

lululemon athletica inc.
Form 10-Q
September 11, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended August 3, 2014

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

lululemon athletica inc.
(Exact name of registrant as specified in its charter)

Delaware	20-3842867
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1818 Cornwall Avenue, Vancouver, British Columbia	V6J 1C7
(Address of principal executive offices)	(Zip Code)

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

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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post such files). Yes ☐ No ☐

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

Large accelerated filer <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>

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

At September 8, 2014, there were 113,413,705 shares of the registrant's common stock, par value \$0.005 per share, outstanding.

Exchangeable and Special Voting Shares:

At September 8, 2014, there were outstanding 29,937,820 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 September 8, 2014, the registrant had outstanding 29,937,820 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

	August 3, 2014 (Unaudited)	February 2, 2014
(Amounts in thousands, except per share amounts)		
ASSETS		
Current assets		
Cash and cash equivalents	\$725,073	\$698,649
Accounts receivable	8,835	11,903
Inventories	176,502	186,090
Prepaid expenses and other current assets	63,692	46,197
	974,102	942,839
Property and equipment, net	285,849	255,603
Goodwill and intangible assets, net	27,938	28,201
Deferred income tax asset	4,992	18,300
Other non-current assets	5,039	4,745
	\$1,297,920	\$1,249,688
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$7,100	\$12,647
Accrued liabilities	51,392	42,310
Accrued compensation and related expenses	26,614	19,445
Income taxes payable	562	769
Unredeemed gift card liability	29,232	38,343
	114,900	113,514
Non-current liabilities	56,353	39,492
	171,253	153,006
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, issued and outstanding 29,938 and 29,955	—	—
Special voting stock, \$0.000005 par value, 60,000 shares authorized, issued and outstanding 29,938 and 29,955	—	—
Common stock, \$0.005 par value, 400,000 shares authorized, issued and outstanding 114,185 and 115,342	571	577
Additional paid-in capital	240,343	240,351
Retained earnings	937,767	923,822
Accumulated other comprehensive loss	(52,014)	(68,068)
	1,126,667	1,096,682
	\$1,297,920	\$1,249,688

See accompanying notes to the interim consolidated financial statements

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CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

	Thirteen Weeks Ended August 3, 2014 (Unaudited)	Thirteen Weeks Ended August 4, 2013	Twenty-Six Weeks Ended August 3, 2014	Twenty-Six Weeks Ended August 4, 2013
	(Amounts in thousands, except per share amounts)			
Net revenue	\$390,708	\$344,513	\$775,326	\$690,295
Cost of goods sold	193,401	158,558	382,275	333,616
Gross profit	197,307	185,955	393,051	356,679
Selling, general and administrative expenses	129,419	106,969	255,362	211,804
Income from operations	67,888	78,986	137,689	144,875
Other income (expense), net	1,890	1,295	3,533	2,796
Income before provision for income taxes	69,778	80,281	141,222	147,671
Provision for income taxes	21,030	23,816	73,493	43,928
Net income	\$48,748	\$56,465	\$67,729	\$103,743
Basic earnings per share	\$0.34	\$0.39	\$0.47	\$0.72
Diluted earnings per share	\$0.33	\$0.39	\$0.46	\$0.71
Basic weighted-average number of shares outstanding	145,180	144,818	145,282	144,650
Diluted weighted-average number of shares outstanding	145,544	145,916	145,715	145,901
Other comprehensive income (loss):				
Foreign currency translation adjustment	3,664	(21,901)	) 16,054	(26,348)
Comprehensive income	\$52,412	\$34,564	\$83,783	\$77,395
See accompanying notes to the interim consolidated financial statements				

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CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Exchangeable Stock		Special Voting Stock		Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
	Shares	Par Value	Shares	Par Value	Shares	Par Value				
(Unaudited)										
(Amounts in thousands)										
Balance at February 2, 2014	29,955	\$—	29,955	\$—	115,342	\$577	\$240,351	\$923,822	\$ (68,068)	\$1,096,682
Net income.								67,729		67,729
Foreign currency translation adjustment									16,054	16,054
Stock-based compensation							3,369			3,369
Excess tax benefit from stock-based compensation							46			46
Common stock issued upon exchange of exchangeable shares	(17)	—	(17)	—	17	—	—			—
Restricted share issuance					29	—	—			—
Stock options exercised					125	1	2,250			2,251
Common stock issued upon settlement of performance-based restricted stock units					171	1	(1)			—
Shares withheld related to net share settlement of performance-based restricted stock units					(77)	—	(3,660)			(3,660)
Repurchase of common stock					(1,422)	(8)	(2,012)	(53,784)		(55,804)
Balance at August 3, 2014	29,938	\$—	29,938	\$—	114,185	\$571	\$240,343	\$937,767	\$ (52,014)	\$1,126,667
See accompanying notes to the interim consolidated financial statements										

