# William Blair Growth Stock Conference

## Company Participants

- Howard Tubin, Company Representative
- Sharon Zackfia, Analyst
- Stuart Haselden, CFO and COO

## Presentation

### Sharon Zackfia {BIO 4804954 <GO>}

Hi. Good morning. I'm Sharon Zackfia. And I'm very happy to have with us today from lululemon, Stuart Haselden, COO and CFO. With a limited number of small-format, highly productive stores generating average sales productivity of roughly $1,600 per square foot, a growing e-commerce business and a 100% proprietary product, lululemon is a retailer built for the 21st century with full control over its product and little potential disintermediation from either brick-and-mortar channel disruption or pure-play e-commerce competition. This control over its own destiny is apparent in management's 5-year plan is to double revenue and more than double earnings by 2020, inclusive of a mid-teens sales CAGR predicted on mid-single-digit comps.

Before I turn in the podium over to Stuart, there is a video that they're going to run. Oh. And I need to tell you, there's a complete list of research disclosures and potential conflicts of interest at williamblair.com.

### Stuart Haselden {BIO 17615686 <GO>}

Good morning. It's good to be here and exciting to see that video. I never get tired of watching that. I'll give you some stats in a little while. But it's been a really interesting way in which we stretched our business model to acquire new guests, something we've never done before. So it's been a fun project.

Obligatory forward-looking statements. And our first slide here. So it's a great shot of Howard in one of his yoga poses here. Which one is that, Howard? Is that tree pose?

### Howard Tubin {BIO 6382352 <GO>}

(inaudible)

### Stuart Haselden {BIO 17615686 <GO>}

I think that's -- I actually don't think that's tree pose. I don't -- I'm not sure what that is. But we appreciate Howard offering that. There's some big ideas on this slide. So the first bullet here, $4 billion in revenue. That's our trajectory for 2020. That is the revenue growth goal that we have. And the other items here on the page are key growth drivers for how we will accomplish that revenue number over the next few years.

The first one listed, our men's business, currently, around 18% of the total today. We're projecting it to be 1/4 of the business by 2020. A lot of energy around our men's business. So you can imagine, as a company that has been rooted around yoga and women's apparel, there's a deep opportunity for us to drive our men's business. And as we've done research around this, we are confident in the -- the products that we have offer something that's really special and differentiated. It's still a bit of a secret. And so as we're able to extend the model to have a closer connection with our male guests, we see the potential well above 25%. We feel that's the number we can deliver as part of that $4 billion number in 2020.

Cross-functional team. We have a new men's designer, Ben Stubbington, who joined us last October. You're going to see some exciting new styles from Ben as he evolves our product offerings, particularly in the second half of the year, jackets and outerwear notably. So there's a lot of opportunity from a product standpoint and then to continue to innovate in the categories that we're currently in as well as exploring new categories to enter.

And from a channel standpoint, you've heard us talk a lot about the colocated model. And this is where we are expanding selected super productive stores, typically in the $7 million range, adding 50% incremental square footage. And we're seeing a 30% to 40% lift in revenue in these stores. A big part of that strategy is our men's business. And so in these really productive stores, it's difficult for us to merchandise our men's business properly or in a powerful way. And so through the colocated strategy, we're able to really present the men's assortment more powerfully. A good example of this was Mall Of America in Minnesota, where we increased the square footage of that store 50%. We increased the men's square footage 100%. And we saw an 80% increase in sales in men's with the same inventory. So that's been an important lesson for us. We've got about 15 of those stores planned for 2017. We'll do more next year. We did about 12 last year. And we've been pleased almost universally with the results.

As we look at the other items listed here, e-commerce been a big focus for the company. A lot of discussion around this over the last 2 quarters. It's incredible the amount of progress that we've made in 60 days. Again, cross-functional team supported by Deloitte Digital, an aggressive strategy and timetable to improve the visual merchandising of the site as well as the functionality. We've seen marked improvements in conversion since we've been in that work. We've done 2 website releases since April. We have more in the works as we look to complete a major overhaul at the front end of the website over the second half of the year.

So we're seeing that effort pay off. And that's reflected in the guidance that we offered for the Second Quarter and the full year. We're seeing a recovery in the trend in e-commerce in the -- and just -- I mean, stepping back strategically for a second, the omnichannel strategy that we have. And really that is emerging in the world, is profound. And this is a central part of how we think about how we serve our guests and how we show up cross-channelly. So we want the guests to have a seamless experience online and in stores. I think we're -- we still have work to do with our digital experience. But we're pleased with the progress that we've made.

