

ICR XChange Conference

Company Participants

- John E. Currie, Chief Financial Officer & Executive Vice President
- Laurent Potdevin, Chief Executive Officer & Director

Other Participants

- Bob S. Drbul, Analyst, Nomura Securities International, Inc.

MANAGEMENT DISCUSSION SECTION

Bob S. Drbul {BIO 3131258 <GO>}

Hello. Thank you. Good afternoon, everybody. My name is Bob Drbul and I am from Nomura Securities. It gives me great pleasure today to be here with lululemon. I think we were talking about some of my opening comments it's been a very interesting year and what a difference a year makes especially for lululemon.

What we like about lulu, essentially, is the loyalty among the consumer, the unit story, the unit growth opportunity that is global, the story that's there and as the management team has transitioned it's always a good sign when you transition a management team from outgoing CFO to a new CFO that we think is also very talented. We've got Laurent Potdevin is the CEO, he'll be speaking; John Currie, the CFO, will also be speaking, and Chris Tham, is in the front row here as well, and Joey Teklits (1:06), Director of Investor Relations, is also here with us today.

So with that I'd like to turn the microphone over to Laurent.

Laurent Potdevin {BIO 18481730 <GO>}

Good afternoon. I think this mic is on actually. All right. It's a big crowd for being the end of the day. I mean I don't know if it's as grueling for you guys as it's been for us, but the timing of these meetings back to back was intense.

Anyway, John and I are very pleased to be here today to give you an update on the business. So I'll do a brief presentation, John will go a little bit further into the press release that we issued this morning, and then we'll go into a function show, and I'm assuming that's what you guys are all here for. And you'll get a glimpse of our spring 2015 products for both men's and women's.

So don't forget to click - so this is what I was told not to screw up. So before we begin, this is just a reminder that this presentation will include forward-looking

statements. Statements that are covered by Safe Harbor provisions and you can find more details in our SEC filings. I'm assuming you're done reading all of that.

So, quick overview. I mean I couldn't be happier and more proud of the performance that the team delivered during the holiday season. We continued to build on the momentum that we saw in Q3, clearly hit an inflection point late in Q2, early in Q3, and we've continued to build on that momentum during the holiday with higher traffic, sequentially improving comps, and just a great holiday season with less markdowns than last year.

And what I'd like to do is share a quick personal story that really in my mind – in my mind really sort of helped me visualize the lululemon opportunity. So on December 26, I was in Los Angeles where my kids live with their mother and my parents had flown from Europe. My daughter was going to a volleyball tournament and needed an outfit, so we decided to go the El Segundo store, which is the closest to their home. And away from the madness of Boxing Day in Canada, at 10:30 in the morning I was really hoping that I'd get to interact with the educators in a fairly quiet environment.

And I walked into a jam-packed store. The music was blasting. People were lining at the cash register, people were lining at the changing room, like arms, like loaded with products, and the energy was incredible. I mean guests were engaging with educators, guests were engaging with each other, and we called our educators to educate us for a reason for a long time, and for some reason we continued to call our stores, but that environment was so much more than a store. I mean it was a community hub. And the energy that you experienced in that location was just incredible. And that's how I feel and see the lululemon opportunity. I mean it's a market that we created. We've got amazing products. We're leading the market with very strong margin and we deliver guest experience that are unique and second to none. So when I think about the global opportunity, I really think the El Segundo store and I take that around the world, both in-stores and online across gender, both men's and women's around the globe and in the future across a number of new categories.

So a lot of people have said, well what a year – what a difference a year makes. And I wasn't around last year and I certainly took my share of fumbling early on. So, but when I think about this past year and despite all the headwinds that you guys are very well aware of, I think the team delivered tremendous performance. Like nine months ago we had set out – I got to move my slides, right – so nine months ago we had set out to achieve three goals. One was to strengthen the foundation of the business, so that we could scale the business around the globe and start growing across multiple categories; it was to reignite our product engine, and it was to accelerate our global expansion.

We've clearly strengthened our business foundation. Our product flow, our predictability has greatly improved, our quality at the store level is impeccable, and our guest experience continue to be so incredibly unique. And we're very much on track to finish that foundational work by the end of 2015 and see the full impact of

our work with Q1 of 2016 when our designers, developers, and R&D will have had a chance to work through the entire go-to-market calendar and see their product come to life.

From the standpoint of reigniting our product engine, Tara and Jennifer have done an outstanding job in a very short period of time re-assorting, reflowing the assortment, shifting the balance of product and really shaping the product where we had opportunities with our fast growing (6:45) group. And what we saw in Q4 was tremendous performance of our bottoms. It's clearly an indication that we've turned the corner in reigniting our product engine.

