

ICR XChange Conference

Company Participants

- Amy Steiner, Store Manager
- Christine Day, CEO
- John Currie, CFO

Other Participants

- Erika Maschmeyer, Analyst, Robert W. Baird & Company, Inc.
- Unidentified Participant, Analyst, Unknown

Presentation

Erika Maschmeyer {BIO 16351096 <GO>}

Hi, I'm Erika Maschmeyer, Baird's senior research analyst covering softline, retail. And department stores. It is my great pleasure to introduce our next company today, lululemon, one that really needs no introduction, one of the most exciting growth stories in retail.

With us from the Company, we have CEO Christine Day, CFO John Currie, VP of Corporate Communications Therese Hayes, as well as some educators. So without further ado, I will pass it over to John.

John Currie {BIO 1494810 <GO>}

Thanks, Erika.

I'll start with just an update on our guidance. As most of you would know by now, we updated our guidance Monday night after the close of the market. With just three weeks to go in the quarter, we have pretty good visibility on how we're going to come in. The previous guidance that we gave in early December was for revenue of \$475 million to \$480 million, high single-digit comp. And earnings per share of \$0.71 to \$0.73.

So as we announced Monday night, we expect to come in at the high end of that revenue guidance, comps still in the high single digits. And earnings per share a little bit better than our previous estimate, coming in at \$0.74, most of that attributable to a slightly stronger gross margin coming from less than we expected in terms of markdowns. We did a good job of holding our pricing through to the end of the shopping season, marking down only after the holiday for a brief period to clear the excess inventory. So we got the flowthrough on that to EPS.

That takes our results for the year to, again, the high end of the revenue range. So \$1.365 billion. That's about a 36% increase year over year. Comp in the mid-teens and EPS of \$1.84, which is about an 80 -- sorry, a 45% increase year over year.

Some of the factors that went into the margin profile in Q4, looking year over year. We got some benefit from being in a better inventory position. We saved on airfreight compared to last year. And of course, with higher volumes we got leverage on fixed costs, such as occupancy and depreciation.

Offsetting that to some extent, we continue to invest in innovation, in terms of our fabric, in terms of the complexity of our garments. And that does compress gross margin. But it's a very deliberate investment. Then, markdowns, even though less than we anticipated, you may recall last year we spent the whole year in a very constrained inventory position, which resulted in less than normal markdowns. This year with a better inventory position, our markdowns still very low. But a little bit higher than last year.

SG&A, we are getting leverage on fixed costs. Pretty much every department within the office, the SSC, we are getting leverage, with the exception of IT where we continue to make heavy investments and will over the next couple of years to continue to build the platform and invest in systems to support our future growth.

Then, secondly, as we've been talking about over the last 12 to 18 months, we're continuing to push forward on our international strategy. In 2012, including Q4, we made significant investments behind the scenes, setting the stage for future international expansion.

So with Q4 2012 pretty much behind us, the quarter ends in 2.5 weeks, we're really looking at 2013 at this point. And as we head into 2013, we're in a very strong position. We now have 211 stores globally. Within that, there's 135 stores in the US towards our eventual target of 300. So that rollout is well underway and very strong. We have a strong pipeline and just a little bit below 50% built out. So lots of runway just in terms of North American square footage growth.

Our e-commerce business continues to grow. We increased penetration to more than 14%. And e-commerce going forward, both domestically and internationally, is a huge opportunity to extend our revenue grab.

In terms of sales per square foot, it looks like we'll end the year at approximately \$2,050 a square foot. That does make us the highest productivity apparel retailer in North America. And all of that allows us to deliver an operating margin in excess of 27%.

We enter 2013 with a very strong balance sheet. We'll likely have somewhere around \$600 million of cash. Our inventory position is great. We've cleared the post-holiday, broken size runs. So we'll enter into 2013 with a very clean inventory position, not a

lot of aged inventory. And a good balanced inventory level to capture our expected demand into 2013.

And we have made a lot of progress setting the stage for our international expansion, which increasingly will become our focus over the next three to five years.

