

Goldman Sachs 30th Annual Global Retailing Conference

Company Participants

- Calvin McDonald, Chief Executive Officer
- Meghan Frank, Chief Financial Officer

Other Participants

- Brooke Roach, Goldman Sachs

Presentation

Brooke Roach {BIO 20387757 <GO>}

Good morning, and thank you for joining us for this next session of the Goldman Sachs Global Retailing Conference. My name is Brooke Roach, and I cover the apparel and accessories brands here at Goldman Sachs. And it is my absolute pleasure to introduce our next fireside chat with Lululemon. Joining me here today is Calvin McDonald, CEO; and Meghan Frank, CFO. Welcome, Calvin. Welcome, Meghan.

Calvin McDonald {BIO 16657186 <GO>}

Thank you.

Meghan Frank {BIO 21694519 <GO>}

Thanks for having us.

Questions And Answers

Q - Brooke Roach {BIO 20387757 <GO>}

Calvin, maybe we can kick off the session with an update on your Power of Three x2 growth plan. The plan has been in place for a little over a year now. Where do you think you've seen the greatest success so far? And where do you still see the most opportunities?

A - Calvin McDonald {BIO 16657186 <GO>}

As you mentioned, we kicked off Power of Three originally back in 2019, arrived early on that plan and still so early in the trajectory and growth that our next five-year plan picked up on the theme, the Power of Three x2. And we're about a year and a half into this five-year plan. It's built upon three pillars of product, guest experience and

market expansion, underpinned by our Impact Agenda report with goals to double men's, double e-com, quadruple international while doubling the business. And as of 2022, we are ahead of schedule. Revenue is 30% versus a goal of 15%. Our men's business is at 27% versus a growth target of 20%. E-com is 33% versus a growth target of 16%, and our international 35% versus a growth target of 30%. So great momentum and success in the business, which we're very excited about equally though to the opportunities.

We are early in our growth trajectory and opportunity still. And really the growth drivers are driven by -- our growth continues to be very balanced. So as much as I just celebrated the key metrics you look at the core strength of the business, our women's still grew double-digit. Our store still grew double-digit and North America still grew double-digits. So when I look at the performance of the business across product and cutting it category, sweat and the different men's, women's, we see very balanced contribution across channel and markets. So then you overlay the growth drivers of very low unaided brand awareness, single-digit internationally outside of UK and Australia, where we're low-teens. In the US, we're less than 50% and men's is in the teens.

So we have significant growth potential still in unaided brand awareness. Our product road map in areas in which we innovate and develop into is significant. We still have a lot of opportunity to keep developing, keep innovating into performance as well as on-the-move and our international expansion. With 22% of sales last quarter, and I've said before, this brand is a global brand and has the potential of being 50-50. So significant runway of growth, early innings in our trajectory which is exciting. So, really to answer the second part of your question, I would say our successes are our opportunity. And we don't need to deviate from the playbook. The opportunity really is us just continuing down through the Power of Three what we know with the guest response to is where we see the growth continue to come from.

Q - Brooke Roach {BIO 20387757 <GO>}

That's great color. Thank you so much. Perhaps we can bridge that long-term opportunity and talk a little bit about some of the recent successes that you've had. You recently reported results and you mentioned that you'd seen a recent acceleration in North America. Wondering if you can comment a little bit more on current trends. What have you seen throughout back-to-school? And what's driving that acceleration between product or category?

A - Calvin McDonald {BIO 16657186 <GO>}

Definitely, product is core to the growth momentum in our business, and coming out of quarter two into quarter three and we had a very, very strong quarter two performance, especially when you compare to the industry to the categories to others we gained share 1.35% market share. So we continue to put on share driven by new guest acquisition and then migrating them up through the brand, increasing the spend. The brand has one of the highest retention ratios that I've ever seen. So once we get a guest, they really are our guest for a very long -- I don't want to say, life, but guest for a very long period of time. And as we continue to innovate, we're able to expand share of wallet with them and that momentum continues.

