Analyst Report

Report Date: February 20, 2024

Analysts: Cinnie Lin & Yesenia Ye

Company: lululemon athletica (LULU)

Industry: Apparel SIC CODE 2300

Target Price: $624.84

Current Price: $506.60 (as of 12/11/2023)

Investment Recommendation: BUY

Investment Thesis

- lululemon is a maturing company with continued plans for strong growth, namely their Power of Three x2 strategy launched in 2022. In the long term, we expect lululemon to maintain its impressive growth and become a market leader behind Nike and Adidas.
- We believe that the company is undervalued by the street because we are more optimistic in the short-term. We expect the company to repeat history and beat their goals of doubling menswear, doubling e-commerce, and quadrupling international sales by 2025, a year earlier than company expectations.

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Company Overview

lululemon athletica referred to as lululemon, is a designer, distributor, and retailer of technical athletic apparel, footwear, and accessories. Their upcoming 2023 fiscal year will end January 28, 2024. Beyond apparel and footwear for athletic activities such as running and yoga, they also focus on building a community of guests through their membership program and in-home connected fitness subscription: lululemon Studio (formerly MIRROR). Lululemon purchased MIRROR, an at-home fitness company that included a touchscreen interactive workout platform integrated with live and on-demand classes. As of 2023, the company will no longer sell the Mirror hardware, and instead as of November 1, 2023, have entered a partnership with Peloton where Peloton will be the exclusive fitness content provider for lululemon. Users of the lululemon Studio app will be able to access Peloton classes.


Lululemon Yoga Align Leggings


Chargefeel Women's Shoes


Wunderlust Weekender Bag

lululemon and Peloton partner to bring you a bright new future of fitness.

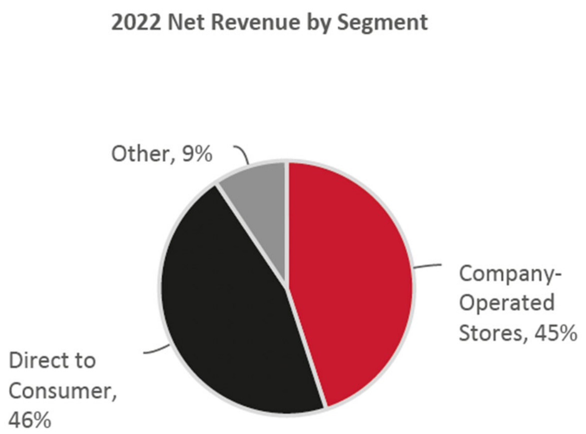
Strategy

Since 2019, the fiscal year where lululemon solidified its current leadership, they have been executing a plan named “Power of Three”. This plan established goals to double their total net revenue by 2023 by doubling men’s revenue, digital net revenue, and quadrupling international net revenue. They were able to achieve this ahead of schedule in 2022.

In 2022, the company launched their new strategy: “Power of Three x2”, comprised of three pillars of Product Innovation, Guest Experience, and Market Expansion. Once again, lululemon is targeting to double their men’s business, double the digital business, and quadruple international business while growing total revenue from $6.25B in 2021 to $12.5B by 2026.

Segmentation

Lululemon segments their business by channel: company-operated stores, direct to consumer (DTC) which mostly encompasses e-commerce, and Other, which includes outlet stores, wholesale accounts, sale of repurchased products, subscriptions through lululemon Studio, and more. A breakdown of fiscal year 2022 revenue segmentation looks as follows:



Segmentation: Geography

The company has retail stores in primarily the United States but has planned for more international expansion through retail stores especially in China. For a list of the number of stores per country, please see appendix A. An important metric in this area is their sales per square foot metrics. It was $1,580 and $1,443 for 2022 and 2021 respectively. Besides more stores, they also wanted to increase retail square footage, and their sales per square foot metric.

Segmentation: Channel

Plans to grow men's business and digital business is a direct resolution of how they strategize their channels. They will likely place a large focus on their e-commerce platform (lululemon.com) and grow their product merchandise especially for men. There is a lot of opportunity here. Take for example, under women's shoes currently one can see a selection of sneakers, trainers, running shoes and more. However, for men, the only offerings are color two options of slides.

Outlook

We strongly believe that lululemon has all the components in place to achieve their goals for Power of Three x2. Much like their first plan, we believe that they will yet again achieve their five-year plan a year early in 2025.