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CONSOLIDATED STATEMENTS OF CASH FLOWS

	Twenty-Six Weeks Ended August 3, 2014 (Unaudited) (Amounts in thousands)	Twenty-Six Weeks Ended August 4, 2013	
Cash flows from operating activities			
Net income	\$67,729	\$103,743	
Items not affecting cash			
Provision for inventories	699	15,915	
Depreciation and amortization	26,097	23,807	
Stock-based compensation	3,369	8,288	
Deferred income taxes	27,789	1,205	
Excess tax benefits from stock-based compensation	(46	) (5,972)
Other, including net changes in other non-cash balances			
Prepaid tax installments	(5,819	) (10,115)
Other prepaid expenses and other current assets	(8,649	) (7,583)
Inventories	9,980	(26,141)
Accounts payable	(5,709	) 11,667	
Accrued liabilities	8,675	9,294	
Income taxes payable	(207	) (39,794)
Accrued compensation and related expenses	7,013	(7,019)
Other non-cash balances	(6,936	) (6,364)
Net cash provided by operating activities	123,985	70,931	
Cash flows from investing activities			
Purchase of property and equipment	(52,102	) (44,014)
Net cash used in investing activities	(52,102	) (44,014)
Cash flows from financing activities			
Proceeds from exercise of stock options	2,251	5,134	
Excess tax benefits from stock-based compensation	46	5,972	
Taxes paid related to net share settlement of equity awards	(3,660	) (4,801)
Repurchase of common stock	(55,804) —	
Net cash (used in) provided by financing activities	(57,167	) 6,305	
Effect of exchange rate changes on cash and cash equivalents	11,708	(13,128)
Increase in cash and cash equivalents	26,424	20,094	
Cash and cash equivalents, beginning of period	\$698,649	\$590,179	
Cash and cash equivalents, end of period	\$725,073	\$610,273	
See accompanying notes to the interim consolidated financial statements			

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NOTES TO THE UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except per share and store count information, unless otherwise indicated)

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, manufacture and distribution of healthy lifestyle inspired athletic apparel, which is sold through a chain of corporate-owned and operated retail stores, direct to consumer through e-commerce, showrooms, a network of wholesale accounts, outlets and warehouse sales. The Company's primary markets are the United States, Canada, Australia, New Zealand, and the United Kingdom, where 185, 54, 25, five, and one corporate-owned store(s) were in operation as of August 3, 2014, respectively. There were a total of 270 and 254 corporate-owned stores in operation as of August 3, 2014 and February 2, 2014, respectively.

Basis of presentation

The unaudited interim consolidated financial statements as of August 3, 2014 and for the thirteen and twenty-six weeks ended August 3, 2014 and August 4, 2013 are presented using the United States dollar and have been prepared by the Company under the rules and regulations of the Securities and Exchange Commission ("SEC"). In the opinion of management, 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 2, 2014 is derived from the Company's audited consolidated financial statements and notes for the fiscal year ended February 2, 2014, included in Item 8 in the fiscal 2013 Annual Report on Form 10-K filed with the SEC on March 27, 2014. 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 the Company's 2013 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 2014 will end on February 1, 2015.

The Company's business is affected by the pattern of seasonality common to most retail apparel businesses. The results for the periods presented are not necessarily indicative of future financial results.

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

NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS

In April 2014, the FASB amended ASC Topic 205 Presentation of Financial Statements ("ASC 205") and ASC Topic 360 Property, Plant, and Equipment ("ASC 360") to change the criteria for reporting discontinued operations. The amendments also require new disclosures about discontinued operations and disposals of components of an entity that do not qualify for discontinued operations reporting. The amendments in this update are effective for all disposals of components of an entity that occur within annual periods beginning on or after December 15, 2014, and interim periods within annual periods beginning on or after December 15, 2015. Early adoption is permitted. The Company early adopted these amendments in the first quarter of fiscal 2014 with no impact on the Company's consolidated financial statements.

In May 2014, the FASB issued ASC Topic 606 Revenue from Contracts with Customers ("ASC 606"), which supersedes the revenue recognition requirements in ASC Topic 605 Revenue Recognition, including most industry-specific revenue recognition guidance throughout the Industry Topics of the Codification. This guidance requires that an entity recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services, and expands the related disclosure requirements. This guidance is effective for public companies for years,

and interim periods within those years, beginning on or after December 15, 2016, and early application is not permitted. The Company has not yet determined the impact this guidance may have on its consolidated financial statements.