In particular, coming out of Q2 into Q3, we continue to see success in our product and product launches across women's, men's and accessories. And in particular in men's, we launched two new franchises in our lounge area with Steady State and Soft Jersey far exceeded our expectations. The team's chasing inventory now because results have been so strong for us. Equally, we continue to tweak and test and learn on our digital marketing. So that unaided awareness is a huge opportunity for us. So we're constantly learning and testing different ways, and we just saw a really good response to our back-to-school messaging, leveraging some of the items that resonate and work for that across those categories. So there's a variety of drivers in the North American business that really we saw a nice momentum coming out of a very strong quarter.

Q - Brooke Roach {BIO 20387757 <GO>}

That's really great. You mentioned some of the success that you've seen with some recent marketing. One of the things that you've highlighted on that last call is that opportunity for marketing with Get Into It campaign. Can you talk a little bit more about how we should be thinking about advertising either on an expense basis and how are you thinking about the outcomes that you're seeing as a result of those early marketing campaigns that you've been investing behind?

A - Calvin McDonald {BIO 16657186 <GO>}

When you think of marketing and brand-building at Lululemon, it definitely is an end [ph], building on what has always worked for us and that is grassroots, community base, building relationships, connections. We've done it in North America. It's what's fueling our business internationally. It's what's building a very strong foundational business in a market like China for the brand. And the opportunity and what we are seeing is going after that unaided awareness through a variety of campaigns, as you mentioned. And the growth and success of the business is allowing us to reinvest, test and learn and apply that.

So from a modeling perspective, we shared that we're maintaining our advertising as a percentage of revenue but higher revenue means we can choose to invest and have the team try different things and really get at that unaided awareness. And we're doing that, Get Into It campaign was a great example. We saw really good success. Excited about the second version of that happening in the next few weeks where men's will play, featuring the whole ABC franchise as well as we're going to do some test and learn and going out and acquiring Him with some different media channels that we're going to test. So definitely, an opportunity. Building upon grassroots and community activations which will always be at the heart of the brands. But it's a real meaningful opportunity. So we're committed to moving our unaided awareness up and trying different initiatives to do it and staying within the model that we shared on our Power of Three x2.

Q - Brooke Roach {BIO 20387757 <GO>}

Great. On that last comment, you mentioned that you're still in the very early innings of brand awareness in China specifically. I wonder if we could dive a little deeper into the opportunity in that market. You've been growing very strongly there. What is the customer that you're acquiring in China today? Can you elaborate on the growth

opportunity ahead? And what are the most important drivers? Is it Tier-2, Tier-3 city expansion, new-store builds? Where do you see that expansion?

A - Calvin McDonald {BIO 16657186 <GO>}

It's definitely all the above. And I'll come back to guest but we're predominantly in Tier-1, Tier-2 cities. About a 50-50 split. We have a few stores in Tier-3 and we're just over 100 doors. We've indicated that we can easily see a path to 200. And as the economy and that market continues to develop and the middle class expands, I think there's opportunity beyond that. Every store we opened is far exceeding our internal plans as well as our online business. So it's very similar and balanced across stores and channel, very important the role that stores play equally, because stores are the hub of back to that comment of community grassroots, relationship building. We have over 500 local ambassadors within that market that we have relationships with and they represent the brand. They support and activate in our community, and we really recruit our guests that way as well as what online allows us to do and test and learn into new markets. So we're pleased with our success momentum, and we shared our continual growth in China.

And when you look at the guest and we cut it across age, when we cut it across gender, it's very similar to what we see in North America. Brand is definitely positioned premium within that marketplace. And similar to here, there's local competitors, there's other traditional athletic brands. They discount. They're broadly distributed through wholesale. We're D2C. We're tightly held. We do not discount and it's a full price, innovative-driven brand activated through community, and it is resonating the same way there as it does here in North America.

Q - Brooke Roach {BIO 20387757 <GO>}

There's been a few concerns about the health of the economy in China. And I'm curious if the economy were to weaken in China, what levers can you pull to continue to drive growth there? And maybe said another way, is your growth outlook in China in any way dependent on the macro outlook in China?