Revenue

Short-Term Revenue

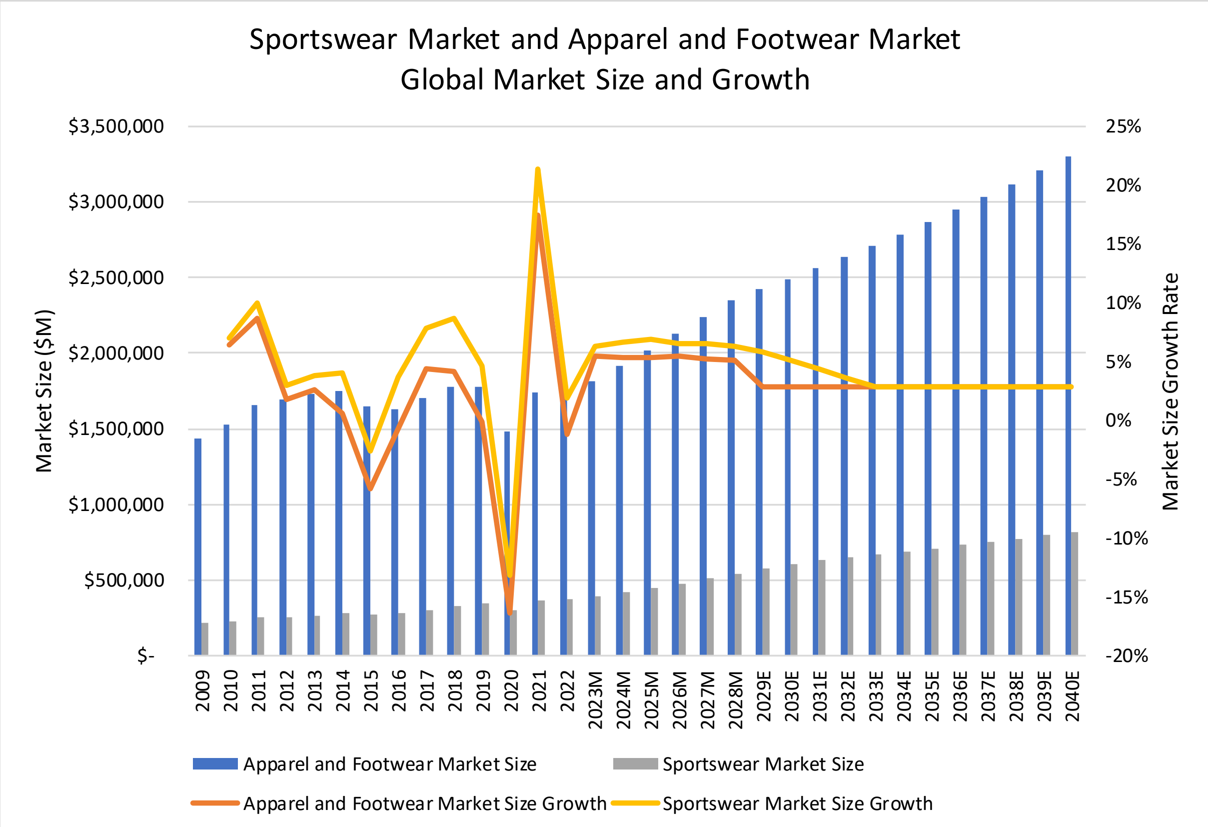
We project revenue based on the company's channel segmentation: company-operated stores, DTC, and Other segments. For company-operated stores, we multiplied number of stores by sales per square foot by average square foot per store. We first needed to forecast the number of stores we expect lululemon to launch each year. In 2023, leadership indicates that they will launch 55 new stores (net of store closures). We benchmarked around this number and believed that they will continue to launch on average 55 stores every year from 2023-2028. Next, we forecasted sales per square foot and average square foot per store based on historical growth values. This resulted in a consistent 6.78% growth rate for sales per square foot and 3.75% growth rate for average square foot per store. We chose to grow both of these because leadership has said that they plan to launch more stores that are larger in size through their earnings calls. The revenue of the company-operated stores from 2023-2028 is therefore the product of number of stores, sales per square foot, and average square foot per store.

For DTC revenue, management's goal was to double e-commerce sales by 2026. With better improvements in technology and continued strength in online shopping, we believe that they can achieve this a year early, much like they did with their 2019-2023 plan. Here, we placed the value of $5.5B in 2025, which is double the 2021 DTC revenue. From 2023-2025, we plan that they will achieve this goal in even increments. Even after 2025, we believe that they will continue to grow DTC in the same numerical value per year of ~$592M per year.

Lastly, we grow the Others segment based on a consistent 9% share of the revenue. They have not placed any particular strategic focus on this segment, thus we do not expect any major changes.

