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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

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**Form 10-Q**

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(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended **November 3, 2019**

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number **001-33608**

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**lululemon athletica inc.**

(Exact name of registrant as specified in its charter)

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**Delaware**

*(State or other jurisdiction of incorporation or organization)*

**20-3842867**

*(I.R.S. Employer Identification No.)*

**1818 Cornwall Avenue, Vancouver, British Columbia V6J 1C7**

*(Address of principal executive offices)*

**Registrant's telephone number, including area code:  
604-732-6124**

**Former name, former address and former fiscal year, if changed since last report:  
N/A**

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**Securities registered pursuant to Section 12(b) of the Act:**

| <u>Title of each class</u>                | <u>Trading symbol(s)</u> | <u>Name of each exchange on which registered</u> |
|---|--------------------------|--|
| Common Stock, par value \$0.005 per share | LULU                     | Nasdaq Global Select Market                      |

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

At December 6, 2019, there were 123,334,595 shares of the registrant's common stock, par value \$0.005 per share, outstanding.

*Exchangeable and Special Voting Shares:*

At December 6, 2019, there were outstanding 6,960,312 exchangeable shares of Lulu Canadian Holding, Inc., a wholly-owned subsidiary of the registrant. Exchangeable shares are exchangeable for an equal number of shares of the registrant's common stock.

In addition, at December 6, 2019, the registrant had outstanding 6,960,312 shares of special voting stock, through which the holders of exchangeable shares of Lulu Canadian Holding, Inc. may exercise their voting rights with respect to the registrant. The special voting stock and the registrant's common stock generally vote together as a single class on all matters on which the common stock is entitled to vote.

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**PART I**  
**FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**lululemon athletica inc.**  
**CONSOLIDATED BALANCE SHEETS**  
*(Unaudited; Amounts in thousands, except per share amounts)*

|  | November 3,<br>2019 | February 3,<br>2019 |
|--|---------------------|---------------------|
| <b>ASSETS</b>  |                     |                     |
| Current assets   |                     |                     |
| Cash and cash equivalents  | \$ 586,153          | \$ 881,320          |
| Accounts receivable  | 35,744              | 35,786              |
| Inventories  | 627,102             | 404,842             |
| Prepaid and receivable income taxes  | 126,715             | 49,385              |
| Other prepaid expenses and other current assets  | 75,962              | 57,949              |
|  | 1,451,676           | 1,429,282           |
| Property and equipment, net  | 656,372             | 567,237             |
| Right-of-use lease assets  | 652,492             | —                   |
| Goodwill   | 24,478              | 24,239              |
| Deferred income tax assets   | 26,339              | 26,549              |
| Other non-current assets   | 43,787              | 37,404              |
|  | <u>\$ 2,855,144</u> | <u>\$ 2,084,711</u> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                     |                     |
| Current liabilities  |                     |                     |
| Accounts payable   | \$ 116,281          | \$ 95,533           |
| Accrued inventory liabilities  | 10,074              | 16,241              |
| Accrued compensation and related expenses  | 98,442              | 109,181             |
| Current lease liabilities  | 131,385             | —                   |
| Current income taxes payable   | 12,351              | 67,412              |
| Unredeemed gift card liability   | 75,025              | 99,412              |
| Other current liabilities  | 131,211             | 112,698             |
|  | 574,769             | 500,477             |
| Non-current lease liabilities  | 563,925             | —                   |
| Non-current income taxes payable   | 48,226              | 42,099              |
| Deferred income tax liabilities  | 14,190              | 14,249              |
| Other non-current liabilities  | 5,298               | 81,911              |
|  | 1,206,408           | 638,736             |
| Commitments and contingencies  |                     |                     |
| Stockholders' equity   |                     |                     |
| Undesignated preferred stock, \$0.01 par value: 5,000 shares authorized; none issued and outstanding         | —                   | —                   |
| Exchangeable stock, no par value: 60,000 shares authorized; 6,960 and 9,332 issued and outstanding           | —                   | —                   |
| Special voting stock, \$0.000005 par value: 60,000 shares authorized; 6,960 and 9,332 issued and outstanding | —                   | —                   |
| Common stock, \$0.005 par value: 400,000 shares authorized; 123,336 and 121,600 issued and outstanding       | 617                 | 608                 |
| Additional paid-in capital   | 343,335             | 315,285             |
| Retained earnings  | 1,522,921           | 1,346,890           |
| Accumulated other comprehensive loss   | (218,137)           | (216,808)           |
|  | 1,648,736           | 1,445,975           |
|  | <u>\$ 2,855,144</u> | <u>\$ 2,084,711</u> |

See accompanying notes to the unaudited interim consolidated financial statements

**lululemon athletica inc.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME**  
*(Unaudited; Amounts in thousands, except per share amounts)*

|   | Quarter Ended     |                  | Three Quarters Ended |                   |
|---|-------------------|------------------|----------------------|-------------------|
|   | November 3, 2019  | October 28, 2018 | November 3, 2019     | October 28, 2018  |
| Net revenue   | \$ 916,138        | \$ 747,655       | \$ 2,581,805         | \$ 2,120,861      |
| Cost of goods sold                                    | 411,094           | 340,878          | 1,169,245            | 973,157           |
| Gross profit  | 505,044           | 406,777          | 1,412,560            | 1,147,704         |
| Selling, general and administrative expenses          | 329,215           | 270,874          | 939,937              | 773,288           |
| Income from operations                                | 175,829           | 135,903          | 472,623              | 374,416           |
| Other income (expense), net                           | 1,925             | 2,044            | 6,154                | 6,553             |
| Income before income tax expense                      | 177,754           | 137,947          | 478,777              | 380,969           |
| Income tax expense                                    | 51,772            | 43,534           | 131,202              | 115,633           |
| Net income  | <u>\$ 125,982</u> | <u>\$ 94,413</u> | <u>\$ 347,575</u>    | <u>\$ 265,336</u> |
| <b>Other comprehensive income (loss):</b>             |                   |                  |                      |                   |
| Foreign currency translation adjustment               | 9,880             | (7,318)          | (1,329)              | (68,539)          |
| Comprehensive income                                  | <u>\$ 135,862</u> | <u>\$ 87,095</u> | <u>\$ 346,246</u>    | <u>\$ 196,797</u> |
| <br>  |                   |                  |                      |                   |
| Basic earnings per share                              | \$ 0.97           | \$ 0.71          | \$ 2.67              | \$ 1.98           |
| Diluted earnings per share                            | \$ 0.96           | \$ 0.71          | \$ 2.65              | \$ 1.97           |
| Basic weighted-average number of shares outstanding   | 130,282           | 132,406          | 130,420              | 133,964           |
| Diluted weighted-average number of shares outstanding | 130,805           | 133,077          | 130,975              | 134,512           |

See accompanying notes to the unaudited interim consolidated financial statements

**lululemon athletica inc.**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
*(Unaudited; Amounts in thousands)*

**Quarter Ended November 3, 2019**

|   | Exchangeable Stock | Special Voting Stock |           | Common Stock |           | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Total        |
|---|--------------------|----------------------|-----------|--------------|-----------|----------------------------|-------------------|--------------------------------------|--------------|
|   | Shares             | Shares               | Par Value | Shares       | Par Value |                            |                   |                                      |              |
| Balance at August 4, 2019   | 7,381              | 7,381                | \$ —      | 122,921      | \$ 615    | \$ 329,915                 | \$ 1,404,866      | \$ (228,017)                         | \$ 1,507,379 |
| Net income  |                    |                      |           |              |           |                            | 125,982           |                                      | 125,982      |
| Foreign currency translation adjustment                                     |                    |                      |           |              |           |                            |                   | 9,880                                | 9,880        |
| Common stock issued upon exchange of exchangeable shares                    | (421)              | (421)                | —         | 421          | 2         | (2)                        |                   |                                      | —            |
| Stock-based compensation expense  |                    |                      |           |              |           | 14,065                     |                   |                                      | 14,065       |
| Common stock issued upon settlement of stock-based compensation             |                    |                      |           | 50           | —         | 1,516                      |                   |                                      | 1,516        |
| Shares withheld related to net share settlement of stock-based compensation |                    |                      |           | (12)         | —         | (2,093)                    |                   |                                      | (2,093)      |
| Repurchase of common stock  |                    |                      |           | (44)         | —         | (66)                       | (7,927)           |                                      | (7,993)      |
| Balance at November 3, 2019   | 6,960              | 6,960                | \$ —      | 123,336      | \$ 617    | \$ 343,335                 | \$ 1,522,921      | \$ (218,137)                         | \$ 1,648,736 |

**Quarter Ended October 28, 2018**

|   | Exchangeable Stock | Special Voting Stock |           | Common Stock |           | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Total        |
|---|--------------------|----------------------|-----------|--------------|-----------|----------------------------|-------------------|--------------------------------------|--------------|
|   | Shares             | Shares               | Par Value | Shares       | Par Value |                            |                   |                                      |              |
| Balance at July 29, 2018  | 9,776              | 9,776                | \$ —      | 122,656      | \$ 613    | \$ 299,702                 | \$ 1,224,044      | \$ (204,144)                         | \$ 1,320,215 |
| Net income  |                    |                      |           |              |           |                            | 94,413            |                                      | 94,413       |
| Foreign currency translation adjustment                                     |                    |                      |           |              |           |                            |                   | (7,318)                              | (7,318)      |
| Stock-based compensation expense  |                    |                      |           |              |           | 5,568                      |                   |                                      | 5,568        |
| Common stock issued upon settlement of stock-based compensation             |                    |                      |           | 87           | 1         | 3,504                      |                   |                                      | 3,505        |
| Shares withheld related to net share settlement of stock-based compensation |                    |                      |           | (11)         | (1)       | (1,536)                    |                   |                                      | (1,537)      |
| Repurchase of common stock  |                    |                      |           | (65)         | —         | (84)                       | (8,005)           |                                      | (8,089)      |
| Balance at October 28, 2018   | 9,776              | 9,776                | \$ —      | 122,667      | \$ 613    | \$ 307,154                 | \$ 1,310,452      | \$ (211,462)                         | \$ 1,406,757 |

Three Quarters Ended November 3, 2019

|   | Exchangeable Stock |         | Special Voting Stock |         | Common Stock |            | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Total |
|---|--------------------|---------|----------------------|---------|--------------|------------|----------------------------|-------------------|--------------------------------------|-------|
|   | Shares             | Shares  | Par Value            | Shares  | Par Value    |            |                            |                   |                                      |       |
| Balance at February 3, 2019   | 9,332              | 9,332   | \$ —                 | 121,600 | \$ 608       | \$ 315,285 | \$ 1,346,890               | \$ (216,808)      | \$ 1,445,975                         |       |
| Net income  |                    |         |                      |         |              |            | 347,575                    |                   | 347,575                              |       |
| Foreign currency translation adjustment                                     |                    |         |                      |         |              |            |                            | (1,329)           | (1,329)                              |       |
| Common stock issued upon exchange of exchangeable shares                    | (2,372)            | (2,372) | —                    | 2,372   | 12           | (12)       |                            |                   | —                                    |       |
| Stock-based compensation expense  |                    |         |                      |         |              | 36,070     |                            |                   | 36,070                               |       |
| Common stock issued upon settlement of stock-based compensation             |                    |         |                      | 547     | 3            | 15,027     |                            |                   | 15,030                               |       |
| Shares withheld related to net share settlement of stock-based compensation |                    |         |                      | (129)   | (1)          | (21,492)   |                            |                   | (21,493)                             |       |
| Repurchase of common stock  |                    |         |                      | (1,054) | (5)          | (1,543)    | (171,544)                  |                   | (173,092)                            |       |
| Balance at November 3, 2019   | 6,960              | 6,960   | \$ —                 | 123,336 | \$ 617       | \$ 343,335 | \$ 1,522,921               | \$ (218,137)      | \$ 1,648,736                         |       |

Three Quarters Ended October 28, 2018

|   | Exchangeable Stock |        | Special Voting Stock |         | Common Stock |            | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Total |
|---|--------------------|--------|----------------------|---------|--------------|------------|----------------------------|-------------------|--------------------------------------|-------|
|   | Shares             | Shares | Par Value            | Shares  | Par Value    |            |                            |                   |                                      |       |
| Balance at January 28, 2018   | 9,781              | 9,781  | \$ —                 | 125,650 | \$ 628       | \$ 284,253 | \$ 1,455,002               | \$ (142,923)      | \$ 1,596,960                         |       |
| Net income  |                    |        |                      |         |              |            | 265,336                    |                   | 265,336                              |       |
| Foreign currency translation adjustment                                     |                    |        |                      |         |              |            |                            | (68,539)          | (68,539)                             |       |
| Common stock issued upon exchange of exchangeable shares                    | (5)                | (5)    | —                    | 5       | —            | —          |                            |                   | —                                    |       |
| Stock-based compensation expense  |                    |        |                      |         |              | 18,616     |                            |                   | 18,616                               |       |
| Common stock issued upon settlement of stock-based compensation             |                    |        |                      | 524     | 3            | 17,254     |                            |                   | 17,257                               |       |
| Shares withheld related to net share settlement of stock-based compensation |                    |        |                      | (92)    | (1)          | (8,537)    |                            |                   | (8,538)                              |       |
| Repurchase of common stock  |                    |        |                      | (3,420) | (17)         | (4,432)    | (409,886)                  |                   | (414,335)                            |       |
| Balance at October 28, 2018   | 9,776              | 9,776  | \$ —                 | 122,667 | \$ 613       | \$ 307,154 | \$ 1,310,452               | \$ (211,462)      | \$ 1,406,757                         |       |

See accompanying notes to the unaudited interim consolidated financial statements

**lululemon athletica inc.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
*(Unaudited; Amounts in thousands)*

|   | Three Quarters Ended |                  |
|---|----------------------|------------------|
|   | November 3, 2019     | October 28, 2018 |
| Cash flows from operating activities  |                      |                  |
| Net income  | \$ 347,575           | \$ 265,336       |
| Adjustments to reconcile net income to net cash provided by operating activities: |                      |                  |
| Depreciation and amortization   | 114,444              | 87,115           |
| Stock-based compensation expense  | 36,070               | 18,616           |
| Settlement of derivatives not designated in a hedging relationship                | (3,375)              | (4,670)          |
| Changes in operating assets and liabilities:                                      |                      |                  |
| Inventories   | (225,124)            | (177,890)        |
| Prepaid and receivable income taxes   | (77,330)             | (27,645)         |
| Other prepaid expenses and other current and non-current assets                   | (63,107)             | (18,402)         |
| Accounts payable  | 21,085               | 129,617          |
| Accrued inventory liabilities   | (5,940)              | (392)            |
| Accrued compensation and related expenses   | (10,223)             | 18,009           |
| Current income taxes payable  | (54,700)             | 9,817            |
| Unredeemed gift card liability  | (24,183)             | (17,827)         |
| Non-current income taxes payable  | 6,127                | 5,844            |
| Right-of-use lease assets and current and non-current lease liabilities           | 9,794                | —                |
| Other current and non-current liabilities   | 23,993               | 29,348           |
| Net cash provided by operating activities   | 95,106               | 316,876          |
| Cash flows from investing activities  |                      |                  |
| Purchase of property and equipment  | (214,217)            | (156,746)        |
| Settlement of net investment hedges   | 3,378                | (8,397)          |
| Other investing activities  | (1,636)              | (771)            |
| Net cash used in investing activities   | (212,475)            | (165,914)        |
| Cash flows from financing activities  |                      |                  |
| Proceeds from settlement of stock-based compensation                              | 15,030               | 17,257           |
| Taxes paid related to net share settlement of stock-based compensation            | (21,493)             | (8,538)          |
| Repurchase of common stock  | (173,092)            | (414,335)        |
| Other financing activities  | —                    | (745)            |
| Net cash used in financing activities   | (179,555)            | (406,361)        |
| Effect of exchange rate changes on cash and cash equivalents                      | 1,757                | (31,495)         |
| Decrease in cash and cash equivalents   | (295,167)            | (286,894)        |
| Cash and cash equivalents, beginning of period                                    | \$ 881,320           | \$ 990,501       |
| Cash and cash equivalents, end of period  | \$ 586,153           | \$ 703,607       |

See accompanying notes to the unaudited interim consolidated financial statements

**lululemon athletica inc.**  
**INDEX FOR NOTES TO THE UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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**lululemon athletica inc.**  
**NOTES TO THE UNAUDITED INTERIM CONSOLIDATED FINANCIAL**  
**STATEMENTS**

**NOTE 1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION**

***Nature of operations***

lululemon athletica inc., a Delaware corporation ("lululemon" and, together with its subsidiaries unless the context otherwise requires, the "Company") is engaged in the design, distribution, and retail of healthy lifestyle inspired athletic apparel and accessories. The Company primarily conducts its business through company-operated stores and direct to consumer through e-commerce. It also generates net revenue from outlets, sales from temporary locations, sales to wholesale accounts, license and supply arrangements, and warehouse sales. The Company operates stores in the United States, Canada, China, Australia, the United Kingdom, Japan, New Zealand, Germany, South Korea, Singapore, France, Sweden, Ireland, the Netherlands, and Switzerland. There were 479 and 440 company-operated stores in operation as of November 3, 2019 and February 3, 2019, respectively.

***Basis of presentation***

The unaudited interim consolidated financial statements as of November 3, 2019 and for the quarters and three quarters ended November 3, 2019 and October 28, 2018 are presented in United States dollars and have been prepared by the Company under the rules and regulations of the Securities and Exchange Commission ("SEC"). The financial information is presented in accordance with United States generally accepted accounting principles ("GAAP") for interim financial information and, accordingly, does not include all of the information and footnotes required by GAAP for complete financial statements. The financial information as of February 3, 2019 is derived from the Company's audited consolidated financial statements and related notes for the fiscal year ended February 3, 2019, which are included in Item 8 in the Company's fiscal 2018 Annual Report on Form 10-K filed with the SEC on March 27, 2019. These unaudited interim consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary to a fair statement of the results for the interim periods presented. These unaudited interim consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and related notes included in Item 8 in the Company's fiscal 2018 Annual Report on Form 10-K. Except as disclosed in Note 2 of these unaudited interim consolidated financial statements pertaining to the adoption of new accounting pronouncements, there have been no significant changes to the Company's significant accounting policies as described in the Company's fiscal 2018 Annual Report on Form 10-K.

The Company's fiscal year ends on the Sunday closest to January 31 of the following year, typically resulting in a 52-week year, but occasionally giving rise to an additional week, resulting in a 53-week year. Fiscal 2019 will end on February 2, 2020 and will be a 52-week year. Fiscal 2018 was a 53-week year.

In accordance with the Disclosure Modernization and Simplification final rule issued by the SEC and effective for the Company beginning with the quarter ended May 5, 2019, a reconciliation of the changes of stockholders' equity is presented for all periods for which the results of operations are presented.

The Company's business is affected by the pattern of seasonality common to most retail apparel businesses. Historically, the Company has recognized a significant portion of its operating profit in the fourth fiscal quarter of each year as a result of increased net revenue during the holiday season.

Certain comparative figures have been reclassified to conform to the financial presentation adopted for the current year.

**NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS**

***Recently adopted accounting pronouncements***

In February 2016, the FASB issued ASC 842, *Leases* ("ASC 842") to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Under the new guidance, lessees are required to recognize a lease liability, which represents the discounted obligation to make future minimum lease payments, and a corresponding right-of-use asset on the balance sheet. The Company adopted ASC 842 on February 4, 2019 using the modified retrospective approach and has elected not to restate comparative periods.