In June 2014, the FASB amended ASC Topic 718 Compensation - Stock Compensation ("ASC 718") for share-based payments in which the terms of the award provide that a performance target can be achieved after the requisite service period. The amendments require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. This guidance is effective for public companies for years, and interim periods

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within those years, beginning on or after December 15, 2015, and early application is permitted. The Company has not yet determined the impact this guidance may have on its consolidated financial statements.

NOTE 3. STOCK-BASED COMPENSATION**Stock-based compensation plans**

The Company's 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 \$3,369 and \$8,288 for the twenty-six weeks ended August 3, 2014 and August 4, 2013, respectively. Total unrecognized compensation cost for all stock-based compensation plans was \$20,731 at August 3, 2014, which is expected to be recognized over a weighted-average period of 2.5 years.

Company stock options, performance-based restricted stock units, restricted shares and restricted stock units

A summary of the Company's stock option, performance-based restricted stock unit, restricted share and restricted stock unit activity as of August 3, 2014 and changes during the twenty-six week period then ended is presented below:

	Stock Options		Performance-Based Restricted Stock Units		Restricted Shares		Restricted Stock Units	
	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
Balance at February 2, 2014	669	\$ 30.76	428	\$ 57.08	57	\$ 51.99	—	\$ —
Granted	206	52.30	300	49.87	29	38.25	23	50.53
Exercised	125	18.00	171	38.85	14	64.30	—	—
Forfeited	44	60.72	46	60.81	—	—	1	52.59
Balance at August 3, 2014	706	\$ 37.44	511	\$ 58.60	72	\$ 43.69	22	\$ 50.47
Exercisable at August 3, 2014	356	\$ 20.32						

The fair value of each stock option granted is estimated on date of grant using the Black-Scholes model. The assumptions used to calculate the fair value of 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 historical experience of similar awards, giving consideration for expectations of future employee behavior. Expected volatility is based upon the historical volatility of the Company's 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 in effect on the first day of fiscal 2014 for the period corresponding with the expected term of the options. The following assumptions were used in calculating the fair value of stock options granted in fiscal 2014:

	Stock Options Granted During Fiscal 2014	
Expected term	4.0 years	
Expected volatility	45.93	%
Risk-free interest rate	1.04	%
Dividend yield	—	%

The Company's performance-based restricted stock units are awarded to eligible employees and entitle the grantee to receive a maximum of 1.5 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 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.

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Employee stock purchase plan

The Company's Board of Directors and stockholders approved the Company's Employee Share Purchase Plan ("ESPP") in September 2007. Contributions are determined by eligible employees, subject to certain limits as defined in the ESPP, and the Company matches one-third of that amount. The maximum number of shares available under the ESPP is 6,000 shares. During the thirteen weeks ended August 3, 2014, there were 45 shares purchased under the ESPP in the open market.

NOTE 4. EARNINGS PER SHARE

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

	Thirteen Weeks Ended August 3, 2014	Thirteen Weeks Ended August 4, 2013	Twenty-Six Weeks Ended August 3, 2014	Twenty-Six Weeks Ended August 4, 2013
Net income	\$48,748	\$56,465	\$67,729	\$103,743
Basic weighted-average number of shares outstanding	145,180	144,818	145,282	144,650
Effect of stock options assumed exercised	364	1,098	433	1,251
Diluted weighted-average number of shares outstanding	145,544	145,916	145,715	145,901
Basic earnings per share	\$0.34	\$0.39	\$0.47	\$0.72
Diluted earnings per share	\$0.33	\$0.39	\$0.46	\$0.71

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 twenty-six weeks ended August 3, 2014 and August 4, 2013, 288 and 49 stock options, respectively, were anti-dilutive to earnings per share and therefore have been excluded from the computation of diluted earnings per share.

On June 11, 2014 the Company's Board of Directors approved a program to repurchase shares of the Company's common stock up to an aggregate value of \$450,000. The common stock is to be repurchased in the open market at prevailing market prices, with the timing and actual number of shares to be repurchased depending upon market conditions and other factors. The program is expected to be completed by June 2016. During the thirteen weeks ended August 3, 2014, 1,422 shares were repurchased under the program at a total cost of \$55,804. Subsequent to August 3, 2014, and up to September 8, 2014, 775 shares were repurchased at a total cost of \$30,642.