So just to give a snapshot of where we are internationally, we've now added distribution centers to service Europe out of Amsterdam, to service Asia out of Hong Kong, in addition to our distribution centers in Canada, in the US. And in Australia.

In terms of showrooms, as we've talked about before, we have two showrooms in Hong Kong and one in London. All of those are performing tremendously well. In addition to those showrooms, we have people on the ground that we call community connectors that are laying the groundwork, getting to know the local yoga studios, establishing strategic sales accounts. And setting the groundwork for eventual showrooms in additional markets in Germany, in the Netherlands, in Japan. And Singapore. And we'll add more over the next few months.

So for 2013 what you'll see internationally, in Hong Kong, the market's definitely ready for stores. And we are now in an intense search for our first permanent store location in Hong Kong.

In Europe, as I mentioned, the London showroom is doing very well. But what you'll see in Europe is that we'll go much deeper in terms of showrooms in 2013 to set the stage for store openings as early as 2014. So you'll see several more showrooms in London and throughout the UK, in Germany, likely Netherlands. And possibly other countries.

And in addition to that, we now have country-specific websites servicing not just Canada and the US and Australia. But we have a UK site, we have an EU site that services 24 countries. And we have a site out of Hong Kong that services Hong Kong and Singapore.

So 2013, again, will be another year of extending the same strategy, working with showrooms and e-commerce, to set the stage for additional store growth in 2014. And with that, I'm going to turn it over to Christine.

Christine Day {BIO 6942457 <GO>}

Good morning. I want to spend a little bit of time today sharing with you and bringing you in a little closer to some of the magic at lululemon. And what we do that we really feel differentiates us in the marketplace and really creates the culture of lululemon everywhere that we go.

And for us, yoga is at our core. It's not only what we do, it's actually a way of being, a way of leading. It's about being a very centered and accountable individual in your personal practice.

As John said, we're pushing into Europe. And one of the things that we do -- and into Asia, we actually have been in markets up to two years prior to actually having any physical presence.

And what do we mean by that? We have teams that are on the ground. We call them community connectors. They go out and they start sourcing out all of the great yoga studios, spin studios, Pilates studios, the great run ambassadors. And they just go out and they be in that market without really any expectations of driving revenue, just creating networks, creating relationships, learning what the market is, what's driving the consumer.

And so, you can see here, then we started advertising on the back of Yoga Journal, starting to own the brand, create the desire.

So here we have pictures of one of our German ambassadors and one of our ambassadors from Tokyo. So we have this kind of presence right now in about eight markets. And that will continue to grow into other markets. So what we're doing is we're creating desire and being the brand that everybody is waiting for in a real, authentic way.

Now going back to our performance over the quarter and going forward, what are some of the most important learnings that we've had from the quarter? The first is we still have opportunities in architecture. I think our product in the Fourth Quarter was some of the best we've ever had. We had a tremendous amount of color, we had a lot of innovation. And we pushed the envelope in a lot of new directions as a Company.

That said, as you kind of transition into a more technical space, particularly in Canada, coming from our grassroots of really yoga and a little bit more casual wear, for us there were some misses that are the favorite gifts under the Christmas tree for those guests. And so we really know that we have to stay there. And making sure that in the architecture we have the gift-giving price points as well.

The other thing. And I'm going to show a graph in a few minutes. But that ability to transact during peak. You know, this year was a very compressed holiday season right up to the end. And we had lines that were 50 to 70 people deep, an hour wait to buy a gift card so clearly there's a lot of pressure on our stores and for the guest experience during that time. We actually had to have mall security limit people in and out because of the number of people we had waiting for fits and waiting for the store.

So some things that we're doing there are the handheld POS. We had a test in 20 stores this year. In 15 of them, it went really well, learned some lessons in five others. And that will be part of how we address the lines going forward.

The ability to transact gift cards online and download, we got about halfway there this holiday season. But couldn't actually download and change the POS in time

without disrupting holiday. So we didn't implement it this year. But we'll have it for next year so that guests can buy online gift cards all the way up until the 25th, downloadable to your phones or printable.