The Company has chosen to apply the transition package of three practical expedients which allow companies not to reassess whether agreements contain leases, the classification of leases, and the capitalization of initial direct costs. The Company did not elect the practical expedient to use hindsight when determining the lease term.

The primary financial statement impact upon adoption was the recognition, on a discounted basis, of the Company's minimum payments under noncancelable operating leases as right-of-use assets and obligations on the consolidated balance sheets. As of February 4, 2019, right-of-use assets and lease liabilities were \$619.6 million and \$651.1 million, respectively. Pre-existing lease balances of \$34.8 million from current assets, \$9.3 million from non-current assets, and \$75.5 million from non-current liabilities were reclassified to right-of-use assets and lease liabilities as part of the adoption of the new standard. There was no cumulative earnings effect adjustment on transition.

In August 2017, the FASB amended ASC 815, *Derivatives and Hedging*, to more closely align hedge accounting with companies' risk management strategies, simplify the application of hedge accounting, and increase transparency as to the scope and results of hedging programs. It makes more financial and non-financial hedging strategies eligible for hedge accounting. It also amends the presentation and disclosure requirements and changes how companies assess effectiveness. The Company adopted this guidance in the first quarter of fiscal 2019, and it did not have a material impact on the Company's consolidated financial statements.

In August 2018, the FASB clarified ASC 350-40, *Intangibles - Goodwill and Other - Internal-Use Software* for certain aspects of accounting for implementation costs incurred in a cloud computing arrangement that is a service contract. Under the update, an entity expenses costs incurred in the preliminary-project and post-implementation-operation stages. An entity also capitalizes certain costs incurred during the application-development stage, as well as certain costs related to enhancements. The ASU does not change the accounting for the service component of a cloud computing arrangement. This standard is effective beginning in the first quarter of 2020, with early adoption permitted. The Company adopted this guidance in the first quarter of fiscal 2019, and it did not have a material impact on the Company's consolidated financial statements.

#### ***Accounting policies as a result of the adoption of ASC 842***

##### ***Operating leases***

At lease commencement, which is generally when the Company takes possession of the asset, the Company records a lease liability and corresponding right-of-use asset. Lease liabilities represent the present value of minimum lease payments over the expected lease term, which includes options to extend or terminate the lease when it is reasonably certain those options will be exercised. The present value of the lease liability is determined using the Company's incremental collateralized borrowing rate at the lease commencement.

Minimum lease payments include base rent, fixed escalation of rental payments, and rental payments that are adjusted periodically depending on a rate or index. In determining minimum lease payments, the Company does not separate non-lease components for real estate leases. Non-lease components are generally services that the lessor performs for the Company associated with the leased asset, such as common area maintenance.

Right-of-use assets represent the right to control the use of the leased asset during the lease and are initially recognized in an amount equal to the lease liability. In addition, prepaid rent, initial direct costs, and adjustments for lease incentives are components of the right-of-use asset. Over the lease term the lease expense is amortized on a straight-line basis beginning on the lease commencement date. Right-of-use assets are assessed for impairment as part of the impairment of long-lived assets, which is performed whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable.

Variable lease payments, including contingent rental payments based on sales volume, are recognized when the achievement of the specific target is probable. A right-of-use asset and lease liability are not recognized for leases with an initial term of 12 months or less, and the lease expense is recognized on a straight-line basis over the lease term.

##### ***Recently issued accounting pronouncements***

In August 2018, the FASB released guidance on ASC 350-40, *"Intangibles-Goodwill and Other-Internal-Use Software"*. This update requires a customer in a cloud computing service arrangement to follow the internal-use software guidance in order to determine which implementation costs to defer and recognize as an asset. This guidance is effective for the Company beginning in the first quarter of fiscal year 2020, with early adoption permitted. The Company is currently evaluating the impact that this new guidance may have on its consolidated financial statements but does not believe it will have a material impact.

**NOTE 3. CREDIT FACILITY**

On June 6, 2018, the Company entered into Amendment No. 1 to its credit agreement. This amended the credit agreement to provide for (i) an increase in the aggregate commitments under the unsecured five-year revolving credit facility to \$400.0 million, with an increase of the sub-limits for the issuance of letters of credit and extensions of swing line loans to \$50.0 million for each, (ii) an increase in the option, subject to certain conditions as set forth in the credit agreement, to request increases in commitments under the revolving facility from \$400.0 million to \$600.0 million, and (iii) an extension in the maturity of the revolving facility from December 15, 2021 to June 6, 2023.

In addition, this amendment decreased the applicable margins for LIBOR loans from 1.00%-1.75% to 1.00%-1.50% and for alternate base rate loans from 0.00%-0.75% to 0.00%-0.50%, reduced the commitment fee on average daily unused amounts under the revolving facility from 0.125%-0.200% to 0.10%-0.20%, and reduced fees for unused letters of credit from 1.00%-1.75% to 1.00%-1.50%.

The Company had no borrowings outstanding under this credit facility as of November 3, 2019 and February 3, 2019. As of November 3, 2019, the Company had letters of credit of \$2.0 million outstanding.

**NOTE 4. STOCK-BASED COMPENSATION AND BENEFIT PLANS**

*Stock-based compensation plans*

The Company's eligible employees participate in various stock-based compensation plans, which are provided by the Company directly.

Stock-based compensation expense charged to income for the plans was \$35.7 million and \$19.0 million for the three quarters ended November 3, 2019 and October 28, 2018, respectively. Total unrecognized compensation cost for all stock-based compensation plans was \$70.3 million at November 3, 2019, which is expected to be recognized over a weighted-average period of 2.2 years.

A summary of the balances of the Company's stock-based compensation plans as of November 3, 2019, and changes during the first three quarters then ended, is presented below:

|   | Stock Options |                                 | Performance-Based Restricted Stock Units |  | Restricted Shares |  | Restricted Stock Units |  | Restricted Stock Units (Liability Accounting) |                             |
|---|---------------|---------------------------------|--|--|-------------------|--|------------------------|--|---|-----------------------------|
|   | Number        | Weighted-Average Exercise Price | Number                                   | Weighted-Average Grant Date Fair Value | Number            | Weighted-Average Grant Date Fair Value | Number                 | Weighted-Average Grant Date Fair Value | Number  | Weighted-Average Fair Value |
| <i>(In thousands, except per share amounts)</i> |               |                                 |  |  |                   |  |                        |  |   |                             |
| Balance at February 3, 2019                     | 870           | \$ 73.34                        | 280                                      | \$ 78.01                               | 6                 | \$ 124.19                              | 440                    | \$ 73.73                               | 44  | \$ 146.12                   |
| Granted   | 324           | 167.99                          | 93                                       | 142.29                                 | 7                 | 175.82                                 | 121                    | 168.41                                 | —   | —                           |
| Exercised/released                              | 247           | 60.95                           | 97                                       | 72.04                                  | 6                 | 124.19                                 | 182                    | 70.38                                  | 15  | 179.67                      |
| Forfeited/expired                               | 54            | 88.90                           | 15                                       | 94.30                                  | —                 | —                                      | 29                     | 95.27                                  | —   | —                           |
| Balance at November 3, 2019                     | 893           | \$ 110.17                       | 261                                      | \$ 102.23                              | 7                 | \$ 175.82                              | 350                    | \$ 106.39                              | 29  | \$ 200.69                   |
| Exercisable at November 3, 2019                 | 152           | \$ 72.32                        |  |  |                   |  |                        |  |   |                             |

The grant date fair value of each stock option granted is estimated on the date of grant using the Black-Scholes model. The assumptions used to calculate the fair value of the options granted are evaluated and revised, as necessary, to reflect market conditions and the Company's historical experience. The expected term of the options is based upon the historical experience of similar awards, giving consideration to expectations of future employee behavior. Expected volatility is based upon the historical volatility of the Company's common stock for the period corresponding with the expected term of the options. The risk-free interest rate is based on the U.S. Treasury yield curve for the period corresponding with the expected term of the options. The following are weighted averages of the assumptions that were used in calculating the fair value of stock options granted during the first three quarters of fiscal 2019:

|                         | <b>Three Quarters<br/>Ended<br/>November 3, 2019</b> |
|-------------------------|--|
| Expected term           | 3.75 years   |
| Expected volatility     | 38.43%   |
| Risk-free interest rate | 2.19%  |
| Dividend yield          | —%   |

The Company's performance-based restricted stock units are awarded to eligible employees and entitle the grantee to receive a maximum of two shares of common stock per performance-based restricted stock unit if the Company achieves specified performance goals and the grantee remains employed during the vesting period. The fair value of performance-based restricted stock units is based on the closing price of the Company's common stock on the award date. Expense for performance-based restricted stock units is recognized when it is probable that the performance goal will be achieved.

The grant date fair value of the restricted shares and restricted stock units is based on the closing price of the Company's common stock on the award date. Restricted stock units that are settled in cash or common stock at the election of the employee are remeasured to fair value at the end of each reporting period until settlement. This fair value is based on the closing price of the Company's common stock on the last business day before each period end.

#### ***Employee share purchase plan***

The Company's board of directors and stockholders approved the Company's Employee Share Purchase Plan ("ESPP") in September 2007. Contributions are made by eligible employees, subject to certain limits defined in the ESPP, and the Company matches one-third of the contribution. The maximum number of shares authorized to be purchased under the ESPP is 6.0 million shares. All shares purchased under the ESPP are purchased in the open market. During the quarter ended November 3, 2019, there were 21.5 thousand shares purchased.

#### ***Defined contribution pension plans***

The Company offers defined contribution pension plans to its eligible employees. Participating employees may elect to defer and contribute a portion of their eligible compensation to a plan up to limits stated in the plan documents, not to exceed the dollar amounts set by applicable laws. The Company matches 50% to 75% of the contribution depending on the participant's length of service, and the contribution is subject to a two year vesting period. The Company's net expense for the defined contribution plans was \$6.4 million and \$4.7 million in the first three quarters of fiscal 2019 and fiscal 2018, respectively.

#### **NOTE 5. FAIR VALUE MEASUREMENT**

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements are made using a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value:

- Level 1 - defined as observable inputs such as quoted prices in active markets;
- Level 2 - defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and
- Level 3 - defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

**Assets and liabilities measured at fair value on a recurring basis**

The fair value measurement is categorized in its entirety by reference to its lowest level of significant input. As of November 3, 2019 and February 3, 2019, the Company held certain assets and liabilities that are required to be measured at fair value on a recurring basis:

|                                       | November 3, 2019 | Level 1    | Level 2 | Level 3 | Balance Sheet Classification                    |
|---------------------------------------|------------------|------------|---------|---------|---|
| <i>(In thousands)</i>                 |                  |            |         |         |   |
| Money market funds                    | \$ 278,080       | \$ 278,080 | \$ —    | \$ —    | Cash and cash equivalents                       |
| Treasury bills                        | 26,619           | 26,619     | —       | —       | Cash and cash equivalents                       |
| Term deposits                         | 66,736           | —          | 66,736  | —       | Cash and cash equivalents                       |
| Forward currency contract assets      | 2,934            | —          | 2,934   | —       | Other prepaid expenses and other current assets |
| Forward currency contract liabilities | 3,964            | —          | 3,964   | —       | Other current liabilities                       |

  

|                                       | February 3, 2019 | Level 1    | Level 2 | Level 3 | Balance Sheet Classification                    |
|---------------------------------------|------------------|------------|---------|---------|---|
| <i>(In thousands)</i>                 |                  |            |         |         |   |
| Money market funds                    | \$ 471,888       | \$ 471,888 | \$ —    | \$ —    | Cash and cash equivalents                       |
| Treasury bills                        | 99,958           | 99,958     | —       | —       | Cash and cash equivalents                       |
| Term deposits                         | 63,522           | —          | 63,522  | —       | Cash and cash equivalents                       |
| Forward currency contract assets      | 516              | —          | 516     | —       | Other prepaid expenses and other current assets |
| Forward currency contract liabilities | 1,042            | —          | 1,042   | —       | Other current liabilities                       |

The Company records accounts receivable, accounts payable, and accrued liabilities at cost. The carrying values of these instruments approximate their fair value due to their short-term maturities.

The Company has short-term, highly liquid investments classified as cash equivalents, which are invested in money market funds, Treasury bills, and term deposits. The Company records cash equivalents at their original purchase prices plus interest that has accrued at the stated rate.

The fair values of the forward currency contract assets and liabilities are determined using observable Level 2 inputs, including foreign currency spot exchange rates, forward pricing curves, and interest rates. The fair values consider the credit risk of the Company and its counterparties. The Company's Master International Swap Dealers Association, Inc., Agreements and other similar arrangements allow net settlements under certain conditions. However, the Company records all derivatives on its consolidated balance sheets at fair value and does not offset derivative assets and liabilities.

**NOTE 6. DERIVATIVE FINANCIAL INSTRUMENTS**

**Foreign exchange risk**

The Company is exposed to risks associated with changes in foreign currency exchange rates and uses derivative financial instruments to manage its exposure to certain of these foreign currency exchange rate risks. The Company does not enter into derivative contracts for speculative or trading purposes.

The Company currently hedges against changes in the Canadian dollar to U.S. dollar exchange rate and changes in the Chinese Yuan to U.S. dollar exchange rate using forward currency contracts.

**Net investment hedges**

The Company is exposed to foreign exchange gains and losses which arise on translation of its foreign subsidiaries' balance sheets into U.S. dollars. These gains and losses are recorded as a foreign currency translation adjustment in accumulated other comprehensive income or loss within stockholders' equity.

The Company holds a significant portion of its assets in Canada and enters into forward currency contracts designed to hedge a portion of the foreign currency exposure that arises on translation of a Canadian subsidiary into U.S. dollars. These

forward currency contracts are designated as net investment hedges. The effective portions of the hedges are reported in accumulated other comprehensive income or loss and will subsequently be reclassified to net earnings in the period in which the hedged investment is either sold or substantially liquidated. Hedge effectiveness is measured using a method based on changes in forward exchange rates. The Company recorded no ineffectiveness from net investment hedges during the first three quarters of fiscal 2019.

The Company classifies the cash flows at settlement of its net investment hedges within investing activities in the consolidated statements of cash flows.

***Derivatives not designated as hedging instruments***

The Company is exposed to gains and losses arising from changes in foreign exchange rates associated with transactions which are undertaken by its subsidiaries in currencies other than their functional currency. Such transactions include intercompany transactions and inventory purchases. These transactions result in the recognition of certain foreign currency denominated monetary assets and liabilities which are remeasured to the quarter-end or settlement date exchange rate. The resulting foreign currency gains and losses are recorded in selling, general and administrative expenses.

During the first three quarters of fiscal 2019, the Company entered into certain forward currency contracts designed to economically hedge the foreign exchange revaluation gains and losses that are recognized by its Canadian and Chinese subsidiaries on U.S. dollar denominated monetary assets and liabilities. The Company has not applied hedge accounting to these instruments and the change in fair value of these derivatives is recorded within selling, general and administrative expenses.

The Company classifies the cash flows at settlement of its forward currency contracts which are not designated in hedging relationships within operating activities in the consolidated statements of cash flows.

***Quantitative disclosures about derivative financial instruments***

The Company presents its derivative assets and derivative liabilities at their gross fair values within other prepaid expenses and other current assets and other current liabilities on the consolidated balance sheets. However, the Company's Master International Swap Dealers Association, Inc., Agreements and other similar arrangements allow net settlements under certain conditions. As of November 3, 2019, there were derivative assets of \$2.9 million and derivative liabilities of \$4.0 million subject to enforceable netting arrangements.

The notional amounts and fair values of forward currency contracts were as follows:

|  | November 3, 2019 |          |             | February 3, 2019 |        |             |
|--|------------------|----------|-------------|------------------|--------|-------------|
|  | Gross Notional   | Assets   | Liabilities | Gross Notional   | Assets | Liabilities |
| <i>(In thousands)</i>                                      |                  |          |             |                  |        |             |
| Derivatives designated as net investment hedges:           |                  |          |             |                  |        |             |
| Forward currency contracts                                 | \$ 196,000       | \$ —     | \$ 3,317    | \$ 328,000       | \$ —   | \$ 1,042    |
| Derivatives not designated in a hedging relationship:      |                  |          |             |                  |        |             |
| Forward currency contracts                                 | 241,000          | 2,934    | 647         | 309,000          | 516    | —           |
| Net derivatives recognized on consolidated balance sheets: |                  |          |             |                  |        |             |
| Forward currency contracts                                 |                  | \$ 2,934 | \$ 3,964    |                  | \$ 516 | \$ 1,042    |

The forward currency contracts designated as net investment hedges outstanding as of November 3, 2019 mature on different dates between November 2019 and March 2020.

The forward currency contracts not designated in a hedging relationship outstanding as of November 3, 2019 mature on different dates between November 2019 and March 2020.

The pre-tax gains and losses on foreign exchange forward contracts recorded in accumulated other comprehensive income were as follows:

|  | Quarter Ended    |                  | Three Quarters Ended |                  |
|--|------------------|------------------|----------------------|------------------|
|  | November 3, 2019 | October 28, 2018 | November 3, 2019     | October 28, 2018 |
| <i>(In thousands)</i>  |                  |                  |                      |                  |
| <b>(Losses) gains recognized in foreign currency translation adjustment:</b> |                  |                  |                      |                  |
| Derivatives designated as net investment hedges                              | \$ (839)         | \$ 2,291         | \$ 1,103             | \$ 18,829        |

No gains or losses have been reclassified from accumulated other comprehensive income into net income for derivative financial instruments in a net investment hedging relationship, as the Company has not sold or liquidated (or substantially liquidated) its hedged subsidiary.

The pre-tax net foreign exchange and derivative gains and losses recorded in the consolidated statement of operations were as follows:

|   | Quarter Ended     |                   | Three Quarters Ended |                   |
|---|-------------------|-------------------|----------------------|-------------------|
|   | November 3, 2019  | October 28, 2018  | November 3, 2019     | October 28, 2018  |
| <i>(In thousands)</i>   |                   |                   |                      |                   |
| <b>(Losses) gains recognized in selling, general and administrative expenses:</b> |                   |                   |                      |                   |
| Foreign exchange (losses) gains   | \$ (2,945)        | \$ 395            | \$ (1,700)           | \$ 12,999         |
| Derivatives not designated in a hedging relationship                              | (94)              | (1,715)           | (1,603)              | (17,301)          |
| Net foreign exchange and derivative (losses) gains                                | <u>\$ (3,039)</u> | <u>\$ (1,320)</u> | <u>\$ (3,303)</u>    | <u>\$ (4,302)</u> |

**Credit risk**

The Company is exposed to credit-related losses in the event of nonperformance by the counterparties to the forward currency contracts. The credit risk amount is the Company's unrealized gains on its derivative instruments, based on foreign currency rates at the time of nonperformance.

The Company's forward currency contracts are entered into with large, reputable financial institutions that are monitored by the Company for counterparty risk.

The Company's derivative contracts contain certain credit risk-related contingent features. Under certain circumstances, including an event of default, bankruptcy, termination, and cross default under the Company's revolving credit facility, the Company may be required to make immediate payment for outstanding liabilities under its derivative contracts.

**NOTE 7. LEASES**

The Company has obligations under operating leases for its store and other retail locations, distribution centers, offices, and equipment. As of November 3, 2019, the lease terms of the various leases range from two to 15 years. The majority of the Company's leases include renewal options at the sole discretion of the Company. In general, it is not reasonably certain that lease renewals will be exercised at lease commencement and therefore lease renewals are not included in the lease term.