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NOTE 5. SUPPLEMENTARY FINANCIAL INFORMATION

A summary of certain balance sheet accounts is as follows:

	August 3, 2014	February 2, 2014
Inventories:		
Finished goods	\$187,402	\$196,292
Provision to reduce inventory to market value	(10,900)	) (10,202
	\$176,502	\$186,090
Prepaid expenses and other current assets:		
Prepaid tax installments	\$31,122	\$25,211
Prepaid expenses	32,570	20,986
	\$63,692	\$46,197
Property and equipment:		
Land	\$69,155	\$67,903
Buildings	26,972	20,407
Leasehold improvements	163,869	140,748
Furniture and fixtures	46,565	41,400
Computer hardware	33,712	29,497
Computer software	84,034	70,537
Equipment and vehicles	5,625	4,108
Accumulated amortization and depreciation	(144,083)	) (118,997
	\$285,849	\$255,603
Goodwill and intangible assets:		
Goodwill	\$25,496	\$25,496
Changes in foreign currency exchange rates	(91)	) (217
	25,405	25,279
Reacquired franchise rights	10,630	10,630
Accumulated amortization	(8,240)	) (7,830
Changes in foreign currency exchange rates	143	122
	2,533	2,922
	\$27,938	\$28,201
Accrued liabilities:		
Inventory purchases	\$16,707	\$12,715
Sales tax collected	8,508	8,341
Accrued rent	4,730	5,936
Other	21,447	15,318
	\$51,392	\$42,310
Non-current liabilities:		
Deferred lease liability	\$19,168	\$17,994
Tenant inducements	18,706	17,521
Deferred income tax liability	18,479	3,977
	\$56,353	\$39,492

NOTE 6. LEGAL PROCEEDINGS

On October 25, 2013, plaintiff Laborers' District Council Industry Pension Fund filed a books-and-records action in the Delaware Court of Chancery entitled Laborers' District Council Construction Industry Pension Fund v. lululemon athletica inc., C.A. No. 9039-VCP (Del. Ch.) under 8 Del. C. Sec. 220 based on a demand letter it sent to the Company on or around August 8, 2013 to request certain lululemon records relating to the March 2013 sheer Luon issue, the Company's announcement

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that its then CEO, Christine Day, intended to resign, and certain stock trades executed by the then-Chairman of the Company's board of directors, Mr. Wilson, prior to the Company's announcement regarding its former CEO, Christine Day. The Court held a one-day trial on February 19, 2014, which took the form of an oral argument. On April 2, 2014, the Court rejected the majority of books and records sought by plaintiff and ordered the Company to produce a narrow category of documents relating to one trade made by the Company's former Chairman. On June 11, 2014, the Court consolidated this action with the action captioned Hallandale Beach Police Officers and Firefighters' Personnel Retirement Fund v. lululemon athletica inc., C.A. No. 8522-VCP (Del. Ch.), which is described below. On June 13, 2014, Plaintiffs filed a Motion to Enforce the Court's April 2, 2014 Telephonic Rulings and Compel in Camera Inspection of Withheld and Redacted Documents, which remains pending. The Company believes there is no merit to the motion.

On August 12, 2013 and August 23, 2013, plaintiffs Thomas Canty and Tammy Federman filed shareholder derivative actions entitled Canty v. Day, et al., No. 13-CV-5629 (S.D.N.Y.) and Federman v. Day, et al., No. 13-CV-5977 (S.D.N.Y.). Plaintiffs allege that they are acting on behalf of the Company and name as defendants current and former directors and certain officers of the Company. On January 17, 2014, plaintiffs filed an amended complaint, operative in both actions. In that amended complaint, plaintiffs challenge certain public disclosures and conduct relating to the March 2013 sheer Luon issue, the June 2013 announcement regarding the resignation of the Company's former CEO, Christine Day, and certain stock trades executed by Mr. Wilson and Ms. Day in the months leading up to that announcement. Plaintiffs allege violations of Section 14(a) of the Securities Exchange Act and breach of fiduciary duty, unjust enrichment, abuse of control, and gross mismanagement. On April 9, 2014, the Court dismissed all of plaintiffs' claims due to plaintiffs' failure to make a pre-suit demand. On May 9, 2014, plaintiff in the Canty action filed a notice of appeal to the United States Court of Appeals for the Second Circuit. The Company believes there is no merit to the appeal.