A - Meghan Frank {BIO 21694519 <GO>}

Yeah. I'd say we obviously continue to really closely monitor the macro environment. And then as Calvin mentioned, we're really closely monitoring our guest behavior. We're still really early in our growth trajectory in China, which I think helps us if there are any near-term headwinds there. I think it's important to note, we take a portfolio approach to growth. So certainly, other levers and markets we could pull should that need present itself and plan for multiple scenarios as we navigate. But just to date we're really pleased with the performance of that market and then how the consumer there is holding out for us.

Q - Brooke Roach {BIO 20387757 <GO>}

Meghan, let's stick with you for a moment and round out the China discussion with a discussion on margins and international margins. You've recently described China's margins as the closest to North America of each of your international markets. Can

you describe the key drivers and the potential timeline for a potential narrowing of that gap?

A - Meghan Frank {BIO 21694519 <GO>}

Yeah. I mean I'd say again, we're still really early in our China opportunity. So the margins are very healthy. They're the closest to our North America region. And in the near-term, I'd say our focus is really on driving into the opportunity we have there. We have low unaided brand awareness as we've discussed, and a lot of store expansion opportunity in front of us. So really focused on investing into that market, driving into that opportunity. So I would say over the longer-term, that margin gap narrowing, but not in the next five-year trajectory.

Q - Brooke Roach {BIO 20387757 <GO>}

Great. Let's zoom out to total Lululemon Inc. You mentioned store growth as an opportunity in China, but maybe we can talk about the store fleet portfolio opportunity globally. Where is -- where do you see the most opportunity? And how much more runway is there for store growth even in your most mature markets? Maybe said another way, as you increase your penetration of some of those extra square footage stores, what's the next opportunity from here?

A - Meghan Frank {BIO 21694519 <GO>}

Yeah. So we've got a target right now low-double digit square footage growth. We feel good about that target. We overachieved that last year. We're on track to that this year, a little bit ahead. And really, that's a catch-up from COVID impacts and accelerating on our road map in international. Within the low-double digit growth, North America is 5% square footage growth and then international, obviously higher.

I would say still a lot of runway in front of us in terms of store openings. We have a little bit over 600 stores today. So still see store count openings. And then in addition to that, where we see high sales productivity, high sales per square foot, we are looking to expand our stores, what we call our co-located strategy. So it gives us an opportunity to increase our footprint, capitalize on the high traffic in that market, and be able to display a full assortment of women's, men's accessories footwear products. So that -- we're further along in that strategy in North America, very early stage in international in both of those components, both in new store and then the store expansion strategy would play into that square footage growth.

Q - Brooke Roach {BIO 20387757 <GO>}

That's really great color. Maybe we can dive just a little bit deeper into that store productivity comment. You mentioned that sometimes you use high-- highest store productivity stores to drive co-located expansions. But as you think about the store productivity that you see in your fleet today, how fast are new stores coming up the productivity curve? And do you think that there's additional sales per square foot that can be realized in your current fleet?

A - Meghan Frank {BIO 21694519 <GO>}

Yeah. I mean that's -- we're very highly productive today. So over 1,600 sales per square foot on an average for the fleet. I would say we see about two years to three years today in terms of reaching maturation for a store. And I do see opportunities in our existing fleet to increase their productivity on a like-for-like basis. But overall, we're really looking at maximizing both our top and bottom line. So expanding where that makes sense and really to gauge that we're looking at sales per square foot traffic in that location in order to inform those decisions.

Q - Brooke Roach {BIO 20387757 <GO>}

Excellent. Let's switch gears to some of the category comments. And one of the questions that we are asking every company at our conference today is a question on category and share of wallet. And there's been a lot of debate about the athletic category in aggregate, whether or not there's still opportunity for that category to continue to gain share of wallet in the consumer following several years of very strong performance.

As you look into next year, what is the most important factor to drive higher spending in the athletic category in aggregate? And what do you think is Lulu's opportunity to continue to gain share?

A - Calvin McDonald {BIO 16657186 <GO>}

I think in good times and in challenging times what a brand needs to do is just give reason for guests to buy and have that not be priced, which we continue to see in the market and those around us pull that lever when they don't have true innovation. So for us -- both, I think anyone competing as well as for us, we focus on innovation as the driver of demand creation. And how we approach innovating in apparel is through, one, obsessing over unmet needs by the guest. So where can we bring solutions?