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The following table details the Company's net lease expense. Certain of the Company's leases include rent escalation clauses, rent holidays, and leasehold rental incentives. The majority of the Company's leases for store premises also include contingent rental payments based on sales volume. The variable lease expenses disclosed below include contingent rent payments and other non-fixed lease related costs, including common area maintenance, property taxes, and landlord's insurance.

|                          | <u>Quarter Ended</u>    | <u>Three Quarters Ended</u> |
|--------------------------|-------------------------|-----------------------------|
|                          | <u>November 3, 2019</u> | <u>November 3, 2019</u>     |
|                          | <i>(In thousands)</i>   |                             |
| Net lease expense:       |                         |                             |
| Operating lease expense  | \$ 44,497               | \$ 130,171                  |
| Short-term lease expense | 2,680                   | 6,996                       |
| Variable lease expense   | 17,972                  | 51,661                      |
|                          | <u>\$ 65,149</u>        | <u>\$ 188,828</u>           |

The following table presents future minimum lease payments and the impact of discounting.

|                                    | <u>November 3, 2019</u> |
|------------------------------------|-------------------------|
|                                    | <i>(In thousands)</i>   |
| Final quarter of fiscal 2019       | \$ 39,438               |
| 2020                               | 144,260                 |
| 2021                               | 148,987                 |
| 2022                               | 123,962                 |
| 2023                               | 97,445                  |
| After 2024                         | 225,243                 |
| Future minimum lease payments      | <u>\$ 779,335</u>       |
| Impact of discounting              | <u>(84,025)</u>         |
| Present value of lease liabilities | <u>\$ 695,310</u>       |
| Balance sheet classification:      |                         |
| Current lease liabilities          | \$ 131,385              |
| Non-current lease liabilities      | 563,925                 |
|                                    | <u>\$ 695,310</u>       |

The weighted-average remaining lease term and weighted-average discount rate were as follows:

|                                       | <u>November 3, 2019</u> |
|---------------------------------------|-------------------------|
| Weighted-average remaining lease term | 6.02 years              |
| Weighted-average discount rate        | 3.69%                   |

The following table presents supplemental cash flow information related to our leases.

|  | <u>Quarter Ended</u>    | <u>Three Quarters Ended</u> |
|--|-------------------------|-----------------------------|
|  | <u>November 3, 2019</u> | <u>November 3, 2019</u>     |
|  | <i>(In thousands)</i>   |                             |
| Cash paid for amounts included in the measurement of lease liabilities | \$ 44,398               | \$ 129,071                  |
| Leased assets obtained in exchange for new operating lease liabilities | 35,902                  | 143,776                     |

**Disclosures related to periods prior to adoption of ASC 842**

The following table details the Company's total rent expense prior to the adoption of ASC 842 as well as the property taxes for leased locations.

|                                     | <u>Quarter Ended</u>    | <u>Three Quarters Ended</u> |
|-------------------------------------|-------------------------|-----------------------------|
|                                     | <u>October 28, 2018</u> | <u>October 28, 2018</u>     |
|                                     | <i>(In thousands)</i>   |                             |
| Total rent expense:                 |                         |                             |
| Minimum rent expense                | \$ 42,514               | \$ 119,123                  |
| Common area expenses                | 6,161                   | 16,831                      |
| Rent contingent on sales            | 2,772                   | 9,244                       |
|                                     | <u>\$ 51,447</u>        | <u>\$ 145,198</u>           |
| Property taxes for leased locations | \$ 4,401                | \$ 12,817                   |

The table below summarizes the Company's contractual arrangements as of February 3, 2019, and the timing and effect that such commitments are expected to have on its liquidity and cash flows in future periods. Minimum annual basic rent payments excluding other executory operating costs, pursuant to lease agreements are approximately as laid out in the table below. These amounts include commitments in respect of lease agreements have been executed, but have not yet commenced.

|                                 | <u>Payments Due by Fiscal Year</u> |             |             |             |             |             |                   |
|---------------------------------|------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------------|
|                                 | <u>Total</u>                       | <u>2019</u> | <u>2020</u> | <u>2021</u> | <u>2022</u> | <u>2023</u> | <u>Thereafter</u> |
|                                 | <i>(In thousands)</i>              |             |             |             |             |             |                   |
| Operating leases (minimum rent) | \$ 783,913                         | \$ 169,822  | \$ 147,541  | \$ 123,032  | \$ 99,471   | \$ 73,213   | \$ 170,834        |

**NOTE 8. INCOME TAXES**

The U.S. Tax Cuts and Jobs Act ("U.S. tax reform") was enacted on December 22, 2017 and introduced significant changes to U.S. income tax laws. The U.S. tax reform reduced the U.S. federal income tax rate from 35% to 21%, introduced a shift to a territorial tax system and changed how foreign earnings are subject to U.S. tax, and imposed a mandatory one-time transition tax on the deemed repatriation of accumulated undistributed earnings of foreign subsidiaries. The U.S. tax reform also introduced new taxes on certain foreign-sourced earnings and certain related-party payments, which are referred to as the GILTI tax and the base erosion anti-abuse tax. Accounting for the income tax effects of the U.S. tax reform is complex and requires significant judgement and estimates in the interpretation and calculations of its provisions.

The SEC issued Staff Accounting Bulletin 118 ("SAB 118") which allowed companies to record and adjust provisional estimates of the impacts of the U.S. tax reform within a one-year measurement period. As disclosed in Note 14 to the audited consolidated financial statements included in Item 8 of the Company's fiscal 2017 Annual Report on Form 10-K filed with the SEC on March 27, 2018, the Company recorded certain provisional amounts in the fourth quarter of fiscal 2017.

During the third quarter of fiscal 2018, the Company adjusted the provisional amount recorded for the mandatory one-time transition tax as a result of completing its U.S. federal income tax return and incorporating recently issued guidance into its calculations. This resulted in the recognition of an additional tax expense of \$5.2 million during the third quarter of fiscal 2018, which increased the Company's effective tax rate by 380 basis points during the third quarter and by 140 basis points during the first three quarters of fiscal 2018.

As disclosed in Note 14 to the audited consolidated financial statements included in Item 8 of the Company's fiscal 2018 Annual Report on Form 10-K filed with the SEC on March 27, 2019, the Company completed the accounting for the income tax effects of the U.S. tax reform in fiscal 2018.

**NOTE 9. EARNINGS PER SHARE**

The details of the computation of basic and diluted earnings per share are as follows:

|   | Quarter Ended                                   |                  | Three Quarters Ended |                  |
|---|---|------------------|----------------------|------------------|
|   | November 3, 2019                                | October 28, 2018 | November 3, 2019     | October 28, 2018 |
|   | <i>(In thousands, except per share amounts)</i> |                  |                      |                  |
| Net income  | \$ 125,982                                      | \$ 94,413        | \$ 347,575           | \$ 265,336       |
| Basic weighted-average number of shares outstanding     | 130,282   | 132,406          | 130,420              | 133,964          |
| Assumed conversion of dilutive stock options and awards | 523   | 671              | 555                  | 548              |
| Diluted weighted-average number of shares outstanding   | 130,805   | 133,077          | 130,975              | 134,512          |
| Basic earnings per share                                | \$ 0.97   | \$ 0.71          | \$ 2.67              | \$ 1.98          |
| Diluted earnings per share                              | \$ 0.96   | \$ 0.71          | \$ 2.65              | \$ 1.97          |

The Company's calculation of weighted-average shares includes the common stock of the Company as well as the exchangeable shares. Exchangeable shares are the equivalent of common shares in all material respects. All classes of stock have, in effect, the same rights and share equally in undistributed net income. For the three quarters ended November 3, 2019 and October 28, 2018, 63.0 thousand and 41.5 thousand stock options and awards, respectively, were anti-dilutive to earnings per share and therefore have been excluded from the computation of diluted earnings per share.

On November 29, 2017, the Company's board of directors approved a stock repurchase program for up to \$200.0 million and on June 6, 2018, the board of directors approved an increase to this stock repurchase program, authorizing the repurchase of up to a total of \$600.0 million of the Company's common shares. On January 31, 2019, the Company's board of directors approved an additional stock repurchase program for up to \$500.0 million of the Company's common shares on the open market or in privately negotiated transactions. Common shares repurchased on the open market are at prevailing market prices, including under plans complying with the provisions of Rule 10b5-1 and Rule 10b-18 of the Securities Exchange Act of 1934. The timing and actual number of common shares to be repurchased will depend upon market conditions, eligibility to trade, and other factors, in accordance with Securities and Exchange Commission requirements, and the repurchase program is expected to be completed by January 2021. As of November 3, 2019, the remaining aggregate value of shares available to be repurchased under these programs was \$327.6 million.

During the three quarters ended November 3, 2019 and October 28, 2018, 1.1 million and 3.4 million shares, respectively, were repurchased under the program at a total cost of \$173.1 million and \$414.3 million, respectively.

Subsequent to November 3, 2019, and up to December 6, 2019, 1.6 thousand shares were repurchased at a total cost of \$0.3 million.

**NOTE 10. SUPPLEMENTARY FINANCIAL INFORMATION**

A summary of certain consolidated balance sheet accounts is as follows:

|   | November 3,<br>2019   | February 3,<br>2019 |
|---|-----------------------|---------------------|
|   | <i>(In thousands)</i> |                     |
| Inventories:  |                       |                     |
| Finished goods  | \$ 652,838            | \$ 420,931          |
| Provision to reduce inventories to net realizable value | (25,736)              | (16,089)            |
|   | <u>\$ 627,102</u>     | <u>\$ 404,842</u>   |

|   | November 3,<br>2019   | February 3,<br>2019 |
|---|-----------------------|---------------------|
|   | <i>(In thousands)</i> |                     |
| <b>Property and equipment, net:</b>                 |                       |                     |
| Land  | \$ 72,225             | \$ 78,636           |
| Buildings   | 30,298                | 38,030              |
| Leasehold improvements                              | 442,796               | 362,571             |
| Furniture and fixtures                              | 105,593               | 103,733             |
| Computer hardware                                   | 90,414                | 69,542              |
| Computer software                                   | 311,475               | 230,689             |
| Equipment and vehicles                              | 19,365                | 15,009              |
| Work in progress                                    | 73,332                | 74,271              |
| Property and equipment, gross                       | 1,145,498             | 972,481             |
| Accumulated depreciation                            | (489,126)             | (405,244)           |
|   | <u>\$ 656,372</u>     | <u>\$ 567,237</u>   |
| <b>Other non-current assets:</b>                    |                       |                     |
| Security deposits                                   | \$ 18,766             | \$ 15,793           |
| Cloud computing arrangement implementation costs    | 14,237                | 2,395               |
| Deferred lease assets                               | —                     | 9,286               |
| Other   | 10,784                | 9,930               |
|   | <u>\$ 43,787</u>      | <u>\$ 37,404</u>    |
| <b>Other current liabilities:</b>                   |                       |                     |
| Accrued duty, freight, and other operating expenses | \$ 71,913             | \$ 49,945           |
| Sales tax collected                                 | 13,193                | 16,091              |
| Accrued capital expenditures                        | 10,621                | 11,295              |
| Deferred revenue                                    | 10,427                | 8,045               |
| Sales return allowances                             | 8,858                 | 11,318              |
| Accrued rent  | 7,114                 | 7,331               |
| Forward currency contract liabilities               | 3,964                 | 1,042               |
| Lease termination liabilities                       | 314                   | 2,293               |
| Other   | 4,807                 | 5,338               |
|   | <u>\$ 131,211</u>     | <u>\$ 112,698</u>   |
| <b>Other non-current liabilities:</b>               |                       |                     |
| Tenant inducements                                  | \$ —                  | \$ 42,138           |
| Deferred lease liabilities                          | —                     | 33,406              |
| Other   | 5,298                 | 6,367               |
|   | <u>\$ 5,298</u>       | <u>\$ 81,911</u>    |

**NOTE 11. SEGMENTED INFORMATION AND DISAGGREGATED NET REVENUE**

The Company applies ASC Topic 280, *Segment Reporting* ("ASC 280"), in determining reportable segments for its financial statement disclosure. The Company reports segments based on the financial information it uses in managing its business. The Company's reportable segments are comprised of company-operated stores and direct to consumer. Direct to consumer represents sales from the Company's e-commerce websites and mobile apps. Outlets, temporary locations, sales to wholesale accounts, license and supply arrangements, and warehouse sale net revenue have been combined into other.

|  | Quarter Ended     |                   | Three Quarters Ended |                     |
|--|-------------------|-------------------|----------------------|---------------------|
|  | November 3, 2019  | October 28, 2018  | November 3, 2019     | October 28, 2018    |
| <i>(In thousands)</i>                    |                   |                   |                      |                     |
| <b>Net revenue:</b>                      |                   |                   |                      |                     |
| Company-operated stores                  | \$ 579,521        | \$ 476,877        | \$ 1,669,699         | \$ 1,396,376        |
| Direct to consumer                       | 246,697           | 189,375           | 674,177              | 514,623             |
| Other                                    | 89,920            | 81,403            | 237,929              | 209,862             |
|  | <u>\$ 916,138</u> | <u>\$ 747,655</u> | <u>\$ 2,581,805</u>  | <u>\$ 2,120,861</u> |
| <b>Segmented income from operations:</b> |                   |                   |                      |                     |
| Company-operated stores                  | \$ 147,734        | \$ 117,804        | \$ 422,973           | \$ 342,959          |
| Direct to consumer                       | 103,282           | 76,435            | 268,038              | 205,735             |
| Other                                    | 16,944            | 15,019            | 46,196               | 39,336              |
|  | <u>267,960</u>    | <u>209,258</u>    | <u>737,207</u>       | <u>588,030</u>      |
| General corporate expense                | 92,131            | 73,355            | 264,584              | 213,614             |
| Income from operations                   | 175,829           | 135,903           | 472,623              | 374,416             |
| Other income (expense), net              | 1,925             | 2,044             | 6,154                | 6,553               |
| Income before income tax expense         | <u>\$ 177,754</u> | <u>\$ 137,947</u> | <u>\$ 478,777</u>    | <u>\$ 380,969</u>   |
| <b>Capital expenditures:</b>             |                   |                   |                      |                     |
| Company-operated stores                  | \$ 47,939         | \$ 38,053         | \$ 128,675           | \$ 85,054           |
| Direct to consumer                       | 1,165             | 540               | 14,975               | 1,854               |
| Corporate and other                      | 29,349            | 34,146            | 70,567               | 69,838              |
|  | <u>\$ 78,453</u>  | <u>\$ 72,739</u>  | <u>\$ 214,217</u>    | <u>\$ 156,746</u>   |
| <b>Depreciation and amortization:</b>    |                   |                   |                      |                     |
| Company-operated stores                  | \$ 26,434         | \$ 19,383         | \$ 71,206            | \$ 54,954           |
| Direct to consumer                       | 3,498             | 2,336             | 8,930                | 7,237               |
| Corporate and other                      | 14,090            | 9,967             | 34,308               | 24,924              |
|  | <u>\$ 44,022</u>  | <u>\$ 31,686</u>  | <u>\$ 114,444</u>    | <u>\$ 87,115</u>    |

The following table disaggregates the Company's net revenue by geographic area. The economic conditions in these areas could affect the amount and timing of the Company's net revenue and cash flows.

|                          | Quarter Ended     |                   | Three Quarters Ended |                     |
|--------------------------|-------------------|-------------------|----------------------|---------------------|
|                          | November 3, 2019  | October 28, 2018  | November 3, 2019     | October 28, 2018    |
| <i>(In thousands)</i>    |                   |                   |                      |                     |
| United States            | \$ 645,600        | \$ 527,331        | \$ 1,821,090         | \$ 1,502,013        |
| Canada                   | 159,552           | 137,991           | 428,802              | 374,418             |
| Outside of North America | 110,986           | 82,333            | 331,913              | 244,430             |
|                          | <u>\$ 916,138</u> | <u>\$ 747,655</u> | <u>\$ 2,581,805</u>  | <u>\$ 2,120,861</u> |

## **NOTE 12. LEGAL PROCEEDINGS AND OTHER CONTINGENCIES**

In addition to the legal proceedings described below, the Company is, from time to time, involved in routine legal matters, and audits and inspections by governmental agencies and other third parties which are incidental to the conduct of its business. This includes legal matters such as initiation and defense of proceedings to protect intellectual property rights, personal injury claims, product liability claims, employment claims, and similar matters. The Company believes the ultimate resolution of any such legal proceedings, audits, and inspections will not have a material adverse effect on its consolidated balance sheets, results of operations or cash flows.

On October 9, 2015, certain current and former hourly employees of the Company filed a class action lawsuit in the Supreme Court of New York entitled *Rebecca Gathmann-Landini et al v. lululemon USA inc.* On December 2, 2015, the case was moved to the United States District Court for the Eastern District of New York. The lawsuit alleges that the Company violated various New York labor codes by failing to pay all earned wages, including overtime compensation. The plaintiffs are seeking an unspecified amount of damages. The Company intends to vigorously defend this matter.

On November 21, 2018, plaintiff David Shabbouei filed in the Delaware Court of Chancery a derivative lawsuit on behalf of the Company against certain of the Company's current and former directors and officers, captioned *David Shabbouei v. Laurent Potdevin, et al.*, 2018-0847-JRS. Plaintiff claims that the defendants breached their fiduciary duties to the Company by allegedly failing to address alleged sexual harassment, gender discrimination, and related conduct at the Company. Plaintiff also claims that the defendants breached their fiduciary duties to the Company and wasted corporate assets with respect to the separation agreement entered into by the Company and Laurent Potdevin in connection with his departure from the Company in February 2018. Plaintiff also further brings an unjust enrichment claim against Mr. Potdevin with respect to the separation agreement. Plaintiff seeks unspecified money damages for the Company for the defendants' alleged breaches of fiduciary duty, waste and unjust enrichment, disgorgement of all profits, benefits and other compensation Mr. Potdevin received as a result of defendants' alleged conduct for the Company, an order directing the Company to implement corporate governance and internal procedures, and an award of plaintiff's attorneys' fees, costs and expenses. The defendants and the Company have moved to dismiss the action.

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Some of the statements contained in this Form 10-Q and any documents incorporated herein by reference constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements, other than statements of historical facts, included or incorporated in this Form 10-Q are forward-looking statements, particularly statements which relate to expectations, beliefs, projections, future plans and strategies, anticipated events or trends and similar expressions concerning matters that are not historical facts, such as statements regarding our future financial condition or results of operations, our prospects and strategies for future growth, the development and introduction of new products, and the implementation of our marketing and branding strategies. In many cases, you can identify forward-looking statements by terms such as "may," "will," "should," "expects," "plans," "anticipates," "believes," "estimates," "intends," "predicts," "potential" or the negative of these terms or other comparable terminology.

The forward-looking statements contained in this Form 10-Q and any documents incorporated herein by reference reflect our current views about future events and are subject to risks, uncertainties, assumptions, and changes in circumstances that may cause events or our actual activities or results to differ significantly from those expressed in any forward-looking statement. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future events, results, actions, levels of activity, performance, or achievements. Readers are cautioned not to place undue reliance on these forward-looking statements. A number of important factors could cause actual results to differ materially from those indicated by the forward-looking statements, including, but not limited to, those factors described in "Risk Factors" and elsewhere in this report.