On July 2, 2013, plaintiff Houssam Alkhoury filed a putative shareholder class action entitled Alkhoury v. lululemon athletica inc., et al., No. 13-CV-4596 (S.D.N.Y.) against lululemon, a certain director and a certain officer of the Company (collectively, "Defendants"). On October 1, 2013, the Court appointed Louisiana Sheriffs' Pension & Relief Fund as Lead Plaintiff and on November 1, 2013, Lead Plaintiff filed a consolidated class action complaint on behalf of a proposed class of purchasers of lululemon stock between September 7, 2012 through June 11, 2013 (the "Complaint"). In its Complaint, Lead Plaintiff asserted causes of action under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 against Defendants based on certain public disclosures made by the Company relating to lululemon's product quality and the March 2013 sheer Luon issue. On January 15, 2014, Lead Plaintiff filed a consolidated amended class action complaint (the "Amended Complaint") on behalf of a proposed class of purchasers of lululemon stock between September 7, 2012 through January 10, 2014. In its Amended Complaint, Lead Plaintiff added new claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 based on certain of lululemon's public disclosures related to the Company's ongoing quality control improvements and the impact of those improvements on the Company's financial results. On April 18, 2014, the Court dismissed all of Lead Plaintiff's claims for failure to state a claim. On May 16, 2014, Lead Plaintiff filed a notice of appeal to the United States Court of Appeals for the Second Circuit. The Company believes there is no merit to the appeal.

On May 3, 2013, plaintiff Hallandale Beach Police Officers and Firefighters' Personnel Retirement Fund filed a books-and-records action in the Delaware Court of Chancery entitled Hallandale Beach Police Officers and Firefighters' Personnel Retirement Fund v. lululemon athletica inc., C.A. No. 8522-VCP (Del. Ch.) under 8 Del. C. Sec. 220 based on a demand letter it sent to the Company on April 17, 2013 to request certain lululemon records relating to the March 2013 sheer Luon issue and revisions to the Company's executive bonus plan. The Company moved to dismiss the complaint on May 28, 2013. On June 14, 2013, plaintiff sent a supplemental demand letter that requested additional records from the Company relating to the Company's announcement that Christine Day intended to resign as the Company's Chief Executive Officer, and certain stock trades executed by the Company's then-Chairman, Mr. Wilson, prior to the Company's announcement regarding Ms. Day. On July 1, 2013, plaintiff filed an amended complaint to incorporate allegations relating to the June 14, 2013 supplemental demand letter. The Company moved to dismiss the amended complaint on August 15, 2013, and in response to this filing, plaintiffs

served the Company with a new demand letter and then filed a second amended complaint on November 4, 2013. The Company moved to dismiss the second amended complaint on December 4, 2013 and the Court held argument on the motion on February 5, 2014. On April 2, 2014, the Court rejected the majority of books and records sought by plaintiff and ordered the Company to produce a narrow category of documents relating to one trade made by the Company's former Chairman. On June 11, 2014 the Court consolidated this action with the action captioned Laborers' District Council Construction Industry Pension Fund v. lululemon athletica inc., C.A. No. 9039-VCP (Del. Ch.) which is described above. On June 13, 2014 Plaintiffs filed a Motion to Enforce the Court's April 2, 2014 Telephonic Rulings and Compel in Camera Inspection of Withheld and Redacted Documents, which remains pending. The Company believes there is no merit to the motion.

The Company has indemnification agreements with certain of its current and former officers and directors that may require it, among other things, to indemnify such current or former officers and directors against certain liabilities that may arise by reason of their status or service as directors or officers and to advance their expenses incurred as a result of any proceeding against them as to which they could be indemnified.

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The Company is unable at this time to predict the amount of its legal expenses associated with these proceedings and any settlement or damages associated with these matters. In the event that the Company is unsuccessful in its defense, or if the Company pursues settlement with regard to any of these actions, the Company could be required to pay significant final settlement amounts and/or judgments that exceed the limits of its insurance policies or the carriers may decline to fund such final settlements and/or judgments, which could have a material adverse effect on the Company's financial condition and liquidity. Regardless of whether any of the claims asserted against the Company in these actions are valid, or whether the Company is ultimately held liable, such litigation may be expensive to defend and may divert resources away from the Company's operations and negatively impact earnings. Further, the Company may not be able to obtain adequate insurance to protect it from these types of litigation matters or extraordinary business losses.

In addition to the legal matters described above, the Company is, from time to time, involved in routine legal matters incidental to its business. The Company believes the ultimate resolution of any such current proceeding will not have a material adverse effect on its continued financial position, results of operations or cash flows.