So those are just some of the things that we're doing, along with distribution. We'll be making some investments in an East Coast DC so that we can shorten the replenishment time to stores. So we still have a lot of opportunity, even as well as we did, to continue to drive the business. And we know the demand is there. And creating the systems to capture it.

And most importantly, too, is management stability. With a lot of brand new managers, they're just operating their store in holiday. The second-year managers can really rock it. And so making sure that we have that pipeline of people and that stability as we grow is also really critical.

But the other learning that we had, which we know to be true and we held, is the premium brand pricing. We had less than 2% of our units on sale or marked down prior to holiday and had about the same, within a %, post holiday. And so, that premium pricing strategy for the long term in a marketplace that's full of discounting has, I think, been a very strong thing for our brand and continues to give us that business momentum and strong earnings capability.

Now we recognize, though, that the consumer is changing. And we have to change who we are as it's going to a more discount holiday, more gift cards during the holiday season to be redeemed after at sales. So we're up for that game and we have a lot of great things that we'll be implementing next year to play in that changing consumer world.

So I just wanted to show you the chart from -- this is 2007. This is also last year, 2011. And it's our this year, 2012, holiday sales. And you can see that 53rd week really has a different slope than the other holiday seasons. And so that's what we're preparing for because this coming year, the holiday season is six days shorter. And so, we know we have to be ready to go and transact peak volumes in our store. But a very consistent pattern, which is what gave us the faith to hold on and not do anything silly with discounting.

So where do we think the opportunities are going forward in North America? One, I've already talked about, which is all of the systems, the East Coast distribution center. We have some stores here in Florida where it can take nine days to get replenishment. So the out-of-stock levels are unacceptable. We solved that in a lot of our other East Coast stores with overnighting. But you really can't do the whole portfolio. So that East Coast distribution system investment will be critical for us to handle the volume and increase the availability of product and drive revenue in those stores.

Most people think that we'd get capped out in our top volume stores. The stores like West Ed, last year it had a \$205,000 day. This year, it had a \$250,000 day. They're

ringing \$27,000 an hour in that store. And it's just an enormous machine.

So the stores that are used to dealing that high volume can handle the peaks really well. It's the next layer of stores that you're still building the muscle to handle that high sales capacity. And that's where our focus is. It is not at the top-level stores.

The next opportunity is men's. And I think for Canada in particular, this is an enormous growth lever for us. A little over a year and a half ago, men's penetration was about 8% of sales. This year to date -- this year on year to date, it's about 12% with the holiday season peaking at 15%. So we know that we're gaining a lot of traction in Canada in men's.

And you'll see us making substantial investment in our men's team. We have an offer out to a great GMM candidate to run men's, working with Sheree. And so you'll see us make a lot more concentrated effort, which will drive Canada and the US business.

Iviva had an exceptional holiday season. We were really pleased. We only had five showrooms in the US. But they really drove a tremendous amount of business to our US e-commerce site. And if you took the iviva concept and ranked it on sales per square foot, it would be number 12 in retail right now. So it's doing over \$900 a square foot and is growing stronger margins every day. So we're ready to roll out iviva and you'll see us open some stores in the US.

Then, as John talked about, international. Our showrooms are fantastic because what we can do already in London and Hong Kong is we can test all the product margins, we can test all the hidden costs, we can test our people costs, the duty import fees so that we can really build our global pricing model, which will be five or six zones. And we'll also build desire. So that when we go to open stores, we've got revenue and we've got a pricing model that supports the gross margins and the business model that we're looking for.

And so, this certainty gives us a lot of confidence in the business model internationally. And our goal is to avoid the big losses that we've seen a lot of people who go before us do.

So I'm spending a little bit of time on how we create the market. And what does that look like? We're not a grow anywhere, grow fast Company. We are about creating deep, sustainable relationships, which people value for the long term, with our guests and building community.

