lululemon

Q3 Fiscal 2017 Earnings Commentary

December 6, 2017

The financial measures discussed below include both GAAP and adjusted non-GAAP financial measures. In connection with the restructuring of its ivivva operations, the Company recognized pre-tax costs totaling $22.2 million in the third quarter of fiscal 2017. The adjusted financial measures exclude the impact of the ivivva restructuring and the related tax effects, and also exclude certain discrete tax items which were recognized during the third quarter of fiscal 2016.

Please see the section captioned "Reconciliation of Non-GAAP Financial Measures" included in the accompanying financial tables, 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.

This earnings commentary should be read in conjunction with the Company's quarterly report on Form 10-Q filed with the Securities and Exchange Commission ("SEC") on, or about, December 6, 2017 and its annual report on Form 10-K filed with the SEC on March 29, 2017. These reports are available at www.sec.gov.

The below narrative compares the third quarter of fiscal 2017 to the third quarter of fiscal 2016 unless otherwise noted.

Sales

- **Total net revenue** increased 14% to $619.0 million, with the increase primarily resulting from:
  - the opening of 46 net new lululemon branded company-operated stores since Q3 2016. We opened 30 net new lululemon branded company-operated stores in North America, 13 in Asia Pacific, and three in Europe;
  - a total comparable sales increase of 7% on a constant dollar basis, comprised of a comparable store sales increase of 1% and an ecommerce increase of 25%;
  - an increase in net revenue of $6.8 million, or 2.0%, due to foreign exchange; and
  - an increase in other revenue.

  The increase in net revenue was partially offset by the closure of 48 of our ivivva branded company-operated stores as part of the restructuring of our ivivva operations.

- **Company-operated store revenue** totaled $425.1 million, or 68.7% of total revenue, compared to $393.5 million, or 72.3% of total revenue, in Q3 2016.

- **Ecommerce revenue** totaled $131.2 million, or 21.2% of total revenue, compared to $104.0 million, or 19.1% of total revenue, in Q3 2016.

- **Other revenue**, which includes outlets, showrooms, temporary locations, sales to wholesale accounts, license and supply arrangements, and warehouse sales, totaled $62.7 million, or 10.1% of total net revenue, compared to $46.9 million, or 8.6% of total net revenue, in Q3 2016.

Store Count

- **New stores**: We opened 15 net new lululemon branded company-operated stores in Q3 2017. We opened 12 in North America, two in Asia Pacific, and one in Europe.

- **Total company-operated stores**: At the end of Q3 2017, we had 388 total company-operated stores (including seven ivivva) compared to 389 (including 54 ivivva) at the end of Q3 2016. Of the 388 company-operated stores, 316 were in our comparable store base, including 272 stores in North America, 34 stores in Asia Pacific, and 10 stores in Europe.

- **Showrooms**: At the end of Q3 2017, we had a total of 24 showrooms compared to 57 at the end of Q3 2016. Of the 24 showrooms, we had 12 in Europe, eight in North America, and four in Asia Pacific.

- **ivivva**: On August 20, 2017, as part of the restructuring of our ivivva operations, we closed 48 of our 55 ivivva branded company-operated stores. The seven remaining ivivva branded company-operated stores remain in operation and are not expected to close. All of our other ivivva branded locations, including showrooms and other temporary locations, have been closed.

Gross Profit

- **Gross profit** was $322.0 million, or 52.0% of net revenue, compared to $278.4 million, or 51.1% of net revenue, in Q3 2016. Excluding the impact of the restructuring of the ivivva operations, adjusted gross margin increased 110 basis points to 52.2%. The increase in gross margin was primarily the result of:

  – an increase in product margin of 70 basis points which was primarily due to a favorable mix of higher margin product and lower product costs, partially offset by higher markdowns;

  – a decrease in occupancy, depreciation and product and supply chain costs of 20 basis points;

  – a favorable impact of foreign exchange rates of 20 basis points.