Long-Term Revenue

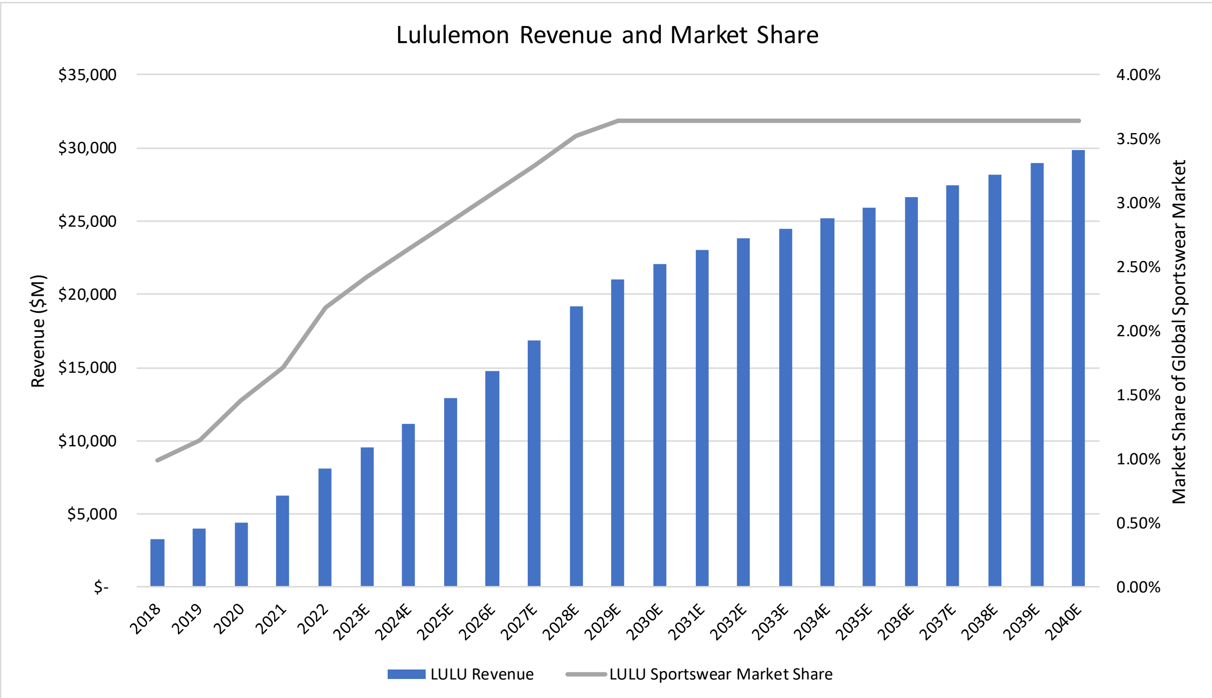
For the longer term, we forecast revenue based on market size and market share. The global market size of sportswear is currently growing more quickly than the global market size of general apparel and footwear (Euromonitor estimates a discrepancy of roughly 125 bps for the next five years), but we believe that the two markets' growth rates will eventually converge to the long-term apparel and footwear market growth rate. In mature sportswear markets, North America and Western Europe, the combined sportswear market size has hovered around 25% of the total apparel and footwear market size in recent years, so we anticipate that this is the maximum ratio between sportswear and total apparel sales. Therefore, the two markets' growth rates will converge once the sportswear market size hits roughly 25% of the apparel and footwear market size. According to Euromonitor, the average long-term growth rate of the global apparel and footwear market is 2.84%, so we have forecasted the sportswear market to show decreasing growth rates from FY28 (the end of Euromonitor's forecasts) until the growth rate is equal to 2.84% and the sportswear market size is a quarter of the apparel and footwear market size, in FY33. In the chart below, years ending with an M are forecasted by Euromonitor, and those ending with an E are forecasted by the authors of this report.



Next, we looked at lululemon's market share in the sportswear market. The last year of our detailed revenue forecast above is FY28, when the company has a forecasted market share of 3.52% (using Euromonitor's forecasted sportswear market size). The top competitors in the space, Nike and Adidas, have consistent market shares in the low double digits and high single digits, respectively. According to Euromonitor data, no other competitor has surpassed a 3.9% market share in recent years, and most hover at or below 3%. We believe that lululemon has a greater chance at success than most of its competitors but won't reach the dominance of Nike or Adidas.

We believe that lululemon will hit its peak market share of 3.64% in FY30, then maintain it consistently. We believe that FY30 will be a plateau point for two reasons. First, a plateau year of FY30 means a timeline of 23 years from its IPO (2007) to plateau point, which closely matches the 22-year timeline of when Adidas went public (1995) to its peak market share (FY17). We believe that Adidas is a useful reference point because it is a successful competitor in the sportswear space but is not as much of a unicorn as Nike is. Second, lululemon has now announced two five-year growth plans and we are forecasting that they hit their next growth plan (Power of Three x2, announced in April 2022) of doubling revenue to $12.5B in FY25. After that goal is reached, the next five-year plan would probably begin in FY26 and then end in FY30, so FY30 could be a good time for LULU to exit its growth phase and begin its plateau.