And it's also about the philosophy of how we run the Company. You know, I don't know -- and I proudly admit this -- everything that everyone is doing. I got a Google alert the day before yesterday on my phone. And it was lululemon. So I looked at it. And I found out we were doing an inaugural ball in Washington, DC, that the first lady is coming to. And it was something that our Washington, DC, team worked on

with some of the first lady's people to celebrate health and fitness. So it's a wear your best athletic wear to an inaugural ball in Washington, DC.

And that kind of magic that comes from our people and that creativity and that high level of engagement is really the strength of the Company. And I'm just amazed at everything that our people do every day and that they don't need permission for. And this is really grassroots. They don't get big budgets to do this. So they make a lot of magic happen that really connects our guests and the communities.

This is a picture -- if any of you attended our SeaWheeze half marathon -- last year was our inaugural one, in Vancouver, B.C., we ended up with close to 7,000 participants in it. This year, we expect to have about 10,000. Registration opens today for any of you who would like to come. This was at the end of the day. We had 1,000 people doing yoga on Kits Beach. So it's a really fantastic experience.

But what was most important about this was we involved the local community. There were three stages along the run where we invited the community to come down and celebrate with the runners. So we had a pancake breakfast out in front of our original store, which the run went by. We had all of the big inflatables in kind of a fun park from the Winter Olympics in another one for the community to bring all their kids to. Then, we had a luau party on the West End.

And so, the community came down and celebrated and cheered with everybody. We also invited the arts community to come out with us. And so you had the opera singers singing to you, you had the salsa band end up in trees singing to you, you had some of the local tai chi clubs come down and do tai chi. So it was a really interactive community celebrating the arts experience and celebrating our hometown of Vancouver.

We do this kind of event in all the communities that we are, maybe not at this scope and level that we did here. But it's creating those connections, that emotional bond. And just bringing joy in people's lives.

We also sponsored the women's specialized team, which did really well. And for us, what does that mean? We don't give them a ton of money. We do do their uniforms for them and we actually give them a yoga instructor and we help them with their training. And it's great for the yoga instructor. And we did that also for the men's cycling team. And the next year, they loved their yoga instructor so much that they actually kept him on. And it's now spreading to all the other teams to have a yoga instructor with you when you do your specialized cycling. So that's how we take another's sport is the yoga and. And create that connection to improve performance through cross-training with yoga.

Wanderlust was a big event. We help them host it at Whistler. And we do a little different approach in this. We actually send participants from our stores, from our community. And most importantly we give access to yoga instructors that we work with to teach at Wanderlust, which is a big honor.

This morning, how many of you participated in yoga? A few, yes. We saw a lot of guys there. I was actually really impressed. Jason was our instructor. And after the class this morning, Jason was told that we have sponsored him to be a teacher at the Vermont Wanderlust that's coming up, which is a really big deal. And I didn't know that the team was going to do this this morning. But he got one of 20 slots to teach at the Wanderlust. And it turns out that his mom lives an hour and a half and he hasn't seen her in a couple of years. So it's just those kinds of serendipitous things that happen, that when we talk about elevating the world from mediocrity to greatness, those are the types of stories that we're talking about.

For somebody like Jason, that ability to teach at Wanderlust is like a career highlight and that's how we work with our ambassadors. We're, in essence, their cooperative marketing arm. And we help them build their business because we know that the more people they have in their classes, the more opportunity we have to put clothing on people and help build healthy communities.

We also work with elite ambassadors and we invite them on a retreat globally around the world. So this was our yoga retreat in Hawaii, on Maui. And we had about eight or nine elite athletes from around the world from different sports, some of them from the upcoming Winter Olympics, some of them from cycling, et cetera. And they influence the communities that they work with.

So I'm going to end there because I want to make sure I leave time. This morning at yoga, we brought some product along and we asked people to put it on. And you changed in really interesting places. I was pretty impressed out there on the lawn. So after you product tested, you gave some feedback. And feedback is the core of who we are and how we learn about what to change or what people love about product. And so here are our educators from our Florida stores and showrooms to tell you what we learned.

