A Work Project presented as part of the requirements for the Award of a Master's degree in Finance from the Nova School of Business and Economics.

Equity Research – Lululemon Athletica Inc

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Abstract: The objective of this equity analysis was to determine whether Lululemon Athletica is undervalued or overvalued to, based on that, make a recommendation to buy, sell or hold. There are no clear guidelines for stock price forecast so, in this research, quantitative (statistical and peers' analysis) and qualitative approaches were used to calculate the company's target share price. Lululemon's revenues, cost of capital and return on invested capital were estimated for the next ten years. Once the forecast was done, the Discounted Cash Flow Model was used to compute the target price. A value of $260.10 was obtained, resulting in a BUY recommendation.

Key Words: Lululemon, Valuation, Sportswear, Forecast

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LULULEMON ATHLETICA INC

COMPANY REPORT

SPORTSWEAR

3 JANUARY 2020

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The momentum of Athletic Apparel

Lululemon Succeed as Others Apparel Suffocate

- Given our projections for the next decade for **Lululemon Athletica Inc**, we are starting this article with a recommendation to **BUY**. The weighted average **target price** is **$260.10**, which gives a one-year return of **11.43%** for shareholders.

- **Strong quarter results**: Lululemon's earnings and sales in Q3 2019 beat for the 11th consecutive time **the market expectation**. As a result, Lululemon's stock price increased 88.44% last year, largely surpassing the 30.01% growth of the industry.

- **Power of Three Strategy**. Lululemon has the objective of more than doubling men and digital revenues and quadrupling international sales within the next 5 years. To accomplish it, a new strategy based on three pillars was launched: **product innovation, omni-guest experiences** and **international expansion.** This plan affects not only Lululemon's Company Operated Stores division, but also its Direct to Consumer and Others Channels segments.

- **Valuation**: To evaluate the company, the **Discounted Cash Flow Model** was used, estimating the revenues for each segment with a **cost of capital of 6.40%** and a **perpetuity growth rate of 4.12%.** The forecasted period ends in 2030 when we believe that the company will mature and therefore stabilize.

Company description

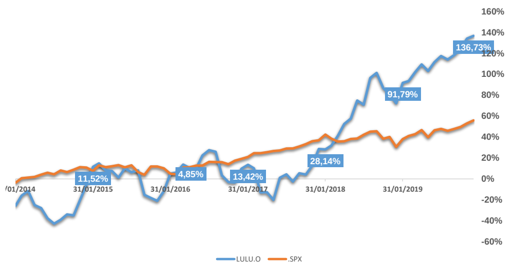
Lululemon Athletica is a yoga-inspired, technical athletic apparel company for women and men. Operates through three segments, Company Operated Stores, Digital and Other Channels. The company has been fighting to gain a place among the sportswear giants.

Recommendation:	**BUY**
Price Target FY20:	**260.10 $**
Price (as of 3-Jan-20)	**233.42 $**

Reuters: LULU.O, Bloomberg: LULU US Equity

52-week range ($)	118.28-235.50
Market Cap ($B)	29.97
Outstanding Shares (m)	123.33
Other (…)	

Source: Bloomberg and Reuters



Source: Reuters

(Values in $ millions)	2018	2019E	2020F
Revenues	3 288	3 914	5 023
EBIT	715	722	959
EBIT Margin	21.75 %	18.44 %	19.09 %
Net Profit	484	518	691
Revenues Per Segment			
Company Operated Stores	2 126	2 526	3 453
Direct to Consumer	858	1 001	1 159
Other Channels	303	386	410

Source: Company Data and Analyst Estimates

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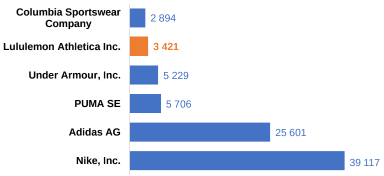
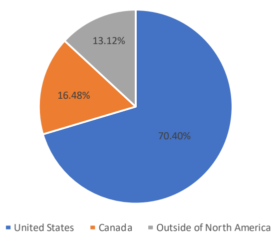
Exhibit 1: Global Sales of the Top Performance Apparel, Accessories and Footwear Companies in 2019



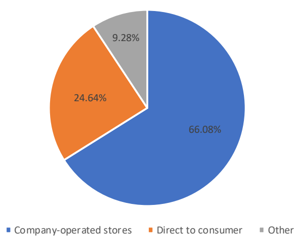
Source: Statista

Exhibit 2: Revenues by Region



Source: Company Data

Exhibit 3: Revenues by Segment



Source: Company Data

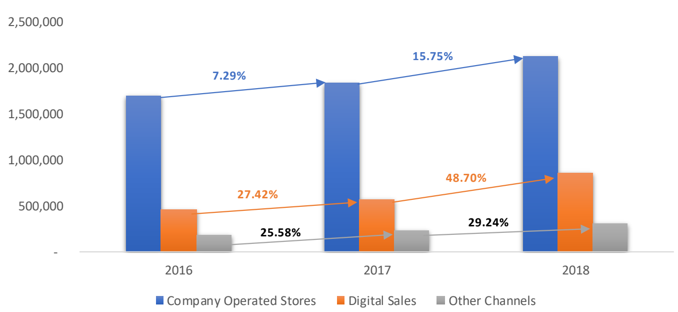
Lululemon, with headquarters in Vancouver (Canada), dates its history back to 1998. It was founded by Dennis J.Wilson and, ever since, has been committed to its mission: "*elevate the world from mediocrity to greatness*". It began as a design studio by day and a yoga studio by night, and over the years it was able to change, grow and take steps towards **establishing itself as a worlwide leading sportwear company.** At the present time, Lululemon is an international firm that provides athletic apparel and accessories for all genders, all ages and numerous sports *(see Exhibit 1)*.

Geographically, as mentioned above, the company already has a worldwide presence and is projected to increase further. At the moment, more than **85%** of Lululemon sales come from the **United States and Canada** *(see Exhibit 2).* To reduce the dependency on these markets and further develop its business, market expansion to China, APAC and EMEA regions is one of Lululemon's **"Power of Three Growth Strategy"** initiatives. As a matter of fact, **international growth** has been around **40%** in the most recent quarters, with **China reporting a massive 55% growth** in comparable sales YoY.

Lululemon is organized into three different segments: **Company-Operated Stores**, **Digital** and **Others**. Company-operated stores represent more than half of Lululemon revenues, followed by Digital with 24.64% and finally by Others with 9.28% *(see Exhibit 3).*

Regarding the evolution of **revenues**, the company grew **24.13%** in 2018**, 22.78%,** in the first quarter of 2019, **22.09%** in the second and **22.53%** in the third. With this strong performance during the first three quarters of the year, and knowing Lululemon's seasonality pattern, where the last quartar usually is stronger than the others, we estimate that the company will **reach revenues of $3.9 billion in FY19**, representing a **growth of 19.04%.** Concerning the segments, last year**, Digital witnessed** an increase of **48%**, **Company Operated Stores** raised **15.75%,** and the **Others** segment increased **29.24%.** *(see Exhibit 4)*

Exhibit 4: Revenues Growth

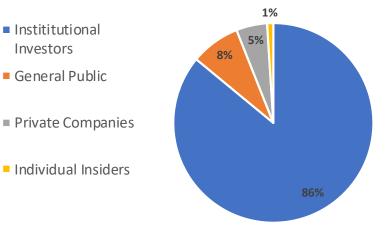


Source: Company Data

In April 2019, Lululemon announced the **"*Power of Three Growth Strategy*"** to drive growth. Despite the fact that this topic will be further discussed in the strategy section, it is important to highlight that the forecast for the next five years estimates that **men's and digital revenues will more than double and that international revenues will quadruple** as a result of this strategy**.** As a matter of fact, **Digital sales grew 35%** in **Q1 2019**, **31%** in **Q2 2019** and **30%** in **Q3 2019**, while **Men's** revenues increased **33%** in **Q1 2019**, **35%** in **Q2 2019** and **38%** in **Q3 2019**. These results, together with the current yoga and sportswear trends and Lululemon's strength as a brand, indicate that the company is very likely to **achieve its goals.**

1.1 Shareholder Structure

Exhibit 5: Shareholder Composition



Source: SimplyWall

Regarding Lululemon's Equity structure[1], it is split into four different groups *(Exhibit 5)*: **Institutional Investors**, who have the biggest share of the company, representing **86%** of total shares; **General Public,** that currently account for **8%** of total shares; **Private Companies** that currently account for **5%** of total shares; and **Individual Insiders** who own the remaining **1%** of total shares. In the last few years, the weight of **Institutional Investors has been increasing,** which shows confidence amongst professional investors. Nonetheless, if those investors change their view on Lululemon' stock, due to the significant power that they have, the value of the share can rapidly decline.

In contrast to *Nike* and *Adidas*, Lululemon's main competitors, Lululemon has **never paid cash dividends** neither is expecting to do it in the near future. However, the company has a **stock repurchase program** and, thus, has been making share buyback for quite a long time now. This program is mainly supported by the company's solid operating cash flows and cash in hand. For example, in FY2018, the company concluded with cash and cash equivalents of $881 million and operating cash flows of 742.8 million. With a new $500 million repurchase program authorized by the company, Lululemon not only **emphasizes its focus on increasing shareholder value**, but also demonstrates the c**onfidence in its own prospects**. Actually, during the first half of fiscal year 2019, the company already bought back 1.9 million shares at a cost of $165.1 million.

2. Economic Overview

Lululemon has a strategic plan to further expand its presence worldwide, being **essential to understand** both micro (regional) and macro (global) **economy drivers**.

[1] Simply Wall Source

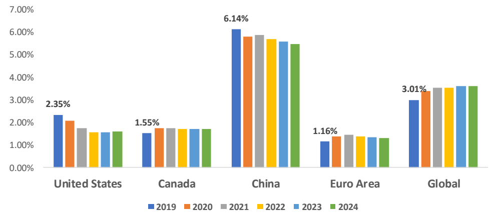
The global real GDP growth, an essential economic indicator, **is expected to be 3% in 2019**[2], which compared with the average of 3.3% observed between 2012-2019[3], is a slight slowdown. From **2020 onwards**, however, a **recovery tendency** is predicted, with an expected 3.4%[1] GDP growth in 2020. This **economic erratic behaviour** is partially **explained** by the **trade tension between the US and China**, the political uncertainty in Europe because of **Brexit** and **Catalonia** and the unexpected slowdown in some emerging markets. All this induces a lower capital investment and a weaker global demand, resulting in a decrease from 3.7% in 2018 to 1.2% in 2019 in the World Real Trade growth[2]. Thereafter, a progressive improvement to 1.6% in 2020 and 2.3% in 2021 is expected. Regarding the **inflation**[1], another important metric, a drop from 3.6% in 2018 to 3.4% in 2019 is predicted, yet a **new increase to 3.6%** is estimated for **2020**. In the long term, a **world real GDP growth of 3,2%** and an inflation rate of **3,7%** are expected in **2030**[4].

Exhibit 6: Inflation Rate (%) from 2019 to 2024

	2019	2020	2021	2022	2023	2024
United States	1,82%	2,27%	2,43%	2,34%	2,30%	2,29%
Canada	2,01%	2,03%	2,00%	2,15%	2,15%	1,99%
China	2,31%	2,43%	2,80%	2,90%	3,00%	3,00%
Euro Area	1,23%	1,38%	1,50%	1,67%	1,77%	1,84%
Global	3,41%	3,56%	3,48%	3,45%	3,43%	3,42%

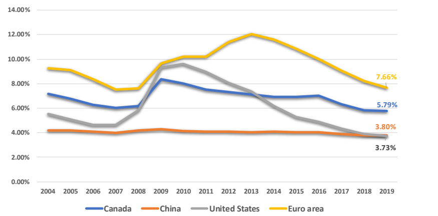
Source: International Monetary Fund and OECD

Exhibit 7: GDP Growth (%) from 2019 to 2024



Source: International Monetary Fund

Exhibit 8: Evolution of Unemployment Rate (%) from 2004 to 2019



Source: International Monetary Fund

In terms of the **unemployment rate**, it is possible to see some **signs of recovery** after the crisis period *(Exhibit 8)*, showing the current market optimism and confidence. However, the **labour market** is gradually becoming **less attractive** with a **deceleration not only** on **job creation** (1.3% in 2018-2019[2] and a decrease to 0.64% in 2020-2021[2]), leading to a predicted unemployment rate[2] of 5.2% in 2019 and around the same level in 2020 and 2021 (5.1%), **but also** on the **real wage growth** - expected to be 1.2% and 1.1% in 2018-19 and 2020-2021, respectively[2].