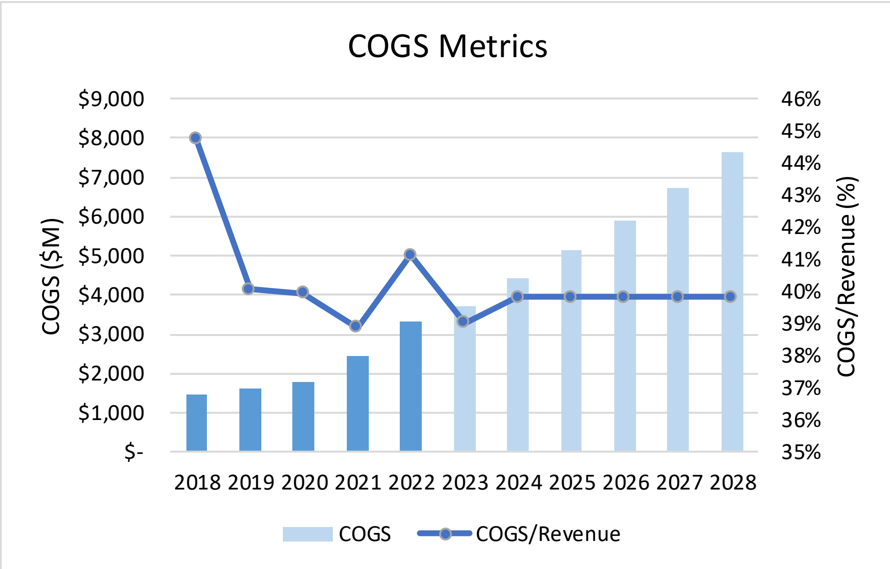
After lululemon's market share plateaus, we expect it to remain consistent for the long term, meaning that the company's revenue growth rate will match that of the sportswear market. Eventually, in FY33, this will converge to the long-term apparel and footwear market size growth rate of 2.84%. We can use this expected market share and market size to forecast long-term revenue accordingly.



COGS and Gross Margin

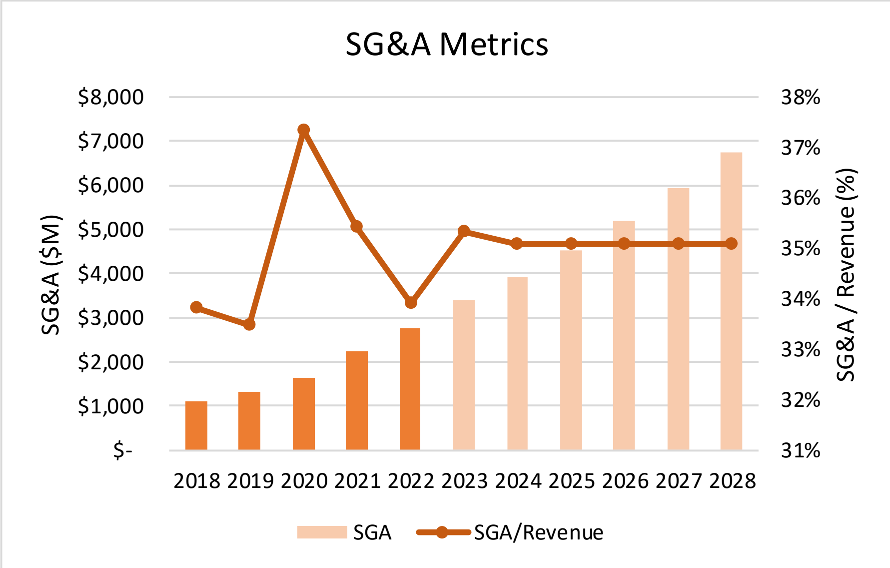
In 2023, based on the quarterly earnings transcript, leadership has predicted that gross margin will land at 60.88%, two percentage points above last year. We have seen leadership provide accurate accounts of their financials in previous reports. Gross margins in 2024-2028 are maintained at 60.18%, the historical average margin from 2019-2023.

We backed out our COGS numbers in order to maintain these levels of gross margin. For example, in 2023 we expect that gross margin will be 60.88%. To get this margin, the gross profit/revenue would need to equal 0.6088. Gross profit is defined as Revenue-COGS, thus (Revenue-COGS)/Revenue = 0.6088. With Revenue at $9.5B, the COGS value that would fulfill this equation is $3.7B.



SG&A and Operating Margin

The SG&A value for 2023 is given by leadership and they have given accurate accounts in the past. From 2023 on, we do not foresee any major changes within SG&A, so we kept the operating margin steady at the average rate from their first strategic plan in 2019-2022. The average operating margin was 25.53%, which is held constant until 2028.



Depreciation & Amortization

We calculated their D&A based on the number of stores that they have and plan to open in the future as part of their market expansion pillar of the Power of Three x2 plan. We did not take any IP into account as it seems that IP does not play a dominant role in their D&A.