And achieving a 25% penetration in e-commerce by 2020, we believe, is more than achievable and is not the height of our aspirations. And we believe that number can be well higher than 25%. It's -- and it's a great business. It's accretive to our overall operating profit margins. It's a higher-margin business than our store business. And again, the degree to which our e-commerce and our store businesses are becoming intertwined is hard to understate. And that is really the future of our business and the world, frankly.

So -- and then the last growth driver, I'll call it here, is international. A lot of excitement, particularly in Asia. We're going to open 15 new stores in Asia. And what's exciting about it is as we have had success in Singapore and Hong Kong and Seoul and Tokyo, we are now being pulled into markets, particularly in Asia -- I'm sorry, particularly in China: Shanghai, Beijing, Chengdu, Guangzhou, Shenzhen. These are all markets that we're seeing -- while awareness is still low, we're seeing a deep appetite for the brand, particularly as we're being pulled into markets by the landlord community, which gives us confidence that this is -- these are markets that are ripe for penetration.

A little slower progress in Europe. We still see deep opportunity there. But the more rapid growth right now internationally is certainly in Asia.

What's happening now? That's not Howard. So This Is Yoga. So you saw the video. It's something we began to work on last year. We mentioned it as -- in terms of brand, marketing and media that we're working on and spent some money on in the second half of last year. And we're thrilled to unveil this. We think it's a beautiful expression of our brand and our cultures. And it reflects the DNA of the company, the yoga-grounded activity business. But it expresses the diversity of what yoga means, particularly within the context of our culture -- our business culture. So there are some beautiful stories here. I'm not going to go through them all. But suffice it to say, we've been very pleased with the impact that this has had with potential -- with our current guests as well as potential guests. We've had 240 million impressions. We got 26 million views of that video. And we think this is an important way we are able to stretch our business model to acquire new guests, to talk to people that don't know us. So really pleased with how this has landed. And we're still early days in determining exactly how to take this strategy forward. But really pleased with the feedback that we've gotten and the impact that we're seeing.

So coming back to the website. So if you were able to look at the website side-by-side today versus even three months ago, you're going to see much more engaging video content, much more engaging photography. It depicts the functionality of the product in a more powerful way. It's -- the manner in which we are able to present the style options is much more effective. So -- and that -- those are the things that are visible. Under the covers, there's a number of technology improvements that we've made, functionality improvements that are driving improvements in conversion. So this is the underpinnings of the work that we started back in April, or in March even, that we talked about on the Q4 call and spent some more time on, on the Q1 call. And this is the meat of how we are turning around the digital business. So we just wanted to mention that today.

Mind Over Miles. Great collaboration with Kerri Walsh Jennings. This is a style that when it landed, it sold out almost immediately. It's a Luxtreme fabric that was able to -- while not a bright color, it's not black or gray. And it helps lighten the assortment, the color palette, at a time when we really needed it. And it's a powerful collaboration with Kerri, who's a great fit for us culturally.

The Enlite Bra. So great story here. Over two years in R&D in our Whitespace team developing the technology behind this. We -- in the first 2 weeks, I think the stat was we were over -- we're 300% overplanned for the -- for what we had bought for this launch. And we're aggressively chasing additional units to meet demand. So technical story, not a low price point. So this bra is just under $100. And we've seen no resistance to price, which -- the lesson that we take from this is when we deliver innovation that matters to the guest, price is not an issue. And so we're thrilled to see how it's performing. And again, this is a great validation of the innovation strategy that we have to deliver technical innovation that matters to our guests.

And ivivva. So we shared the change with our ivivva business on the last call. This is a tough decision. It's a brand that we care a lot about and we believe in. Ultimately, as we had worked over the last couple years to course correct the profit profile of the store business, we concluded that this is ultimately our strongest and most viable economic model as primarily an e-commerce business. So we made the move to divest ourselves of the store business and reposition it as a primarily digital business. We're in that work now. That will unfold over the course of the summer. And it's -- while a great way for us to acquire new guests, if you will, as we are able to engage in a powerful way with girls as well as their mothers, it's a brand that stands for something very positive in the world and that we're proud to be associated with and to continue to develop.