Exhibit 9: Unemployment Rate (%) from 2018 to 2021

	2018	2019	2020	2021
United States	3,89%	3,73%	3,53%	3,55%
Canada	5,83%	5,79%	6,00%	6,12%
China	3,80%	3,80%	3,80%	3,80%
Euro Area	8,20%	7,66%	7,47%	7,34%
Global	5,30%	5,20%	5,12%	5,10%

Source: International Monetary Fund and OECD

Another relevant indicator that shows the reluctance that consumers feel about the global economic outlook is the **Consumer Confidence Development**. As can be seen in *Exhibit 10*, the presented values indicate that consumers are expected to **keep their spending level** despite having an **increment in their purchasing power**.

Exhibit 10: Consumer Confidence Index and Consumer Confidence Development from 2017 to 2019

	Consumer Confidence Index		
	2017	2018	2019
USA	101.20	101.07	101.11
China	103.84	103.90	104.28
Euro Area	100.80	100.04	99.81
Global	100.85	100.48	100.11

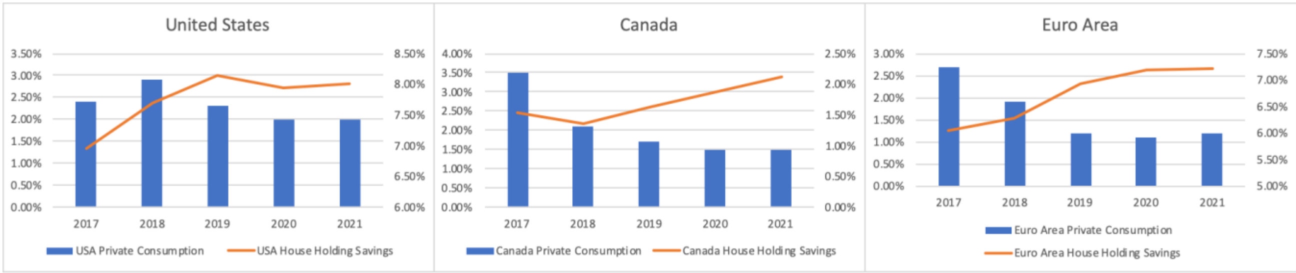
	Consumer Confidence Development		
	2017	2018	2019
USA	95.9	98.3	96.8
Canada	54.5	52.43	52.65
China	122.6	123	124.3
Euro Area	-2,8	-7,8	-7,2

Source: International Monetary Fund and Trading Economics

[2] International Monetary Fund
[3] OECD Economic Outlook
[4] Passport

This is **based on** a **private consumption drop** and on an **increasing household saving ratio** *(Exhibit 11)*. The way in which Lululemon will oppose to this tendency is a critical factor for its expansion strategy success.

Exhibit 11: Private Consumption and House Holding Saving from 2017 to 2021 (%)



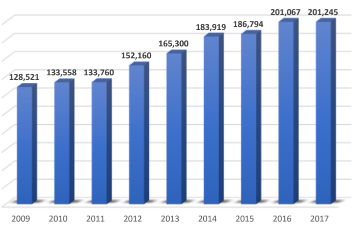
Source: OECD

3. Industry Overview

"The number tell the story: the health club industry continues to expand its presence around the globe and to serve more people every day. In 2017, health club membership topped 174 million consumers around the world"

Despite the timid growth presented in the previous chapter, the **sportswear industry future seems considerably more promising**. In the last couple of years, several factors have been identified as a plausible reason for the **extraordinary performance** that **the Global Sportswear Industry** is facing. Among these reasons are the internationalization, the popularity of sportswear as part of mainstream fashion and the new trend of health and wellness. All of these **yielded great opportunities** for **sports** and fashion **brands**. A good example of this was the rise in the number of sport clubs and gyms, which helps strengthen the concept of health as the new wealth and consequently the concept of sportswear as an important part of an active life *(Exhibit 12)*.

Exhibit 12: Total number of health clubs worldwide (in million)



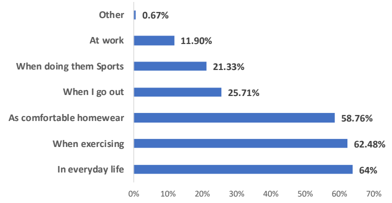
Source: Statista

Whereas before it was incredibly dangerous to enter into the fashion industry because it could damage the credibility of the brand, nowadays, and as a result of the **acceptance of sportswear** as part of mainstream fashion, **the industries are more connected than ever before**. In fact, many premium brands that were only focused on casual apparel and footwear already started selling athletic clothes and shoes.

Furthermore, due to the **health and wellness** trend people, started to construct their identities around fitness, so immediately spending money on apparel and footwear, and consequently, boosting the sales in the sportswear market. Indeed, nowadays, many people consider ***"health as the new wealth"*** and because of that they see **premium athletic** wear as a **worthy investment**. As a result, people started not only to acquire clothes for their needs from premium sportswear brands, but also to replace premium casual clothing for premium sportswear.

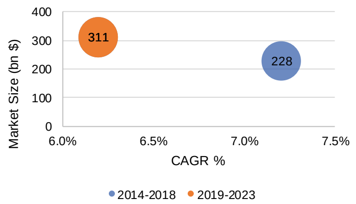
This tendency to **wear sports apparel daily** *(Exhibit 13), which* already is socially acceptable and quite mature in regions such as North America and Western Europe, in Emerging markets is only **gaining traction** now. Considering both these new

Exhibit 13: When do you wear sports?



Source: Statista

Exhibit 14: Sportswear Industry CAGR (%) and Market Size



Source: Passport

countries attraction and their large population, we can only believe that the market will not only keep its impressive/recent winning performance but also face a boost in its sales. In fact, from 2019 to 2023, *Passport* anticipates that **Asia Pacific** is going to be the region with highest **CAGR (7.99%),** followed by **Europe** and **North America** with **5.96%** and **5.23%,** respectively.

All the reasons above mentioned help explain the **remarkable industry growth**. Considering the regions where Lululemon nowadays operates, the sports apparel market grew at a **CAGR** of **7.21%** from 2014 to 2019, reaching an impressive amount of **$228 billion**. Similarly, it is estimated[5] that it will reach $**311 billion** by 2023, registering a **CARG** of **6.2%** from 2019 to 2023 *(Exhibit 14).*

Lululemon already is a part of the sportswear industry, being able to establish a **solid position** in the market mainly due to its capacity to develop **new** and **innovative products** in the past few years. The effort that the company has done so far allowed Lululemon **to increase its market share** and **confidence** among customers. Moreover, the fact that global health and wellness are becoming key indicators of the living standard allowed **Lululemon Athletica to boost its sales** as customers more and more choose to wear sportswear in social environments based on their new comfort and fitness-centric mentality. Taking in consideration the aforementioned explanation and the expectation for the whole sportswear industry, we believe that Lululemon will continue to **successfully take advantage** of the current tendencies.

3.1 Competition

The **rivalry on the sportswear** industry has **significantly increased** in recent years and is now a highly competitive sector. Even though *Nike* and *Adidas* still stand apart, many new competitors have entered the market and are getting the most from the industry changes. One of the best examples of this is *Under Armour*, a recent player, who has been able to enter this business and to content with the two major brands that controlled the industry for a long time. However, despite the growth of the sportswear market in terms of players and competitiveness, **new entrants still have room, as is proved by Lululemon.** In fact, **Lululemon CAGR** from 2014 to 2018 **surpasses** its biggest **competitors CARG**, and this can be quickly noted by glancing at *Exhibit 15.*

Exhibit 15: Revenues (in $ million) and respective growth (%) from 2014 to 2018

	Revenues					
	2014	2015	2016	2017	2018	CAGR
Nike	30,601	32,376	34,350	36,397	39,117	6.33%
		5.80%	*6.10%*	*5.96%*	*7.47%*	
Adidas	14,534	16,915	18,483	21,218	21,915	10.81%
		16.38%	*9.27%*	*14.80%*	*3.28%*	
Under Armour	3,084	3,963	4,825	4,989	5,193	13.91%
		28.50%	*21.75%*	*3.40%*	*4.09%*	
Lululemon	**1,797**	**2,060**	**2,344**	**2,649**	**3,288**	**16.30%**
		14.64%	*13.79%*	*13.01%*	*24.12%*	

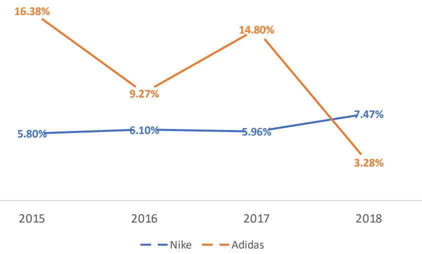
Source: Reuters

[5] Euromonitor

With intense competition in the sportwear market and with Lululemon fighting to reach a place near the major brands – *Nike*, *Adidas* and *Under Armour* –, it is important to analyse how those players with considerable size are fighting back.

Concerning ***Nike***[6], a look at the industry history immediately shows that *Nike* has been the **dominating brand** for a long time. However, this **position** is now under *Adidas* **threat.** In fact, if the growth tendency of *Adidas* and *Nike* remains unchanged, Nike will not be the top-ranking spotswear company anymore *(Exhibit 16)*.

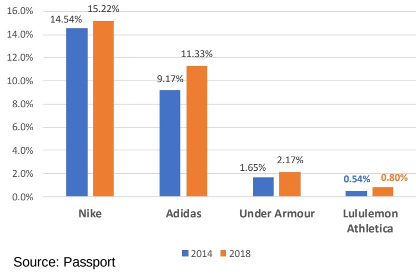
Exhibit 16: Nike vs Adidas Revenues growth from 2015 to 2018 (%)



Source: Reuters

Nowadays, about two-thirds of *Nike* total sales rely on footwear. Though, *Nike's* CEO named clothing as "one of Nike's greatest growth opportunities". In this sense, ***Nike*** already **launched a yoga collection** for both women and men. This served as a **warning signal** for Lululemon as *Nike* is currently **focused in penetrating the yoga niche**, serving both men and women at a **lower price than Lululemon** does. However, *Nike's* core business still is selling shoes and that is not expected to change in the near future, which is why we **expect Lululemon** to continue to **do well**. Moreover, *Nike* launch the "Nike Consumer Experience" which aims to improve the control over the brand image and to fortify the relation with customers. Interestingly, this **same customer approach** through digital technologies is being **followed by Lululemon**, who wants to take advantage of the growth that is facing the internet retail market.

Exhibit 17: Lululemon vs Major Competitors Market Share



Source: Passport

The information above illustrates how much ***Nike*** and **Lululemon have in common**, with **similar digital strategies** and ideas to expand their target customers. Although Nike has increased both the depth and breadth of its clothing portfolio to bring in new and more loyal clients, **Lululemon has been able to gain market share** *(Exhibit 17)*. And if, a few years ago, Lululemon could be considered a small, niche company, nowadays, this can no longer be said. In fact, with the expansion of the portfolio beyond yoga and women, Lululemon is already fighting to overtake the main brands.

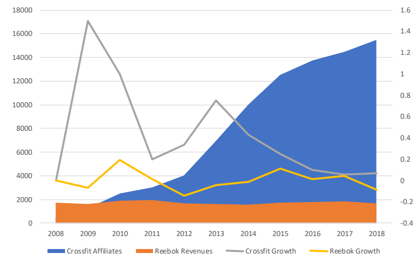
Regarding ***Adidas***[7], as aforementioned, is one of the two biggest sportswear retailers in the world and is therefore perceived by us as one of Lulemon's main competitors. Despite having faced a few bad years, with the recent change of its CEO, Adidas could be back on track and ready to **challenge** the comfortable **top market spot of *Nike*.**

The **tremendous progres**s that the company has faced lately can be partly explained by the **success of** its reinvigorated **old school models**. Knowing that nostalgia is a force to entice buyers, *Adidas* bet on the **re-launching of old shoes**, such as Stan Smith and Superstar, to **caught the attention of shoppers**, and was able to put the

[6] Information from Nike Reports and Calls and CNBC news.
[7] Information from Adidas Reports and Calls, and CNBC, Financial Times and Bloomberg News

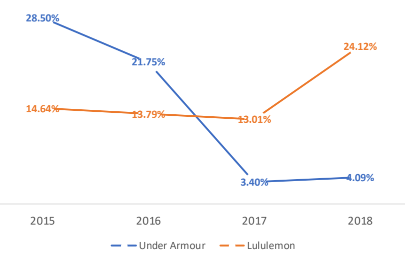
spotlight that had been missing for a very long time back on the brand. Additionally, another significant strategic decision ***Adidas*** took was to **acquire *Reebok***, a world-renowned company that **regulates CrossFit**, a sport that is booming and growing exponentially since 2012. Thus, ***Reebok***, as main Crossfit Games sponsor and partner, **expected its sales to grow at a rate that goes hand in hand with the sport boom**. However, the sales are **not reflecting** the same boom as the number of CrossFit followers *(see exhibit 18)*. Despite the growth verified in the last few years, sales are still increasing at a slower rate than the sport itself. So, it can be assumed that *Reebok* does not take all the value from this sport, **leaving an opening for Lululemon** to expand in line with its strategy: men's market and sports outside yoga.