And finally, when you think about accelerating our global expansion, we've opened a store in London. We've just opened a store in Singapore. We're about to open our second store in London in Chelsea next week or the following, and we've identified a number of showroom locations. So we're going to be staying very true to our go-to-market strategy, which is about building showrooms, getting involved in the communities, gaining momentum with ambassadors, and we're going to do that over a shorter period of time, so that we can accelerate our international growth. So we had three pretty significant goals to achieve over the past year and the team delivered outstanding performance.

So, moving forward, I mean, we're going to continue to build on our current momentum, and 2015 - I think John described 2015 really well on our Q3 call when he called it an overlap year. I mean some of the investments that we've made, in terms of building the foundation, are going to sort of normalize and phase out. I mean we still have a couple of large projects, including merchandising, planning, and allocation, and then we're going to ramp up some investments around product innovation in raw materials, in silhouettes, and in categories, as well as investments in the area of being very guest-centric both in-store and digitally. So you can expect to see operating margin leveraging in 2016.

So when you think about the key success factors of lululemon, it's always been about products, brand and community and guest experience. And what you saw in Q4 with better product flow, better predictability, is that you saw the ability to see these three circles come together. And for the first time, and this is tremendous - this is a tremendous unlock in terms of the potential of the brand. I mean these three areas are starting to work really closely together.

So being able to predict the product coming into the store has allowed us to do much better product modifications for our guest. It has allowed us to build campaigns that will deliver seamlessly across digital and in-stores, and it's allowed us to much better educate our educators in store so that they could, in turn, educate our guests.

So we've got three fantastic leaders in those three areas, with Delaney leading store experience, with Duke Stump that recently joined us to lead Brand and Community, and with Tara leading the product group. And we're really at a time now where we

can switch from playing defense to playing offense. And so I'm really looking forward to those three leaders coming together and unlocking so much of the potential that we've got ahead of us. And clearly as we start playing offense, innovation is going to be fueling all three elements of that business.

So product, well we're leading through design of innovative product. I mean in the whitespace - some of you saw our whitespace area last year. I mean these guys have done tremendous work. That combined with the talent that we hired on the design side is really giving us the tools to continue to lead in a way that's unprecedented and really sort of focus on innovation from a raw material standpoint, from a silhouette standpoint across men's and women's and down the road across multiple categories. And we're at a time now where with better product flow and with better predictability we can really start working with our vendors. We can move away from working on the tactics of supply chain to really sort of looking down the future and working on innovation with them, so very clearly a year of stabilizing the business, creating momentum from a product standpoint, and now moving full steam ahead.

Guest experience, clearly something that we've always done really well and our focus is going to be in a couple of areas. One, from a digital standpoint, we've got a tremendous opportunity to create more intimate, more personalized relationship with our guests. And so we're implementing CRM. We're doing a full global redesign of our website. But think about - given that we touch every guest experience, I mean think about - and I use that example because she's a friend of mine. I mean she's a consultant. She lives in Park City. She does most of her buying online. When she goes to the store, at this point in time our new store in Park City, we don't know who she is. And so think about an environment where she goes to the store, we know exactly who she is, we know what kind of activities she gets involved to, and when she goes on vacation to Hawaii, when she lands, we actually can connect her with one of our ambassadors and give to elective class next to her hotel. So the ability to really leverage technology, CRM and from a product standpoint, our RFID project is really going to allow us to create much more intimate, and continue to build on what is already a very good, and a very unique and powerful guest experience.

And then from a store standpoint, I mean, we're not over saturated, we've got a very strong footprint. And we're starting to play with different formats. So the economics always have to work first, but you're starting to see us play with different formats. So in Soho we opened a men's only store. We're opening larger footprint in Flatiron, New York or in Robson, Vancouver or in Miami, recently. And so we're sort of playing with different format and trying to leverage the men's opportunity. And when it comes to men's, we're trying the men's only store, but we'll also - I really like the idea of the side-by-side because she still shops for him a lot. So a real focus on guest experience.

And finally, from a brand and community standpoint, I mean it's really sort of deepening our voice, I mean, taking all the work that we do so well at the grass root level and sort of giving it, amplifying that voice, so there is that global resonance. And I'm really, personally, very passionate about the balance of doing good and doing well. So in the near future you can expect a little bit more focus on increasing

our focus in that sense and really sort of having a mission that makes us a little bit more inclusive. And that's going to resonate with our guests very, very strongly.

So with that said, 2014 was a year of stabilizing the business. The whole team did a great job battling all sorts of headwinds. The first six months were certainly interesting and not what I had, necessarily, anticipated, but our work is paying off. The second half of the year has been tremendous. We're going to continue to build on the momentum that we've created. And I'm really, really excited about 2015.