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NOTE 7. SEGMENT REPORTING

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 corporate-owned stores, direct to consumer and other. Direct to consumer includes sales from the Company's e-commerce websites. Showroom sales, sales to wholesale accounts, outlet sales and warehouse sales have been combined into other. The Company has reviewed the classification of its expenses amongst its reportable segments and has updated the classification of some of these expenses. Accordingly, all prior year comparable information has been reclassified to conform to the current year classification. Information for these segments is detailed in the table below:

	Thirteen Weeks Ended August 3, 2014	Thirteen Weeks Ended August 4, 2013	Twenty-Six Weeks Ended August 3, 2014	Twenty-Six Weeks Ended August 4, 2013
Net revenue:				
Corporate-owned stores	\$294,040	\$273,768	\$582,142	\$543,126
Direct to consumer	63,481	49,384	129,455	103,350
Other	33,187	21,361	63,729	43,819
	\$390,708	\$344,513	\$775,326	\$690,295
Income from operations before general corporate expense:				
Corporate-owned stores	\$74,891	\$83,226	\$150,596	\$154,099
Direct to consumer	24,087	19,828	51,182	41,023
Other	3,496	3,720	6,786	8,082
	102,474	106,774	208,564	203,204
General corporate expense	34,586	27,788	70,875	58,329
Income from operations	67,888	78,986	137,689	144,875
Other income (expense), net	1,890	1,295	3,533	2,796
Income before provision for income taxes	\$69,778	\$80,281	\$141,222	\$147,671
Capital expenditures:				
Corporate-owned stores	\$15,805	\$15,852	\$31,671	\$26,441
Direct to consumer	3,751	2,392	4,863	2,763
Corporate	7,099	4,794	15,568	14,810
	\$26,655	\$23,038	\$52,102	\$44,014
Depreciation:				
Corporate-owned stores	\$9,027	\$7,509	\$17,424	\$15,003
Direct to consumer	1,255	1,118	2,261	2,113
Corporate	3,354	3,451	6,412	6,691
	\$13,636	\$12,078	\$26,097	\$23,807

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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 Section 27A of the Securities Act of 1933 and the Private Securities Litigation Reform Act of 1995. 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.

Our 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 2014 will end on February 1, 2015.

We will 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

Fiscal 2014 is a transitional year, as we focus on building a scalable foundation to support and drive growth in our businesses. In addition to our plans for North American and international expansion, we are also focused on initiatives related to rebuilding our brand experience, connecting with our guests and communities, and creating innovative, technical and beautiful product. We continue to invest in our product quality and supply chain, as we believe this is the foundation of our guest loyalty. Our focus on building foundation will also extend to our other categories, including our men's and ivivva business, where we see potential for future expansion. We believe our strong cash flow generation, solid balance sheet and healthy liquidity provide us with the financial flexibility to execute the initiatives which we believe will continue to lead our profitable growth.

Throughout the first two quarters of fiscal 2014, we were able to grow our e-commerce business which we believe has further increased our brand awareness and has made our product available in new markets, including those outside of North America. Net revenue from our direct to consumer channel increased 25% and, represented 16.7% of total revenue in the first two quarters of fiscal 2014 compared to 15.0% of total revenue in the same period of the prior year. Continuing increases in traffic on our e-commerce website lead us to believe that there is potential for our direct to consumer segment to become an increasingly substantial part of our business and we plan to continue to commit a significant portion of our resources to further developing this channel.

We increased our store base through execution of our real estate strategy, when and where we saw opportunities for success. We opened seven net new corporate-owned stores during the second quarter of fiscal 2014. We also opened our East Coast distribution center in Columbus, Ohio during the second quarter of fiscal 2014. Where we find opportunities for growth through opening showrooms, or other community presence efforts, we expect to expand our store base and therefore our business. Our growth strategy relies on expansion in North America, particularly in the United States. We also believe that international growth is an opportunity and are expanding our foothold in markets by establishing local community connections, distributing to strategic sales partners and opening showrooms where we believe we can successfully seed the markets.

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Operating Segment Overview

lululemon is a designer and retailer of technical athletic apparel operating primarily in North America and Australia. Our healthy lifestyle inspired athletic apparel is marketed under the lululemon athletica and ivivva athletica brand names. Collectively our brands offer a comprehensive line of apparel and accessories including pants, shorts, tops and jackets designed for athletic pursuits such as yoga, running and general fitness, and dance-inspired apparel for female youth. As of August 3, 2014, our branded apparel was principally sold through 270 corporate-owned stores that are located in the United States, Canada, Australia, New Zealand and the United Kingdom and via our e-commerce websites included in our direct to consumer sales channel. We believe our vertical retail strategy allows us to interact more directly with and gain insights from our guests while providing us with greater control of our brand. In the thirteen week period ended August 3, 2014, 67% of our net revenue was derived from the sales of our products in the United States, 26% of our net revenue was derived from sales of our products in Canada, and 7% of our net revenue was derived from sales of our products outside of North America. In the thirteen week period ended August 4, 2013, 64% of our net revenue was derived from the sales of our products in the United States, 30% of our net revenue was derived from sales of our products in Canada, and 6% of our net revenue was derived from sales of our products outside of North America.