The forward-looking statements contained in this Form 10-Q reflect our views and assumptions only as of the date of this Form 10-Q and are expressly qualified in their entirety by the cautionary statements included in this Form 10-Q. Except as required by applicable securities law, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events.

This information should be read in conjunction with the unaudited interim consolidated financial statements and the notes included in Item 1 of Part I of this Quarterly Report on Form 10-Q and the audited consolidated financial statements and notes, and Management's Discussion and Analysis of Financial Condition and Results of Operations, contained in our fiscal 2018 Annual Report on Form 10-K filed with the SEC on March 27, 2019.

We disclose material non-public information through one or more of the following channels: our investor relations website (<http://investor.lululemon.com/>), the social media channels identified on our investor relations website, press releases, SEC filings, public conference calls, and webcasts.

### **Overview**

lululemon athletica inc. is principally a designer, distributor, and retailer of healthy lifestyle inspired athletic apparel and accessories. We have a vision to be the experiential brand that ignites a community of people through sweat, grow, and connect, which we call "living the sweatlife." Since our inception, we have fostered a distinctive corporate culture; we promote a set of core values in our business which include taking personal responsibility, nurturing entrepreneurial spirit, acting with honesty and courage, valuing connection, and choosing to have fun. These core values attract passionate and motivated employees who are driven to achieve personal and professional goals, and share our purpose "to elevate the world by unleashing the full potential within every one of us."

Our healthy lifestyle inspired athletic apparel and accessories are marketed under the lululemon brand. We offer a comprehensive line of apparel and accessories for women and men. Our apparel assortment includes items such as pants, shorts, tops, and jackets designed for a healthy lifestyle including athletic activities such as yoga, running, training, and most other sweaty pursuits. We also offer fitness-related accessories.

### **Financial Highlights**

The summary below provides both GAAP and adjusted non-GAAP financial measures. The adjusted financial measures exclude the tax expense recognized during the third quarter of fiscal 2018 related to the U.S. tax reform.

For the third quarter of fiscal 2019, compared to the third quarter of fiscal 2018:

- Net revenue increased 23% to \$916.1 million. On a constant dollar basis, net revenue increased 23%.
- Total comparable sales, which includes comparable store sales and direct to consumer, increased 16%. On a constant dollar basis, total comparable sales increased 17%.
  - Comparable store sales increased 10%, or increased 11% on a constant dollar basis.
  - Direct to consumer net revenue increased 29%, or increased 30% on a constant dollar basis.
- Gross profit increased 24% to \$505.0 million.
- Gross margin increased 70 basis points to 55.1%.
- Income from operations increased 29% to \$175.8 million.
- Operating margin increased 100 basis points to 19.2%.
- Income tax expense increased 19% to \$51.8 million. Our effective tax rate for the third quarter of fiscal 2019 was 29.1% compared to 31.6% for the third quarter of fiscal 2018. The adjusted effective tax rate for the third quarter of fiscal 2018 was 27.8%.
- Diluted earnings per share were \$0.96 compared to \$0.71 in the third quarter of fiscal 2018. Adjusted diluted earnings per share for the third quarter of fiscal 2018 were \$0.75.

Due to the 53rd week in fiscal 2018, comparable sales are calculated on a one week shifted basis such that the 13 weeks and 39 weeks ended November 3, 2019 are compared to the 13 weeks and 39 weeks ended November 4, 2018 rather than October 28, 2018.

Refer to the non-GAAP reconciliation tables contained in the "Non-GAAP Financial Measures" section of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" for reconciliations between constant dollar changes in net revenue, total comparable sales, comparable store sales, and direct to consumer net revenue, and adjusted effective tax rates and diluted earnings per share, and the most directly comparable measures calculated in accordance with GAAP.

## Results of Operations

### Third Quarter Results

The following table summarizes key components of our results of operations for the quarters ended November 3, 2019 and October 28, 2018. The percentages are presented as a percentage of net revenue.

|  | Quarter Ended         |                  |                      |                  |
|--|-----------------------|------------------|----------------------|------------------|
|  | November 3, 2019      | October 28, 2018 | November 3, 2019     | October 28, 2018 |
|  | <i>(In thousands)</i> |                  | <i>(Percentages)</i> |                  |
| Net revenue                                  | \$ 916,138            | \$ 747,655       | 100.0%               | 100.0%           |
| Cost of goods sold                           | 411,094               | 340,878          | 44.9                 | 45.6             |
| Gross profit                                 | 505,044               | 406,777          | 55.1                 | 54.4             |
| Selling, general and administrative expenses | 329,215               | 270,874          | 35.9                 | 36.2             |
| Income from operations                       | 175,829               | 135,903          | 19.2                 | 18.2             |
| Other income (expense), net                  | 1,925                 | 2,044            | 0.2                  | 0.3              |
| Income before income tax expense             | 177,754               | 137,947          | 19.4                 | 18.5             |
| Income tax expense                           | 51,772                | 43,534           | 5.7                  | 5.8              |
| Net income                                   | \$ 125,982            | \$ 94,413        | 13.8%                | 12.6%            |

### Net Revenue

Net revenue increased \$168.5 million, or 23%, to \$916.1 million for the third quarter of fiscal 2019 from \$747.7 million for the third quarter of fiscal 2018. On a constant dollar basis, assuming the average exchange rates for the third quarter of fiscal 2019 remained constant with the average exchange rates for the third quarter of fiscal 2018, net revenue increased \$175.3 million, or 23%.

The increase in net revenue was primarily due to increased company-operated store net revenue, including from new company-operated stores as well as an increase in comparable store sales, increased direct to consumer net revenue, and an increase in net revenue from our other retail locations.

Based on a shifted calendar, total comparable sales, which includes comparable store sales and direct to consumer, increased 16% in the third quarter of fiscal 2019 compared to the third quarter of fiscal 2018. Total comparable sales increased 17% on a constant dollar basis.

Net revenue on a segment basis for the quarters ended November 3, 2019 and October 28, 2018 is summarized below. The percentages are presented as a percentage of total net revenue.

|                         | Quarter Ended         |                  |                      |                  |
|-------------------------|-----------------------|------------------|----------------------|------------------|
|                         | November 3, 2019      | October 28, 2018 | November 3, 2019     | October 28, 2018 |
|                         | <i>(In thousands)</i> |                  | <i>(Percentages)</i> |                  |
| Company-operated stores | \$ 579,521            | \$ 476,877       | 63.3%                | 63.8%            |
| Direct to consumer      | 246,697               | 189,375          | 26.9                 | 25.3             |
| Other                   | 89,920                | 81,403           | 9.8                  | 10.9             |
| Net revenue             | \$ 916,138            | \$ 747,655       | 100.0%               | 100.0%           |

*Company-Operated Stores.* Net revenue from our company-operated stores segment increased \$102.6 million, or 22%, to \$579.5 million in the third quarter of fiscal 2019 from \$476.9 million in the third quarter of fiscal 2018. The following contributed to the increase in net revenue from our company-operated stores segment:

- Net revenue from company-operated stores we opened or significantly expanded subsequent to October 28, 2018 contributed \$61.1 million to the increase. We opened 53 net new company-operated stores since the third quarter of fiscal 2018, including 22 stores in Asia, 21 stores in North America, seven stores in Europe, and three stores in Australia/New Zealand.

- Based on a shifted calendar, a comparable store sales increase of 10% in the third quarter of fiscal 2019 compared to the third quarter of fiscal 2018. Comparable store sales increased 11% on a constant dollar basis. The increase in comparable store sales was primarily a result of increased store traffic.

*Direct to Consumer.* Net revenue from our direct to consumer segment increased \$57.3 million to \$246.7 million in the third quarter of fiscal 2019 from \$189.4 million in the third quarter of fiscal 2018. Based on a shifted calendar, direct to consumer net revenue increased 29%, or increased 30% on a constant dollar basis. This was primarily a result of increased website traffic.

*Other.* Net revenue from our other segment increased \$8.5 million, or 10%, to \$89.9 million in the third quarter of fiscal 2019 from \$81.4 million in the third quarter of fiscal 2018. This increase was primarily the result of an increase in sales to wholesale accounts in the third quarter of fiscal 2019 compared to the third quarter of fiscal 2018.

### **Gross Profit**

Gross profit increased \$98.3 million, or 24%, to \$505.0 million for the third quarter of fiscal 2019 from \$406.8 million for the third quarter of fiscal 2018.

Gross profit as a percentage of net revenue, or gross margin, increased 70 basis points to 55.1% in the third quarter of fiscal 2019 from 54.4% in the third quarter of fiscal 2018. The increase in gross margin was primarily the result of:

- an increase in product margin of 120 basis points which was primarily due to lower product costs, a favorable mix of higher margin product, and lower markdowns; and
- a decrease in occupancy and depreciation costs as a percentage of revenue of 10 basis points.

This was partially offset by an increase in costs as a percentage of revenue related to our distribution centers and our product departments of 40 basis points, and an unfavorable impact of foreign exchange rates of 20 basis points.

### **Selling, General and Administrative Expenses**

Selling, general and administrative expenses increased \$58.3 million, or 22%, to \$329.2 million in the third quarter of fiscal 2019 from \$270.9 million in the third quarter of fiscal 2018. The increase in selling, general and administrative expenses was primarily due to:

- an increase in costs related to our operating channels of \$34.0 million, comprised of:
  - an increase in employee costs of \$17.8 million primarily from a growth in labor hours and benefits, mainly associated with new company-operated stores and other new operating locations, and due to higher incentive compensation expenses;
  - an increase in variable costs of \$12.0 million primarily due to an increase in distribution costs, credit card fees, and packaging costs as a result of increased net revenue; and
  - an increase in other costs of \$4.2 million primarily due to increases in digital marketing expenses, information technology costs, and other costs associated with our operating locations;
- an increase in head office costs of \$22.7 million, comprised of:
  - an increase in employee costs of \$14.2 million due to increased incentive and stock-based compensation expense and due to increased wages, primarily from additional employees to support the growth in our business; and
  - an increase in other costs of \$8.4 million primarily due to increases in depreciation, information technology costs, and other head office costs; and
- an increase in net foreign exchange and derivative revaluation losses of \$1.7 million.

As a percentage of net revenue, selling, general and administrative expenses decreased 30 basis points, to 35.9% in the third quarter of fiscal 2019 from 36.2% in the third quarter of fiscal 2018.

### **Income from Operations**

Income from operations increased \$39.9 million, or 29%, to \$175.8 million in the third quarter of fiscal 2019 from \$135.9 million in the third quarter of fiscal 2018. Operating margin increased 100 basis points to 19.2% compared to 18.2% in the third quarter of fiscal 2018.

On a segment basis, we determine income from operations without taking into account our general corporate expenses.

Segmented income from operations for the quarters ended November 3, 2019 and October 28, 2018 is summarized below. The percentages are presented as a percentage of net revenue of the respective operating segments.

|                                   | Quarter Ended         |                   |  |                  |
|-----------------------------------|-----------------------|-------------------|--|------------------|
|                                   | November 3, 2019      | October 28, 2018  | November 3, 2019                       | October 28, 2018 |
|                                   | <i>(In thousands)</i> |                   | <i>(Percentage of segment revenue)</i> |                  |
| Segmented income from operations: |                       |                   |  |                  |
| Company-operated stores           | \$ 147,734            | \$ 117,804        | 25.5%                                  | 24.7%            |
| Direct to consumer                | 103,282               | 76,435            | 41.9                                   | 40.4             |
| Other                             | 16,944                | 15,019            | 18.8                                   | 18.5             |
|                                   | <u>267,960</u>        | <u>209,258</u>    |  |                  |
| General corporate expense         | 92,131                | 73,355            |  |                  |
| Income from operations            | <u>\$ 175,829</u>     | <u>\$ 135,903</u> |  |                  |

*Company-Operated Stores.* Income from operations from our company-operated stores segment increased \$29.9 million, or 25%, to \$147.7 million for the third quarter of fiscal 2019 from \$117.8 million for the third quarter of fiscal 2018. The increase was primarily the result of increased gross profit of \$53.8 million which was primarily due to increased net revenue and higher gross margin. This was partially offset by an increase in selling, general and administrative expenses, primarily due to an increase in employee costs, primarily due to an increased number of company-operated stores and higher incentive compensation expenses. Additionally, there were increased store operating expenses including higher credit card fees, distribution costs, and packaging costs primarily as a result of higher net revenue. Income from operations as a percentage of company-operated stores net revenue increased 80 basis points primarily due to leverage on selling, general and administrative expenses and higher gross margin.

*Direct to Consumer.* Income from operations from our direct to consumer segment increased \$26.8 million, or 35%, to \$103.3 million for the third quarter of fiscal 2019 from \$76.4 million for the third quarter of fiscal 2018. The increase was primarily the result of increased gross profit of \$41.9 million which was primarily due to increased net revenue and higher gross margin. This was partially offset by an increase in selling, general and administrative expenses primarily due to higher variable costs including distribution costs, credit card fees, and packaging costs as a result of higher net revenue, as well as higher information technology costs, digital marketing expenses, and employee costs. Income from operations as a percentage of direct to consumer net revenue increased 150 basis points primarily due to higher gross margin, partially offset by deleverage on selling, general and administrative expenses.

*Other.* Other income from operations increased \$1.9 million, or 13%, to \$16.9 million for the third quarter of fiscal 2019 from \$15.0 million for the third quarter of fiscal 2018. The increase was primarily the result of increased gross profit of \$2.6 million which was due to increased net revenue. The increase in gross profit was partially offset by an increase in selling, general and administrative expenses, primarily due to increased employee costs, primarily due to an increased number of temporary locations, and increased operating expenses, partially offset by a decrease in marketing costs. Income from operations as a percentage of other net revenue increased 30 basis points primarily due to leverage on selling, general and administrative expenses, partially offset by a decrease in gross margin.

*General Corporate Expense.* General corporate expense increased \$18.8 million, or 26%, to \$92.1 million for the third quarter of fiscal 2019 from \$73.4 million for the third quarter of fiscal 2018. This increase was primarily due to increases in head office employee costs, depreciation, information technology costs, and an increase in net foreign exchange and derivative revaluation losses of \$1.7 million.

#### Other Income (Expense), Net

Other income, net decreased \$0.1 million, or 6%, to \$1.9 million for the third quarter of fiscal 2019 from income of \$2.0 million for the third quarter of fiscal 2018. The decrease was primarily due to a decrease in net interest income. The decrease in other income, net was partially offset by a decrease in interest expense, primarily the result of borrowings on our revolving credit facility during the third quarter of fiscal 2018.

## Income Tax Expense

Income tax expense increased \$8.2 million, or 19%, to \$51.8 million for the third quarter of fiscal 2019 from \$43.5 million for the third quarter of fiscal 2018.

During the third quarter of fiscal 2018, we adjusted the provisional amount recorded for the mandatory one-time transition tax on the deemed repatriation of accumulated undistributed earnings of foreign subsidiaries imposed by U.S. tax reform. This resulted in the recognition of an additional tax expense of \$5.2 million. Additional information is outlined in Note 8 to the unaudited interim consolidated financial statements included in Item 1 of Part I of this report.

The effective tax rate for the third quarter of fiscal 2019 was 29.1% compared to 31.6% for the third quarter of fiscal 2018. Excluding the above tax adjustment, the adjusted effective tax rate for the third quarter of fiscal 2018 was 27.8%. The increase in the adjusted effective tax rate was primarily due to adjustments made upon filing the U.S. federal income tax returns in each year, partially offset by an increase in tax deductions related to stock-based compensation.

## Net Income

Net income increased \$31.6 million, or 33%, to \$126.0 million for the third quarter of fiscal 2019 from \$94.4 million for the third quarter of fiscal 2018. This was primarily due to an increase in gross profit of \$98.3 million, partially offset by an increase in selling, general and administrative expenses of \$58.3 million, an increase in income tax expense of \$8.2 million, and a decrease in other income (expense), net of \$0.1 million.

## First Three Quarters Results

The following table summarizes key components of our results of operations for the first three quarters ended November 3, 2019 and October 28, 2018. The percentages are presented as a percentage of net revenue.

|  | Three Quarters Ended  |                  |                      |                  |
|--|-----------------------|------------------|----------------------|------------------|
|  | November 3, 2019      | October 28, 2018 | November 3, 2019     | October 28, 2018 |
|  | <i>(In thousands)</i> |                  | <i>(Percentages)</i> |                  |
| Net revenue                                  | \$ 2,581,805          | \$ 2,120,861     | 100.0%               | 100.0%           |
| Cost of goods sold                           | 1,169,245             | 973,157          | 45.3                 | 45.9             |
| Gross profit                                 | 1,412,560             | 1,147,704        | 54.7                 | 54.1             |
| Selling, general and administrative expenses | 939,937               | 773,288          | 36.4                 | 36.5             |
| Income from operations                       | 472,623               | 374,416          | 18.3                 | 17.7             |
| Other income (expense), net                  | 6,154                 | 6,553            | 0.2                  | 0.3              |
| Income before income tax expense             | 478,777               | 380,969          | 18.5                 | 18.0             |
| Income tax expense                           | 131,202               | 115,633          | 5.1                  | 5.5              |
| Net income                                   | \$ 347,575            | \$ 265,336       | 13.5%                | 12.5%            |

## Net Revenue

Net revenue increased \$460.9 million, or 22%, to \$2.582 billion for the first three quarters of fiscal 2019 from \$2.121 billion for the first three quarters of fiscal 2018. On a constant dollar basis, assuming the average exchange rates for the first three quarters of fiscal 2019 remained constant with the average exchange rates for the first three quarters of fiscal 2018, net revenue increased \$488.7 million, or 23%.

The increase in net revenue was primarily due to increased company-operated store net revenue, including from new company-operated stores as well as an increase in comparable store sales, increased direct to consumer net revenue, and an increase in net revenue from our other retail locations.

Based on a shifted calendar, total comparable sales, which includes comparable store sales and direct to consumer, increased 15% in the first three quarters of fiscal 2019 compared to the first three quarters of fiscal 2018. Total comparable sales increased 16% on a constant dollar basis.

Net revenue on a segment basis for the first three quarters ended November 3, 2019 and October 28, 2018 is summarized below. The percentages are presented as a percentage of total net revenue.

|                         | Three Quarters Ended  |                  |                      |                  |
|-------------------------|-----------------------|------------------|----------------------|------------------|
|                         | November 3, 2019      | October 28, 2018 | November 3, 2019     | October 28, 2018 |
|                         | <i>(In thousands)</i> |                  | <i>(Percentages)</i> |                  |
| Company-operated stores | \$ 1,669,699          | \$ 1,396,376     | 64.7%                | 65.8%            |
| Direct to consumer      | 674,177               | 514,623          | 26.1                 | 24.3             |
| Other                   | 237,929               | 209,862          | 9.2                  | 9.9              |
| Net revenue             | \$ 2,581,805          | \$ 2,120,861     | 100.0%               | 100.0%           |

*Company-Operated Stores.* Net revenue from our company-operated stores segment increased \$273.3 million, or 20%, to \$1.670 billion in the first three quarters of fiscal 2019 from \$1.396 billion in the first three quarters of fiscal 2018. The following contributed to the increase in net revenue from our company-operated stores segment:

- Net revenue from company-operated stores we opened or significantly expanded subsequent to October 28, 2018 contributed \$161.2 million to the increase. We opened 53 net new company-operated stores since the third quarter of fiscal 2018, including 22 stores in Asia, 21 stores in North America, seven stores in Europe, and three stores in Australia/New Zealand.
- Based on a shifted calendar, a comparable store sales increase of 9% in the first three quarters of fiscal 2019 compared to the first three quarters of fiscal 2018. Comparable store sales increased 10% on a constant dollar basis. The increase in comparable store sales was primarily a result of increased store traffic.