First, we looked at the historical stores per each region of North America (NA), Asia Pacific (APAC), and Europe (EUR) from 2018 until 2022. We forecasted 2023 numbers based on leadership's direction of opening 55 new stores. They specifically said 35 of the new locations will be international, with a majority in China. Using this information, we allocated 20 stores to NA, 25 stores to APAC, and 10 stores to EUR for 2023, bringing the total company-operated stores to 710.

Forecasting into the future, we believe that it is more likely that they will average the number of stores opened around 55, rather than maintain a growth percentage of locations each year. Thus, we believe that they will continue to reflect 2023 new store additions per year from 2024-2028. As a check to these numbers, the growth rates as well as each region's share per store are relatively stable with no drastic changes.

	2018	2019	2020	2021	2022	2023 Q1-3	2024	2025	2026	2027	2028
Revenue ($)	$3,288,319,000	$3,979,296,000	$4,401,879,000	$6,256,617,000	$8,110,518,000	$9,566,500,000	$11,146,166,923	$12,875,306,360	$14,774,538,698	$16,867,180,121	$19,179,584,048
Sales per Sqft	$ -	$ 1,657	$ -	$ 1,443	$ 1,580	$ 1,687	$ 1,802	$ 1,924	$ 2,054	$ 2,194	$ 2,343
Sqft per year		2,401,506		4,335,840	5,133,239	5,670,091	6,186,664	6,692,411	7,191,724	7,688,748	8,187,406
NA # of Stores	349	368	377	387	419	439	459	479	499	519	539
Share of NA stores	79%	75%	72%	67%	64%	62%	59%	56%	53%	50%	50%
APAC # of stores	70	94	112	150	190	215	240	265	290	315	340
Share of APAC Stores	16%	19%	21%	26%	29%	30%	33%	36%	39%	42%	45%
EUR # of stores	21	29	32	37	46	56	66	76	86	96	106
Share of EUR stores	5%	6%	6%	6%	7%	8%	9%	9%	10%	10%	11%
company-operated stores	440	491	521	574	655	710	765	820	875	930	985
	440	491	521	574	655	710	765	820	875	930	985

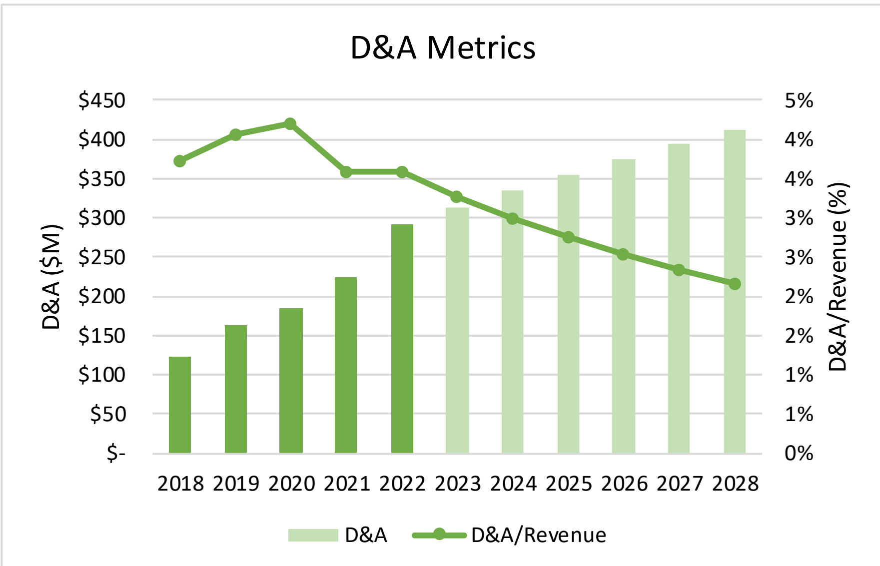
Knowing total stores, number of stores per region, and share of stores per region we apply that to the square footage that lululemon has. To find the square footage that lululemon had per year, we use revenue divided by the sales per square that we forecasted under revenue.

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Revenue ($)	$3,288,319,000	$3,979,296,000	$4,401,879,000	$6,256,617,000	$8,110,518,000	$9,566,500,000	$11,146,166,923	$12,875,306,360	$14,774,538,698	$16,867,180,121	$19,179,584,048
Sales per Sqft	$ -	$ 1,657	$ -	$ 1,443	$ 1,580	$ 1,687	$ 1,802	$ 1,924	$ 2,054	$ 2,194	$ 2,343
Sqft per year		2,401,506		4,335,840	5,133,239	5,670,091	6,186,664	6,692,411	7,191,724	7,688,748	8,187,406