Second, very much rooted in science's feel. It all starts at the fabric level for us. We have an incredible team. They obsess over performance of fabrics, feel of fabric. So those in the room that are Lululemon guests, I'm sure when you think of the product you love most, at some point, feel comes to mind, how it feels on, how it feels to touch, how it feels to perform. That doesn't just happen, that's the obsession of our innovation and where we begin with proprietary fabrics technology and a pipeline full of ideas that we continue to innovate and will bring forth. So those combined with the versatility.

One of the other things rooted in the success of Lululemon, I think, is just the versatile nature of the product, and that could be across performance. We don't think through verticals. Yes, we market or design for run, but it can be used for many activities. And really across all of our activity base, we take that approach. Yoga, Run and Train being sort of the three primary, we call, own activities, but golf, hike and tennis being our play activities. But the versatility across all those is that you can interchange and where it's actually performing or not performing. And I think the quality combined with the feel, the innovation, the fit and the versatility of that just resonates with the guest and is definitely how we create product and what the guest expects from the brand. And we're going to continue to do that because we see

success in driving our business clearly through product and product innovation. And we do believe we're leaders in innovating apparel athletic, which stretches across wear occasions from sweat through to every day.

Q - Brooke Roach {BIO 20387757 <GO>}

That's really great color. One of the areas that you've also been innovating in is bags and accessories, and that's been a category with standout performance the last year or so. As you begin to comp those tougher compares, maybe at the belt bag or other accessories items, how are you thinking about the opportunity of the total bags category now that you've seen some of those early successes? Help us dream the dream of understanding the innovation pipeline in some of those newer emerging categories.

A - Calvin McDonald {BIO 16657186 <GO>}

We're really excited about the success and momentum and growth we're seeing in our accessory business. It's about 10% of our overall sales, and we see a significant opportunity to keep developing into that category. I think the non-luxury bag business globally is around \$110 billion. We have less than 1% share. Other players in that have around 2% to 3% share. So it's definitely very fragmented, but we have room for growth. And that growth is going to be split across use cases of both performance in every day and performance -- we have a lot of opportunity in and around hiking, in and around to and from, but then just every day totes and other opportunities. And -- so we're excited. We've seen great success to our Backpack program that we've launched this year, revised improvements on that.

And as it relates to the Everywhere Belt Bag, we are cycling over the success from last year, and our accessory business was up 41% as a category last quarter. So the beauty of successes is that you can keep building upon these successes. And I think one of the differentiators of Lululemon is our success isn't rooted in fashion. It is fashionable and that people feel good in what they wear, but it's not where we begin. We begin with unmet needs through science of feel, performance, and that means we have a very healthy core business that is less risky in terms of the seasonal and fashionable fluctuations. We play color and others on top of that. But it's a 50% core base business.

And in our accessories and with Everywhere Belt Bags, the team is building iterations. They're adding different fabrics and color waves to that, building out the franchise. But we're continuing to see the stickiness of that product. We're expanding it into being a legitimate player in the bag accessory business. And as I said, seen good success in the first quarter that we're comping with innovation that we will build upon, build out and leverage that relationship with the guests. And the number of new guests that we saw come into the brand through that product, both spread skewed a little bit younger, but we're not just young, but the team is doing a great job in building, strengthening the relationship and expanding them into the brand. So we're excited about the potential we have in accessories and the Everywhere Belt Bag when you get a hit success like that, I think it's just positive to the brand.

Q - Brooke Roach {BIO 20387757 <GO>}

You mentioned innovation, not price as a key driver of your growth. And one of the questions we're asking everyone at our conference today is their outlook for pricing. So maybe we can take that now. Now that inflation seems to have peaked, how are you thinking about pricing into 2024? Are you planning on raising, lowering or maintaining your core prices?

A - Meghan Frank {BIO 21694519 <GO>}

Yeah, we haven't used price as a lever to drive our business. We've really maintained our posture on pricing, which is looking -- obviously, being mindful of the competitive landscape, but looking at the quality and make of our goods functionality. We did take modest price increases on about 10% of our assortment last year, so not a material increase. And we'll employ the same strategy going forward. So no plans to veer from that to date.