*Direct to Consumer.* Net revenue from our direct to consumer segment increased \$159.6 million to \$674.2 million in the first three quarters of fiscal 2019 from \$514.6 million in the first three quarters of fiscal 2018. Based on a shifted calendar, direct to consumer net revenue increased 30%, or increased 32% on a constant dollar basis. This was primarily a result of increased website traffic, partially offset by a decrease in dollar value per transaction.

*Other.* Net revenue from our other segment increased \$28.1 million, or 13%, to \$237.9 million in the first three quarters of fiscal 2019 from \$209.9 million in the first three quarters of fiscal 2018. This increase was primarily the result of an increase in net revenue from sales to wholesale accounts, and an increased number of temporary locations, including seasonal stores, open during the first three quarters of fiscal 2019 compared to the first three quarters of fiscal 2018.

### Gross Profit

Gross profit increased \$264.9 million, or 23%, to \$1.413 billion for the first three quarters of fiscal 2019 from \$1.148 billion for the first three quarters of fiscal 2018.

Gross profit as a percentage of net revenue, or gross margin, increased 60 basis points, to 54.7% in the first three quarters of fiscal 2019 from 54.1% in the first three quarters of fiscal 2018. The increase in gross margin was primarily the result of an increase in product margin of 130 basis points which was primarily due to lower product costs, a favorable mix of higher margin product, and lower markdowns.

This was partially offset by an increase in costs as a percentage of revenue related to our distribution centers and our product departments of 40 basis points, an unfavorable impact of foreign exchange rates of 20 basis points, and an increase in occupancy and depreciation costs as a percentage of revenue of 10 basis points.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses increased \$166.6 million, or 22%, to \$939.9 million in the first three quarters of fiscal 2019 from \$773.3 million in the first three quarters of fiscal 2018. The increase in selling, general and administrative expenses was primarily due to:

- an increase in costs related to our operating channels of \$99.4 million, comprised of:
  - an increase in employee costs of \$52.1 million primarily from a growth in labor hours and benefits, mainly associated with new company-operated stores and other new operating locations, and due to higher incentive compensation expenses;
  - an increase in variable costs of \$30.1 million primarily due to an increase in distribution costs, credit card fees, and packaging costs as a result of increased net revenue; and

- an increase in other costs of \$17.1 million primarily due to an increase in digital marketing expenses, information technology costs, security costs, repairs and maintenance costs, and other costs associated with our operating locations;
- an increase in head office costs of \$68.3 million, comprised of:
  - an increase in employee costs of \$41.6 million primarily due to increased incentive and stock-based compensation expense, increased wages, and increased travel expenses, primarily from additional employees to support the growth in our business; and
  - an increase in other costs of \$26.6 million primarily due to an increase in depreciation, professional fees, information technology costs, brand and community costs, and other head office costs.

The increase in selling, general and administrative expenses was partially offset by a decrease in net foreign exchange and derivative revaluation losses of \$1.0 million.

As a percentage of net revenue, selling, general and administrative expenses decreased 10 basis points, to 36.4% in the first three quarters of fiscal 2019 from 36.5% in the first three quarters of fiscal 2018.

### Income from Operations

Income from operations increased \$98.2 million, or 26%, to \$472.6 million in the first three quarters of fiscal 2019 from \$374.4 million in the first three quarters of fiscal 2018. Operating margin increased 60 basis points to 18.3% compared to 17.7% in the first three quarters of fiscal 2018.

On a segment basis, we determine income from operations without taking into account our general corporate expenses.

Segmented income from operations for the first three quarters ended November 3, 2019 and October 28, 2018 is summarized below. The percentages are presented as a percentage of net revenue of the respective operating segments.

|                                   | Three Quarters Ended  |                   |  |                  |
|-----------------------------------|-----------------------|-------------------|--|------------------|
|                                   | November 3, 2019      | October 28, 2018  | November 3, 2019                       | October 28, 2018 |
|                                   | <i>(In thousands)</i> |                   | <i>(Percentage of segment revenue)</i> |                  |
| Segmented income from operations: |                       |                   |  |                  |
| Company-operated stores           | \$ 422,973            | \$ 342,959        | 25.3%                                  | 24.6%            |
| Direct to consumer                | 268,038               | 205,735           | 39.8                                   | 40.0             |
| Other                             | 46,196                | 39,336            | 19.4                                   | 18.7             |
|                                   | <u>737,207</u>        | <u>588,030</u>    |  |                  |
| General corporate expense         | 264,584               | 213,614           |  |                  |
| Income from operations            | <u>\$ 472,623</u>     | <u>\$ 374,416</u> |  |                  |

*Company-Operated Stores.* Income from operations from our company-operated stores segment increased \$80.0 million, or 23%, to \$423.0 million for the first three quarters of fiscal 2019 from \$343.0 million for the first three quarters of fiscal 2018. The increase was primarily the result of increased gross profit of \$147.6 million which was primarily due to increased net revenue and higher gross margin. This was partially offset by an increase in selling, general and administrative expenses, primarily due to increased employee costs, primarily due to an increased number of company-operated stores and higher incentive compensation expenses. Additionally, there were increased store operating expenses including higher credit card fees, distribution costs, and packaging costs primarily as a result of higher net revenue, as well as increases in security and repairs and maintenance costs. Income from operations as a percentage of company-operated stores net revenue increased by 70 basis points, primarily due to an increase in gross margin and leverage on selling, general and administrative expenses.

*Direct to Consumer.* Income from operations from our direct to consumer segment increased \$62.3 million, or 30%, to \$268.0 million for the first three quarters of fiscal 2019 from \$205.7 million for the first three quarters of fiscal 2018. The increase was primarily the result of increased gross profit of \$107.3 million which was primarily due to increased net revenue and higher gross margin. This was partially offset by an increase in selling, general and administrative expenses primarily due to higher variable costs including distribution costs, credit card fees, and packaging costs as a result of higher net revenue, as well as higher digital marketing expenses, information technology costs, and employee costs. Income from operations as a percentage of direct to consumer net revenue decreased 20 basis points, primarily due to deleverage on selling, general and administrative expenses, partially offset by an increase in gross margin.

*Other.* Other income from operations increased \$6.9 million, or 17%, to \$46.2 million for the first three quarters of fiscal 2019 from \$39.3 million for the first three quarters of fiscal 2018. The increase was primarily the result of increased gross profit of \$10.0 million which was primarily due to increased net revenue. The increase in gross profit was partially offset by an increase in selling, general and administrative expenses including increased employee costs and increased operating expenses, partially offset by a decrease in marketing costs. Income from operations as a percentage of other net revenue increased 70 basis points, primarily due to leverage on selling, general and administrative expenses, partially offset by a decrease in gross margin.

*General Corporate Expense.* General corporate expense increased \$51.0 million, or 24%, to \$264.6 million for the first three quarters of fiscal 2019 from \$213.6 million for the first three quarters of fiscal 2018. This increase was primarily due to increases in head office employee costs, depreciation, professional fees, information technology costs, and brand and community costs, partially offset by a decrease in net foreign exchange and derivative revaluation losses of \$1.0 million.

#### **Other Income (Expense), Net**

Other income, net decreased \$0.4 million, or 6%, to \$6.2 million for the first three quarters of fiscal 2019 from income of \$6.6 million for the first three quarters of fiscal 2018. The decrease was primarily due to a decrease in net interest income, primarily due to a decrease in cash and cash equivalents in the first three quarters of fiscal 2019 compared to the first three quarters of fiscal 2018. The decrease in other income, net was partially offset by a decrease in interest expense, primarily the result of borrowings on our revolving credit facility during the first three quarters of fiscal 2018.

#### **Income Tax Expense**

Income tax expense increased \$15.6 million, or 13%, to \$131.2 million for the first three quarters of fiscal 2019 from \$115.6 million for the first three quarters of fiscal 2018.

During the third quarter of fiscal 2018, we adjusted the provisional amount recorded for the mandatory one-time transition tax on the deemed repatriation of accumulated undistributed earnings of foreign subsidiaries imposed by U.S. tax reform. This resulted in the recognition of an additional tax expense of \$5.2 million. Additional information is outlined in Note 8 to the unaudited interim consolidated financial statements included in Item 1 of Part I of this report.

The effective tax rate for the first three quarters of fiscal 2019 was 27.4% compared to 30.4% for the first three quarters of fiscal 2018. Excluding the above tax adjustment, the effective tax rate for the first three quarters of fiscal 2018 was 29.0%. The decrease in the effective tax rate was primarily due to changes in legislation and guidance related to the global intangible low-taxed income tax which were released during the fourth quarter of fiscal 2018 and an increase in tax deductions related to stock-based compensation.

#### **Net Income**

Net income increased \$82.2 million, or 31%, to \$347.6 million for the first three quarters of fiscal 2019 from \$265.3 million for the first three quarters of fiscal 2018. This was primarily due to an increase in gross profit of \$264.9 million, partially offset by an increase in selling, general and administrative expenses of \$166.6 million, an increase in income tax expense of \$15.6 million, and a decrease in other income (expense), net of \$0.4 million.

#### **Comparable Store Sales and Total Comparable Sales**

We separately track comparable store sales, which reflect net revenue from company-operated stores that have been open for at least 12 full fiscal months, or open for 12 full fiscal months after being significantly expanded. Comparable store sales exclude sales from our direct to consumer and other segments. Total comparable sales combines comparable store sales and direct to consumer sales. In fiscal years following a 53 week year, the prior year period is shifted by one week to compare similar calendar weeks.

The comparable sales measures we report may not be equivalent to similarly titled measures reported by other companies.

#### **Non-GAAP Financial Measures**

Constant dollar changes in net revenue, total comparable sales, comparable store sales, direct to consumer net revenue, and the adjusted financial results are non-GAAP financial measures.

A constant dollar basis assumes the average foreign exchange rates for the period remained constant with the average foreign exchange rates for the same period of the prior year. We provide constant dollar changes in net revenue, total comparable sales, comparable store sales, and direct to consumer net revenue because we use these measures to understand the

underlying growth rate of net revenue excluding the impact of changes in foreign exchange rates. We believe that disclosing these measures on a constant dollar basis is useful to investors because it enables them to better understand the level of growth of our business.

Adjusted income tax expense, effective tax rates, and diluted earnings per share exclude the amounts recognized in connection with the U.S. tax reform. We believe these adjusted financial measures are useful to investors as the adjustments do not directly relate to our ongoing business operations and therefore do not contribute to a meaningful evaluation of the trend in our operating performance. Furthermore, we do not believe the adjustments are reflective of our expectations of our future operating performance and believe these non-GAAP measures are useful to investors because of their comparability to our historical information.

The presentation of this financial information is not intended to be considered in isolation or as a substitute for, or with greater prominence to, the financial information prepared and presented in accordance with GAAP. A reconciliation of the non-GAAP financial measures follows, which includes more detail on the GAAP financial measure that is most directly comparable to each non-GAAP financial measure, and the related reconciliations between these financial measures.

#### Constant dollar changes in net revenue

The below changes in net revenue show the change compared to the corresponding period in the prior year.

|  | Quarter Ended<br>November 3, 2019 |               | Three Quarters Ended<br>November 3, 2019 |               |
|--|-----------------------------------|---------------|--|---------------|
|  | (In thousands)                    | (Percentages) | (In thousands)                           | (Percentages) |
| Change   | \$ 168,483                        | 23%           | \$ 460,944                               | 22%           |
| Adjustments due to foreign exchange rate changes | 6,776                             | —             | 27,744                                   | 1             |
| Change in constant dollars                       | <u>\$ 175,259</u>                 | <u>23%</u>    | <u>\$ 488,688</u>                        | <u>23%</u>    |

#### Constant dollar changes in total comparable sales, comparable store sales, and direct to consumer net revenue

Due to the 53rd week in fiscal 2018, the below changes in total comparable sales, comparable store sales, and direct to consumer net revenue are calculated on a one week shifted basis such that the 13 weeks and 39 weeks ended November 3, 2019 are compared to the 13 weeks and 39 weeks ended November 4, 2018 rather than October 28, 2018.

|   | Quarter Ended<br>November 3, 2019        |  |                                   | Three Quarters Ended<br>November 3, 2019 |  |                                   |
|---|--|--|-----------------------------------|--|--|-----------------------------------|
|   | Total Comparable<br>Sales <sup>1,2</sup> | Comparable Store<br>Sales <sup>2</sup> | Direct to Consumer<br>Net Revenue | Total Comparable<br>Sales <sup>1,2</sup> | Comparable Store<br>Sales <sup>2</sup> | Direct to Consumer<br>Net Revenue |
| Change  | 16%                                      | 10%                                    | 29%                               | 15%                                      | 9%                                     | 30%                               |
| Adjustments due to foreign<br>exchange rate changes | 1  | 1                                      | 1                                 | 1  | 1                                      | 2                                 |
| Change in constant dollars                          | <u>17%</u>                               | <u>11%</u>                             | <u>30%</u>                        | <u>16%</u>                               | <u>10%</u>                             | <u>32%</u>                        |

(1) Total comparable sales includes comparable store sales and direct to consumer sales.

(2) Comparable store sales reflects net revenue from company-operated stores that have been open for at least 12 full fiscal months, or open for at least 12 full fiscal months after being significantly expanded.

### Adjusted financial measures

The following tables reconcile the adjusted financial measures with the most directly comparable measures calculated in accordance with GAAP. The adjustments relate to U.S. tax reform. Please refer to Note 8 of the unaudited interim consolidated financial statements included in Item 1 of Part I of this report for further information on these adjustments.

|                            | Quarter Ended<br>October 28, 2018               |                 |                                | Three Quarters Ended<br>October 28, 2018 |                 |                                |
|----------------------------|---|-----------------|--------------------------------|--|-----------------|--------------------------------|
|                            | GAAP Results                                    | U.S. Tax Reform | Adjusted Results<br>(Non-GAAP) | GAAP Results                             | U.S. Tax Reform | Adjusted Results<br>(Non-GAAP) |
|                            | <i>(In thousands, except per share amounts)</i> |                 |                                |  |                 |                                |
| Income tax expense         | \$ 43,534                                       | \$ (5,163)      | \$ 38,371                      | \$ 115,633                               | \$ (5,163)      | \$ 110,471                     |
| Effective tax rate         | 31.6%   | (3.8)%          | 27.8%                          | 30.4%                                    | (1.4)%          | 29.0%                          |
| Diluted earnings per share | \$ 0.71   | \$ 0.04         | \$ 0.75                        | \$ 1.97                                  | \$ 0.04         | \$ 2.01                        |

### Seasonality

Our business is affected by the general seasonal trends common to the retail apparel industry. Our annual net revenue is weighted more heavily toward our fourth fiscal quarter, reflecting our historical strength in sales during the holiday season, while our operating expenses are more equally distributed throughout the year. As a result, a substantial portion of our operating profits are generated in the fourth quarter of our fiscal year. For example, we generated approximately 47%, 56%, and 47% of our full year operating profit during the fourth quarters of fiscal 2018, fiscal 2017, and fiscal 2016, respectively. Excluding the costs we incurred in connection with the ivivva restructuring, we generated approximately 51% of our operating profit during the fourth quarter of fiscal 2017.

### Liquidity and Capital Resources

Our primary sources of liquidity are our current balances of cash and cash equivalents, cash flows from operations, and capacity under our revolving credit facility. Our primary cash needs are capital expenditures for opening new stores and remodeling or relocating existing stores, making information technology system investments and enhancements, funding working capital requirements, and making other strategic capital investments both in North America and internationally. We may also use cash to repurchase shares of our common stock. Cash and cash equivalents in excess of our needs are held in interest bearing accounts with financial institutions, as well as in money market funds, treasury bills, and term deposits.

As of November 3, 2019, our working capital, excluding cash and cash equivalents, was \$290.8 million, our cash and cash equivalents were \$586.2 million, and our capacity under our revolving facility was \$398.0 million.

The following table summarizes our net cash flows provided by and used in operating, investing, and financing activities for the periods indicated:

|   | Three Quarters Ended  |                  |
|---|-----------------------|------------------|
|   | November 3, 2019      | October 28, 2018 |
|   | <i>(In thousands)</i> |                  |
| Total cash provided by (used in):       |                       |                  |
| Operating activities                    | \$ 95,106             | \$ 316,876       |
| Investing activities                    | (212,475)             | (165,914)        |
| Financing activities                    | (179,555)             | (406,361)        |
| Effect of exchange rate changes on cash | 1,757                 | (31,495)         |
| Decrease in cash and cash equivalents   | \$ (295,167)          | \$ (286,894)     |

### Operating Activities

Cash flows provided by operating activities consist primarily of net income adjusted for certain items including depreciation and amortization, stock-based compensation expense, and the effect of changes in operating assets and liabilities.

Cash provided by operating activities decreased \$221.8 million, to \$95.1 million for the first three quarters of fiscal 2019 compared to \$316.9 million for the first three quarters of fiscal 2018, primarily as a result of the following:

- an increase in cash used in operating activities of \$350.1 million as a result of changes in operating assets and liabilities, primarily due to the following:
  - \$113.9 million related to income taxes, primarily due to payments for withholding taxes on repatriated foreign earnings, as well as timing of tax installments;
  - \$108.5 million related to accounts payable, primarily due to a change in our payment terms in the prior fiscal year;
  - \$52.8 million related to inventory, primarily due to an increase in inventory purchases to support our growth; and
  - \$44.7 million related to other prepaid expenses and other current and non-current assets.

This was partially offset by an increase of \$82.2 million in net income, and an increase of \$46.1 million in non-cash expenses primarily related to an increase in depreciation and stock-based compensation expense.

### **Investing Activities**

Cash flows used in investing activities relate to capital expenditures, the settlement of net investment hedges, and other investing activities. The capital expenditures were primarily for opening new company-operated stores, remodeling or relocating certain stores, and ongoing store refurbishment. We also had capital expenditures related to information technology and business systems, related to corporate buildings, and for opening retail locations other than company-operated stores.

Cash used in investing activities increased \$46.6 million to \$212.5 million for the first three quarters of fiscal 2019 from \$165.9 million for the first three quarters of fiscal 2018. The increase was primarily the result of an increase in capital expenditures related to our company-operated stores, primarily as a result of an increased number of new company-operated stores as well as an increase in renovations and relocations of existing stores. Increased capital expenditures related to our direct to consumer channel as well as increased corporate capital expenditures also contributed to the increase in cash used in investing activities.

### **Financing Activities**

Cash flows used in financing activities consist primarily of cash used to repurchase shares of our common stock, certain cash flows related to stock-based compensation, and other financing activities.

Cash used in financing activities decreased \$226.8 million to \$179.6 million for the first three quarters of fiscal 2019 compared to \$406.4 million for the first three quarters of fiscal 2018. The decrease was primarily the result of a decrease in our stock repurchases.

Our cash used in financing activities for the first three quarters of fiscal 2019 included \$173.1 million to repurchase 1.1 million shares of our common stock compared to \$414.3 million to repurchase 3.4 million shares for the first three quarters of fiscal 2018. During the first quarter of fiscal 2019, we repurchased 1.0 million shares in a private transaction, and during the second quarter of fiscal 2018, we repurchased 3.3 million shares in a private transaction. The other common stock was repurchased in the open market at prevailing market prices, including under plans complying with the provisions of Rule 10b5-1 and Rule 10b-18 of the Securities Exchange Act of 1934, with the timing and actual number of shares repurchased depending upon market conditions, eligibility to trade, and other factors.