Our net revenue increased from \$1.4 billion in fiscal 2012 to \$1.6 billion in fiscal 2013, representing an annual growth rate of 16%. Our net revenue also increased from \$344.5 million in the second quarter of fiscal 2013 to \$390.7 million in second quarter of fiscal 2014, representing an 13% increase, and total comparable sales, which includes comparable store sales and direct to consumer, decreased 1% in the second quarter of fiscal 2014 compared to the second quarter of fiscal 2013. Excluding the effect of foreign currency fluctuations, total comparable sales would have remained flat. Our ability to open new stores has been driven by increasing demand for our technical athletic apparel and a growing recognition of the lululemon athletica brand. We believe our superior products, strategic store locations, inviting guest experience and distinctive corporate culture are responsible for our strong financial performance.

We have three reportable segments: corporate-owned stores, direct to consumer and other. We report our segments based on the financial information we use in managing our businesses. While we prepare financial information for each corporate-owned store, we have aggregated all of the corporate-owned stores into one reportable segment due to the similarities in the economic and other characteristics of these stores. Our direct to consumer segment accounted for 16.2% of our net revenue in second quarter of fiscal 2014, compared to 14.3% in the second quarter of fiscal 2013. Our other segment, consisting of sales from company-operated showrooms, sales to wholesale accounts, outlets and warehouse sales, accounted for less than 10% of our net revenue in the first two quarters of fiscal 2014 and fiscal 2013.

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Results of Operations

Thirteen Week Results

The following table summarizes key components of our results of operations for the thirteen weeks ended August 3, 2014 and August 4, 2013. The operating results are expressed in dollar amounts. The percentages are presented as a percentage of net revenue.

	Thirteen Weeks Ended August 3, 2014 and August 4, 2013			
	2014 (In thousands)	2013	2014 (Percentages)	2013
Net revenue	\$390,708	\$344,513	100.0	100.0
Cost of goods sold	193,401	158,558	49.5	46.0
Gross profit	197,307	185,955	50.5	54.0
Selling, general and administrative expenses	129,419	106,969	33.1	31.1
Income from operations	67,888	78,986	17.4	22.9
Other income (expense), net	1,890	1,295	0.5	0.4
Income before provision for income taxes	69,778	80,281	17.9	23.3
Provision for income taxes	21,030	23,816	5.4	6.9
Net income	\$48,748	\$56,465	12.5	16.4
Net Revenue				

Net revenue increased \$46.2 million, or 13%, to \$390.7 million for the second quarter of fiscal 2014 from \$344.5 million for the second quarter of fiscal 2013. Assuming the average exchange rates for the second quarter of fiscal 2014 remained constant with the average exchange rates for the second quarter of fiscal 2013, our net revenue would have increased \$51.3 million, or 15%.

The net revenue increase was driven by sales from new stores opened and the growth of our direct to consumer segment. Total comparable sales, which includes comparable store sales and direct to consumer decreased 1% in the second quarter of fiscal 2014 compared to the second quarter of fiscal 2013. Excluding the effect of foreign currency fluctuations, total comparable sales would have remained flat.

Our net revenue on a segment basis for the thirteen weeks ended August 3, 2014 and August 4, 2013 is summarized below. Net revenue is expressed in dollar amounts. The percentages are presented as a percentage of total net revenue.

	Thirteen Weeks Ended August 3, 2014 and August 4, 2013			
	2014 (In thousands)	2013	2014 (Percentages)	2013
Corporate-owned stores	\$294,040	\$273,768	75.3	79.5
Direct to consumer	63,481	49,384	16.2	14.3
Other	33,187	21,361	8.5	6.2
Net revenue	\$390,708	\$344,513	100.0	100.0

Corporate-Owned Stores. Net revenue from our corporate-owned stores segment increased \$20.3 million, or 7%, to \$294.0 million in the second quarter of fiscal 2014 from \$273.8 million in the second quarter of fiscal 2013. Net revenue from corporate-owned stores we opened subsequent to August 4, 2013, and therefore not included in comparable store sales, contributed \$39.2 million to the increase. Net new store openings since the second quarter of fiscal 2013 included 38 stores in the United States, one store in Canada, one store in Australia, three stores in New Zealand and one store in the United Kingdom. The increase in net revenue from our corporate-owned stores segment was offset by a comparable store sales decrease of 7% in the second quarter of fiscal 2014 compared to the second quarter of fiscal 2013, which resulted in an \$18.9 million decrease to net revenue, including the effect of foreign currency fluctuations. Excluding the effect of foreign currency fluctuations, comparable store sales would have decreased 5%, or \$15.5 million, in the second quarter of fiscal 2014. The comparable store sales decrease was primarily the result of decreased traffic.