We split the total square foot per year between the regions based on their store share. Then we took the difference of square foot year over year, and the resulting difference is the square footage of newly built stores. This square footage was multiplied by the cost to build per region to give us the value of each regions' stores We found each region's cost from different sources on the internet. Using the value of each regions' stores, we summed up to find total value of new stores per year, divided by 10 for 10 years of usable life. The total depreciation was summed together as follows:

	2018	2019	2020	2021	2022	2023 Q1-3	2024	2025	2026	2027	2028
2019		$ 161,800,000	$ 161,800,000	$ 161,800,000	$ 161,800,000	$ 161,800,000	$ 161,800,000	$ 161,800,000	$ 161,800,000	$ 161,800,000	$ 161,800,000
2020			$ 23,460,000	$ 23,460,000	$ 23,460,000	$ 23,460,000	$ 23,460,000	$ 23,460,000	$ 23,460,000	$ 23,460,000	$ 23,460,000
2021				$ 38,946,000	$ 38,946,000	$ 38,946,000	$ 38,946,000	$ 38,946,000	$ 38,946,000	$ 38,946,000	$ 38,946,000
2022					$ 67,585,000	$ 67,585,000	$ 67,585,000	$ 67,585,000	$ 67,585,000	$ 67,585,000	$ 67,585,000
2023						$ 21,643,601	$ 21,643,601	$ 21,643,601	$ 21,643,601	$ 21,643,601	$ 21,643,601
2024							$ 20,636,607	$ 20,636,607	$ 20,636,607	$ 20,636,607	$ 20,636,607
2025								$ 20,093,756	$ 20,093,756	$ 20,093,756	$ 20,093,756
2026									$ 19,767,591	$ 19,767,591	$ 19,767,591
2027										$ 19,636,596	$ 19,636,596
2028											$ 19,683,739
Total Depreciation	$ -	$ 161,800,000	$ 185,260,000	$ 224,206,000	$ 291,791,000	$ 313,434,601	$ 334,071,208	$ 354,164,964	$ 373,932,555	$ 393,569,151	$ 413,252,890
Total Depreciation (M)	$ -	$ 162	$ 185	$ 224	$ 292	$ 313	$ 334	$ 354	$ 374	$ 394	$ 413

This resulted in our D&A forecast. The growth rate that results is relatively stable, from a growth rate of 7.42% in 2023 to 5.0% in 2028. This makes logical sense since we believe that they opted for more new store openings and thus higher than typical D&A growth rates in 2021 and 2022 as an expansion response to inactivity during COVID.



Non-Recurring Income/Expense

In 2023, lululemon's decision to stop selling the Studio Mirror hardware makes them recognize an inventory obsolescence provision of $23.7M. This should be a one-year expense. We do not foresee any other non-recurring income or expenses at this time.

Capital Expenditure

LULU's capex/revenue ratio has consistently hovered around 6%-7% for the last five years. It is set higher than the Damodaran apparel industry average ratio of 1.5% but this is likely due to LULU's growth strategies. LULU has plans to continue expanding, so we are estimating capex by maintaining a consistent capex/revenue ratio with the 5-year average of 6.72%.

NWC

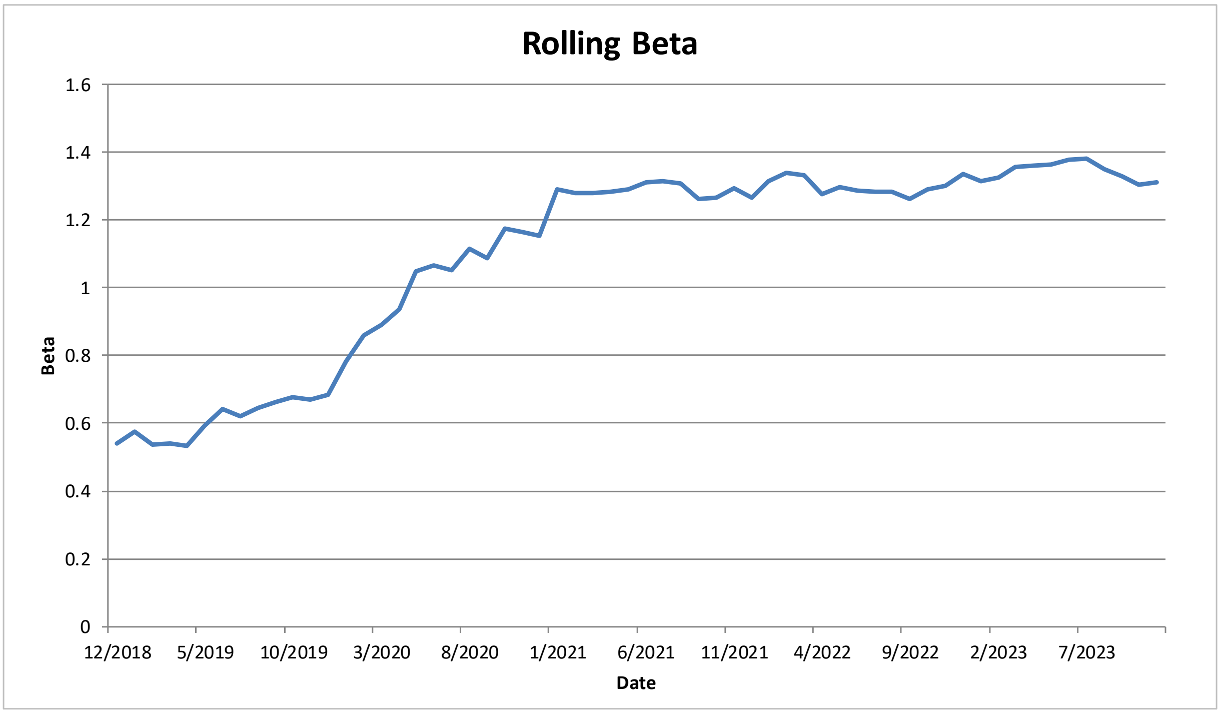
LULU's working capital to revenue ratio has stayed fairly consistent around 9%-10%, excluding COVID years. To estimate working capital, we will maintain this 5-year average ratio of 9.22% as LULU continues to expand.