We believe that our cash and cash equivalent balances, cash generated from operations, and borrowings available to us under our revolving credit facility will be adequate to meet our liquidity needs and capital expenditure requirements for at least the next 12 months. Our cash from operations may be negatively impacted by a decrease in demand for our products as well as the other factors described in Item 1 of Part II of this Quarterly Report on Form 10-Q. In addition, we may make discretionary capital improvements with respect to our stores, distribution facilities, headquarters, or systems, or we may repurchase shares under an approved stock repurchase program, which we would expect to fund through the use of cash, issuance of debt or equity securities or other external financing sources to the extent we were unable to fund such capital expenditures out of our cash and cash equivalents and cash generated from operations.

### **Revolving Credit Facility**

On December 15, 2016, we entered into a credit agreement for \$150.0 million under an unsecured five-year revolving credit facility. Bank of America, N.A., is administrative agent and HSBC Bank Canada is the syndication agent and letter of credit issuer, and the lenders party thereto. Borrowings under the revolving credit facility may be made, in U.S. Dollars, Euros, Canadian Dollars, and in other currencies, subject to the approval of the administrative agent and the lenders. Up to \$35.0

million of the revolving credit facility is available for the issuance of letters of credit and up to \$25.0 million is available for the issuance of swing line loans. Commitments under the revolving credit facility may be increased by up to \$200.0 million, subject to certain conditions, including the approval of the lenders. Borrowings under the agreement may be prepaid and commitments may be reduced or terminated without premium or penalty (other than customary breakage costs). The principal amount outstanding under the credit agreement, if any, will be due and payable in full on December 15, 2021, subject to provisions that permit us to request a limited number of one year extensions annually.

Borrowings made under the revolving credit facility bear interest at a rate per annum equal to, at our option, either (a) a rate based on the rates applicable for deposits on the interbank market for U.S. Dollars or the applicable currency in which the borrowings are made ("LIBOR") or (b) an alternate base rate, plus, in each case, an applicable margin. The applicable margin is determined by reference to a pricing grid, based on the ratio of indebtedness to earnings before interest, tax depreciation, amortization, and rent ("EBITDAR") and ranges between 1.00%-1.75% for LIBOR loans and 0.00%-0.75% for alternate base rate loans. Additionally, a commitment fee of between 0.125%-0.200%, also determined by reference to the pricing grid, is payable on the average daily unused amounts under the revolving credit facility.

The credit agreement contains negative covenants that, among other things and subject to certain exceptions, limit the ability of our subsidiaries to incur indebtedness, incur liens, undergo fundamental changes, make dispositions of all or substantially all of their assets, alter their businesses and enter into agreements limiting subsidiary dividends and distributions.

We are also required to maintain a consolidated rent-adjusted leverage ratio of not greater than 3.50:1.00 and we are not permitted to allow the ratio of consolidated EBITDAR to consolidated interest charges (plus rent) to be less than 2.00:1.00. The credit agreement also contains certain customary representations, warranties, affirmative covenants, and events of default (including, among others, an event of default upon the occurrence of a change of control). If an event of default occurs, the credit agreement may be terminated and the maturity of any outstanding amounts may be accelerated.

On June 6, 2018, we entered into Amendment No. 1 to the credit agreement. The Amendment amended the credit agreement to provide for (i) an increase in the aggregate commitments under the unsecured five-year revolving credit facility to \$400.0 million, with an increase of the sub-limits for the issuance of letters of credit and extensions of swing line loans to \$50.0 million for each, (ii) an increase in the option, subject to certain conditions as set forth in the credit agreement, to request increases in commitments under the revolving facility from \$400.0 million to \$600.0 million and (iii) an extension in the maturity of the revolving facility from December 15, 2021 to June 6, 2023.

In addition, the Amendment decreased the applicable margins for LIBOR loans from 1.00%-1.75% to 1.00%-1.50% and for alternate base rate loans from 0.00%-0.75% to 0.00%-0.50%, reduced the commitment fee on average daily unused amounts under the revolving facility from 0.125%-0.200% to 0.10%-0.20%, and reduced fees for unused letters of credit from 1.00%-1.75% to 1.00%-1.50%.

As of November 3, 2019, aside from letters of credit of \$2.0 million, we had no other borrowings outstanding under this credit facility.

#### ***Off-Balance Sheet Arrangements***

We enter into standby letters of credit to secure certain of our obligations, including leases, taxes, and duties. As of November 3, 2019, letters of credit and letters of guarantee totaling \$2.0 million had been issued.

We have not entered into any transactions, agreements or other contractual arrangements to which an entity unconsolidated with us is a party and under which we have (i) any obligation under a guarantee, (ii) any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity, (iii) any obligation under derivative instruments that are indexed to our shares and classified as equity in our consolidated balance sheets, or (iv) any obligation arising out of a variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with us.

#### ***Critical Accounting Policies and Estimates***

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions. Predicting future events is inherently an imprecise activity and, as such, requires the use of judgment. Actual results may vary from our estimates in amounts that may be material to the financial statements. An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used or changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact our consolidated financial statements. Our critical accounting policies and estimates are discussed in our fiscal 2018 Annual Report

on Form 10-K filed with the SEC on March 27, 2019, and in Notes 2, 5, 6, and 7 included in Item 1 of Part I of this Quarterly Report on Form 10-Q.

### **Operating Locations**

Our company-operated stores by country as of November 3, 2019 and February 3, 2019 are summarized in the table below.

|                               | November 3,<br>2019 | February 3,<br>2019 |
|-------------------------------|---------------------|---------------------|
| United States                 | 301                 | 285                 |
| Canada                        | 63                  | 64                  |
| China <sup>(1)</sup>          | 34                  | 22                  |
| Australia                     | 31                  | 29                  |
| United Kingdom                | 14                  | 12                  |
| Japan                         | 7                   | 5                   |
| New Zealand                   | 7                   | 7                   |
| Germany                       | 6                   | 5                   |
| South Korea                   | 5                   | 4                   |
| Singapore                     | 4                   | 3                   |
| France                        | 2                   | 1                   |
| Sweden                        | 2                   | 1                   |
| Ireland                       | 1                   | 1                   |
| Netherlands                   | 1                   | —                   |
| Switzerland                   | 1                   | 1                   |
| Total company-operated stores | <u>479</u>          | <u>440</u>          |

<sup>(1)</sup> Included within China as of November 3, 2019, were six company-operated stores in the Hong Kong Special Administrative Region, two company-operated stores in the Macao Special Administration Region, and one company-operated store in the Taiwan Province. As of February 3, 2019, there were five company-operated stores in the Hong Kong Special Administrative Region, one company-operated store in the Macao Special Administration Region, and one company-operated store in the Taiwan Province.

Retail locations operated by third parties under license and supply arrangements are not included in the above table. As of November 3, 2019, there were eight licensed locations, including four in Mexico, three in the United Arab Emirates, and one in Qatar.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

*Foreign Currency Exchange Risk.* The functional currency of our foreign subsidiaries is generally the applicable local currency. Our consolidated financial statements are presented in U.S. dollars. Therefore, the net revenue, expenses, assets, and liabilities of our foreign subsidiaries are translated from their functional currencies into U.S. dollars. Fluctuations in the value of the U.S. dollar affect the reported amounts of net revenue, expenses, assets, and liabilities. Foreign exchange differences which arise on translation of our foreign subsidiaries' balance sheets into U.S. dollars are recorded as a foreign currency translation adjustment in accumulated other comprehensive income or loss within stockholders' equity.

We also have exposure to changes in foreign exchange rates associated with transactions which are undertaken by our subsidiaries in currencies other than their functional currency. Such transactions include intercompany transactions and inventory purchases denominated in currencies other than the functional currency of the purchasing entity. As a result, we have been impacted by changes in exchange rates and may be impacted for the foreseeable future. The potential impact of currency fluctuation increases as our international expansion increases.

As of November 3, 2019, we had certain forward currency contracts outstanding in order to hedge a portion of the foreign currency exposure that arises on translation of a Canadian subsidiary into U.S. dollars. We also had certain forward currency contracts outstanding in an effort to reduce our exposure to the foreign exchange revaluation gains and losses that are recognized by our Canadian and Chinese subsidiaries on U.S. dollar denominated monetary assets and liabilities. Please refer to Note 6 to the unaudited interim consolidated financial statements included in Item 1 of Part I of this report for further information, including details of the notional amounts outstanding.

In the future, in an effort to reduce foreign exchange risks, we may enter into further derivative financial instruments including hedging additional currency pairs. We do not, and do not intend to, engage in the practice of trading derivative securities for profit.

We currently generate a significant portion of our net revenue and incur a significant portion of our expenses in Canada. We also hold a significant portion of our net assets in Canada. The reporting currency for our consolidated financial statements is the U.S. dollar. A strengthening of the U.S. dollar against the Canadian dollar results in:

- the following impacts to the consolidated statements of operations:
  - a decrease in our net revenue upon translation of the sales made by our Canadian operations into U.S. dollars for the purposes of consolidation;
  - a decrease in our selling, general and administrative expenses incurred by our Canadian operations upon translation into U.S. dollars for the purposes of consolidation;
  - foreign exchange revaluation gains by our Canadian subsidiaries on U.S. dollar denominated monetary assets and liabilities; and
  - derivative valuation losses on forward currency contracts not designated in a hedging relationship;
- the following impacts to the consolidated balance sheets:
  - a decrease in the foreign currency translation adjustment which arises on the translation of our Canadian subsidiaries' balance sheets into U.S. dollars; and
  - an increase in the foreign currency translation adjustment from derivative valuation losses on forward currency contracts, entered into as net investment hedges of a Canadian subsidiary.

During the first three quarters of fiscal 2019, the change in the relative value of the U.S. dollar against the Canadian dollar resulted in a \$0.9 million reduction in accumulated other comprehensive loss within stockholders' equity. During the first three quarters of fiscal 2018, the change in the relative value of the U.S. dollar against the Canadian dollar resulted in a \$66.9 million increase in accumulated other comprehensive loss within stockholders' equity.

A 10% appreciation in the relative value of the U.S. dollar against the Canadian dollar compared to the exchange rates in effect for the first three quarters of fiscal 2019 would have resulted in lower income from operations of approximately \$3.9 million in the first three quarters of fiscal 2019. This assumes a consistent 10% appreciation in the U.S. dollar against the Canadian dollar over the first three quarters of fiscal 2019. The timing of changes in the relative value of the U.S. dollar combined with the seasonal nature of our business, can affect the magnitude of the impact that fluctuations in foreign exchange rates have on our income from operations.

*Interest Rate Risk.* Our revolving credit facility provides us with available borrowings in an amount up to \$400.0 million in the aggregate. Because our revolving credit facility bears interest at a variable rate, we will be exposed to market risks relating to changes in interest rates, if we have a meaningful outstanding balance. As of November 3, 2019, aside from letters of credit of \$2.0 million, we had no other borrowings outstanding under this credit facility. We currently do not engage in any interest rate hedging activity and currently have no intention to do so. However, in the future, if we have a meaningful outstanding balance under our revolving facility, in an effort to mitigate losses associated with these risks, we may at times enter into derivative financial instruments, although we have not historically done so. These may take the form of forward contracts, option contracts, or interest rate swaps. We do not, and do not intend to, engage in the practice of trading derivative securities for profit.

Our cash and cash equivalent balances are held in the form of cash on hand, bank balances, short-term deposits and treasury bills with original maturities of three months or less, and in money market funds. We do not believe these balances are subject to material interest rate risk.

*Credit Risk.* We have cash on deposit with various large, reputable financial institutions and have invested in U.S. and Canadian Treasury Bills, and in AAA-rated money market funds. The amount of cash and cash equivalents held with certain financial institutions exceeds government-insured limits. We are also exposed to credit-related losses in the event of nonperformance by the financial institutions that are counterparties to our forward currency contracts. The credit risk amount is our unrealized gains on our derivative instruments, based on foreign currency rates at the time of nonperformance. We have not experienced any losses related to these items, and we believe credit risk to be minimal. We seek to minimize our credit risk by entering into transactions with credit worthy and reputable financial institutions and by monitoring the credit standing of the financial institutions with whom we transact. We seek to limit the amount of exposure with any one counterparty.

***Inflation***

Inflationary factors such as increases in the cost of our product and overhead costs may adversely affect our operating results. Although we do not believe that inflation has had a material impact on our financial position or results of operations to date, a high rate of inflation in the future may have an adverse effect on our ability to maintain current levels of gross margin and selling, general and administrative expenses as a percentage of net revenue if the selling prices of our products do not increase with these increased costs.

**ITEM 4. CONTROLS AND PROCEDURES**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934, or the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial and accounting officer, to allow timely decisions to be made regarding required disclosure. We have established a Disclosure Committee, consisting of certain members of management, to assist in this evaluation. The Disclosure Committee meets on a quarterly basis, and as needed.

Our management, including our principal executive officer and principal financial and accounting officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Exchange Act) at November 3, 2019. Based on that evaluation, our principal executive officer and principal financial and accounting officer concluded that, at November 3, 2019, our disclosure controls and procedures were effective.

There were no changes in our internal control over financial reporting during the quarter ended November 3, 2019 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

In addition to the legal matters described in Note 12 to the unaudited interim consolidated financial statements included in Item 1 of Part I of this report and in our fiscal 2018 Annual Report on Form 10-K, we are, from time to time, involved in routine legal matters incidental to the conduct of our business, including legal matters such as initiation and defense of proceedings to protect intellectual property rights, personal injury claims, product liability claims, employment claims, and similar matters. We believe the ultimate resolution of any such current proceeding will not have a material adverse effect on our continued financial position, results of operations or cash flows.

### ITEM 1A. RISK FACTORS

*In addition to the other information contained in this Form 10-Q and in our Annual Report on Form 10-K for our 2018 fiscal year, the following risk factors should be considered carefully in evaluating our business. Our business, financial condition, or results of operations could be materially adversely affected by any of these risks. Please note that additional risks not presently known to us or that we currently deem immaterial could also impair our business and operations.*

***Our success depends on our ability to maintain the value and reputation of our brand.***

Our success depends on the value and reputation of the lululemon brand. The lululemon name is integral to our business as well as to the implementation of our strategies for expanding our business. Maintaining, promoting, and positioning our brand will depend largely on the success of our marketing and merchandising efforts and our ability to provide a consistent, high quality product, and guest experience. We rely on social media, as one of our marketing strategies, to have a positive impact on both our brand value and reputation. Our brand and reputation could be adversely affected if we fail to achieve these objectives, if our public image was to be tarnished by negative publicity, which could be amplified by social media, if we fail to deliver innovative and high quality products acceptable to our guests, or if we face or mishandle a product recall. Additionally, while we devote considerable efforts and resources to protecting our intellectual property, if these efforts are not successful the value of our brand may be harmed. Any harm to our brand and reputation could have a material adverse effect on our financial condition.

***If any of our products are unacceptable to us or our guests, our business could be harmed.***

We have occasionally received, and may in the future receive, shipments of products that fail to comply with our technical specifications or that fail to conform to our quality control standards. We have also received, and may in the future receive, products that are otherwise unacceptable to us or our guests. Under these circumstances, unless we are able to obtain replacement products in a timely manner, we risk the loss of net revenue resulting from the inability to sell those products and related increased administrative and shipping costs. Additionally, if the unacceptability of our products is not discovered until after such products are purchased by our guests, our guests could lose confidence in our products or we could face a product recall and our results of operations could suffer and our business, reputation, and brand could be harmed.

***We operate in a highly competitive market and the size and resources of some of our competitors may allow them to compete more effectively than we can, resulting in a loss of our market share and a decrease in our net revenue and profitability.***

The market for technical athletic apparel is highly competitive. Competition may result in pricing pressures, reduced profit margins or lost market share, or a failure to grow or maintain our market share, any of which could substantially harm our business and results of operations. We compete directly against wholesalers and direct retailers of athletic apparel, including large, diversified apparel companies with substantial market share and established companies expanding their production and marketing of technical athletic apparel, as well as against retailers specifically focused on women's athletic apparel. We also face competition from wholesalers and direct retailers of traditional commodity athletic apparel, such as cotton T-shirts and sweatshirts. Many of our competitors are large apparel and sporting goods companies with strong worldwide brand recognition. Because of the fragmented nature of the industry, we also compete with other apparel sellers, including those specializing in yoga apparel and other activewear. Many of our competitors have significant competitive advantages, including longer operating histories, larger and broader customer bases, more established relationships with a broader set of suppliers, greater brand recognition and greater financial, research and development, store development, marketing, distribution, and other resources than we do.

Our competitors may be able to achieve and maintain brand awareness and market share more quickly and effectively than we can. In contrast to our "grassroots" marketing approach, many of our competitors promote their brands through

traditional forms of advertising, such as print media and television commercials, and through celebrity endorsements, and have substantial resources to devote to such efforts. Our competitors may also create and maintain brand awareness using traditional forms of advertising more quickly than we can. Our competitors may also be able to increase sales in their new and existing markets faster than we do by emphasizing different distribution channels than we do, such as catalog sales or an extensive franchise network.

In addition, because we hold limited patents and exclusive intellectual property rights in the technology, fabrics or processes underlying our products, our current and future competitors are able to manufacture and sell products with performance characteristics, fabrication techniques, and styling similar to our products.

***Our reliance on suppliers to provide fabrics for and to produce our products could cause problems in our supply chain.***

We do not manufacture our products or the raw materials for them and rely instead on suppliers. Many of the specialty fabrics used in our products are technically advanced textile products developed and manufactured by third parties and may be available, in the short-term, from only one or a very limited number of sources. We work with a group of approximately 65 suppliers to provide the fabrics for our products. In fiscal 2018, approximately 60% of our fabrics were produced by our top five fabric suppliers, and the largest single manufacturer produced approximately 35% of raw materials used. We work with a group of approximately 44 vendors that manufacture our products, five of which produced approximately 60% of our products in fiscal 2018. During fiscal 2018, the largest single manufacturer produced approximately 21% of our product offerings. We have no long-term contracts with any of our suppliers or manufacturing sources for the production and supply of our fabrics and garments, and we compete with other companies for fabrics, raw materials, and production.

We have experienced, and may in the future experience, a significant disruption in the supply of fabrics or raw materials from current sources and we may be unable to locate alternative materials suppliers of comparable quality at an acceptable price, or at all. In addition, if we experience significant increased demand, or if we need to replace an existing supplier or manufacturer, we may be unable to locate additional supplies of fabrics or raw materials or additional manufacturing capacity on terms that are acceptable to us, or at all, or we may be unable to locate any supplier or manufacturer with sufficient capacity to meet our requirements or to fill our orders in a timely manner. Identifying a suitable supplier is an involved process that requires us to become satisfied with its quality control, responsiveness and service, financial stability, and labor and other ethical practices. Even if we are able to expand existing or find new manufacturing or fabric sources, we may encounter delays in production and added costs as a result of the time it takes to train our suppliers and manufacturers in our methods, products, and quality control standards. Delays related to supplier changes could also arise due to an increase in shipping times if new suppliers are located farther away from our markets or from other participants in our supply chain. Any delays, interruption, or increased costs in the supply of fabric or manufacture of our products could have an adverse effect on our ability to meet guest demand for our products and result in lower net revenue and income from operations both in the short and long term.