Direct to Consumer. Net revenue from our direct to consumer segment increased \$14.1 million, or 29%, to \$63.5 million in the second quarter of fiscal 2014 from \$49.4 million in the second quarter of fiscal 2013. The increase in net revenue was primarily the result of increasing traffic on our e-commerce websites.

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Other. Net revenue from our other segment increased \$11.8 million, or 55%, to \$33.2 million in the second quarter of fiscal 2014 from \$21.4 million in the second quarter of fiscal 2013. This increase was primarily the result of six new outlets opened since the second quarter of fiscal 2013. Increased revenue from our showrooms also contributed to the increase in net revenue from our other segment. We operate our other segment to increase interest in our product in markets we have not otherwise entered with corporate-owned stores.

Gross Profit

Gross profit increased \$11.4 million, or 6%, to \$197.3 million for the second quarter of fiscal 2014 from \$185.9 million for the second quarter of fiscal 2013. Increased net revenues were partially offset by increased cost of goods sold.

The increase in gross profit was partially offset by increased costs related to our production, design, distribution and merchandising departments, as well as increases in fixed costs, such as occupancy costs and depreciation.

Gross profit as a percentage of net revenue, or gross margin, decreased by 350 basis points, to 50.5% in the second quarter of fiscal 2014 from 54.0% in the second quarter of fiscal 2013. The decrease in gross margin was primarily the result of:

- a decrease in product margin of 260 basis points primarily due to a higher mix of lower margin seasonal items and increased product costs;
- an increase in expenses related to our product and supply chain departments, relative to the increase in net revenue of 70 basis points;
- an increase in fixed costs, such as depreciation and occupancy costs, relative to the increase in net revenue, which contributed to a decrease in gross margin of 40 basis points; and
- an unfavorable impact of foreign exchange rates on product costs which contributed to a decrease in gross margin of 50 basis points.

The decrease in gross margin was partially offset by a decrease in markdowns and discounts of 70 basis points driven by high sell-through of seasonal items.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased \$22.5 million, or 21%, to \$129.4 million in the second quarter of fiscal 2014 from \$107.0 million in the second quarter of fiscal 2013. The increase in selling, general and administrative expenses was principally comprised of:

- an increase in employee costs of \$8.4 million as we experienced natural growth in labor hours associated with new corporate-owned stores, outlets, showrooms and other;
- an increase in variable store costs of \$1.2 million as a result of increased sales volume from new corporate-owned stores, outlets, showrooms and other;
- an increase in other head office costs of \$2.0 million as a result of the overall growth of our business and investment in strategic initiatives and projects;
- an increase in variable costs such as distribution costs, credit card fees and packaging related to our direct to consumer segment of \$2.3 million as a result of increased sales volume;
- an increase in administrative costs related to our direct to consumer segment of \$0.6 million associated with the growth in this channel and increased head count to support it; and
- an increase in other costs, including occupancy costs and depreciation not included in cost of goods sold, of \$8.4 million, partly as a result of a \$1.3 million foreign exchange loss in the second quarter of fiscal 2014 compared to a \$4.4 million foreign exchange gain in the second quarter of fiscal 2013.

The increase was partially offset by a decrease in head office employee costs of \$0.4 million as a result of decreased stock-based compensation expense.

As a percentage of net revenue, selling, general and administrative expenses increased 200 basis points, to 33.1% from 31.1%.

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Income from Operations

Income from operations decreased \$11.1 million, or 14%, to \$67.9 million in the second quarter of fiscal 2014 from \$79.0 million in the second quarter of fiscal 2013. The decrease was a result of increased selling, general and administrative costs of \$22.5 million, partially offset by increased gross profit of \$11.4 million.

On a segment basis, we determine income from operations without taking into account our general corporate expenses. We have reviewed our classification of our expenses amongst our reportable segments and have updated the classification of some of these expenses. Accordingly, all prior year comparable information has been reclassified to conform to the current year classification.

Income from operations before general corporate expenses for the thirteen weeks ended August 3, 2014 and August 4, 2013 is summarized below and is expressed in dollar amounts. The percentages are presented as a percentage of net revenue of the respective operating segments.

Thirteen Weeks Ended August 3, 2014 and August 4, 2013		
2014	2013	2014