lululemon athletica

Consumer Discretionary
NASDAQ: LULU
Market Perform | Buy

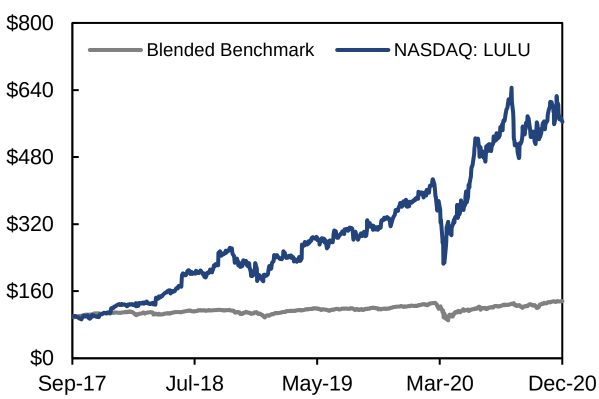
December 31, 2020
Breanna Schollaardt, Portfolio Manager

Return on Investment	
Current Share Price	$348.03
Target Price	$379.00
Dividend Yield	0.00%
Implied Return	9%
Conviction Rating	1

Market Profile	
52-Week Range	$128.85 - $399.90
Market Capitalization (US$mm)	$43,546
Net Debt (US$mm)	($1)
Enterprise Value (US$mm)	$43,545
Beta (5-Year Monthly)	1.23

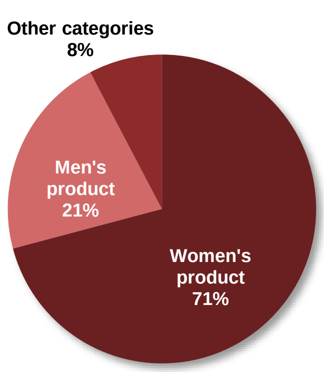
Metrics	**2020E**	**2021E**	**2022E**
Revenue (US$mm)	$4,181	$4,921	$5,864
EBITDA (US$mm)	$1,005	$1,360	$1,621
EPS	$4.19	$5.81	$6.92
EV/EBITDA	43.3x	32.0x	26.9x

Historical Trading Performance (Indexed to $100)



Source: S&P Capital IQ

Figure 1: Revenue Segments



Source: Company Filings

Investment Thesis Summary

- The CPMT views LULU as a company positioned for impressive growth due to its highly developed understanding of consumers and continual efforts to expand
- The Company has been able to grow its e-commerce sales from 8.1% of net revenues in FY2010 to 28.6% in FY2019, the Fund expects this growth to continue
- With a large focus on work-from-home, athleisure wear, and a higher importance placed on healthier lifestyles, LULU should continue to report impressive comparable sales and increase its market share in the space

Business Description

lululemon athletica (NASDAQ: LULU) is a Canadian activewear apparel retailer that designs, distributes, and retails internationally. LULU was founded in Vancouver, BC by Dennis “Chip” Wilson in 1998 and opened its first standalone store in Kitsilano, Vancouver in 2000. Wilson originally created the brand as he noted a lack of options for women’s activewear and that competitors such as Nike (NYSE: NKE) and Adidas (XTRA: ADS) were offering essentially men’s apparel in smaller sizes and different colours. The brand has quickly adapted and has begun to offer gear for men, women, and young girls. The Company has an ambassador program with elite athletes and a program called “Sweat Collective” with members of the community that are in search of and teach sweaty pursuits.