***Our business could be harmed if our suppliers and manufacturers do not comply with our Vendor Code of Ethics or applicable laws.***

While we require our suppliers and manufacturers to comply with our Vendor Code of Ethics, which includes labor, health and safety, and environment standards, we do not control their practices. If suppliers or contractors do not comply with these standards or applicable laws or there is negative publicity regarding the production methods of any of our suppliers or manufacturers, even if unfounded or not material to our supply chain, our reputation and sales could be adversely affected, we could be subject to legal liability, or we could be forced to locate alternative suppliers or manufacturing sources.

***An economic downturn or economic uncertainty in our key markets may adversely affect consumer discretionary spending and demand for our products.***

Many of our products may be considered discretionary items for consumers. Factors affecting the level of consumer spending for such discretionary items include general economic conditions, particularly those in North America, and other factors such as consumer confidence in future economic conditions, fears of recession, the availability and cost of consumer credit, levels of unemployment, and tax rates. As global economic conditions continue to be volatile or economic uncertainty remains, trends in consumer discretionary spending also remain unpredictable and subject to reductions due to credit constraints and uncertainties about the future. Unfavorable economic conditions may lead consumers to delay or reduce purchases of our products. Consumer demand for our products may not reach our targets, or may decline, when there is an economic downturn or economic uncertainty in our key markets, particularly in North America. Our sensitivity to economic cycles and any related fluctuation in consumer demand may have a material adverse effect on our financial condition.

***Our sales and profitability may decline as a result of increasing product costs and decreasing selling prices.***

Our business is subject to significant pressure on costs and pricing caused by many factors, including intense competition, constrained sourcing capacity and related inflationary pressure, pressure from consumers to reduce the prices we charge for our products, and changes in consumer demand. These factors may cause us to experience increased costs, reduce our prices to consumers or experience reduced sales in response to increased prices, any of which could cause our operating margin to decline if we are unable to offset these factors with reductions in operating costs and could have a material adverse effect on our financial condition, operating results, and cash flows.

***If we are unable to anticipate consumer preferences and successfully develop and introduce new, innovative, and updated products, we may not be able to maintain or increase our sales and profitability.***

Our success depends on our ability to identify and originate product trends as well as to anticipate and react to changing consumer demands in a timely manner. All of our products are subject to changing consumer preferences that cannot be predicted with certainty. If we are unable to introduce new products or novel technologies in a timely manner or our new products or technologies are not accepted by our guests, our competitors may introduce similar products in a more timely fashion, which could hurt our goal to be viewed as a leader in technical athletic apparel innovation. Our new products may not receive consumer acceptance as consumer preferences could shift rapidly to different types of athletic apparel or away from these types of products altogether, and our future success depends in part on our ability to anticipate and respond to these changes. Our failure to anticipate and respond in a timely manner to changing consumer preferences could lead to, among other things, lower sales and excess inventory levels. Even if we are successful in anticipating consumer preferences, our ability to adequately react to and address those preferences will in part depend upon our continued ability to develop and introduce innovative, high-quality products. Our failure to effectively introduce new products that are accepted by consumers could result in a decrease in net revenue and excess inventory levels, which could have a material adverse effect on our financial condition.

***Our results of operations could be materially harmed if we are unable to accurately forecast guest demand for our products.***

To ensure adequate inventory supply, we must forecast inventory needs and place orders with our manufacturers based on our estimates of future demand for particular products. Our ability to accurately forecast demand for our products could be affected by many factors, including an increase or decrease in guest demand for our products or for products of our competitors, our failure to accurately forecast guest acceptance of new products, product introductions by competitors, unanticipated changes in general market conditions, and weakening of economic conditions or consumer confidence in future economic conditions. If we fail to accurately forecast guest demand, we may experience excess inventory levels or a shortage of products available for sale in our stores or for delivery to guests.

Inventory levels in excess of guest demand may result in inventory write-downs or write-offs and the sale of excess inventory at discounted prices, which would cause our gross margin to suffer and could impair the strength and exclusivity of our brand. Conversely, if we underestimate guest demand for our products, our manufacturers may not be able to deliver products to meet our requirements, and this could result in damage to our reputation and guest relationships.

***Our inability to safeguard against security breaches or our failure to comply with data privacy laws could damage our customer relationships and result in significant legal and financial exposure.***

As part of our normal operations, we receive confidential, proprietary, and personally identifiable information, including credit card information, and information about our customers, our employees, job applicants, and other third parties. Our business employs systems and websites that allow for the storage and transmission of this information. However, despite our safeguards and security processes and protections, security breaches could expose us to a risk of theft or misuse of this information, and could result in litigation and potential liability. The retail industry, in particular, has been the target of many recent cyber-attacks. We may not have the resources or technical sophistication to be able to anticipate or prevent rapidly evolving types of cyber-attacks. Attacks may be targeted at us, our vendors or customers, or others who have entrusted us with information. In addition, despite taking measures to safeguard our information security and privacy environment from security breaches, our customers and our business could still be exposed to risk. Actual or anticipated attacks may cause us to incur increasing costs including costs to deploy additional personnel and protection technologies, train employees and engage third party experts and consultants. Advances in computer capabilities, new technological discoveries or other developments may result in the technology used by us to protect transaction or other data being breached or compromised. Measures we implement to protect against cyber-attacks may also have the potential to impact our customers' shopping experience or decrease activity on our websites by making them more difficult to use. Data and security breaches can also occur as a result of non-technical issues including intentional or inadvertent breach by employees or persons with whom we have commercial relationships that result in the unauthorized release of personal or confidential information. Any compromise or breach of our

security could result in a violation of applicable privacy and other laws, significant legal and financial exposure, and damage to our brand and reputation or other harm to our business.

Additionally, the European Union has adopted a comprehensive General Data Privacy Regulation (the "GDPR"). The GDPR requires companies to satisfy new requirements regarding the handling of personal and sensitive data, including its use, protection and the ability of persons whose data is stored to correct or delete such data about themselves. Failure to comply with GDPR requirements could result in penalties of up to four percent of worldwide revenue. The GDPR and other similar laws and regulations, as well as any associated inquiries or investigations or any other government actions, may be costly to comply with, increase our operating costs, require significant management time and attention, and subject us to remedies that may harm our business, including fines, negative publicity, or demands or orders that we modify or cease existing business practices.

***Any material disruption of our information technology systems or unexpected network interruption could disrupt our business and reduce our sales.***

We are increasingly dependent on information technology systems and third-parties to operate our e-commerce websites, process transactions, respond to guest inquiries, manage inventory, purchase, sell and ship goods on a timely basis, and maintain cost-efficient operations. The failure of our information technology systems to operate properly or effectively, problems with transitioning to upgraded or replacement systems, or difficulty in integrating new systems, could adversely affect our business. In addition, we have e-commerce websites in the United States, Canada, and internationally. Our information technology systems, websites, and operations of third parties on whom we rely, may encounter damage or disruption or slowdown caused by a failure to successfully upgrade systems, system failures, viruses, computer "hackers", natural disasters, or other causes. These could cause information, including data related to guest orders, to be lost or delayed which could, especially if the disruption or slowdown occurred during the holiday season, result in delays in the delivery of products to our stores and guests or lost sales, which could reduce demand for our products and cause our sales to decline. The concentration of our primary offices, two of our distribution centers, and a number of our stores along the west coast of North America could amplify the impact of a natural disaster occurring in that area to our business, including to our information technology systems. In addition, if changes in technology cause our information systems to become obsolete, or if our information systems are inadequate to handle our growth, we could lose guests. We have limited back-up systems and redundancies, and our information technology systems and websites have experienced system failures and electrical outages in the past which have disrupted our operations. Any significant disruption in our information technology systems or websites could harm our reputation and credibility, and could have a material adverse effect on our business, financial condition, and results of operations.

***If the technology-based systems that give our customers the ability to shop with us online do not function effectively, our operating results, as well as our ability to grow our e-commerce business globally, could be materially adversely affected.***

Many of our customers shop with us through our e-commerce websites and mobile apps. Increasingly, customers are using tablets and smart phones to shop online with us and with our competitors and to do comparison shopping. We are increasingly using social media and proprietary mobile apps to interact with our customers and as a means to enhance their shopping experience. Any failure on our part to provide attractive, effective, reliable, user-friendly e-commerce platforms that offer a wide assortment of merchandise with rapid delivery options and that continually meet the changing expectations of online shoppers could place us at a competitive disadvantage, result in the loss of e-commerce and other sales, harm our reputation with customers, have a material adverse impact on the growth of our e-commerce business globally and could have a material adverse impact on our business and results of operations.

***Changes in consumer shopping preferences and shifts in distribution channels could materially impact our results of operations.***

We sell our products through a variety of trade channels, with a significant portion through traditional brick-and-mortar retail channels. As strong e-commerce channels emerge and develop, we are evolving towards an omni-channel approach to support the shopping behavior of our guests. This involves country and region specific websites, social media, product notification emails, mobile apps, including mobile apps on in-store devices that allow demand to be fulfilled via our distribution centers, and online order fulfillment through stores. The diversion of sales from our company-operated stores could adversely impact our return on investment and could lead to store closures and impairment charges. We could have difficulty in recreating the in-store experience through direct channels. We could also be exposed to liability for online content. Our failure to successfully integrate our digital and physical channels and respond to these risks might adversely impact our business and results of operations, as well as damage our reputation and brands.

***The fluctuating cost of raw materials could increase our cost of goods sold and cause our results of operations and financial condition to suffer.***

The fabrics used by our suppliers and manufacturers include synthetic fabrics whose raw materials include petroleum-based products. Our products also include silver and natural fibers, including cotton. Our costs for raw materials are affected by, among other things, weather, consumer demand, speculation on the commodities market, the relative valuations and fluctuations of the currencies of producer versus consumer countries, and other factors that are generally unpredictable and beyond our control. Increases in the cost of raw materials, including petroleum or the prices we pay for silver and our cotton yarn and cotton-based textiles, could have a material adverse effect on our cost of goods sold, results of operations, financial condition, and cash flows.

***Our limited operating experience and limited brand recognition in new international markets may limit our expansion and cause our business and growth to suffer.***

Our future growth depends in part on our expansion efforts outside of North America. We have limited experience with regulatory environments and market practices internationally, and we may not be able to penetrate or successfully operate in any new market. In connection with our expansion efforts we may encounter obstacles we did not face in North America, including cultural and linguistic differences, differences in regulatory environments, labor practices and market practices, difficulties in keeping abreast of market, business and technical developments, and foreign guests' tastes and preferences. We may also encounter difficulty expanding into new international markets because of limited brand recognition leading to delayed acceptance of our technical athletic apparel by guests in these new international markets. Our failure to develop our business in new international markets or disappointing growth outside of existing markets could harm our business and results of operations.

***If we encounter problems with our distribution system, our ability to deliver our products to the market and to meet guest expectations could be harmed.***

We rely on our distribution facilities for substantially all of our product distribution. Our distribution facilities include computer controlled and automated equipment, which means their operations may be subject to a number of risks related to security or computer viruses, the proper operation of software and hardware, electronic or power interruptions, or other system failures. In addition, our operations could also be interrupted by labor difficulties, extreme or severe weather conditions or by floods, fires, or other natural disasters near our distribution centers. If we encounter problems with our distribution system, our ability to meet guest expectations, manage inventory, complete sales, and achieve objectives for operating efficiencies could be harmed.

***Our fabrics and manufacturing technology generally are not patented and can be imitated by our competitors.***

The intellectual property rights in the technology, fabrics, and processes used to manufacture our products generally are owned or controlled by our suppliers and are generally not unique to us. Our ability to obtain intellectual property protection for our products is therefore limited and we do not generally own patents or hold exclusive intellectual property rights in the technology, fabrics or processes underlying our products. As a result, our current and future competitors are able to manufacture and sell products with performance characteristics, fabrics and styling similar to our products. Because many of our competitors have significantly greater financial, distribution, marketing, and other resources than we do, they may be able to manufacture and sell products based on our fabrics and manufacturing technology at lower prices than we can. If our competitors do sell similar products to ours at lower prices, our net revenue and profitability could suffer.

***Our failure or inability to protect our intellectual property rights could diminish the value of our brand and weaken our competitive position.***

We currently rely on a combination of copyright, trademark, trade dress, and unfair competition laws, as well as confidentiality procedures and licensing arrangements, to establish and protect our intellectual property rights. The steps we take to protect our intellectual property rights may not be adequate to prevent infringement of these rights by others, including imitation of our products and misappropriation of our brand. In addition, intellectual property protection may be unavailable or limited in some foreign countries where laws or law enforcement practices may not protect our intellectual property rights as fully as in the United States or Canada, and it may be more difficult for us to successfully challenge the use of our intellectual property rights by other parties in these countries. If we fail to protect and maintain our intellectual property rights, the value of our brand could be diminished, and our competitive position may suffer.

***Our ability to source and sell our merchandise profitably or at all could be hurt if new trade restrictions are imposed or existing trade restrictions become more burdensome.***

The United States and the countries in which our products are produced or sold internationally have imposed and may impose additional quotas, duties, tariffs, or other restrictions or regulations, or may adversely adjust prevailing quota, duty, or tariff levels. The results of any audits or related disputes regarding these restrictions or regulations could have an adverse effect on our financial statements for the period or periods for which the applicable final determinations are made. Countries impose, modify, and remove tariffs and other trade restrictions in response to a diverse array of factors, including global and national economic and political conditions, which make it impossible for us to predict future developments regarding tariffs and other trade restrictions. Trade restrictions, including tariffs, quotas, embargoes, safeguards, and customs restrictions, could increase the cost or reduce the supply of products available to us, could increase shipping times, or may require us to modify our supply chain organization or other current business practices, any of which could harm our business, financial condition, and results of operations.

We are dependent on international trade agreements and regulations. The countries in which we produce and sell our products could impose or increase tariffs, duties, or other similar charges that could negatively affect our results of operations, financial position, or cash flows.

Adverse changes in, or withdrawal from, trade agreements or political relationships between the United States and China, Canada, or other countries where we sell or source our products, could negatively impact our results of operations or cash flows. The current political administrations in the United States and China have proposed tariffs which increase the costs of our products. It is possible that further tariffs may be introduced, or increased. Such changes could adversely impact our business and could increase the costs of sourcing our products from China, or could require us to source our products from other countries.

The invocation of Article 50 of the Treaty of the European Union ("EU") by the United Kingdom ("UK") initiated the withdrawal of the UK from the EU, commonly referred to as "Brexit". There is significant uncertainty related to how the UK's trade, duties, and customs arrangements with the EU will be impacted by Brexit as well as the impact on the movement of goods, people, and capital between the UK and the EU. There could be changes in economic conditions in the UK or EU, including foreign exchange rates and consumer markets. Our business could be adversely affected by these changes, including by additional duties on the importation of our products into the UK from the EU and as a result of shipping delays or congestion.

***Changes in tax laws or unanticipated tax liabilities could adversely affect our effective income tax rate and profitability.***

We are subject to the income tax laws of the United States, Canada, and several other international jurisdictions. Our effective income tax rates could be unfavorably impacted by a number of factors, including changes in the mix of earnings amongst countries with differing statutory tax rates, changes in the valuation of deferred tax assets and liabilities, changes in tax laws, new tax interpretations and guidance, the outcome of income tax audits in various jurisdictions around the world, and any repatriation of unremitted earnings for which we have not previously accrued applicable U.S. income taxes and foreign withholding taxes.

We and our subsidiaries engage in a number of intercompany transactions across multiple tax jurisdictions. Although we believe that these transactions reflect the accurate economic allocation of profit and that proper transfer pricing documentation is in place, the profit allocation and transfer pricing terms and conditions may be scrutinized by local tax authorities during an audit and any resulting changes may impact our mix of earnings in countries with differing statutory tax rates.

Current economic and political conditions make tax rules in any jurisdiction, including the United States and Canada, subject to significant change. Changes in applicable U.S., Canadian, or other foreign tax laws and regulations, or their interpretation and application, including the possibility of retroactive effect, could affect our income tax expense and profitability, as they did in fiscal 2017 and fiscal 2018 upon passage of the U.S. Tax Cuts and Jobs Act.

***If we continue to grow at a rapid pace, we may not be able to effectively manage our growth and the increased complexity of our business and as a result our brand image and financial performance may suffer.***

We have expanded our operations rapidly since our inception in 1998 and our net revenue has increased from \$40.7 million in fiscal 2004 to \$3.3 billion in fiscal 2018. If our operations continue to grow at a rapid pace, we may experience difficulties in obtaining sufficient raw materials and manufacturing capacity to produce our products, as well as delays in production and shipments, as our products are subject to risks associated with overseas sourcing and manufacturing. We could be required to continue to expand our sales and marketing, product development and distribution functions, to upgrade our management information systems and other processes and technology, and to obtain more space for our expanding workforce.

This expansion could increase the strain on our resources, and we could experience operating difficulties, including difficulties in hiring, training, and managing an increasing number of employees. These difficulties could result in the erosion of our brand image which could have a material adverse effect on our financial condition.

***We are subject to risks associated with leasing retail and distribution space subject to long-term and non-cancelable leases.***

We lease the majority of our stores under operating leases and our inability to secure appropriate real estate or lease terms could impact our ability to grow. Our leases generally have initial terms of between five and ten years, and generally can be extended in five-year increments if at all. We generally cannot cancel these leases at our option. If an existing or new store is not profitable, and we decide to close it, as we have done in the past and may do in the future, we may nonetheless be committed to perform our obligations under the applicable lease including, among other things, paying the base rent for the balance of the lease term. Similarly, we may be committed to perform our obligations under the applicable leases even if current locations of our stores become unattractive as demographic patterns change. In addition, as each of our leases expire, we may fail to negotiate renewals, either on commercially acceptable terms or at all, which could require us to close stores in desirable locations.

We also lease the majority of our distribution centers and our inability to secure appropriate real estate or lease terms could impact our ability to deliver our products to the market.

***Increasing labor costs and other factors associated with the production of our products in South and South East Asia could increase the costs to produce our products.***

A significant portion of our products are produced in South and South East Asia and increases in the costs of labor and other costs of doing business in the countries in this area could significantly increase our costs to produce our products and could have a negative impact on our operations and earnings. Factors that could negatively affect our business include a potential significant revaluation of the currencies used in these countries, which may result in an increase in the cost of producing products, labor shortage and increases in labor costs, and difficulties and additional costs in transporting products manufactured from these countries to our distribution centers. Also, the imposition of trade sanctions or other regulations against products imported by us from, or the loss of "normal trade relations" status with any country in which our products are manufactured, could significantly increase our cost of products and harm our business.

***The operations of many of our suppliers are subject to additional risks that are beyond our control and that could harm our business, financial condition, and results of operations.***

Almost all of our suppliers are located outside of North America. During fiscal 2018, approximately 58% of our products were manufactured in South East Asia, approximately 21% in South Asia, approximately 12% in China, approximately 8% in the Americas, and the remainder in other regions.

As a result of our international suppliers, we are subject to risks associated with doing business abroad, including:

- political unrest, terrorism, labor disputes, and economic instability resulting in the disruption of trade from foreign countries in which our products are manufactured;
- the imposition of new laws and regulations, including those relating to labor conditions, quality and safety standards, imports, duties, taxes and other charges on imports, as well as trade restrictions and restrictions on currency exchange or the transfer of funds;
- reduced protection for intellectual property rights, including trademark protection, in some countries, particularly China;
- disruptions or delays in shipments whether due to port congestion, labor disputes, product regulations and/or inspections or other factors, natural disasters or health pandemics, or other transportation disruptions; and
- changes in local economic conditions in countries where our manufacturers, suppliers, or guests are located.