Exhibit 18: Crossfit Affiliates vs Reebok Revenues from 2008 to 2018



As stated above, notwithstanding *Adidas* growth over the last few years, **Lululemon revenues are growing more rapidly**. At this point, it is important to highlight that **Lululemon's strength and creativity** now lie outside its origins, **converting Lululemon** into an even more **competitive brand** against the athletic giants. On top of this, the company is being able to grow all over the world, with comparable sales growth of more than 50 percent in Asia last year for example. All these indicators show that **Lululemon** is a new player to consider, **forcing the big retailers to take action if they want to keep their market share**.

Exhibit 19: Under Armour vs Lululemon Revenues growth (%) from 2015 to 2018



Source: Reuters and Company Data

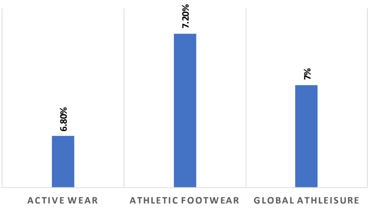
Besides the two giants, there is ***Under Armour***[8], a considerably younger top five player on the sportswear industry . After its foundation, *Under Armour* understood that they would have a long way to go in order to challenge the dominance of the big two. After some years stabilizing its status and increasing its market share, with growing sales and revenues year after year, now this **impressive momentum** seems to have **come to an end**. Looking at the last two years, it can be seen that ***Under Armour* and Lululemon's direction diverged**. *Under Armour* revenues growth decreased, whereas Lululemon revenues rose retaining its position as the leading "best breed" of the booming athletic market *(see exhibit 19)*.

Apart from this, considering CEO Kevin Plank recent words, ***Under Armour*** does not want to diversify its business from traditional footwear and sportswear. He announced that the **company desires to stick to performance products** rather than penetrating the athleisure market. Since this strategy seems to make no sense nowadays, both sides of the market were studied to better understand the expectations *(see exhibit 20)*.

The growth rates in the different sides of the market appear to be comparable, however**, markets are fragmented differently** and therefore there is difference between focusing on one side of the market (performance) or on the other (athleisure).

[8] Information from Under Armour Reports and News

Exhibit 20: Expected Performance different market sides (%)



Source: Mordot Intelligence, Report Buyer, Research and Market

For example, whereas the **performance** industry still **depends** a lot on **celebrity partnerships**, where *Nike* and *Adidas* are almost invincible, **the athleisure business** depends more on **client's loyalty** to the brand, **apparel creativity** and to its pricing strategy. This is the reason why ***Lululemon* generated double-digit growth** in recent years, being able to make a clear distinction between fast fashion and active wear.

In conclusion, it seems plausible to consider that there is a strong correlation between ***Under Armor's* hesitation** to enter in the athleisure market and its perception that it would be **difficult to beat** the competition, mainly due to the **pricing strength and customer's loyalty to the brand**. *Under Armour* is therefore focused on maximizing its market share on its core business.

4. Segmentation Analysis

Lululemon operates through three main channels: Company Operated Stores, Direct to Consumer and Others.

4.1 Company Operated Stores

"Customers want more than a simple transaction"

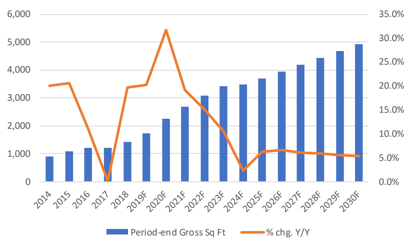
In 2018, **Company Operated Stores** were responsible for more than **64,5%** of Lululemon's total sales, converting this channel the main source of net revenue. With a **16% increase** from the previous year, reaching a value of **$2,1 billion**, these stores are expected to lead the company's expansion and growth strategy for the next years. At the end of year **2018,** Lululemon counted with **440 stores** mainly located in streets, lifestyle centres and in malls. This channel is especially important for those sectors of society that still **do not like online shopping**, and for those who, despite buying online, **enjoy in-store experiences** to try new pieces and styles.

"… Companies must optimize store foot print and learn how to use online as an extension of the in-store experience or vice-versa…"

Journal of Consumer Psychology

In order to strengthen the results of this segment, the firm includes a **real estate plan** in its growth strategy that aims not only to **open new stores** internationally, but also to **increase** their **average square footage** by a low double-digit through 2023. The **objective** is to **open new types of stores**, such as temporary pop-ups and **huge stores** up to 25,000-square-foot, that will enable the plan of co-locating - to have both men and women in the same place - and the plan to develop its new **guest experience concept**.

Exhibit 21: Square Foot (thousands) and Growth Rate (%) from 2014 to 2030



Source: Company Data and Analyst Estimates

"In November, the company will open a new store in the 5th Avenue and its second experience store inside the Mall of America"

By Lululemon' CEO

In this sense, Lululemon has recognized that the **future of in-store shopping** will **depend** on its **ability to offer a richer experience** when the customer visits their physical stores. **Otherwise**, the retail segment would **end up being cannibalized** by the digital channel instead of reinforced by it.

A good example of this approach is the newly opened Lululemon's **Chicago Store** which counts with a **restaurant area** – managed by an outside party that pays a monthly rent –, **a gym and a meditation studio**, besides the **retail space**, constituting, thus, a prototype of what many predict as the store of the future.

Finally, having a physical space where Lululemon brings together its community is essential to put in practise its omni guest experience pillar.

4.2 Direct to Consumer

Net revenue generated in **2018** by the Direct to Consumer segment was **$858.6** million, a **further improvement** over the $**577.6** million generated in **2017**. With this **49%** increase in revenue relative to the previous year, the segment reinforced its relevance for Lululemon's results. Keeping in mind that the digital channel is an effective way to raise brand awareness and to enlarge company's operating radius, the strategy considered for this segment will impact significantly Lululemon's performance over the next years. **Currently**, the company **operates** through both its **e-commerce website** and **mobile app**, with country and region personalized pages. This customization is key to attract online buyers, who want an easy, quick and safe operation. Besides those customers, the segment is particularly important for young women, who enjoy scrolling through brand websites to check their products and share their opinion with other people. Combining this segment with the Company Operated Stores segment, most of society sectors are covered**. In addition**, there is also a "**buy online pick up in store"** functionality in all North American stores which gives the customer an alternative to **experience both segments characteristics**.

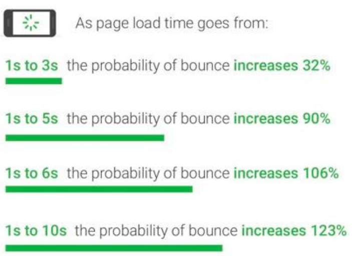
Exhibit 22: Sportswear Digital Sales and Lululemon Digital Sales CAGR from 2014 to 2018 (%)

	CAGR (2014-2018)
Lululemon Digital Sales	27.88%
Sportswear Digital Sales	24.63%

Source: Passport and Company Data

Lululemon, in order to maintain the growth trend of this segment, is **making large investments in digital marketing and advertising promotions**[9]. As a result, digital interaction experienced an **exponential increment since the 3rd quarter of 2018**, with **growth rates of 30%** in **website traffic** and **80% in e-mail shopping**. Furthermore, direct marketing-related traffic increased 60% and there was a 50% spike in transactions made by existing clients.

Exhibit 23: Digital speed vs probability of bounce



Source: Google Study

However, the company can not only focus on marketing and advertising, since **the efficiency of the digital channel is crucial** as other brands have already demonstrated. The phenomenal performance of Lululemon's competitors and peers

[9] Lululemon CEO

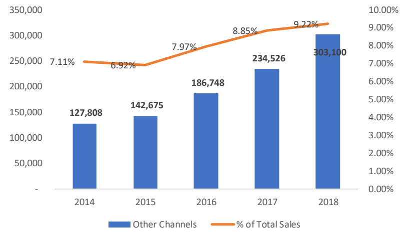
have made customers intolerants to flaws. Hence, **Lululemon must ensure high-quality services both during and after sales**. Therefore, the firm is also focused on **creating a fast and unhindered online experience** and making sure its content is frequently updated.

Finally, this **digital channel is also crucial to get rid of excess inventory**. Lululemon has a section in its website called **"We Made Too Much**" where products are added at discount prices, **creating a win-win solution** for both the company and the client.

4.3 Other Channels

Other Channels' segment increased its revenue to **$301.1 million** in 2018, which represents a growth of **29%** from the previous year. With that result, this complementary **segment accounted** for **9,2% of total sales**. This segment includes channels such as outlets and warehouses, temporary locations, wholesales and showrooms. Despite being the segment with the lowest representation, it **plays an important role** in Lululemon's strategy since, besides being used to sell excess inventory at reduced prices, it is **used to test geographies** where the brand has no presence but intends to, and to **prompt brand awareness** in specific places.

Exhibit 24: Other Channels Revenues (in thousands) and % of Total Sales from 2014 to 2018



Source: Company Data

The segment also includes **license and supply arrangements** like the ones established with partners in locations such as the United Arab Emirates, Kuwait, Qatar, Oman, Bahrain and Mexico, conceding them the right to operate Lululemon branded retail locations. Nonetheless, Lululemon preserves the right to sell through its website in those regions.

Apart from that, also included in this segment, is the **partnership** established with ***Sephora*** during fiscal year 2019 to sell Lululemon's recently launched **beauty package**, with which the **company intends** to enter the **Active Beauty market**. This partnership will enable the company to **sell its product** not only at ***Sephora's* website**, but also at **its stores**.

5. Strategy

Lululemon designed a growth strategy for the next five years based on three pillars – product innovation, omni-guest experiences and international expansion –, that will be reflected to a greater or lesser extent in each segment growth plan. The strategy will be boosted by some key drivers, which may be a result of internal and external factors, that will define the success of it. Understanding the impact of those pillars and drivers is extremely important to properly forecast the company's growth and assess its future valuation. For these reasons, the strategy will be presented pillar by pillar, detailing the effect of the drivers whenever applicable.

5.1 Product innovation

Lululemon recognized that, in order to grow, it would be **necessary to expand beyond its core business: yoga and women**. For this reason, it became a priority to **diversify its target market** and **the range of products** it offers. Therefore, besides focusing on the company's traditional women apparel, Lululemon expanded its scope by offering an **athleisure portfolio and a high-performance line** focused on strength training, running and some new categories.

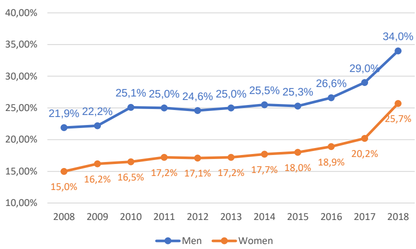
Exhibit 25: Where do you normally exercise, work out or do sport? (%) – United States

Base	Total	Female	Male
…in a sports club	16%	8%	24%
…at a gym/fitness club	39%	32%	47%
…in a yoga studio	8%	8%	8%
…in a spa	4%	3%	5%
…in school/at university	9%	8%	9%
…on my own - no club or studio	60%	69%	52%

Source: Statitsa

On one hand, the latter, despite being a line available for both genders, is seen by the company as a lure for bringing new male clients to its stores, since they usually are more attracted by these types of sports rather than yoga (*see Exhibit 25)*. As a matter of fact, **men are one of the drivers** of Lululemon's strategy. Currently, **running and training items** with anti-stink technology are the products that **most attract men** in Lululemon; they appreciate and are **willing to pay a premium**[10] for clothes with technology that boost their performance. However, this **high-performance line** is also important for the female sector, which has been facing a massive growth (*see Exhibit 26)*. Innovations such as the tank and the sport bra have increased comfort while exercising, improving women's performance and wellness during and after training. In addition to the above, the firm is also **trying to engage men into its yoga products**, making the most of their increasing participation (*see Exhibit 28)*. According to a survey conducted by *Yoga Alliance and Yoga Journal*, the **number of American men** doing yoga more than **doubled between 2012 and 2016**.