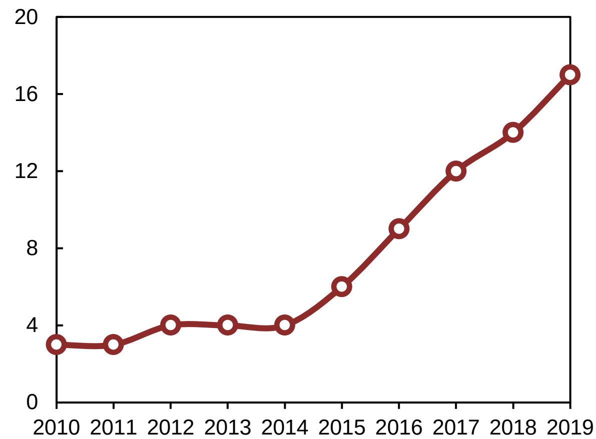
Industry Overview

LULU operates in a niche market lacking any true pure-play competitors. The sportswear industry is sufficient in offering potential comparable companies for LULU and proper industry guidance. U.S. sportswear market sales have increased substantially over the past 10 years at a CAGR of ~6.7%, and, despite the COVID-19 FY2020 impact, sales are projected to grow at ~5% YoY until 2024. In 2009, sportswear sales made up ~20% of total U.S. apparel sales, in comparison to ~32% in 2019. The shift towards the work-from-home environment has been beneficial for the athleisure wear portion of the sportswear segment, with health and wellness being recognized as more important by younger generations. Research conducted found that Generation Z and millennials view exercising as their top two ways to become healthier and lose weight whereas Generation X and Baby Boomers viewed it as the third and the fourth, respectively.

Company Growth and Strategy

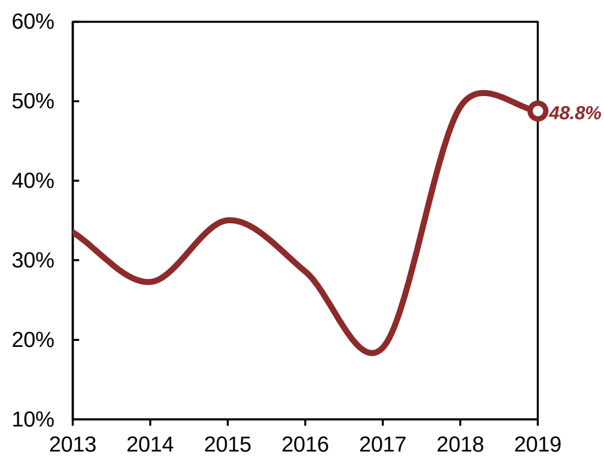
LULU launched its five-year growth plan nearly two years ago. This growth plan (or as advertised by the Company, the ‘Power of Three’), focuses on product innovation, omni-guest experience, and market expansion. Both international and men’s revenues have seen notable increases following the introduction of the growth plan, with the most recent quarter reporting that 14.4% and 21.4% of revenues were made up of international sales and men’s, respectively. The direct-to-consumer (e-commerce) success has been partially due to the COVID-19 pandemic; however, direct-to-consumer revenues were reporting strong growth prior to the pandemic.

Figure 2: Number of Countries with LULU Stores



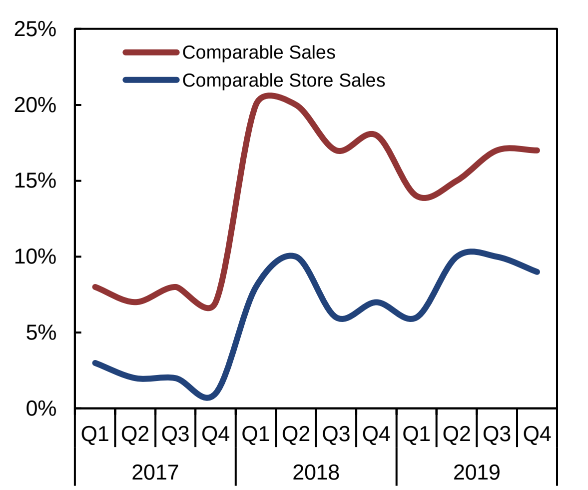
Source: Company Filings

Figure 3: Fiscal Year End Return on Invested Capital



Source: Company Filings

Figure 4: Comparable Sales and Comparable Store Sales



Source: Company Filings

In Q1 2017, direct-to-consumer represented 19.7% of overall revenues, compared to 24.6% in Q3 2019 (last quarter prior to the pandemic). LULU has also focused on store growth. As of the end of FY2013, LULU had 254 stores in comparison with its most recent FY2019 count of 491. In 2017, the Company underwent a restructuring plan mainly focusing on its ivivva stores, which catered to younger girls. This restructuring entailed closing nearly all ivivva stores and moving sales of these products solely to online platforms. More recently, LULU completed its acquisition of MIRROR in July 2020. MIRROR is an at-home fitness company that offers users a subscription-based workout experience. Similar in concept to Peloton (NASDAQ: PTON), MIRROR is equipped with a plethora of workouts. This acquisition is aimed at assisting LULU in continuing to achieve its omni-guest experience section of its Power of Three growth strategy. At-home workouts have grown in popularity due to the COVID-19 pandemic and will likely continue even as gyms and boutique fitness studios re-open.