Selling, General and Administrative Expenses

- **SG&A expenses** were $215.4 million, or 34.8% of net revenue, compared to $185.5 million, or 34.1% of net revenue, in Q3 2016. The deleverage of 70 basis points in our SG&A rate was primarily the result of:

  – planned costs associated with the improvements to our e-commerce platform of approximately 60 basis points; and

  – foreign exchange, including both translation and revaluation impact, of 60 basis points.

  This was partially offset by lower professional fees compared to last year coupled with efficient store and headquarter related spend.

Asset Impairment and Restructuring Costs

- There was $21.0 million in lease termination costs, employee costs, and other restructuring costs related to the ivivva restructuring that was recognized in Q3 2017.

Operating Income

- **Operating income** was $85.6 million, or 13.8% of net revenue, compared to $93.0 million, or 17.1% of net revenue, in Q3 2016. Excluding the pre-tax charges of $22.2 million related to the ivivva restructuring, adjusted operating income increased to $107.8 million, or 17.4% of net revenue, compared to $93.0 million, or 17.1% of net revenue, in Q3 2016.

Income Tax Expense

- **Income tax expense** was $27.7 million, or 32.0% of pre-tax earnings, compared to 27.0% in Q3 2016. The adjusted effective tax rate for Q3 2017 was 30.8% compared to 31.3% in Q3 2016.

Net Income

- **Net income** was $58.9 million, or $0.43 per diluted share, compared to $0.50 per diluted share in Q3 2016. Net income in Q3 2017 included $16.4 million, or $0.13 per share, in ivivva related restructuring charges. Excluding these charges, adjusted earnings per share were $0.56 compared to an adjusted earnings per share of $0.47 in Q3 2016.

Share Count

- Our diluted share count for the quarter was 135.6 million compared to 137.2 million in Q3 2016. This takes into account the weighted impact of the 0.1 million shares which we repurchased in Q3 2017.

- During fiscal 2017, we have repurchased a total of $99.2 million shares. The $100 million approved stock repurchase program was completed during the third quarter of fiscal 2017.

- The company announced that its board of directors has approved a new stock repurchase program for up to $200 million of its common shares in the open market.

Capital Expenditures

- **Capital expenditures** were $57.2 million in Q3 2017 compared to $34.9 million in Q3 2016. The increase was due to higher company-operated stores and ecommerce capital expenditures in Q3 2017 compared to Q3 2016.

Balance Sheet Highlights

- Cash and cash equivalents was $650.1 million at the end of Q3 2017.

- Inventory increased 9% to $396.9 million at the end of Q3 2017.

Forward-Looking Statements and Non-GAAP Reconciliations

Forward-Looking Statements:

This supplemental disclosure contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that involve risks, uncertainties and assumptions, such as statements regarding our future financial condition or results of operations and our prospects and strategies for future growth. In many cases, you can identify forward-looking statements by terms such as "may," "will," "should," "expects," "plans," "anticipates," "outlook," "believes," "intends," "estimates," "predicts," "potential" or the negative of these terms or other comparable terminology. These forward-looking statements also include our guidance and outlook statements. These statements are based on management's current expectations but they involve a number of risks and uncertainties. Actual results and the timing of events could differ materially from those anticipated in the forward-looking statements as a result of risks and uncertainties, which include, without limitation: our ability to maintain the value and reputation of our brand; the acceptability of our products to our guests; our highly competitive market and increasing competition; our reliance on and limited control over third-party suppliers to provide fabrics for and to produce our products; an economic downturn or economic uncertainty in our key markets; increasing product costs and decreasing selling prices; our ability to anticipate consumer preferences and successfully develop and introduce new, innovative and updated products; our ability to accurately forecast guest demand for our products; our ability to safeguard against security breaches with respect to our information technology systems; any material disruption of our information systems; our ability to have technology-based systems function effectively and grow our e-commerce business globally; the fluctuating costs of raw materials; our ability to expand internationally in light of our limited operating experience and limited brand recognition in new international markets; our ability to deliver our products to the market and to meet guest expectations if we have problems with our distribution system; imitation by our competitors; our ability to protect our intellectual property rights; changes in tax laws or unanticipated tax liabilities; our ability to manage our growth and the increased complexity of our business effectively; our ability to cancel store leases if an existing or new store is not profitable; our ability to source our merchandise profitably or at all if new trade restrictions are imposed or existing trade restrictions become more burdensome; increasing labor costs and other factors associated with the production of our products in South and South East Asia; the operations of many of our suppliers are subject to international and other risks; our ability to successfully open new store locations in a timely manner; our ability to comply with trade and other regulations; the continued service of our senior management; seasonality; fluctuations in foreign currency exchange rates; higher than anticipated costs and our ability to realize the benefits associated with the restructuring of our ivivva business; conflicting trademarks and the prevention of sale of certain products; our exposure to various types of litigation; actions of activist stockholders; anti-takeover provisions in our certificate of incorporation and bylaws; and other risks and uncertainties set out in filings made from time to time with the United States Securities and Exchange Commission and available at www.sec.gov, including, without limitation, our most recent reports on Form 10-K and Form 10-Q. You are urged to consider these factors carefully in evaluating the forward-looking statements contained herein and are cautioned not to place undue reliance on such forward-looking statements, which are qualified in their entirety by these cautionary statements. The forward-looking statements made herein speak only as of the date of this disclosure and we undertake no obligation to publicly update such forward-looking statements to reflect subsequent events or circumstances, except as may be required by law.