Unidentified Participant

Good morning. My name is (John). I'm an educator at lululemon athletic at south Miami for three months. And I'm a yogi.

This morning, I was able to give a product, the Groove pants, which I'm wearing, to an investor, Anook, -- I don't see her in here. But Groove pants, the pants that started it all for lululemon. They are made of a cotton feel; breathable signature fabric, luon; flat seams; chafe resistant; great coverage for to and from or when you're in downward-facing dog. Most important. But not least, they make your butt look good. Isn't that the most important product.

So here are some other educators with our products. Namaste.

Good morning, everyone. My name is Eric and I'm from lululemon athletica, south Miami, as well.

So today, I had the opportunity to give out some men's shorts to a gentleman who was doing yoga with me and I got some good feedback from him. He loved the built-in liner, which is inside, already built in, super convenient; zipper pockets to fit your keys, your phone, or whatnot to keep very thing secure. And also the top, same features, four-way stretch. It also has got flat seems. So it's chafe resistant. And the best thing about it is it's anti-stink so you never, ever have to wash it. I'm just kidding . But at least your wife won't hate you for smelling bad. All right. Thank you.

Hi, my name is Christina and I am an educator at the Aventura store. I've only been there for about three months. But I've been a guest and a consumer for several years.

I'm wearing the Run Inspire Crop, which was actually my first purchase of lululemon. And it was really cool because there was a group of us that ran this morning as well. And we had a runner, Courtney, who came out wearing the pants. And her favorite way to sweat is running. So it was great to see her come out in our product and be ready to run in them because they're great with a circle mesh panel in the back for extra ventilation and flat seams for anti-chafe.

I'm also a spin instructor and I do cross-fit. And I wear these in several different aspects of physical activity. So thank you.

Hello, I am Jennifer. I am an educator at the showroom in Miami Beach.

I'm wearing -- I'm also training for the full marathon, the ING, coming up. And all I run in is Luxtreme, which is what I'm wearing, Power Luxtreme. These are the Run For Your Life Crop. We product-tested them -- Karen, I don't know if she's here. But she was able to run with us this morning in them. And what she loved the most about them was that her top was a little sweaty. But not her bottom, because I educated her, telling her that they're made with inherent moisture wicking, which means that it's going to wick the moisture right off of your body and it's going to feel very light.

Also, the cool thing that I love about these crops is that when I'm running, I just zip up my phone back here and I don't need to carry anything else. Got cool little pockets here in the front for the goo on those long runs for those runners you get your goo and it keeps you going. So that's the cool thing about my crops. Thank you.

Good morning, or should I say namaste? My name is Robin. I drove up here from Boca Raton.

I actually gave the Wunder Unders to my new friend Karen. I'm not sure if she's here. She said she was actually going to wear them to the meeting.

But the first thing she said was that she feels like the crops were invisible. And that was awesome because they're super lightweight. It's actually our signature fabric; it's luon on. And so, you're going to dry super-fast. Myself, being one of the founders of

an obstacle race and really into yoga, I know how important it is to be -- have something be lightweight and you can travel with it to and from. So thank you.

Amy Steiner

Hi. Good morning. My name is Amy Steiner. I'm the manager of the Miami Beach showroom just down the street. If you want to come by, we open at 11 a.m. today.

And today, we put on a yoga class and we offered the UnMat to all of the participants. And the UnMat is pretty cool because the way it works is the more you sweat, the more you grip. So if you're a sweaty yogi, you will find that you stay no matter how tough the vinyasa practice is.

And it's great for the analyst yogi on the go because it's really lightweight. You can fold it up, put it in your suitcase, or roll it up, throw it in a bag. Then, if you prefer like a more chill, the in class, you can flip it over and the other side isn't as grippy and it's a little softer. As a yoga instructor, I recommend the UnMat and The Mat to all of our yogis because no matter what type of yoga you practice, one of the sides will suit you. Thank you, guys so much.

Erika Maschmeyer {BIO 16351096 <GO>}

Okay. So thank you, everyone, for being with us today. And with that, I think we'll end the session.

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