Q - Brooke Roach {BIO 20387757 <GO>}

Meghan, maybe we can stick with you and what goes hand-in-hand with pricing is also inventories. I'm curious if you can provide a little bit more color on the inning that you think we're in for your company on inventories as well as what that means for -- how you think about your inventories in relation to the rest of retail.

A - Meghan Frank {BIO 21694519 <GO>}

Yeah. So I think the team has done a really great job managing inventory levels with demand. So certainly, navigating a challenging supply chain dynamic and leveraging airfreight where that made sense to really meet that customer demand. We've got about 45% of our inventory in core product, which has limited markdown exposure for us. So that's the benefit that we've leveraged as we've navigated this time period.

We came in at the end of this quarter, up 14%. We had expected approximately 20%. So a combination of higher sales, lower airfreight costs and then some timing impacting that. We are expecting to be in the high-single digits to low-double digits at the end of Q3 and then in line with sales growth at the end of Q4. So really call it inventory position. We're pleased with where we are today. I think over the long-term, we still have an opportunity to move back to historical turns in terms of inventory, but feel really well positioned.

Q - Brooke Roach {BIO 20387757 <GO>}

And then on that, last year, you had a little higher levels of inventory and also we saw some normalization in markdowns and even particularly in the fourth quarter, the Lulu customer engaged in a greater way with markdown product than they had in the past. Is there an opportunity to recapture some of that markdown pressure from last year?

A - Meghan Frank {BIO 21694519 <GO>}

Yeah. I'd say when I zoom out on an annual basis in '22, we were flat to 2019 in terms of markdown rate, which is a really low level and normalized healthy water line for us. We are expecting this year, again, from an annual perspective, flat '22 and flat to 2019. We are flat year-to-date, essentially flat year-to-date. Q4 was a little bit higher last year, partially driven by, I think, what was going on in the environment with inventory in the marketplace. And we saw some consumer behavior differences from historical. That said, I think we still expect flat for the year. There might be a modest improvement in Q4 as we lap that quarter.

Q - Brooke Roach {BIO 20387757 <GO>}

And maybe putting all this together, as we think about the innovation and growth opportunities that you have in the Power of Three x2 plan, what you're seeing in inventory and markdown in pricing. Meghan, can you talk a little bit more about that long-term margin opportunity? How are you thinking about balancing the gross margin opportunities with some of your margin dilutive growth drivers such as men's or international? And what other levers do you have to drive modest operating margin expansion in the business overall into next year?

A - Meghan Frank {BIO 21694519 <GO>}

Yeah. So we feel really good about our target of modest operating margin expansion. We're overdelivering on that this year. So we guided to 40 basis points to 60 basis points of op margin expansion for the full year. So ahead of that modest target.

I would say when we look over this five-year time horizon, there's some puts and takes on margins. So we've got scale of business, particularly in women's and North America as a benefit. And then we also have some airfreight recovery more modest, given the progress we've made year-to-date. And then offsetting that would be expansion into men's, some expansion in international at a higher penetration and then new categories such as footwear. But the net of that makes us confident in our ability to deliver on that modest operating margin expansion target.

Q - Brooke Roach {BIO 20387757 <GO>}

Calvin, one of the questions that we're asking every company at our conference today is on the consumer backdrop. As you think about the consumer into next year, do you think this consumer is going to be facing more headwinds or less compared to 2023? And how are you thinking about the potential trade-up or trade-down demographic shift by income cohorts?

A - Calvin McDonald {BIO 16657186 <GO>}

I think the challenges in the marketplace are going to continue in terms of where the consumer is. In saying that, I go back to reasons to buy. If you give the consumer a reason to buy, if they see value in that choice, then they'll continue to spend. And I think the success that we've seen in our brand through a pressuring of the consumer and where they choose to spend, be it experiences or on products in a market in which many have used discount as a lever to course correct lack of innovation and demand or to rightsize their inventory, we've said we didn't have an inventory issue.