Mandate Fit and ESG Initiatives

Quality Management: While LULU has seen high turnover throughout its executive team in the past, current CEO Calvin McDonald and the rest of the management team have continued to innovate. LULU has realized impressive growth under their guidance with a two-year TSR of ~186%.

Competitive Advantage: The brand recognition that LULU has achieved over its existence is nearly unparalleled and the Company's ability to commodify the 'sweat life' is impressive. Through continual innovation, such as a membership program and experiential stores, LULU consistently pushes the boundaries of what it means to be a consumer discretionary business. Both LULU's EBITDA margins and comparable sales are impressive in comparison with peers (Figures 4, 5, & 6).

Strong Balance Sheet: LULU utilizes no leverage in its capital structure and sustains a large cash balance of $481mm as of Q3 2020. The Company boasts an impressive LTM ROIC of 43.7% (as of Q3 2020) in comparison with peer average of ~16.6%.

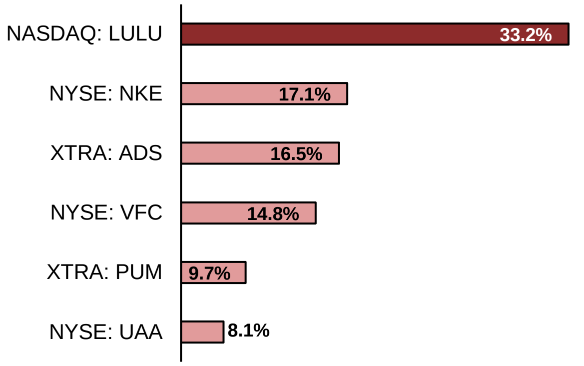
Growing Free Cash Flow: LULU boasts an eight-year FCF CAGR of 22%. The Company continues to reinvest its cash through share repurchases and consistent R&D.

ESG Initiatives: LULU is focusing on diversity and inclusion at all levels of the organization and aims to ensure underrepresented individuals are encouraged to have a constant dialogue with Senior Management. The Company also made the move to offer more inclusive sizing throughout many of its popular products. This innovation will continue along with new and adapted designs. The Company is working to ensure at minimum 75% of products will be made using sustainable materials by 2025. LULU is also looking towards creating a re-sell, recycle, or repair program by 2025; Patagonia International currently offers a similar program which has been highly successful. With these initiatives, the CPMT believes LULU is catering to many consumers' desires which will likely offer the Company continued support.

Valuation and Risks

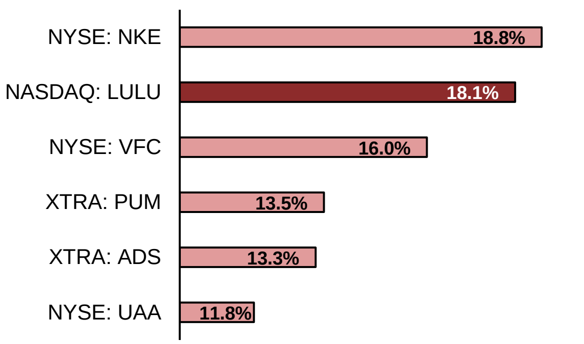
LULU was valued using a 50/50 blended Gordon Growth (using a WACC of 7.45% and a 3% terminal growth rate) and an EV/EBITDA exit multiple of 21.5x. This returned a target price of $379.00, implying a 9% return. The valuation approach was conservative as average EV/EBITDA multiple from a relative valuation of comparable firms is ~32.1x which is much higher than the exit multiple chosen.

Figure 5: EBITDA Margins Prior to COVID-19 Impact



Source: Company Filings

Figure 6: EBITDA Margins (Most Recent Reported Quarter)