So before I turn it to John, I really want to thank him for his guidance, his advice. I mean, this past year would have been many times more difficult for me if I didn't have him by my side. And while we're sorry to see him go, we know that he's going to have a ton of fun skiing. So, and Stuart, who most of you - a lot of you guys know is a fantastic hire that we conducted the search together, so very, very excited for John and for Stuart. And obviously John's leaving us in a very strong position with a very, very strong financial team with Chris, Jodi and Vincent (11:19). So with that, I'll let John dive a little bit deeper into our numbers.

John E. Currie {BIO 1494810 <GO>}

Thank you. Well, both Bob and Laurent said it, but I just have to say it as well. What a difference a year makes. This year I'm here with a CEO. That's an improvement. And I'm not standing up here explaining reduced guidance. I have the pleasure of summarizing the increased guidance that we're able to announce this morning. We really had a tremendous holiday season. We came in with some headwinds in terms of store openings and currency and port disruptions. But we mitigated those to some extent. And strong product assortment, continuation of strong traffic trends that we started seeing in Q3 really allowed us to deliver better than our expectations for Q4. And the strength was across the board. It was both in women's and in men's and it was both in-stores and on e-commerce.

So just briefly, as we announced this morning, we increased our revenue guidance, for the quarter, to \$595 million to \$600 million, so the top end of that range is increased by \$15 million. And we, of course, narrowed the range because we're closer to the end of the quarter. That translates to a combined comp for the quarter of 6% to 7%, up from previous low-single digits. And with the leverage and the higher volume there's strong flow through to EPS, and our guidance is now \$0.71 to \$0.73, an increase from the previous \$0.65 to \$0.69. For the year that takes us to just under \$1.8 billion with a positive 3% combined comp, and normalized EPS in the range of \$1.80 to \$1.82. So we feel great about a strong finish to 2014 and we feel that momentum carrying into 2015.

2015, I don't know how many times I've said today that I'm not giving guidance on 2015 yet. But let me just talk a little bit about some of the factors impacting the P&L and the margin profile. Let me start by talking about currency because with lower oil prices, Canada being a petro dollar, there's been quite a significant change, a reduction in the Canadian dollar versus the U.S. dollar over the past two months to

three months, even since we last gave guidance. In the past when most of our revenue was in Canada, a drop in the Canadian dollar was quite catastrophic.

And the point is really that that's not the case anymore. When the Canadian dollar is lower, of course, it reduces our reported revenue in U.S. dollars and it also compresses our gross margins because we buy product in U.S. dollars even when it's sold in Canada. But because our head office is in Vancouver in Canada, the SG&A that's also in Canadian dollars offsets the negatives in the revenue and the gross margin line, and in fact we have quite a nice natural hedge at this point. If anything, a lower Canadian dollar slightly benefits us. So, again, four years or five years ago, that was a much different conversation, and I think it's important to point out that shift.

Other factors, I mean, as we head into 2015, in addition to the momentum we felt in Q4 in terms of traffic, the stronger product assortment that's going to help drive top line in 2015, we have lots of growth drivers ahead of us still. We're going to end the year at 200 stores in the U.S., which is two-thirds of the way to our target of 300 stores, and we have a robust pipeline for 2015 and beyond to complete that build-out, in addition to continuing to increase our penetration on our e-commerce channel.

ivivva, our second concept, which will end the year with 22 stores, has really hit its stride. It's doing 1,000 a square foot, and so it's time to put our foot to the gas a little bit. So we're looking to add up to 20 stores for ivivva next year.

In terms of margins, we talked a lot, for the last year, about all the work that Tara and Jennifer are doing to shore up the supply chain, all the investments in systems, in people and talent, and process change. And those are well underway and on track. But as we've said before, most of the benefit of that you'll see in 2016. In 2015 there will be some benefit on the margin. We've certainly stabilized our merchandise margins; we'll see some improvement in airfreight, but for the most part, the benefits from that you'll see next year.

As Laurent mentioned, 2015 is sort of an overlap year in terms of investment on the supply chain. It was a heavy year in 2014, a lot of systems and other initiatives that we're putting the finishing touches on in 2015, and we're shifting our focus to more forward-looking playing offense investments, including our R&D, our whitespace facility, and an increased focus on innovation in our product.

In addition to investments on the supply chain, again we're looking to play offense in terms of other areas of investment, include technology, guest experience, innovation, and the brand. So all of this is a way of saying, 2015, we feel like we're entering 2015 in a strong position. The question is not are we going to show leverage in 2015, the question is really as we shift to playing offense, what are the right investments that are enough to be really driving the longer term growth of the business without taking on too much beyond what we can execute well.

So, again, we're still working on the final touches of our 2015 budget with our board, but again, the number one question isn't are we showing leverage? It's really are we doing the right things to support the long-term growth of the brand, because that's really what's important in the long run.

So that's the end of the prepared remarks ahead of the function show. So for the audience listening to this on webcast, this concludes the formal part of the presentation and thank you for joining us today. We'll turn off the audio, visual, and the webcast.

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