We worked through our inventory through full price. We made the investment in inventory because we saw the demand and we saw the challenges on freight, and we wanted to make sure we had the product to satisfy the demand, and we operated through the entire pandemic that way.

There was the discussions of pre-pandemic winners, pandemic winners, post-pandemic winners and you can't be all three. And I think this leadership team, I'm very proud of the way that we took deliberate actions, made deliberate decisions that fueled the business, allowed us to continue the momentum through those tough operating conditions. And '23 is no different, but we stay true to the strength of the brand, innovate product, full price, resonate and connect through community and leverage the stores as well as digital and innovate, innovate, innovate.

And in '23 through to '24, that's going to be the continual playbook. The pipeline for the back half of this year is really exciting, sort of teased a launch of the category for Her coming in Q3 that I'm super excited about. Next year, we have a lot of innovation. We're launching our men's footwear in addition to women's and a lot of other innovations.

So to me, what we don't know is only what the future will bear. We plan, we have agility. I think we have a proven track record of when the storm comes in, how this brand responds, how this team responds, and how the guest responds to the product. Pandemic is probably the best example of that. And we just got stronger and adjusted and managed our way through.

So we're going to lead in with innovation and continue to have agility in the system. And that means where we take bets, where we invest, the ability to pull back if we need to pull back, where we lean in, where we want to lean, satisfy demand, but all of that is rooted in making sure that we always lead with innovative product, selling it to the guest in a way in which he and she will respond. And that's really what we're planning and continuing as we move forward.

Q - Brooke Roach {BIO 20387757 <GO>}

Maybe one last question for you, Calvin. Innovation has been the key theme of today's session. And you've talked about the accelerating pipeline of innovation that you have. You talked about the opportunity for men's footwear launches next year, a broader innovation category across bags. What's fueling that faster pace of innovation relative to what you've seen historically? And how are you making the decisions to lean into certain innovation that in key categories or key items? How are you thinking about putting that together as you look ahead?

A - Calvin McDonald {BIO 16657186 <GO>}

Yeah. It's within Lululemon (Multiple Speakers).

Q - Brooke Roach {BIO 20387757 <GO>}

For lululemon.

A - Calvin McDonald {BIO 16657186 <GO>}

To speed up. I think it's a combination of focus and clarity for the entire team. As I mentioned, the Power of Three x2 is our second version of Power of Three, and that was very much rooted in innovation. Our pipeline and our horizons of innovating, we really look across a three-year horizon. Some things are three-plus years and horizon one might be in the zero to one, zero to two-year time horizon. So I think what you're seeing now and what is coming is the framework and the development of the team that started in the Power of Three. And we're just seeing a lot of that horizon three ideas, dreaming the dream, focusing on the unmet needs, what are the solutions we can create, and the teams working collectively together that are moving into horizons two, horizons one, which we're launching.

So I think it's been a multiyear focus of the team driven by strategy across the three ownable activities into the three play categories, never losing sight of versatility, rooted inside to fill an unmet need. And we're just at that point now where that rhythm is delivering consistent product execution, and '23 is a good example of that. '22 was a great year for innovation for us as well. Launch of women's footwear, launch of a lot of our play activities, continuing to invest and launch into both OTM as well as into Yoga and Run and Train. So I think it is just where we are in that development and the fact that it's a continual focus for the organization.

And as I shared, our opportunity as we expand wear occasions into OTM in particular, on the move for Her, where we're much more developed for Him, and it is completely a new opportunity for us. So there's a lot of exciting things to come and very much rooted in a very deliberate framework that is going to bring and create a ton of exciting solutions for our guests.

Q - Brooke Roach {BIO 20387757 <GO>}

Great. Calvin, Meghan, any final or closing comments to share with the audience?

A - Calvin McDonald {BIO 16657186 <GO>}

No. Just we're 1.5 years in, ahead of schedule, excited about the momentum in the brand and what lies ahead for us.

Q - Brooke Roach {BIO 20387757 <GO>}

Great. Thank you so much, and thank you for joining.

A - Calvin McDonald {BIO 16657186 <GO>}

Thank you.

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it

solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2024, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.