These and other factors beyond our control could interrupt our suppliers' production in offshore facilities, influence the ability of our suppliers to export our products cost-effectively or at all and inhibit our suppliers' ability to procure certain materials, any of which could harm our business, financial condition, and results of operations.

***We may not be able to successfully open new store locations in a timely manner, if at all, which could harm our results of operations.***

Our growth will largely depend on our ability to successfully open and operate new stores, which depends on many factors, including, among others, our ability to:

- identify suitable store locations, the availability of which is outside of our control;
- negotiate acceptable lease terms, including desired tenant improvement allowances;
- hire, train and retain store personnel and field management;
- immerse new store personnel and field management into our corporate culture;
- source sufficient inventory levels; and
- successfully integrate new stores into our existing operations and information technology systems.

Successful new store openings may also be affected by our ability to initiate our grassroots marketing efforts in advance of opening our first store in a new market. We typically rely on our grassroots marketing efforts to build awareness of our brand and demand for our products. Our grassroots marketing efforts are often lengthy and must be tailored to each new market based on our emerging understanding of the market. We may not be able to successfully implement our grassroots marketing efforts in a particular market in a timely manner, if at all. Additionally, we may be unsuccessful in identifying new markets where our technical athletic apparel and other products and brand image will be accepted, or the performance of our stores will be considered successful.

***Our failure to comply with trade and other regulations could lead to investigations or actions by government regulators and negative publicity.***

The labeling, distribution, importation, marketing, and sale of our products are subject to extensive regulation by various federal agencies, including the Federal Trade Commission, Consumer Product Safety Commission and state attorneys general in the United States, the Competition Bureau and Health Canada in Canada, as well as by various other federal, state, provincial, local, and international regulatory authorities in the countries in which our products are distributed or sold. If we fail to comply with any of these regulations, we could become subject to enforcement actions or the imposition of significant penalties or claims, which could harm our results of operations or our ability to conduct our business. In addition, any audits and inspections by governmental agencies related to these matters could result in significant settlement amounts, damages, fines, or other penalties, divert financial and management resources, and result in significant legal fees. An unfavorable outcome of any particular proceeding could have an adverse impact on our business, financial condition, and results of operations. In addition, the adoption of new regulations or changes in the interpretation of existing regulations may result in significant compliance costs or discontinuation of product sales and could impair the marketing of our products, resulting in significant loss of net revenue.

Our international operations are also subject to compliance with the U.S. Foreign Corrupt Practices Act, or FCPA, and other anti-bribery laws applicable to our operations. In many foreign countries, particularly in those with developing economies, it may be a local custom that businesses operating in such countries engage in business practices that are prohibited by the FCPA or other U.S. and foreign laws and regulations applicable to us. Although we have implemented procedures designed to ensure compliance with the FCPA and similar laws, some of our employees, agents, or other channel partners, as well as those companies to which we outsource certain of our business operations, could take actions in violation of our policies. Any such violation could have a material and adverse effect on our business.

***Our future success is substantially dependent on the service of our senior management and other key employees.***

In the last few years, we have had changes to our senior management team including new hires, departures, and role and responsibility changes. The performance of our senior management team and other key employees may not meet our needs and expectations. Also, the loss of services of any of these key employees, or any negative public perception with respect to these individuals, may be disruptive to, or cause uncertainty in, our business and could have a negative impact on our ability to manage and grow our business effectively. Such disruption could have a material adverse impact on our financial performance, financial condition, and the market price of our stock.

We do not maintain a key person life insurance policy on any of the members of our senior management team. As a result, we would have no way to cover the financial loss if we were to lose the services of members of our senior management team.

***Our business is affected by seasonality.***

Our business is affected by the general seasonal trends common to the retail apparel industry. This seasonality may adversely affect our business and cause our results of operations to fluctuate, and, as a result, we believe that comparisons of our operating results between different quarters within a single fiscal year are not necessarily meaningful and that results of operations in any period should not be considered indicative of the results to be expected for any future period.

***Because a significant portion of our net revenue and expenses are generated in countries other than the United States, fluctuations in foreign currency exchange rates have affected our results of operations and may continue to do so in the future.***

The functional currency of our foreign subsidiaries is generally the applicable local currency. Our consolidated financial statements are presented in U.S. dollars. Therefore, the net revenue, expenses, assets, and liabilities of our foreign subsidiaries are translated from their functional currencies into U.S. dollars. Fluctuations in the value of the U.S. dollar affect the reported amounts of net revenue, expenses, assets, and liabilities. Foreign exchange differences which arise on translation of our foreign subsidiaries' balance sheets into U.S. dollars are recorded as a foreign currency translation adjustment in accumulated other comprehensive income or loss within stockholders' equity.

We also have exposure to changes in foreign exchange rates associated with transactions which are undertaken by our subsidiaries in currencies other than their functional currency. Such transactions include intercompany transactions and inventory purchases denominated in currencies other than the functional currency of the purchasing entity. As a result, we have been impacted by changes in exchange rates and may be impacted for the foreseeable future. The potential impact of currency fluctuation increases as our international expansion increases.

We have, and may continue to, enter into forward currency contracts, or other derivative instruments, in an effort to mitigate the foreign exchange risks which we are exposed to. This may include entering into forward currency contracts to hedge against the foreign exchange gains and losses which arise on translation of our foreign subsidiaries' balance sheets into U.S. dollars, or entering into forward currency contracts in an effort to reduce our exposure to foreign exchange revaluation gains and losses that arise on monetary assets and liabilities held by our subsidiaries in a currency other than their functional currency.

Although we use financial instruments to hedge certain foreign currency risks, these measures may not succeed in fully offsetting the negative impact of foreign currency rate movements.

We are exposed to credit-related losses in the event of nonperformance by the counterparties to the forward currency contracts.

***Our trademarks and other proprietary rights could potentially conflict with the rights of others and we may be prevented from selling some of our products.***

Our success depends in large part on our brand image. We believe that our trademarks and other proprietary rights have significant value and are important to identifying and differentiating our products from those of our competitors and creating and sustaining demand for our products. We have applied for and obtained some United States, Canada, and foreign trademark registrations, and will continue to evaluate the registration of additional trademarks as appropriate. However, some or all of these pending trademark applications may not be approved by the applicable governmental authorities. Moreover, even if the applications are approved, third parties may seek to oppose or otherwise challenge these registrations. Additionally, we may face obstacles as we expand our product line and the geographic scope of our sales and marketing. Third parties may assert intellectual property claims against us, particularly as we expand our business and the number of products we offer. Our defense of any claim, regardless of its merit, could be expensive and time consuming and could divert management resources. Successful infringement claims against us could result in significant monetary liability or prevent us from selling some of our products. In addition, resolution of claims may require us to redesign our products, license rights from third parties, or cease using those rights altogether. Any of these events could harm our business and cause our results of operations, liquidity, and financial condition to suffer.

***We are subject to periodic claims and litigation that could result in unexpected expenses and could ultimately be resolved against us.***

From time to time, we are involved in litigation and other proceedings, including matters related to product liability claims, stockholder class action and derivative claims, commercial disputes and intellectual property, as well as trade, regulatory, employment, and other claims related to our business. Any of these proceedings could result in significant settlement amounts, damages, fines, or other penalties, divert financial and management resources, and result in significant

legal fees. An unfavorable outcome of any particular proceeding could exceed the limits of our insurance policies or the carriers may decline to fund such final settlements and/or judgments and could have an adverse impact on our business, financial condition, and results of operations. In addition, any proceeding could negatively impact our reputation among our guests and our brand image.

***Our business could be negatively affected as a result of actions of activist stockholders or others.***

We may be subject to actions or proposals from stockholders or others that may not align with our business strategies or the interests of our other stockholders. Responding to such actions can be costly and time-consuming, disrupt our business and operations, and divert the attention of our board of directors, management, and employees from the pursuit of our business strategies. Such activities could interfere with our ability to execute our strategic plan. Activist stockholders or others may create perceived uncertainties as to the future direction of our business or strategy which may be exploited by our competitors and may make it more difficult to attract and retain qualified personnel and potential guests, and may affect our relationships with current guests, vendors, investors, and other third parties. In addition, a proxy contest for the election of directors at our annual meeting would require us to incur significant legal fees and proxy solicitation expenses and require significant time and attention by management and our board of directors. The perceived uncertainties as to our future direction also could affect the market price and volatility of our securities.

***Anti-takeover provisions of Delaware law and our certificate of incorporation and bylaws could delay and discourage takeover attempts that stockholders may consider to be favorable.***

Certain provisions of our certificate of incorporation and bylaws and applicable provisions of the Delaware General Corporation Law may make it more difficult or impossible for a third-party to acquire control of us or effect a change in our board of directors and management. These provisions include:

- the classification of our board of directors into three classes, with one class elected each year;
- prohibiting cumulative voting in the election of directors;
- the ability of our board of directors to issue preferred stock without stockholder approval;
- the ability to remove a director only for cause and only with the vote of the holders of at least 66 2/3% of our voting stock;
- a special meeting of stockholders may only be called by our chairman or Chief Executive Officer, or upon a resolution adopted by an affirmative vote of a majority of the board of directors, and not by our stockholders;
- prohibiting stockholder action by written consent; and
- our stockholders must comply with advance notice procedures in order to nominate candidates for election to our board of directors or to place stockholder proposals on the agenda for consideration at any meeting of our stockholders.

In addition, we are governed by Section 203 of the Delaware General Corporation Law which, subject to some specified exceptions, prohibits "business combinations" between a Delaware corporation and an "interested stockholder," which is generally defined as a stockholder who becomes a beneficial owner of 15% or more of a Delaware corporation's voting stock, for a three-year period following the date that the stockholder became an interested stockholder. Section 203 could have the effect of delaying, deferring, or preventing a change in control that our stockholders might consider to be in their best interests.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The following table provides information regarding our purchases of shares of our common stock during the quarter ended November 3, 2019 related to our stock repurchase program:

| <b>Period<sup>(1)</sup></b>         | <b>Total Number of Shares Purchased<sup>(2)</sup></b> | <b>Average Price Paid per Share</b> | <b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs<sup>(2)</sup></b> | <b>Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs<sup>(2)</sup></b> |
|-------------------------------------|---|-------------------------------------|---|---|
| August 5, 2019 - September 1, 2019  | 34,143  | \$ 177.24                           | 34,143  | \$ 329,549,525  |
| September 2, 2019 - October 6, 2019 | 4,372   | 184.16                              | 4,372   | 328,744,372   |
| October 7, 2019 - November 3, 2019  | 5,954   | 190.61                              | 5,954   | 327,609,459   |
| <b>Total</b>                        | <b>44,469</b>   |                                     | <b>44,469</b>   |   |

<sup>(1)</sup> Monthly information is presented by reference to our fiscal periods during our third quarter of fiscal 2019.

<sup>(2)</sup> A stock repurchase program was approved by our board of directors in November 2017 for the repurchase of up to \$200 million common shares and in June 2018, our board of directors approved an increase to this stock repurchase program, authorizing the repurchase of up to a total of \$600 million of our common shares.

On January 31, 2019, our board of directors approved a new stock repurchase program of up to \$500 million of our common shares on the open market or in privately negotiated transactions. Common shares repurchased on the open market are at prevailing market prices, including under plans complying with the provisions of Rule 10b5-1 and Rule 10b-18 of the Securities Exchange Act of 1934. The timing and actual number of common shares to be repurchased will depend upon market conditions, eligibility to trade, and other factors. The repurchases are expected to be completed by January 2021.

The following table provides information regarding our purchases of shares of our common stock during the quarter ended November 3, 2019 related to our Employee Share Purchase Plan:

| <b>Period<sup>(1)</sup></b>         | <b>Total Number of Shares Purchased<sup>(2)</sup></b> | <b>Average Price Paid per Share</b> | <b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs<sup>(2)</sup></b> | <b>Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs<sup>(2)</sup></b> |
|-------------------------------------|---|-------------------------------------|---|---|
| August 5, 2019 - September 1, 2019  | 6,426   | \$ 181.78                           | 6,426   | 4,758,460   |
| September 2, 2019 - October 6, 2019 | 9,067   | 189.75                              | 9,067   | 4,749,393   |
| October 7, 2019 - November 3, 2019  | 6,000   | 203.11                              | 6,000   | 4,743,393   |
| <b>Total</b>                        | <b>21,493</b>   |                                     | <b>21,493</b>   |   |

<sup>(1)</sup> Monthly information is presented by reference to our fiscal periods during our third quarter of fiscal 2019.

<sup>(2)</sup> Our Employee Share Purchase Plan (ESPP) was approved by our board of directors and stockholders in September 2007. All shares purchased under the ESPP are purchased on the Nasdaq Global Select Market (or such other stock exchange as we may designate from time to time). Unless our board of directors terminates the ESPP earlier, the ESPP will continue until all shares authorized for purchase under the ESPP have been purchased. The maximum number of shares authorized to be purchased under the ESPP is 6,000,000.

Excluded from this disclosure are shares withheld to settle statutory employee tax withholding related to the vesting of stock-based compensation awards.

**ITEM 5. OTHER INFORMATION**

In our previous proxy statement disclosure regarding certain relationships and related party transactions, we disclosed that we lease our Victoria, BC store from Anthem Properties. The property is managed by Anthem Properties and we lease it from 0823038 BC Ltd, an entity controlled by Dennis J. Wilson.

**ITEM 6. EXHIBITS**

| Exhibit No. | Exhibit Title  | Filed Herewith | Incorporated by Reference |             |          |
|-------------|--|----------------|---------------------------|-------------|----------|
|             |  |                | Form                      | Exhibit No. | File No. |
| 10.1*       | <a href="#">Outside Director Compensation Plan</a>   | X              |                           |             |          |
| 31.1        | <a href="#">Certification of principal executive officer Pursuant to Exchange Act Rule 13a-14(a)</a>   | X              |                           |             |          |
| 31.2        | <a href="#">Certification of principal financial and accounting officer Pursuant to Exchange Act Rule 13a-14(a)</a>  | X              |                           |             |          |
| 32.1**      | <a href="#">Certification of principal executive officer and principal financial and accounting officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</a>  |                |                           |             |          |
| 101         | The following unaudited interim consolidated financial statements from the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended November 3, 2019, formatted in iXBRL: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations and Comprehensive Income, (iii) Consolidated Statements of Stockholders' Equity, (iv) Consolidated Statements of Cash Flows (v) Notes to the Unaudited Interim Consolidated Financial Statements | X              |                           |             |          |

\* Denotes a compensatory plan, contract, or arrangement, in which our directors or executive officers may participate.

\*\* Furnished herewith.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

lululemon athletica inc.

By: /s/ PATRICK J. GUIDO

Patrick J. Guido

Chief Financial Officer

(principal financial and accounting officer)

Dated: December 11, 2019

**Exhibit Index**

| <b>Exhibit No.</b> | <b>Exhibit Title</b>   | <b>Filed Herewith</b> | <b>Incorporated by Reference</b> |                    |                 |                    |
|--------------------|--|-----------------------|----------------------------------|--------------------|-----------------|--------------------|
|                    |  |                       | <b>Form</b>                      | <b>Exhibit No.</b> | <b>File No.</b> | <b>Filing Date</b> |
| 10.1*              | Outside Director Compensation Plan   | X                     |                                  |                    |                 |                    |
| 31.1               | Certification of principal executive officer Pursuant to Exchange Act Rule 13a-14(a)   | X                     |                                  |                    |                 |                    |
| 31.2               | Certification of principal financial and accounting officer Pursuant to Exchange Act Rule 13a-14(a)  | X                     |                                  |                    |                 |                    |
| 32.1**             | Certification of principal executive officer and principal financial and accounting officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |                       |                                  |                    |                 |                    |
| 101                | The following unaudited interim consolidated financial statements from the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended November 3, 2019, formatted in iXBRL: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations and Comprehensive Income, (iii) Consolidated Statements of Stockholders' Equity, (iv) Consolidated Statements of Cash Flows (v) Notes to the Unaudited Interim Consolidated Financial Statements | X                     |                                  |                    |                 |                    |

\* Denotes a compensatory plan, contract, or arrangement, in which our directors or executive officers may participate.

\*\* Furnished herewith.

|  |
|--|
| <b>Non-Employee Director Compensation Plan</b> |
|--|

(Effective September 2019)

**Annual Cash Retainer:<sup>(1)</sup>**

|              |          |
|--------------|----------|
| Board Member | \$85,000 |
|--------------|----------|

**Additional Annual Retainers:**

|                                     |           |
|-------------------------------------|-----------|
| Non-Executive Chairman of the Board | \$135,000 |
| Lead Director                       | \$50,000  |
| Audit Committee Chair               | \$20,000  |
| Audit Committee Member              | \$10,000  |
| Compensation Committee Chair        | \$15,000  |
| Compensation Committee Member       | \$7,500   |
| Nominating Committee Chair          | \$10,000  |
| Nominating Committee Member         | \$5,000   |

**Annual Grant of Restricted Stock<sup>(2)</sup>****\$130,000<sup>(3)</sup>**

**Expense Reimbursement** – for travel, lodging and other reasonable out-of-pocket expenses incurred in attending board and committee meetings.

- (1) The cash retainers will be paid in arrears, quarterly or semi-annually at the Company's discretion. All amounts listed are in United States dollars.
- (2) Each share of restricted stock will be fully vested on the earlier of the first anniversary of the grant date and the Company's next annual meeting. Each non-employee director receives an initial restricted stock award in connection with the director's election or appointment to the board. The initial awards are pro-rated for the partial year of service based on the date of election or appointment. Thereafter, on the date of each annual meeting of stockholders, each person who is either elected to the board at the annual meeting or continues to serve on the board upon the conclusion of the annual meeting will receive the restricted stock award.
- (3) The number of shares issued for restricted stock awards will equal the specified dollar value of the restricted stock award divided by the applicable per share ASC 718 charge as of the grant date as determined by the Company for financial reporting purposes.

I, Calvin McDonald, certify that:

1. I have reviewed this quarterly report on Form 10-Q of lululemon athletica inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

By: /s/ CALVIN MCDONALD  
Calvin McDonald  
Chief Executive Officer and Director  
(principal executive officer)

Date: December 11, 2019

I, Patrick J. Guido, certify that:

1. I have reviewed this quarterly report on Form 10-Q of lululemon athletica inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

By: /s/ PATRICK J. GUIDO

Patrick J. Guido

Chief Financial Officer

(principal financial and accounting officer)

Date: December 11, 2019

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO SECTION 906 OF  
THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of lululemon athletica inc. (the "Company") on Form 10-Q for the third quarter of fiscal 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), each of the undersigned officers of the Company certifies, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to such officer's knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ CALVIN MCDONALD  
Calvin McDonald  
Chief Executive Officer and Director  
(principal executive officer)

Date: December 11, 2019

By: /s/ PATRICK J. GUIDO  
Patrick J. Guido  
Chief Financial Officer  
(principal financial and accounting officer)

Date: December 11, 2019

The foregoing certification is being furnished solely pursuant to 18 U.S.C. § 1350 and is not being filed as part of the Report or as a separate disclosure document.