Okay, getting to some of the numbers. So First Quarter, we did see a moderation in the top line trend. And that was really a reflection of the e-commerce issue that we had seen in the First Quarter and that we've been diligently in the work to course correct over the last 60 days, as I mentioned. We're going to see that number inflect into the Second Quarter and accelerate into the second half. And that's reflected in the guidance that we'll cover in a minute. But the -- but we were pleased -- as you go down the P&L, you can see here, we're able to deliver on the product margin, the gross margin expansion we've been working towards for over two years. So we're pleased to see over 200 basis points of gross margin improvement. This was then offset by SG&A pressure that was largely in line with expectations. Some of this was related to the work that we're in with the website and the digital strategy. The lion's share of these costs are going to land in the Second Quarter and the Third Quarter.

The -- so we're pleased to see that we're able to drive expansion in operating margins in the Second Quarter -- I'm sorry, in the First Quarter, even with the slowdown in the top line trend. And able to show an EPS improvement of 7%. So it is a moment in time that we have taken a lot of lessons from as we move forward and growing stronger with our digital business. And there's been a lot of change in a short amount of time to get that business on track.

Square footage growth continues to be healthy double digits. And I think we've got some balance sheet figures. So balance sheet. The cash and liquidity remain strong, over -- or nearly $700 million in cash at the end of the First Quarter. Inventory is very healthy. So 6% increase in inventories, 3% decline on inventories per square foot. This has been a big focus for us in maintaining a healthy inventory position in the wake of the issues that we and many companies had in 2015 with that particular part of the balance sheet. No debt. And there's a meaningful amount left on our share repurchase authorization, as you see there.

Then guidance. So the -- this is an important part of the story. As we think about how the balance of the year is going to shape up and in the Second Quarter, in particular. So we were pleased that for the full year, we are able to raise guidance by a couple of pennies for the full year. And that was really to signal the confidence that we have and the traction that we're seeing and momentum that we're seeing in the business right now and as well as the initiatives that we have in the pipeline for the balance of the year. On the Q4 call, we went to some lengths to outline the strategic initiatives that we have in the works for this year.

And so a number of these, I mentioned in the setup. But there are -- the digital effort is probably top of the list. There's interesting things that we're doing, as you've seen with innovation with the Enlite Bra. There'll be additional innovation that we'll introduce over the course of the year. The brand marketing that we're excited to see with This Is Yoga, we're finally playing offense in this area and stretching the model, as I mentioned. So there's a number of ways in which we are confident in delivering that outcome and working towards that.

So -- and then as you bring that back to the Second Quarter, the outlook here reflects the inflection, in particular in digital, that we've been talking about. So we'll move from essentially a flat comp in the First Quarter to what you see here as the low to mid-single-digit comp, which puts that e-commerce outcome in the double-digit range. So low to mid; to -- low double-digit to mid-teens outcome is what we're expecting, which is remarkable, given that we posted a flat comp in e-commerce in Q1. So -- and this is -- again, this is a sustainable trend. It's more reflective of where we've been over the last few years than where we were in this -- in the moment in time that we had in Q1. So we're confident that is the correct trajectory when we get it right in terms of the execution online.

EPS for the Second Quarter at $0.33 to $0.35 reflects the cost, about $0.05, of that digital acceleration work. So to get this done quickly is -- it comes with a price tag. And so that work is -- those costs are primarily focused in 2 areas: That's the digital work that's happening -- or the technology work that's happening with the website itself, as well as photography costs, as we have taken an aggressive step to improve the photography of the look and feel of the website, the -- upgrading the quality of the models as well as the overall context and how they're shot. So that -- those costs are reflected in this EPS estimate. And as I mentioned, the lion's share of the cost to recover the digital business trend will fall into the second and Third Quarters.

One of the things we've talked about in terms of the long-term model of the business, where we see revenue growth in the mid-teens, we see comps in the low to mid-single digits, we see gross margins that start with a 5 and we see operating margins that start with a 2, we're pleased to see that the revenue trends are on track with that picture. The gross margin trends are on track with that picture as we'll deliver a gross margin that starts with a 5 this year.

The SG&A part of that equation, we believe, is important. And as we had signaled when we offered guidance for the full year back in Q4, we will be able to leverage our cost structure. And that will begin in the Fourth Quarter of 2017 and carry forward into 2018. So the costs that we're incurring now to, in a short period of time, get our e-commerce business back on track is something that will offer us a meaningful opportunity next year, as we are not repeating those actions, to be able to deliver efficiencies in our cost structure.

So those are some of the key elements of the outlook for this year and as well as how we're thinking about the next several years and connecting to that goal and that trajectory to double revenues by 2020 and more than double earnings in that same time frame. So that's our presentation for this morning. I appreciate everyone's time. We will take questions at the breakout immediately following this presentation. So thank you.