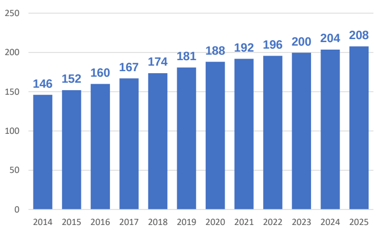
Exhibit 26: Participations in Sports by Gender in US from 2008 to 2018 (%)



Source: US Department of Health and Human Services

On the other hand, the **athleisure trend** is a driver that allows sport companies such as Lululemon to sell its products outside its natural market. It could be c**onsidered the strongest trend**[11] in the industry at the moment, thanks to its **recent acceptance and spread** across most geographies and genders. Due to the improvement in materials and innovative designs, **demand is estimated to further increase**, creating an opportunity for companies to build a high-profitable business around this trend. Despite the fact that women are the origin of this movement by wearing yoga pants and other activewear outside of the sports areas**, men are also a target sector for Lululemon** in this subject. As *Ayako Hommam*, beauty and fashion consultant at *Euromonitor International,* refers, "there is an **emerging key trend (athleisure) that changed men's perception of fashion** and its willingness to spend more time and money to improve its appearance".

Exhibit 27: Total Revenues of global sports apparel market from 2014 to 2025 (in $ billion)



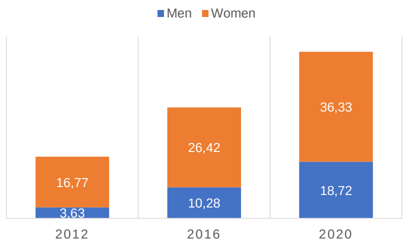
Source: Worldwide Trefis

By looking to **Lululemon's 2nd quarter results of 2019**, the firm seems to be implementing its strategy with regard to the product innovation pillar very well. For

[10] Euromonitor International
[11] The Wall Street Journal

example, **30% of Lululemon's new consumers were men**, meaning a **revenue's growth** in the **men's category of 35%.**

Exhibit 28: Yoga Participation in US by gender from 2012 to 2020 (in million)



Source: Sports Club Advisor

5.2 Omni-guest experiences

In an era in which **technology invites people to spend most of their time online**, it is crucial to **offer different and exciting experiences to customers** in order to avoid depending too much on the digital channel. For this reason, the **firm is developing a plan to offer a full experience** to its customers both outside and inside its stores. Regarding the former, the **company organizes several events** with diverse natures such as the Annual SeaWheeze Half-marathon and Sunset Festival that seek to connect the community with Lululemon's technical products and lifestyle. Concerning the inside experiences, as mentioned before, **Lululemon is setting up huge dynamic stores** where the customer will not only go shopping, but also participate in yoga or meditation sessions, have a meal or just enjoy a gym session.

The best example of **the impact that this pillar** may have on Lululemon's results is its aforementioned Chicago Store. Even being relatively recent, when compared with a traditional branch in the city, there are already some aspects that seem to prove that the new plan will succeed. Firstly, **the experiential store is attracting customers at off-hours,** meaning morning and evening periods. Secondly, **the new store keeps customers 16%**[12] **more time inside than the normal location**, which is crucial to ensure a full experience. It is important to highlight that more time inside does not necessarily mean more time shopping, since that time could have been spent at the gym, meditating or just enjoying a meal. However, in the long-term, **bringing customers to the store** will end-up meaning, with a high **probability, a raise in sales.**

5.3 International Expansion

Lululemon expects to **quadruple international revenues by 2023** based on two main premises: the **number of stores outside North America** will significantly increase (181%) and **the potential of the digital channel** will be fully exploited. Apart from this, the company intends to use the Beauty and Self Care business as a facilitator for entering new markets.

"The firm plans to launch new websites in France, Germany, Korea and Japan until then end of 2019"

By Lululemon' CEO

The **digital transformation is a critical driver** of Lululemon's worldwide growth mainly because it **allows the company to interact more closely with customers** that do not have a physical store nearby. Through its website and app, the firm is able to engage with online users, leading to a stronger brand connection and, as a consequence, additional sales. Furthermore, these platforms generate data that can be used to collect market trends in each region, which will then be used to develop

[12] Lululemon Statement

products adapted to those markets. The **digital channel is also used to disseminate Lululemon's marketing campaigns all around the world**, increasing its web traffic and, as a result, its e-commerce revenues *(Exhibit 29)*. An example of the **success that Lululemon** is facing with its digital channel is its ranking on the newly released *Internet Retailer 2019 Top*[13], where the company is ranked number 81. This makes us believe that the company will be able to fully exploit this channel as previously assumed.

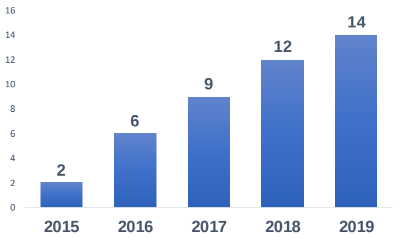
Exhibit 29: Digital Sales vs Site Traffic vs Email List 2018

	Q1 2018	Q2 2018	Q3 2018	FY 2018
Digital Sales	60%	47%	46%	48.7%
Site Traffic	40%	25%	30%	32%
Email List	110%	80%	90%	93%

Source: Company Data

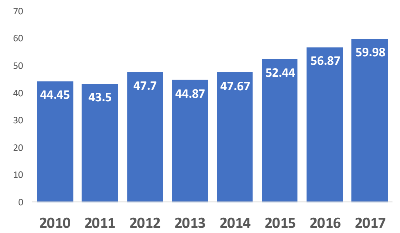
Regarding the opening of **new stores** in countries outside North America, two regions should be highlighted: **Europe** and **China**. **Europe** used to be an unexploited market. However, once successfully tested in the UK (*Exhibit 30*), the company designed a plan to expand its scope to other countries in the region. Knowing that it is a **strong market that has already adhered to the athleisure trend** and that its people care about their health and wellness, Lululemon found **an opportunity to develop its business**. **China**, another key driver, is a fast-growing market with its sportswear industry expected to expand at a **compounded annual growth rate of 10.42%**[14] until 2023. This driver is boosted by governmental reforms, such as the "2016-2020 National Fitness Plan", whose main goal is to sustain the consistent growth of the sportswear market and to create a "moderately prosperous society". It is important to highlight the fact that **China presents** a **young nation,** counting with approximately **400 million millennials**[15] which corresponds to more than the whole US population. Millennials became a **key driver of China's consumer and retail markets**[12] and are an appealing target for both performance and lifestyle sportswear. In addition, as in Europe, people are increasingly becoming more concerned about their health and wellness, which has led them to pursue an active lifestyle (*Exhibit 31*). This, together with Will's Group interest in developing partnerships with sports accessories, athleisure clothing and health product's brands, means an opportunity for Lululemon to expand there.

Exhibit 30: Evolution of Stores in UK from 2015 to 2019



Source: Company Data

Exhibit 31: Number of Members in Health and Fitness in Europe from 2010 to 2017 (in millions)



Source: Statista

6. Forecast

To **forecast Lululemon's cash flow**, a set of inputs for the DCF Model were estimated. To do that, a set of assumptions, which will be presented later in this chapter, were made.

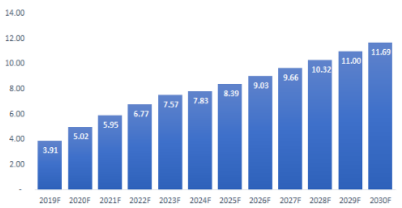
6.1 Revenues

The first step to build the DCF Model was to **estimate Lululemon's expected revenues**, since a considerable number of all financial statements depend on those

[13] Forbes
[14] Passport – Euromonitor International
[15] BBC News

Source: Analyst Estimates

Exhibit 32: Total Revenues Forecast from 2019 to 2030 (In $ Billions)



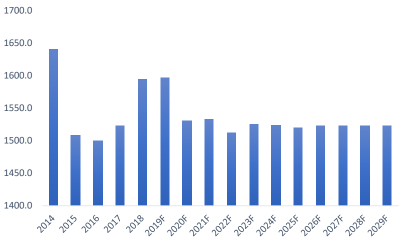
projections. Given that **Lululemon is a fashion company**, it is particularly challenging to value and predict future growth, as the sportswear industry **depends heavily on fashion trends**. It was therefore crucial to link the global economic indicators with their potential impact on the industry and on the company itself.

Apart from the above, it is important to take into consideration that **Lululemon's net revenues** usually present a **seasonal pattern**, with three almost flat first quarters and a **strong last quarter**. This behaviour has been considered during the estimation process, 2019 included, because, so far, the company only reported its results for the first three quarters. The fourth quarter end results will only be released in March 2020.

To do the analysis, company sales were divided according to the segments in which the company operates: **Company Operated Stores**, **Digital Sales** and **Other Channels.** Included in this latter segment, **the Beauty and Self Care business was studied thoroughly.**

Company Operated Stores

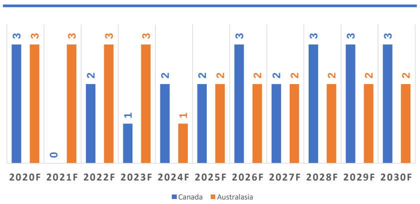
Exhibit 33: Sales per Average Square Feet from 2019 to 2030 (In $ Thousands)



Source: Company Data and Analyst Estimates

To model this segment revenues in the future, *Lululemon's* **sales** were forecasted based on the **average square feet** and the **number of stores**. During the last 5 years, **sales per average square feet** have been **stable**. For this reason, we assumed that the value will **continue** around the **same level**. Concerning the number of new stores, it will vary from region to region (Asia Pacific, Australasia, Canada, China, United States and Western Europe). To forecast the stores, it is important to consider both the estimated **sportswear industry size** (in nominal terms), and the impact that the **value drivers** will have on the demand. The evolution of the **sportswear industry in nominal terms** is particularly relevant because we found a **correlation** between the **market size growth** and the number of **stores opened**.

Exhibit 34: New Stores Per Year in Australasia and Canada from 2020 to 2030

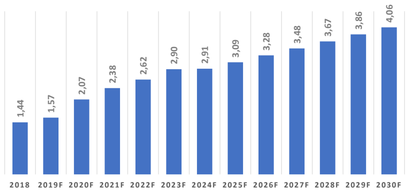


Source: Analyst Estimates

Regarding **Australasia** and **Canada**, the rationale behind the evolution of the company in those regions is similar. During the last five years, the **number of stores opened** in these regions has been relatively stable, with a yearly growth **a little lower** than the overall **sportswear industry growth.** With Lululemon's strategy to increase revenues through expanding its business to the men's market and developing products to sports other than yoga, we believe that the company will continue **opening new stores** at a steady rhythm. Therefore, we determined the number of new stores in each year based on a rolling average of the previous three year's ratio between the industry growth and the number of stores opened. As a result, from 2018 to 2030, we believe that the company will open **23** new stores in Canada and **28** new locations in Australasia, which represent, on average, two stores per year in each region. Accordingly, revenues from stores in Canada will increase from **$322 million** in 2018 to **$648 million** in 2030, and in Australasia will increase from **$181 million** in 2018 to **$477 million** in 2030.

Concerning the **United States of America,** Lululemon's home market, the number of stores has not stopped increasing, thus keeping this market as the top contributor to Lululemon's performance. Following this tendency, we expect this region to continue **leading the number of stores opened** and, consequently, representing the **biggest portion of Lululemon's revenues** in this segment. This hypothesis seems plausible not only because the buying power in the USA is higher compared to that of most of all other regions, but also because it is the company's primary market. This means that it is the region where **Lululemon will probably invest more**, providing new experiences to its customers, **enhancing the company's status and power**, and therefore forging closer and stronger links with the clients. Based on these assumptions, we projected the **number of stores** to grow from **285** in 2018 to **545** in 2030. With the average square feet remaining constant, this growth represents an **increase of approximately 80%** in revenues coming from stores in the USA, reaching an amount of **$4.06 billion in 2030.**

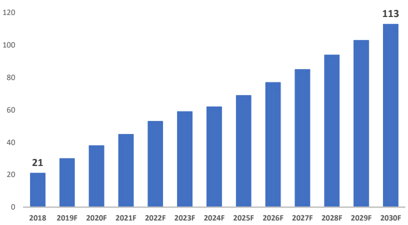
Exhibit 35: Revenues from US Stores from 2018 to 2030 (in $ billion)



Source: Company Data and Analyst Estimates

With regard to **Western Europe**, Lululemon's **market share** loss from 0.46% in 2014 to 0.30% in 2017 served as a **wake-up call** and trigger for action. It has been interpreted as a clear signal that the firm needed to strengthen its internationalization strategy. As a result, **10 stores** spread all over Europe were opened **between 2017 and 2018**, with the aim of recovering at least part of the lost market share. Since the strategy seems to be a winning tactic - in 2018 the **market share increased** to 0.36% -, we believe that the company will continue its expansion in Europe, counting a total of **92 new stores** from 2019 to 2030. The goal is to more than quadruple Lululemon's revenues over the next 10 years in this region to reach a total of **$841 million** in sales.