Source: Company Filings

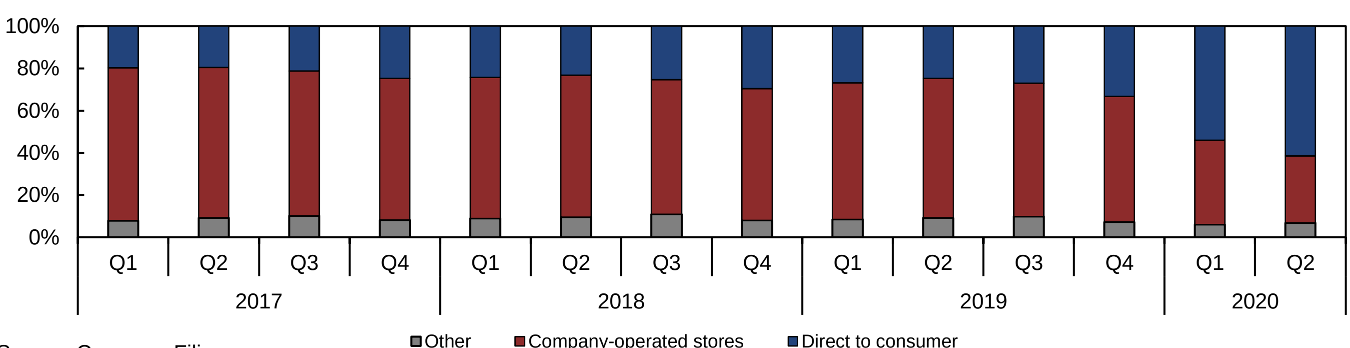
This exit multiple was adjusted down to remain conservative with the uncertain impacts that the pandemic may continue to have on the brick-and-mortar portion of the Company and the sector. The model also reflects a substantial decrease in comparable store sales growth in comparison with historical results for FY2020E. While LULU trades at a premium to peers, the CPMT believes this premium is warranted due to its continued innovation and its ability to capture greater market share, both domestically and internationally. LULU's strong focus on consumer preferences and values is likely to ensure its continued success.

COVID-19 Pandemic and What's Ahead

While the COVID-19 pandemic forced shutdowns of all of LULU's stores at some point, the Company's direct-to-consumer segment made up ~54.0% and ~61.4% of net revenues in Q1 and Q2 of 2020, respectively. In both Q2 and Q3 2020, LULU reported YoY increases in net revenue of 22.2% and 22.0%, respectively. In Q3 2020, LULU also reported YoY net income growth.

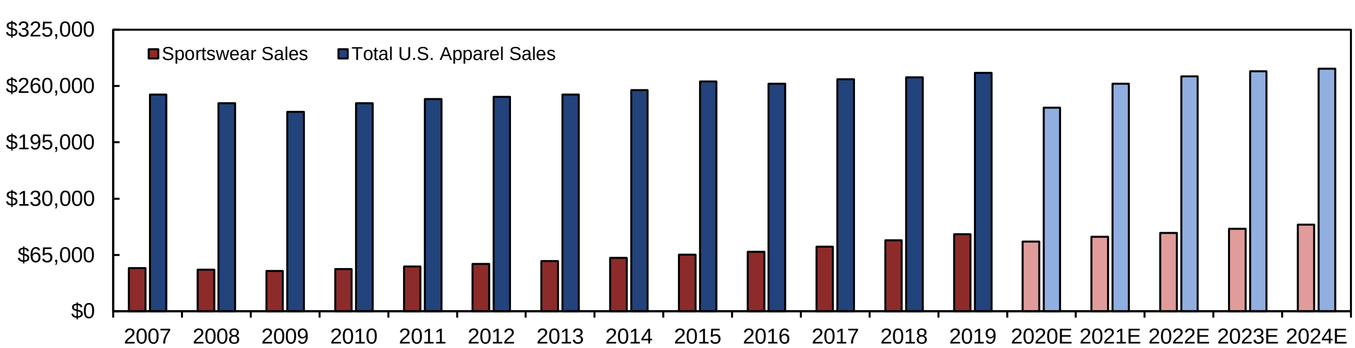
The CPMT views LULU's acquisition of MIRROR as favourable in the long-term. MIRROR's aesthetically pleasing design allows it to be easily incorporated into homes as it does not look like workout equipment, which is an advantage over products offered by PTON. LULU can also ensure instructors on MIRROR are wearing its apparel, further promoting its products. The Company has also introduced experiential stores in two states to test the response these stores receive. The stores are equipped with full workout rooms, a dining area and restaurant full of healthy choices, and large well equipped locker rooms. Additionally, LULU has been testing out a membership program for the past few years. It has introduced the program slowly to certain cities in order to gain insight on the demand for the program. Due to LULU's strong competitive advantage, solid fundamentals, and continual innovation, the CPMT views LULU as an attractive addition to our current holdings.

Figure 7: Revenue Breakdown



Source: Company Filings

Figure 8: U.S. Sportswear Sales vs Overall Apparel Sales (US$mm)



Source: Street Research