Reconciliation of Non-GAAP Financial Measures

Unaudited; Expressed in thousands, except per share amounts

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

The below changes in net revenue, total comparable sales, comparable store sales, and direct to consumer net revenue show the net change for the third quarter of fiscal 2017 compared to the third quarter of fiscal 2016.

	Net Revenue	Total Comparable Sales[1,2]	Comparable Store Sales[2]	Direct to Consumer Net Revenue
Increase	14%	8%	2%	26%
Adjustments due to foreign exchange rate changes	(2)	(1)	(1)	(1)
Increase in constant dollars	12%	7%	1%	25%

[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 months, or open for at least 12 months after being significantly expanded.

Adjusted financial measures

The following table reconciles adjusted financial measures with the most directly comparable measures calculated in accordance with GAAP:

	Quarter Ended October 29, 2017			Quarter Ended October 30, 2016		
	GAAP Results	Adjustments	Adjusted Results (Non-GAAP)	GAAP Results	Adjustments	Adjusted Results (Non-GAAP)
Gross profit[1]	$ 321,962	$ 1,178	$ 323,140	$ 278,426	$ —	$ 278,426
Gross margin[1]	52.0%	0.2 %	52.2%	51.1%	—%	51.1%
Income from operations[1,2]	85,588	22,186	107,774	92,975	—	92,975
Operating margin[1,2]	13.8%	3.6 %	17.4%	17.1%	—%	17.1%
Income before income tax expense[1,2,3]	86,640	22,185	108,825	93,603	186	93,789
Income tax expense[3,4]	27,696	5,813	33,509	25,318	4,005	29,323
Effective tax rate[3,4]	32.0%	(1.2)%	30.8%	27.0%	4.3%	31.3%
Diluted earnings per share[1,2,3,4]	$ 0.43	$ 0.13	$ 0.56	$ 0.50	$ (0.03)	$ 0.47

[1] During the third quarter of fiscal 2017, we recognized costs totaling $1.2 million within cost of goods sold related to the restructuring of our ivivva operations.

[2] During the third quarter of fiscal 2017, we recognized asset impairment and restructuring costs related to the restructuring of our ivivva operations totaling $21.0 million.

[3] The adjustments in the third quarter of fiscal 2016 relate to our transfer pricing arrangements, the associated repatriation of foreign earnings, and net interest costs. These adjustments were recorded in income tax expense and other income (expense), net.

[4] The adjustment to income tax expense for the third quarter of fiscal 2017 represents the tax effect of the ivivva related restructuring adjustments, calculated based on the expected annual tax rate of the applicable tax jurisdictions.

Please refer to Notes 6 and 7 to the unaudited interim consolidated financial statements included in Item 1 of Part I of our Report on Form 10-Q to be filed with the SEC on or about December 6, 2017 for further explanation as to the nature of these items.