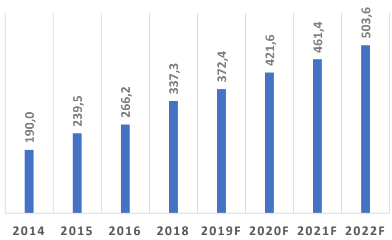
Exhibit 36: Evolution of Stores in Western Europe from 2018 to 2030



Source: Company Data and Analyst Estimates

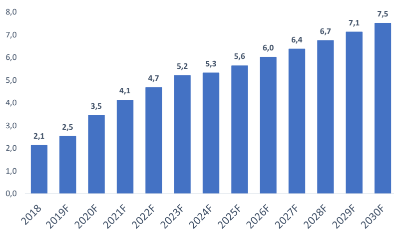
Finally, the **Asia Pacific** and **Greater China** regions are two critical strategic targets, where we estimated the highest expansion growth rates. This assumption is based on two main reasons. On the one hand, the population of **Asia** is highly **involved** in sports like **yoga**, which is one of **Lululemon's strong points**. On the other hand, the **concern with health and fitness** is now **surging** in the region, making people more aware and inevitably tempted to spend their money in sportswear apparel *(Exhibit 36)*. As a matter of fact, some of Lululemon main competitors already started to expand to this region with really good performance. By looking more in detail to **Greater China**, Lululemon already announced first quarter **sales growth of 70%** and second quarter **sales growth of more than 30%.** In order to keep this tendency, Lululemon knows that it is mandatory to boost its presence in the region, resulting in a substantial increase in the number of stores. More precisely, we expect Lululemon to open more than **100 stores in Greater China** and almost **50** in the **remaining Asia Pacific**

Exhibit 37: China Sports Industry Value from 2012 to 2022 (in $ billion)



Source: Statista

Exhibit 38: Stores Revenues Evolution from 2018 to 2030 (in $ billion)



Source: Company Data and Analyst Estimates

countries between 2019 and 2030. This massive investment in Asia should allow the company to increase its revenues from **$171 million** to **$1.5 billion** during this period.

Exhibit 39: Digital Sales Sportswear vs Lululemon CAGR (%)

	CAGR (2014-	CAGR (2018-2030)
Lululemon Digital Sales	27,88%	11,64%
Sportswear Digital Sales	24,63%	12,33%

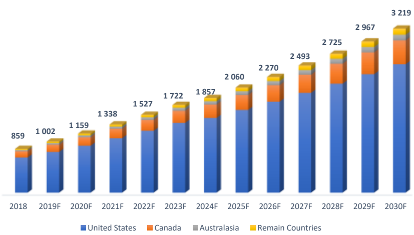
Source: Passport – Euromonitor, Company Data and Analyst Estimates

Digital Sales

Lululemon pretends to use the **power and currency of Internet** to more than double the Digital Channel earnings by 2023. According to last year results, digital sales generated **$858 million in revenue**, representing a **48%** increase compared to 2017 and a **four years CAGR of 27.88%** (*see Exhibit 39)*

To successfully forecast the revenues in this segment from 2018 to 2030, as in the previous one, a geographical division was made. However, unlike before, only four regions were considered: **Australasia, United States, Canada and Remaining Countries**. In all four regions, the **Sportswear Internet Retailing has been increasing its share** within the overall industry market, and this must be taken into consideration when forecasting future developments.

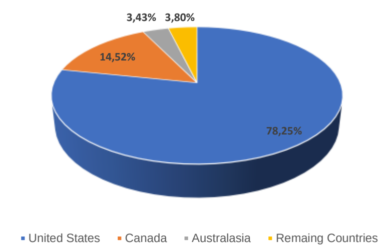
Exhibit 40: Lululemon Digital Sales Evolution from 2018 to 2030 (in $ million)



Source: Company Data and Analyst Estimates

The outlook for the segment **varies from one region to another**. In the **United States**, where Lululemon's growth rate has been higher than the US Sportswear Internet Retailing market growth rate, the **tendency is expected to continue**, although with **slight slowing**, and to contribute to increased market share. This assumption is based on the fact that the company is doing an effort not only to **improve the speed and quality of its website**, but also to **generate loyalty and retain customers from the new target marke**t. These efforts should bring more people to buy through this channel. Consequently, revenues **will increase from $690 million in 2018** to **$2.5 billion in 2030**. In **Canada**, even after solving the website problems, the company **has not been able to catch the attention of customers**, and therefore continues to lose market share. More specifically, **on average**, the **company grew 0.83 times the market** during the last five years. Since there is no **factor predicted to change this behaviour**, we believe it will persist and the company sales from this region will continue to **increase at a slower rate than the distribution channel**. Nonetheless, with the importance that this channel is gaining, Lululemon's revenues are expected to increase more than 250% by 2030, registering an **amount of $467 million**. Regarding **Australasia**, the Internet Retailing Channel is also gaining force, and Lululemon took advantage of it. Since the **company launch of its first website** in the region in 2016, the achieved **results were very good**, with the growth rate always surpassing the distribution channel growth. This example of **Lululemon's capacity to seize the opportunities offered by the Digital channel** support our belief that the company will be able to more than **quadruple its revenues**, reaching an impressive value **of $111 million in 2030**. This is reinforced by that fact that Lululemon expects to launch new specific website designs for each country that should help bring new customers. Finally, **in the rest of the world**, an **increase of**

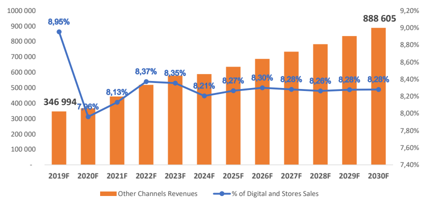
Exhibit 41: Lululemon Digital Sales per Region (%) in 2030



Source: Analyst Estimates

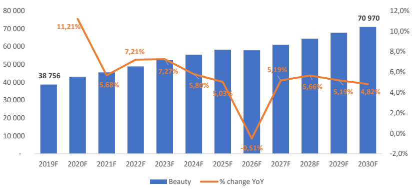
$100 million in sales is expected during the next 10 years. This prevision takes into account that Lululemon just **started to develop its website** for most of these countries last year and that some of them not only are quite used to buy online, but also have a large population. **For example**, in **China, company's sales** from this segment **increased more than 200%** in the first quarter of fiscal year 2019.

Exhibit 42: Lululemon Other Channels Revenues Evolution (in $ thousands) and % of Digital and Stores Sales from 2019 to 2030



Source: Analyst Estimates

Exhibit 43: Beauty and Self Care Revenues Evolution from 2019 to 2030 (in $ thousands)



Source: Analyst Estimates

"The partnership with Sephora extends lululemon's ability to reach new guests while partnering with an authority in the personal care space."

Investor Relations Lululemon

Other Channels and Beauty

As already stated, the **Other Channels segment** was mainly used by Lululemon to **study possible regions** in order to understand whether or not it makes sense to explore that particular place. Over the past five years, earnings from this segment represented **between 7% to 9% of total sales** (*Exhibit 42*). We believe that this percentage will remain the same in the future in what regards this particular purpose.

On top of the above, Lululemon entered a new business during fiscal year 2019: **Beauty and Self Care**. In terms of sales forecast, since it is a new business for Lululemon, *Sephora* and *TopShop* were used as a proxy. The reasons behind this decision were the fact that **Lululemon's product will be sold in *Sephora* websites and stores**, thus being probable to behave with **direct correlation** to *Sephora* products, and to the fact that ***TopShop*** is a fashion company that entered in the Beauty and Self Care business 10 years ago, **reflecting better than any other company which are the main threats and opportunities** to gain a spot in this market. Taking all these into account, we believe that for fiscal year 2019, revenues **coming from beauty will account for 1% of total revenues** and from then on, sales will moderately surpass the industry growth, therefore gaining market share in this industry. In other words, the company is **expected to start** with sales around **$39 million in 2019**, and we estimate that **in 2030** sales will reach an amount close to **$71 million.** This value is a result of the predicted growth over the years, representing a **CAGR from 2019 to 2030 of 5.65%**

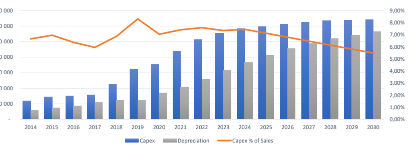
Finally, if we bring all segments together, **Lululemon's sales growth in 2019** should be around **19%.** Assuming that the company will be able to **continue standing out among its competitors**, thus being a **consumer preference**, and taking into account the revenues evolution presented in each segment, we **expect Lululemon to represent 2.89%** of the sportswear market where the company operates in 2030. This market share results in net revenues of **$11.69** billion in 2030, thus having a **CAGR** during the forecasted period of **10.46%.**

6.2 CAPEX

As mentioned before, Lululemon is currently involved in a worldwide expansion strategy, aiming to achieve a top spot in the sportswear market. With such ambition, a **considerable capital expenditure** (CAPEX) **will be needed** in the coming years.

Nevertheless, the company is expected to continue generating **a large amount of cash flow from operating activities** that could be used to finance part of the growth strategy.

Exhibit 44: CAPEX and Depreciation from 2014 to 2030 (in thousands)



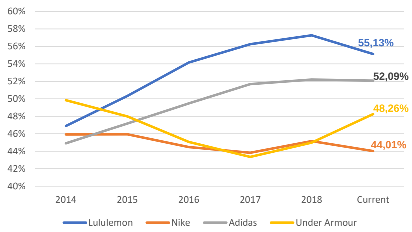
Source: Analyst Estimates

Regarding the payback of these investments, it has been **estimated** that **5% to 7%** of Lululemon's sales over the last five years were a direct result of them. This pattern is projected to remain the same at least for the internationalization period. The **high CAPEX level required** is mainly due to the construction of **new stores,** the **renovation and relocation** of the current ones**,** and the investment in **digital technology and marketing.** Based on the strategy presented before, we expect this investment level to remain high during the forecasted period.

6.3 Gross Margin

Another important factor that **distinguishes Lululemon** from its main competitors is its **Gross Margin** *(Exhibit 45)*. It is important to notice that the company has different gross margins depending on the segment. Specifically, in 2018, the **Digital Segment** presented the highest gross margin (**65%**), whereas both Company Operated Stores and Other Channels registered a gross margin of **56%.** Combining the three over the past five years, an average gross margin of **53.34%** is obtained**,** which exceeds the margins of Lululemon's main competitors. Furthermore, its gross margin was below 50% just once in these last five years.

Exhibit 45: Lululemon Vs Main Competitors Gross Margin from 2014 to 2019 (%)



Gross Margin	2014	2015	2016	2017	2018	Current
Lululemon	46,89%	**50,33%**	**54,17%**	**56,26%**	**57,27%**	**55,13%**
Nike	45,92%	45,93%	44,47%	43,83%	45,15%	44,01%
Adidas	44,90%	47,18%	49,47%	51,68%	52,21%	52,09%
Under Armour	**49,85%**	47,98%	45,06%	43,35%	44,98%	48,26%

Source: Ychart

Yet, in spite of the above, Lululemon's gross margin is not directly comparable to *Nike's*, *Adidas'* or *Under Armour's*, because while most of Lululemon's revenues come from selling **high-priced products**, its competitors also sell a considerable number of low-priced items. All this makes us believe that the **robust gross margin** presented until now is **sustainable** and is likely to continue in the coming years.

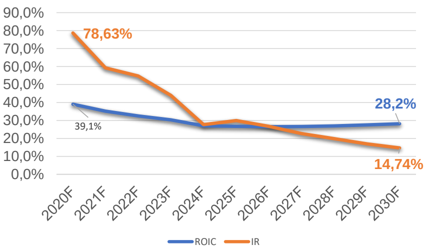
In order to keep its high gross margin, Lululemon has to apply its **premium pricing model** to its extended product mix. For this reason, we assumed that most items developed to cover men's wear and other sports will have a similar target price to the one of existing products. On top of that, Lululemon is strategically **opening new factories** with a Development Department and whitespace research, both focused in **lowering product's costs** while **designing high-quality clothes**. We think that by offering only high-quality clothes, the company preserves its brand reputation and therefore its customers loyalty. In fact, the results since 2018 show that Lululemon's popularity and market penetration is solid and promising.

For all the reasons above mentioned, we estimate a **practically unchanged gross margin** (around 55%) **over the next ten years.**

6.4 Return On Invested Capital (ROIC)

Currently, **Lululemon** has a **leading position in yoga and athleisure apparel** for women in United States and Canada, and despite the competitiveness of the industry, the company has been able to grow at double-digit rates for the past five years. This is partially explained by the firm's competitive advantage over most other brands, as shown by its average annual **ROIC**[16] that **averaged 45%** over the **past 5 years**.

Exhibit 46: Lululemon Estimated ROIC and IR (%) from 2020 to 2030



Source: Analyst Estimations

Nonetheless, it is **not clear whether** Lululemon will be **capable of maintaining its dominance** indefinitely. It is probable that its strongest competitors will readjust their strategy in order to protect their market position. Despite this fact, considering all the information available and already presented in this report, we consider that there are **solid evidences** that Lululemon will **continue to gain market share at the expense of its competitors** in the coming years.