Valuation

We are using a DCF valuation method.

Unlevered Beta

LULU's unlevered beta is 1.06. We first calculated LULU's levered beta over the last 5 years as 1.31, then applied a 30% tax rate and the company's most recent debt/equity ratio of 0.34 to arrive at an unlevered beta of 1.06.



Taxes

We are maintaining an effective income tax rate of 30%, which comes from their annual reports.

Discount Rate

We have calculated a WACC for LULU of 5.7% (using a risk-free rate of 4.8%, a market premium of 6%, and an asset beta of 1.06). We have estimated a steady FCF annual growth rate of 2.84% because we expect lululemon to hold a consistent market share, and 2.84% is the long-term growth rate of the global apparel and footwear market size.

Methodology

The first step of our valuation considers only our shorter-term, more detailed forecast which ends in FY28 and the years before lululemon hits constant growth in FY33. We calculate FCF from FY29-FY33 using an average FCF/revenue ratio of 13%, based on our forecasts from FY23-FY28. Using a discount rate of 5.7%, we calculate a PV of free cash flows through FY33 of $3.20B.

Next, we calculate terminal value based on the forecasted FY33 FCF. Using a discount rate of 5.7% and a long-term growth rate of 2.84%, terminal value is equal to $111.96B. We then discount this as-of-FY33 terminal value back to the present, giving a PV of $64.30B. The total enterprise value of lululemon is equal to the sum of the PV of FCFs through FY33 and the PV of the terminal value, or $81.69B.

In its latest filings at the end of FY22, LULU reported $1.15B of cash and total debt of $1.07B, so our estimated equity value is $82.04B and our estimated share price is $624.84. This represents a 23% premium over the current (as of 12/11/2023) market cap of $66.52B and share price of $506.60. We recommend BUY.

This 23% premium is due to our optimism that lululemon will hit its 5-year growth plans a year early. We are optimistic because, in addition to the analysis outlined above, the lululemon leadership team has remained consistent and has a wealth of industry experience. If we adjust our short-term forecasts for lululemon to hit its 5-year growth plans in 2026 as planned, we see an estimated share price of $526.01, which is more consistent with the market price.

Assumptions

Risk-Free Rate	4.80%
Market Premium	6%
Asset Beta	1.06
Tax rate	30%
Return on Assets	6.07%
Long-Term Growth Rate	2.84%
Discount Rate	5.70%
PV of FCFs through FY33	$3.201B
Terminal Value as of FY33	$111.960B
PV of Terminal Value	$64.301B
Enterprise Value	$81.962B
Cash	$1.154B
Total Debt	$1.070B
Current Market Cap	$66.520B
Shares Outstanding	131.31M
Target Price	$624.84
Current Price	$506.60

Short-Term Financials (in millions):

