have an orderly plan to exit that inventory and align our inventory balances by Q1.

Then, lastly, just wanted to provide some -- the key themes for 2016. Certainly, when we report the Fourth Quarter in March, we'll be able to, at that point, give a more complete view on the outlook for the year as well as update you on our view of the five-year vision for the business. But from the key elements of the growth story as well as the economic model. But certainly some of the key themes we just wanted to highlight today from a revenue standpoint, product innovation remains at the forefront of how we will drive the business broadly and in particular drive our comps across those are our stores and our e-commerce businesses.

Square footage growth, we expect to continue to drive healthy double-digit square footage growth into the foreseeable future; e-commerce digital outsized increases in this area as we continue to invest aggressively in new capabilities from e-commerce standpoint; and international remains a focus for us. For the long-term, we'll continue to accelerate our business through new store openings in both Asia and Europe next year. Gross margin, talked a lot about this. I'm not going to drain the page here. Certainly, the key elements that will drive to leverage an inflection that Laurent mentioned will include air freight, improved costing and logistics and duties. Foreign exchange remains a headwind for us broadly, particularly in Canada. Occupancy and depreciation, while this will be a source of deleverage next year, it will be meaningfully improved to where it was in 2015.

And SG&A, just to make the comment that we will continue to invest aggressively in our growth drivers, you see listed here in terms of digital, international, brand, supply chain and innovation broadly and our Whitespace, our R&D function, which is again at the heart of how we think about our business. So those were the headlines as we think about them into next year. And as I mentioned, we'll be able to provide more specific guidance for 2016 on the March call.

So with that, we're going to conclude the webcast portion of the presentation.

Questions And Answers

Operator

There are no questions.

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