Based on the above, we projected Lululemon's **average annual ROIC** to **exceed its weighted average cost of capital** over the next 10 years, supporting our belief that Lululemon will be able to preserve its competitive advantage. We projected the weighted average **cost of capital at 6.40%** and the **ROIC** at **29.7%** from **2020** to **2030**.

Exhibit 47: Lululemon Estimated ROIC, IR and Growth (%) from 2029 to 2030

Lululemon	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F
ROIC	81,0%	39,1%	35,2%	32,5%	30,3%	27,0%	26,7%	26,6%	26,6%	27,0%	27,5%	28,2%
IR	218,89%	78,63%	59,29%	54,77%	43,94%	27,72%	29,95%	26,71%	22,70%	19,87%	17,02%	14,74%
g	177,21%	30,72%	20,85%	17,80%	13,32%	7,50%	8,01%	7,11%	6,05%	5,36%	4,68%	4,16%

Source: Analyst Estimations

7. Valuation

7.1 Discounted Cash Flow Model

To financially evaluate Lululemon, the **Discounted Cash Flow Model** was used. This method is widely recognised as the most accurate approach to value a high-growth company, and thus it seemed the best option to simulate Lululemon's results based on its core growth drivers.

Exhibit 48: Discounted Cash flow Model Inputs

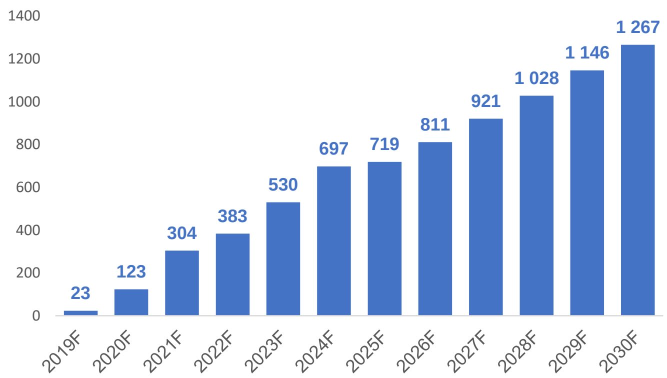
DCF Inputs	
Operating Enterprise Value	$ 34 636 052
Non Operating Enterprise Value	$ 1 259 688
Debt	$ 1 085 634
Equity Value	$ 32 290 731
Perpetual Growth	4,12%
WACC	6,40%
Nº of Sahres Outstanding (Million)	$ 123 330
Share Price	**$ 260,10**

Source: Analyst Estimations

[16] Lululemon' ROIC was calculated dividing NOPLAT of the current year by Invested Capital from previous year

Besides the 4th quarter of 2019, a total of **10 periods were forecasted**, from 2020 until 2030. After that period, the terminal value was computed since the company is expected to be mature in 2030. Moreover, given that long-term projections are highly uncertain, and even more so in high-growth companies, a scenario analysis has been made. This will be further explained in the Scenario Analysis chapter.

Exhibit 49: Lululemon Operating Free Cash Flow from 2019 to 2030 (in $ million)



Source: Analyst Estimations

Weighted Average Cost of Capital (WACC)

In order to evaluate and measure Lululemon's business competitiveness, the cost of capital was computed. The firm's cost of capital, known as **weighted average cost of capital (WACC)**, takes into consideration both the cost of equity and the cost of debt with their correspondent weights.

On the one hand, in what regards the **cost of debt**, Lululemon's whole **debt** value is based on **leases**, and this nature is not expected to change in the coming years. Hence, for the **cost of debt**, a value of **3.75%**, corresponding to the weighted average cost used by the company to discount the future lease payments and to assess its current debt, was assumed. Nonetheless, since this **nature of debt is unusual** in the sportswear industry, a second methodology was used. In this approach, the **cost of debt** equals the risk-free plus the default spread. To calculate the default spread, the interest coverage ratio, which is commonly used as an auxiliary to estimate credit ratings, was employed. A synthetic credit rating of AAA was achieved, corresponding to a **default spread** of **0.75%**. Based on this value and assuming that the **risk-free** is **1.82%**, an estimated **cost of debt** of **2.57%** was obtained.

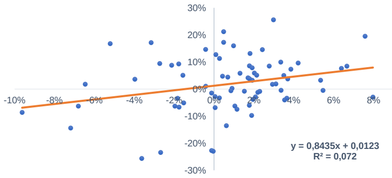
Exhibit 50: Weighted Average Cost of Capital Assumed Inputs

Inputs	
Risk Free	1,82%
Beta	0,843
MRP	5,50%
Tax Rate	21,00%
Cost of Debt	3,75%
Cost of Equity	6,46%
Target D/E	1,82%
D/V	1,78%
E/V	98,22%
WACC	**6,40%**

Source: Analyst Estimations

On the other hand, the cost of equity was given by the Capital Asset Pricing Model (CAPM). In order to compute the CAPM, the Market Risk Premium (MRP), the risk-free rate and the beta values were needed. For the **risk-free**, as used before, the current 10 year US Treasury Bond yield was considered (**1.82%**). For the **MRP,** the value assumed was **5.5%** based on Mckinsey' book recommendation. As for the **beta**, two different methods were used. In the first one, the beta was calculated correlating the excess return of Lululemon and the excess return of the Standard & Poor's 500 (S&P 500) of the past five years with a linear regression. A **raw beta of 0.843** was obtained *(see Exhibit 51)*. In the second one, a peer-related research was carried out to estimate Lululemon's beta. It was done by deriving an unlevered industry beta and then relevering the industry beta to the company's target capital structure. In this way, we firstly obtained the levered of each peer. After that, the Blume adjustment[17] was done in order to smooth raw betas. In third place, and since a comparison between firm's leveraged betas would require the same capital structure and it was not the case, comparable firm's unlevered betas were calculated. The next step was to determine the average unlevered beta using each company's obtained betas. Finally, **Lululemon's relevered beta** was estimated obtaining a value of **0.819** (*see Exhibit 52)*, which is very similar to its 0.843 levered beta obtained before.

Exhibit 51: Linear Regression Lululemon vs S&P500



Source: Reuters and Analyst Calculation

Exhibit 52: Beta Calculation using Comparables

Companies	Ticker	Market Cap	Total Net Debt	Net Debt/ Equity MV	Total Debt / Equity	Adjusted Beta	Unlevered Beta
LULULEMON ATH	**LULU US Equity**	**29 970 434 508**	**- 881 320 000**	**- 0,029**	**0,420**	**0,896**	**0,923**
ADIDAS AG	ADS GR Equity	58 206 738 604	- 1 192 000 000	- 0,020	0,280	0,803	0,820
UNDER ARMOUR-A	UAA US Equity	9 182 466 688	171 431 000	0,019	0,360	0,666	0,653
NIKE INC -CL B	NKE US Equity	158 556 085 463	- 1 184 000 000	- 0,007	0,740	0,906	0,913
PUMA SE	PUM GR Equity	10 355 691 025	- 300 300 000	- 0,029	0,530	0,663	0,683
MONCLER SPA	MONC IM Equity	10 900 135 685	- 450 109 000	- 0,041	0,362	0,798	0,832
Low				- 0,041	0,280	0,663	0,653
Average				- 0,018	0,449	0,789	0,804
Median				- 0,025	0,391	0,801	0,826
High				0,019	0,740	0,906	0,923
Adjusted Relevered Beta	**0,819**						

Source: Analyst Calculations

In view of the above, and since both betas are very similar, a decision to **use the raw beta** to compute Lululemon's **cost of equity** was taken. Additionally, Lululemon's target capital structure ratio was determined, assuming a target debt to equity ratio similar to the one of its peers. As a result, by doing an average between its peers, a **target debt to equity ratio of 1.82%** was projected, which is slightly lower (2.94%) than the current value.

Terminal Growth Rate

As above mentioned, we belive that Lululemon will **mature** in 2030. Consequently, longer-term growth rates are not expected to be as high as in the previous years. So, in order to make sure that the firm's valuation does not increase at a higher rate than the economy, we computed the Terminal Growth Rate taking into consideration the real GDP estimated for all regions where Lululemon operates. In other words, a weighted average of the real GDP of each region considered in this study was calculated and then the US projected inflation was added *(Exhibit 53)*. The weighted

[17] The Blume Adjustement = 1/3*Market Beta + 2/3 Company Beta

average was calculated based on the expected number of stores that each region will have in 2030. A **Terminal Growth Rate** of **4.12%** was obtained.

Exhibit 53: Nominal GDP Growth and Terminal Growth Value

	Number of Stores 2030	Real GDP Growth 2030	Inflation 2030	Weight
US	545	1,4%	2,0%	54,0%
Canada	87	1,5%		8,6%
Western Europe	113	1,3%		11,2%
Asia Pacific	60	4,5%		5,9%
China	140	4,6%		13,9%
Australasia	64	2,2%		6,3%

Real GDP growth	2,08%
Nominal GDP Growth	4,12%
Terminal Growth	**4,12%**

Source: Passport – Euromonitor International and Analyst Calculations

Nonethless, when assuming a perpetual growth, the level of Return on Invested Capital (ROIC) should also be considered, since this level has to be constant in order to be pleausible to assume a terminal growth. As a matter of fact, the forecasted ROIC level is stable from 2024 onwards *(Exhibit 47)*, thus it is safe to assume that the Free Cash Flow in 2034 will be perpetual.

Valuation Outcome – Base Scenario

Finally, considering the 10 years forecasted period followed by perpetuity from 2030 onwards, with a **WACC of 6.40%** and a Terminal Growth rate of **4.12%,** the **DFC Model** gives a share price value for the base scenario of $**261.82** for fiscal year end 2020**.**

7.2 Multiples Valuation

Besides the DCF Model, a second method was used to estimate Lululemon's performance. In this chapter, we are going to evaluate the company through the **Multiples Approach**, which allows for better understanding the **market perception** on Lululemon's value in comparison with other companies from the sportswear industry.

Peer Companies

Before moving on to Lululemon's multiples valuation, it is important to analyse the financial health of its **most direct peers**. For this study, in addition to the **companies** previously described in the **competition section** (*Nike, Adidas* and *Under Armour*), we analysed the trading multiples for ***Puma*** and ***Monclear SPA***. However, due to the differences between both and Lululemon in the growth projections for the near future and in their multiple's analysis, we decided **not to include them** in the final analysis. Regarding the remaining, it is important to notice that ***Nike, Adidas* and *Under Armour*** not only are, together with **Lululemon*,*** the sportswear companies selling their products at higher prices, but also have **similar strategies** to the one presented previously in this report. Therefore, the four of them can be considered premium companies which are currently fighting locally and globally to gain market share and increase their revenues. Thus, with very similar business units, structures, and strategies, an **overall picture** of how the market is looking at **premium sportswear** is given with this analysis.

Multiples Results

To evaluate Lululemon we used the **Enterprise Value to EBIT (EV/EBIT)** and the **Price to Earnings Per Share (P/EPS)** ratios. Regarding the first, Nike is the one that presented the closest value to Lululemon's **27.84x EV/EBIT current ratio**. However, after computing a **simple average** of the **EV/EBIT** ratio for the chosen peers, we got a multiple of **29.58x**, which implied a share price for Lululemon of $**228,83**. This result means that Lululemon is **overvalued**, which goes against our valuation through the DCF Model. It is important to highlight, though, that one of the lacunas of this multiple is that it only analyses the company from a static perspective, not considering neither the expected growth, nor the outcomes of it.

Exhibit 54: Multiples Ratios

Companies	EV to EBIT	P/E
LULULEMON ATH	**27,84x**	**47,95x**
ADIDAS AG	14,17x	32,83x
UNDER ARMOUR-A	51,21x	64,47x
NIKE INC -CL B	25,10x	35,53x
Low	14,17x	32,83x
Average	**29,58x**	**45,20x**
Median	26,47x	41,74x
High	51,21x	64,47x

Source: Reuters

Concerning the **P/EPS ratio**, Lululemon presented a multiple of **47.95x,** which was the second highest just below the multiple presented by Under Armour (**64.47x**). As we did for the previous ratio, we computed a simple average of the P/EPS for the chosen companies, obtaining a multiple value of **45.20x**, which implied that Lululemon share price was **$253.45.** This outcome is not only much more like the one achieved with our DCF valuation, but also is in **line with the prognostic** of Lululemon being **undervalued**. One possible explanation for these two opposite results is the above-mentioned fact that, whereas the EV/EBIT does not consider the expected growth, the P/EPS does.