Year	2019	2020	2021	2022	2023E	2024E	2025E	2026E	2027E	2028E
Revenue	$3,979	$4,402	$6,257	$8,111	$9,567	$11,146	$12,875	$14,775	$16,867	$19,180
	21%	*11%*	*42%*	*30%*	*18%*	*17%*	*16%*	*15%*	*14%*	*14%*
COGS	$1,594	$1,758	$2,433	$3,335	$3,732	$4,439	$5,127	$5,884	$6,717	$7,638
	8%	*10%*	*38%*	*37%*	*12%*	*19%*	*16%*	*16%*	*16%*	*16%*
Gross Profit	**$2,385**	**$2,644**	**$3,824**	**$4,775**	**$5,834**	**$6,707**	**$7,748**	**$8,891**	**$10,150**	**$11,542**
	31%	***11%***	***45%***	***25%***	***22%***	***15%***	***16%***	***15%***	***14%***	***14%***
Gross Margin	60%	60%	61%	59%	61%	60%	60%	60%	60%	60%
OpEx	$1,333	$1,643	$2,217	$2,750	$3,378	$3,909	$4,516	$5,182	$5,916	$6,727
	20%	*23%*	*35%*	*24%*	*23%*	*26%*	*26%*	*26%*	*26%*	*26%*
EBITDA	**$1,052**	**$1,001**	**$1,607**	**$2,025**	**$2,456**	**$2,798**	**$3,232**	**$3,709**	**$4,235**	**$4,815**
	27%	***-5%***	***61%***	***26%***	***21%***	***14%***	***16%***	***15%***	***14%***	***14%***
D&A	$162	$185	$224	$292	$313	$334	$354	$374	$394	$413
	32%	*14%*	*21%*	*30%*	*7%*	*7%*	*6%*	*6%*	*5%*	*5%*
EBIT	**$891**	**$816**	**$1,383**	**$1,734**	**$2,143**	**$2,464**	**$2,878**	**$3,335**	**$3,841**	**$4,402**
	26%	***-8%***	***70%***	***25%***	***24%***	***15%***	***17%***	***16%***	***15%***	***15%***
Op Margin	22%	19%	22%	21%	22%	22%	22%	23%	23%	23%
Nonrecurring Expenses	$7	$4	$(49)	$(401)	$(27)	$-	$-	$-	$-	$-
Interest and Taxes	$252	$230	$359	$478	$624	$727	$849	$984	$1,133	$1,299
Net Income	**$646**	**$589**	**$975**	**$855**	**$1,491**	**$1,737**	**$2,029**	**$2,351**	**$2,708**	**$3,103**
	33%	***-9%***	***66%***	***-12%***	***74%***	***16%***	***17%***	***16%***	***15%***	***15%***

Short-Term Financials Continued (in millions):

Year	2019	2020	2021	2022	2023E	2024E	2025E	2026E	2027E	2028E
After-Tax EBIT	$639	$585	$1,025	$1,256	$1,519	$1,737	$2,029	$2,351	$2,708	$3,103
Working Capital (excl. cash & ST debt)	$426	$440	$457	$720	$882	$1,028	$1,187	$1,362	$1,555	$1,769
Change in WC ($)	$315	$14	$18	$263	$162	$146	$159	$175	$193	$213
D&A	$162	$185	$224	$292	$313	$334	$354	$374	$394	$413
Capex	$283	$229	$395	$639	$680	$749	$865	$993	$1,134	$1,289
FCF	**$832**	**$555**	**$872**	**$1,172**	**$1,314**	**$1,468**	**$1,677**	**$1,907**	**$2,161**	**$2,441**

Long-Term Financials (in millions):

Year	2029E	2030E	2031E	2032E	2033E	2034E	2035E	2036E	2037E	2038E	2039E	2040E
Global Apparel and Footwear Market Size (in $B)	$2,421	$2,490	$2,560	$2,633	$2,708	$2,785	$2,864	$2,946	$3,030	$3,116	$3,204	$3,295
Growth	2.84%	2.84%	2.84%	2.84%	2.84%	2.84%	2.84%	2.84%	2.84%	2.84%	2.84%	2.84%
Global Sportswear Market Size (in $B)	$576	$605	$631	$654	$692	$692	$711	$732	$752	$774	$796	$818
Growth	5.83%	5.08%	4.34%	3.59%	2.84%	2.84%	2.84%	2.84%	2.84%	2.84%	2.84%	2.84%
LULU Revenue (in $B)	$21	$22	$23	$24	$25	$25	$26	$27	$27	$28	$29	$30
Growth	9.4%	5.08%	4.34%	3.59%	2.84%	2.84%	2.84%	2.84%	2.84%	2.84%	2.84%	2.84%
LULU Market Share	3.64%	3.64%	3.64%	3.64%	3.64%	3.64%	3.64%	3.64%	3.64%	3.64%	3.64%	3.64%

Sources
Factset Research Systems, Inc.
Bloomberg, L.P.
Damodaran Online: Home Page for Aswath Damodaran (nyu.edu)
LULU Financial Statements and Annual Reports
Euromonitor International Ltd

Appendix

Appendix A;

Number of company-operated stores by country (market)	January 29, 2023
United States	350
People's Republic of China[(1)]	117
Canada	69
Australia	32
United Kingdom	20
South Korea	16
Germany	10
New Zealand	8
Singapore	8
Japan	7
France	4
Ireland	4
Spain	3
Malaysia	2
Sweden	2
Netherlands	1
Norway	1
Switzerland	1
Total company-operated stores	655