8. Scenario Analysis

Taking into consideration that the previously described assumptions and risks affect the results of our model, we decided to analyze three different scenarios, estimating their likelihood of occurrence. As a result, there is the best-case scenario, the worst-case scenario and the base case scenario.

Our Discounted Cash Flow Model is based on the **base case scenario** since we believe it has the highest probability of occurrence (80%). In this scenario, it was assumed that the company is able to achieve its goal of more than **doubling the digital sales** during the next five years, increasing from $859 Million in 2018 to $1.72 Billion in 2023. Apart from that, in this scenario, we assumed that by **expanding its business** to other regions with high purchasing power and large population, such as China and Western Europe, Lululemon will be able to more than double its number of stores, and therefore to gain market share. Consequently, its **total sportswear market share** where the company operates will increase from 1.44% to **2.89%** over the next teen years. As a result of these assumptions, the scenario gives us a share price for fiscal year ended 2020 of **$261.82**, representing a total shareholder return of **12.17%.**

Regarding our **worst case scenario**, we believe that its likelihood of occurrence is only of 10%. In this case, as the name suggests, we assumed what we considered to be the worst situation that the company could face. In what regards digital sales, the company will **not even be able to double the sales**, missing this target by $13 million. It might happen if, for example, the company faces a substantial problem with its website adaptation to the different countries. Furthermore, this scenario assumes that Lululemon **will face strong entry barriers**, therefore missing the opportunity to increase sales globally at the pace that the company would expect. Consequently, its sportswear **market share** will only rise to **2.33%.** In addition, in this hypothesis, we assumed that the company will **need more capex than initially projected** due to the unexpected entry barriers. As a result, a share price for fiscal year end 2019 of **$212.64** is projected, representing a **negative** total shareholder return of **8.90%.**

Finally, we considered a **best-case scenario,** to which we assigned a 10% probability of occurrence. This scenario puts the company in line with the previous quarters, where it presented impressive results. With this assumption, Lululemon, as in the base scenario, is expected to **more than double its digital sales**, reaching $1.75 Billion in revenues just from the **digital segment**. In this scenario we assumed that Lululemon will be able to caugh **customers attention from Canada,** with sales growth rate that surprasses the expected market growth, ant therefore **regain the market share** lost in **Internet Retailing**. Besides, in our best-case scenario, the company is able to spread its business to China and Western Europe as it does in the base case scenario. All of this will lead to an increase in Lululemon's total sportwear **market share** from 1.44% to **3.11%.** Notwithstanding its ambitious nature, we truly believe that this is an achievable situation, as proven by the most recent quarters. As a result, this scenario gives us a share price for fiscal year ended 2019 of **$293.75,** representing a total shareholder return of **25,85%**

The above-mentioned scenarios were computed with the perpetual **growth rate** of 4.12%. Combining all scenarios with their respective likelihoods, we get an expected target price of **260.10$,** representing, a total shareholder return of **11.43%.**

Exhibit 55: Scenario Analysis

Perpetuity Growth= 4.12%	Probability	Digital Sales in 2018	Digital Sales in 2023	Number of Stores 2030	Price	Shareholder Return	Recommendation
Worst Scenario	10,0%	858 856	1 704 406	795	212,64	-8,90%	SELL
Base Scenario	80,0%	858 856	1 722 211	1009	261,82	12,17%	BUY
Best Scenario	10,0%	858 856	1 950 983	1009	293,75	25,85%	BUY
Expected Share Price					**260,10**	**11,43%**	**BUY**
Current Share Price	233,42						

Source: Company Data and Analyst Estimations

9. Sensitivity Analysis

Exhibit 56: Estimated possible WACC

Cost of Debt	3,75%
Beta	0,843
Wacc	6,40%
Cost of Debt	2,57%
Beta	0,843
Wacc	6,38%
Cost of Debt	3,75%
Beta	0,819
Wacc	6,26%
Cost of Debt	2,57%
Beta	0,819
Wacc	6,25%

Source: Analyst Estimation

Considering that the outcomes obtained in our Valuation Model were defined, to a large extent, by the assumptions we made, and that some of them are unpredictable and therefore have a high level of uncertainty, we decided to test the results.

For this purpose, we computed a sensitivity analysis of the target price depending on the WACC and the growth rate. As previously explained, the cost of debt and the beta, which are essential WACC inputs, were calculated throught two different methods each. Therefore, in order to define the WACC interval to be considered, a combination of the **rolling beta (0.843)** and the **relevered beta (0.819)** with the two different costs of debt obtained was made. Consequently, we have four different possible WACC values *(see exhibit 56)*.

Regarding growth, it is doubtful and volatile but, as is well known**, Lululemon long-term growth** is not forecasted to rise at levels higher than economic growth, particularly if the company matures as expected over the years. In view of this, it was decided to set an interval that not only includes the perpetual growth assumed in our Discounted Cash Flow Model **(4.12%)** but also the average growth of our main competitor **(3.97%).**

From this analysis one can perceive that the target price is very sensitive to changes on both premises, ranging from **$206.87** to **$327.12** a share. Nonetheless, most of the collected values do **not alter our opinion.**

Exhibit 57: Sensitivity Analysis Result

		Growth Rate										
		3,87%	3,92%	3,97%	4,02%	4,07%	4,12%	4,17%	4,22%	4,27%	4,32%	4,37%
WACC	5,98%	327,12	327,12	327,12	327,12	327,12	327,12	327,12	327,12	327,12	327,12	327,12
	6,08%	308,54	308,54	308,54	308,54	308,54	308,54	308,54	308,54	308,54	308,54	308,54
	6,18%	291,78	291,78	291,78	291,78	291,78	291,78	291,78	291,78	291,78	291,78	291,78
	6,28%	276,57	276,57	276,57	276,57	276,57	276,57	276,57	276,57	276,57	276,57	276,57
	6,38%	262,72	262,72	262,72	262,72	262,72	262,72	262,72	262,72	262,72	262,72	262,72
	6,40%	260,10	260,10	260,10	260,10	260,10	**260,10**	260,10	260,10	260,10	260,10	260,10
	6,50%	247,65	247,65	247,65	247,65	247,65	247,65	247,65	247,65	247,65	247,65	247,65
	6,60%	236,21	236,21	236,21	236,21	236,21	236,21	236,21	236,21	236,21	236,21	236,21
	6,70%	225,67	225,67	225,67	225,67	225,67	225,67	225,67	225,67	225,67	225,67	225,67
	6,80%	215,91	215,91	215,91	215,91	215,91	215,91	215,91	215,91	215,91	215,91	215,91
	6,90%	206,87	206,87	206,87	206,87	206,87	206,87	206,87	206,87	206,87	206,87	206,87

Income Statement

Income Statement																	
All values in $ million.	**2014**	**2015**	**2016**	**2017**	**2018**	**2019F**	**2020F**	**2021F**	**2022F**	**2023F**	**2024F**	**2025F**	**2026F**	**2027F**	**2028F**	**2029F**	**2030F**
Net Revenues																	
Company-operated stores	$1 348	$1 516	$ 1 704	$ 1 837	$ 2 126	$ 2 527	$ 3 453	$ 4 120	$ 4 674	$ 5 212	$ 5 324	$ 5 639	$ 6 017	$ 6 374	$ 6 749	$ 7 128	$ 7 513
Direct to consumer	$ 321	$ 402	$ 453	$ 578	$ 859	$ 1 002	$ 1 159	$ 1 338	$ 1 527	$ 1 722	$ 1 857	$ 2 060	$ 2 270	$ 2 493	$ 2 725	$ 2 967	$ 3 219
Other Channels	$ 128	$ 143	$ 187	$ 235	$ 303	$ 347	$ 367	$ 444	$ 519	$ 579	$ 589	$ 636	$ 688	$ 734	$ 783	$ 836	$ 889
Beauty	$ -	$ -	$ -	$ -	$ -	$ 39	$ 43	$ 46	$ 49	$ 52	$ 55	$ 58	$ 58	$ 61	$ 64	$ 68	$ 71
Revenues	**$1 797**	**$2 061**	**$ 2 344**	**$ 2 649**	**$ 3 288**	**$ 3 914**	**$ 5 023**	**$ 5 948**	**$ 6 769**	**$ 7 566**	**$ 7 826**	**$ 8 394**	**$ 9 033**	**$ 9 663**	**$10 322**	**$10 998**	**$11 691**
Cost of Goods Sold without D&A	$ (825)	$ (990)	$(1 057)	$(1 142)	$(1 350)	$(1 677)	$(2 162)	$(2 562)	$(2 916)	$(3 258)	$(3 363)	$(3 602)	$(3 872)	$(4 137)	$ (4 414)	$ (4 699)	$ (4 989)
Selling, General and Administrative Expenses	$ (538)	$ (628)	$ (778)	$ (899)	$(1 110)	$(1 403)	$(1 738)	$(2 059)	$(2 343)	$(2 619)	$(2 706)	$(2 900)	$(3 120)	$(3 335)	$ (3 561)	$ (3 792)	$ (4 029)
Restructuring Costs	$ -	$ -	$ -	$ (43)	$ -	$ -	$ (7)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
EBITDA	**$ 434**	**$ 442**	**$ 509**	**$ 564**	**$ 828**	**$ 835**	**$ 1 117**	**$ 1 326**	**$ 1 510**	**$ 1 689**	**$ 1 756**	**$ 1 891**	**$ 2 041**	**$ 2 191**	**$ 2 347**	**$ 2 508**	**$ 2 673**
Depreciation	$ (57)	$ (73)	$ (87)	$ (108)	$ (122)	$ (123)	$ (169)	$ (208)	$ (259)	$ (315)	$ (367)	$ (414)	$ (454)	$ (489)	$ (519)	$ (544)	$ (565)
EBITA	**$ 377**	**$ 370**	**$ 422**	**$ 456**	**$ 706**	**$ 712**	**$ 947**	**$ 1 119**	**$ 1 251**	**$ 1 374**	**$ 1 389**	**$ 1 477**	**$ 1 587**	**$ 1 702**	**$ 1 828**	**$ 1 964**	**$ 2 108**
Amortization	$ (1)	$ (1)	$ (1)	$ (0)	$ (0)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Operating Profit	**$ 376**	**$ 369**	**$ 421**	**$ 456**	**$ 706**	**$ 712**	**$ 947**	**$ 1 119**	**$ 1 251**	**$ 1 374**	**$ 1 389**	**$ 1 477**	**$ 1 587**	**$ 1 702**	**$ 1 828**	**$ 1 964**	**$ 2 108**
Other Expense, Net	$ 7	$ (1)	$ 2	$ 4	$ 9	$ 10	$ 12	$ 15	$ 17	$ 19	$ 20	$ 21	$ 22	$ 24	$ 26	$ 27	$ 29
EBIT	**$ 383**	**$ 368**	**$ 423**	**$ 460**	**$ 715**	**$ 722**	**$ 959**	**$ 1 134**	**$ 1 268**	**$ 1 393**	**$ 1 409**	**$ 1 498**	**$ 1 609**	**$ 1 726**	**$ 1 854**	**$ 1 991**	**$ 2 137**
Taxex	$ (144)	$ (102)	$ (119)	$ (201)	$ (231)	$ (205)	$ (268)	$ (320)	$ (359)	$ (394)	$ (398)	$ (423)	$ (455)	$ (488)	$ (524)	$ (563)	$ (604)
Net Income Available to Investors	**$ 239**	**$ 266**	**$ 303**	**$ 259**	**$ 484**	**$ 518**	**$ 691**	**$ 814**	**$ 909**	**$ 999**	**$ 1 011**	**$ 1 074**	**$ 1 154**	**$ 1 238**	**$ 1 330**	**$ 1 428**	**$ 1 533**
Foreign Currency Translation Adjustment	$ (105)	$ (65)	$ 37	$ 59	$ (74)	$ (23)	$ (23)	$ (23)	$ (23)	$ (23)	$ (23)	$ (23)	$ (23)	$ (23)	$ (23)	$ (23)	$ (23)
COMPREHENSIVE INCOME	**$ 134**	**$ 201**	**$ 340**	**$ 317**	**$ 410**	**$ 495**	**$ 668**	**$ 791**	**$ 886**	**$ 976**	**$ 988**	**$ 1 051**	**$ 1 131**	**$ 1 215**	**$ 1 307**	**$ 1 406**	**$ 1 510**
Comprehensive Income attributable to shareholders	**$ 134**	**$ 201**	**$ 340**	**$ 317**	**$ 410**	**$ 495**	**$ 668**	**$ 791**	**$ 886**	**$ 976**	**$ 988**	**$ 1 051**	**$ 1 131**	**$ 1 215**	**$ 1 307**	**$ 1 406**	**$ 1 510**

Free Cash Flow

Free Cash Flow Map ($ million)																
All values in $ thousands.	**2015**	**2016**	**2017**	**2018**	**2019F**	**2020F**	**2021F**	**2022F**	**2023F**	**2024F**	**2025F**	**2026F**	**2027F**	**2028F**	**2029F**	**2030F**
Operating E Non Operating Cash Flow																
NOPLAT	**$ 260**	**$ 292**	**$ 315**	**$ 508**	**$ 510**	**$ 683**	**$ 803**	**$ 897**	**$ 986**	**$ 997**	**$ 1 059**	**$ 1 138**	**$ 1 221**	**$ 1 311**	**$ 1 409**	**$ 1 512**
Depreciation	$ 73	$ 87	$ 108	$ 122	$ 123	$ 169	$ 208	$ 259	$ 315	$ 367	$ 414	$ 454	$ 489	$ 519	$ 544	$ 565
Gross Cash Flow	**$ 333**	**$ 379**	**$ 423**	**$ 631**	**$ 633**	**$ 852**	**$ 1 011**	**$ 1 156**	**$ 1 301**	**$ 1 364**	**$ 1 474**	**$ 1 593**	**$ 1 710**	**$ 1 830**	**$ 1 953**	**$ 2 077**
Change in operating working capital	$ (60)	$ (3)	$ 17	$ 88	$ (49)	$ (43)	$ (41)	$ (46)	$ (36)	$ (24)	$ (30)	$ (28)	$ (27)	$ (25)	$ (24)	$ (23)
Right to use leases	$ -	$ -	$ -	$ -	$ (137)	$ (250)	$ (199)	$ (186)	$ (151)	$ (35)	$ (99)	$ (112)	$ (109)	$ (114)	$ (114)	$ (117)
Net capital expenditures	$ (126)	$ (161)	$ (158)	$ (216)	$ (325)	$ (354)	$ (441)	$ (514)	$ (556)	$ (583)	$ (598)	$ (614)	$ (625)	$ (634)	$ (640)	$ (642)
Increase (decrease) in other non-current assets	$ (4)	$ (10)	$ (11)	$ (6)	$ (4)	$ (15)	$ (9)	$ (9)	$ (10)	$ (2)	$ (6)	$ (7)	$ (7)	$ (7)	$ (8)	$ (8)
Decrease (increase) in other current liabilities	$ (10)	$ 1	$ 7	$ 3	$ 0	$ 4	$ 6	$ 3	$ 3	$ 2	$ 1	$ 2	$ 2	$ 1	$ 1	$ 1
Decrease (increase) in other non-current liabilities	$ 7	$ (2)	$ 11	$ 23	$ (78)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Decrease (increase) income tax payable	$ -	$ -	$ 48	$ (6)	$ 6	$ (48)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Increase (decrease) in accumulated other comprehensive income	$ (65)	$ 37	$ 59	$ (74)	$ (23)	$ (23)	$ (23)	$ (23)	$ (23)	$ (23)	$ (23)	$ (23)	$ (23)	$ (23)	$ (23)	$ (23)
Free Cash Flow before Goodwill	**$ 76**	**$ 240**	**$ 397**	**$ 442**	**$ 23**	**$ 123**	**$ 304**	**$ 383**	**$ 530**	**$ 697**	**$ 719**	**$ 811**	**$ 921**	**$ 1 028**	**$ 1 146**	**$ 1 267**
Investment in goodwil and acquired intagibles	$ 1	$ 0	$ (0)	$ 0	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Free Cash Flow Available to Investor	**$ 77**	**$ 241**	**$ 396**	**$ 443**	**$ 23**	**$ 123**	**$ 304**	**$ 383**	**$ 530**	**$ 697**	**$ 719**	**$ 811**	**$ 921**	**$ 1 028**	**$ 1 146**	**$ 1 267**

Balance Sheet

Reformulated Balance Sheet ($ million)																	
Uses	**2014**	**2015**	**2016**	**2017**	**2018**	**2019F**	**2020F**	**2021F**	**2022F**	**2023F**	**2024F**	**2025F**	**2026F**	**2027F**	**2028F**	**2029F**	**2030F**
Current Assets																	
Operating cash	$ 42	$ 49	$ 55	$ 62	$ 78	$ 92	$ 118	$ 140	$ 160	$ 178	$ 185	$ 198	$ 213	$ 228	$ 243	$ 259	$ 276
Accounts Receivable	$ 14	$ 13	$ 9	$ 19	$ 36	$ 24	$ 33	$ 42	$ 45	$ 51	$ 53	$ 56	$ 61	$ 65	$ 70	$ 74	$ 79
Inventories	$ 208	$ 284	$ 298	$ 330	$ 405	$ 453	$ 585	$ 695	$ 798	$ 897	$ 936	$ 1 009	$ 1 086	$ 1 162	$ 1 239	$ 1 316	$ 1 395
Prepaid and receivable income taxes	$ 41	$ 91	$ 81	$ 49	$ 49	$ 62	$ 81	$ 101	$ 112	$ 125	$ 130	$ 139	$ 149	$ 160	$ 171	$ 182	$ 194
Other prepaid expenses and other current assets	$ 24	$ 27	$ 39	$ 40	$ 57	$ 43	$ 43	$ 43	$ 43	$ 43	$ 43	$ 43	$ 43	$ 43	$ 43	$ 43	$ 43
Operating Current Assets	**$ 329**	**$ 464**	**$ 483**	**$ 500**	**$ 625**	**$ 675**	**$ 861**	**$ 1 021**	**$ 1 157**	**$ 1 295**	**$ 1 348**	**$ 1 445**	**$ 1 553**	**$ 1 658**	**$ 1 765**	**$ 1 875**	**$ 1 986**
Current Liabilities																	
Accounts payable	$ (9)	$ (10)	$ (25)	$ (25)	$ (96)	$ (73)	$ (95)	$ (113)	$ (130)	$ (146)	$ (152)	$ (164)	$ (177)	$ (189)	$ (201)	$ (214)	$ (227)
Accrued inventory liabilities	$ (22)	$ (25)	$ (9)	$ (13)	$ (16)	$ (18)	$ (24)	$ (28)	$ (32)	$ (36)	$ (37)	$ (40)	$ (43)	$ (46)	$ (49)	$ (52)	$ (55)
Accrued compensation and related expenses	$ (30)	$ (44)	$ (55)	$ (70)	$ (109)	$ (109)	$ (146)	$ (179)	$ (196)	$ (222)	$ (231)	$ (246)	$ (265)	$ (284)	$ (303)	$ (323)	$ (343)
Current income taxes payable	$ (20)	$ (38)	$ (30)	$ (16)	$ (67)	$ (58)	$ (76)	$ (88)	$ (99)	$ (107)	$ (105)	$ (111)	$ (120)	$ (128)	$ (139)	$ (150)	$ (163)
Unredeemed Gift Card Liability	$ (46)	$ (58)	$ (70)	$ (83)	$ (99)	$ (119)	$ (154)	$ (181)	$ (207)	$ (231)	$ (239)	$ (256)	$ (276)	$ (295)	$ (315)	$ (336)	$ (357)
Other Current Liabilities	$ (14)	$ (43)	$ (44)	$ (61)	$ (93)	$ (104)	$ (128)	$ (154)	$ (171)	$ (194)	$ (201)	$ (215)	$ (232)	$ (249)	$ (266)	$ (284)	$ (302)
Operating Current Liabilities	**$ (142)**	**$ (217)**	**$ (233)**	**$ (268)**	**$ (481)**	**$ (482)**	**$ (624)**	**$ (743)**	**$ (834)**	**$ (936)**	**$ (965)**	**$(1 032)**	**$(1 112)**	**$(1 190)**	**$ (1 273)**	**$ (1 359)**	**$ (1 447)**
Operating Working Capital	**$ 187**	**$ 247**	**$ 250**	**$ 233**	**$ 144**	**$ 193**	**$ 236**	**$ 278**	**$ 323**	**$ 359**	**$ 383**	**$ 413**	**$ 441**	**$ 467**	**$ 493**	**$ 516**	**$ 539**
PPE, Net	$ 296	$ 350	$ 423	$ 474	$ 567	$ 770	$ 954	$ 1 188	$ 1 442	$ 1 683	$ 1 899	$ 2 083	$ 2 242	$ 2 378	$ 2 494	$ 2 590	$ 2 667
Right to use lease assets	$ -	$ -	$ -	$ -	$ 653	$ 790	$ 1 040	$ 1 238	$ 1 424	$ 1 575	$ 1 610	$ 1 709	$ 1 820	$ 1 929	$ 2 043	$ 2 157	$ 2 274
Other Current Liabilities	$ (18)	$ (8)	$ (9)	$ (16)	$ (19)	$ (19)	$ (23)	$ (29)	$ (32)	$ (36)	$ (38)	$ (39)	$ (41)	$ (42)	$ (44)	$ (45)	$ (46)
Other non-current assets	$ 7	$ 11	$ 20	$ 31	$ 37	$ 42	$ 57	$ 66	$ 75	$ 84	$ 87	$ 93	$ 100	$ 107	$ 114	$ 122	$ 130
Other non-current liabilities	$ (43)	$ (50)	$ (48)	$ (59)	$ (82)	$ (4)	$ (4)	$ (4)	$ (4)	$ (4)	$ (4)	$ (4)	$ (4)	$ (4)	$ (4)	$ (4)	$ (4)
Non-current income taxes payable	$ -	$ -	$ -	$ (48)	$ (42)	$ (48)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Invested Capital (excluding goodwilll and intagible assets)	**$ 429**	**$ 549**	**$ 637**	**$ 614**	**$ 606**	**$ 1 723**	**$ 2 260**	**$ 2 737**	**$ 3 228**	**$ 3 661**	**$ 3 937**	**$ 4 255**	**$ 4 559**	**$ 4 836**	**$ 5 096**	**$ 5 336**	**$ 5 559**
Goodwill & Intagible Assets, Net	$ 26	$ 25	$ 25	$ 25	$ 24	$ 24	$ 24	$ 24	$ 24	$ 24	$ 24	$ 24	$ 24	$ 24	$ 24	$ 24	$ 24
Invested Capital	**$ 455**	**$ 574**	**$ 661**	**$ 639**	**$ 630**	**$ 1 748**	**$ 2 285**	**$ 2 761**	**$ 3 252**	**$ 3 685**	**$ 3 962**	**$ 4 279**	**$ 4 583**	**$ 4 860**	**$ 5 121**	**$ 5 360**	**$ 5 583**
Excess of Cash	$ 622	$ 453	$ 680	$ 928	$ 804	$ 1 034	$ 1 224	$ 1 430	$ 1 562	$ 1 646	$ 1 500	$ 1 517	$ 1 592	$ 1 683	$ 1 805	$ 1 947	$ 2 113
Other financial Assets	$ -	$ -	$ -	$ (1)	$ (1)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Tax loss carry forward, Net	$ 9	$ 12	$ 16	$ 36	$ 3	$ 28	$ 36	$ 30	$ 43	$ 47	$ 46	$ 51	$ 55	$ 58	$ 62	$ 66	$ 70
Total Fund Invested	**$1 086**	**$1 038**	**$ 1 357**	**$ 1 601**	**$ 1 436**	**$ 2 810**	**$ 3 544**	**$ 4 220**	**$ 4 857**	**$ 5 378**	**$ 5 507**	**$ 5 848**	**$ 6 230**	**$ 6 601**	**$ 6 988**	**$ 7 374**	**$ 7 766**
Sources	**2,014**	**2,015**	**2,016**	**2,017**	**2,018**	**2019F**	**2020F**	**2021F**	**2022F**	**2023F**	**2024F**	**2025F**	**2026F**	**2027F**	**2028F**	**2029F**	**2030F**
Operating deferred taxes	$ 16	$ 26	$ 24	$ 21	$ 15	$ 35	$ 39	$ 47	$ 63	$ 73	$ 85	$ 95	$ 101	$ 107	$ 112	$ 115	$ 117
Common stock	$ 0,66	$ 0,64	$ 0,64	$ 0,63	$ 0,61	$ 0,62	$ 0,62	$ 0,62	$ 0,62	$ 0,62	$ 0,62	$ 0,62	$ 0,62	$ 0,62	$ 0,62	$ 0,62	$ 0,62
Retained earnings	$1 262	$1 265	$ 1 561	$ 1 739	$ 1 662	$ 2 193	$ 2 682	$ 3 166	$ 3 617	$ 3 993	$ 4 096	$ 4 347	$ 4 629	$ 4 904	$ 5 191	$ 5 478	$ 5 771
Accumulated Other Comprehensive Loss	$ (173)	$ (238)	$ (202)	$ (143)	$ (217)	$ (240)	$ (263)	$ (285)	$ (308)	$ (331)	$ (354)	$ (377)	$ (400)	$ (422)	$ (445)	$ (468)	$ (491)
Equity and Its Equivalents	**$1 105**	**$1 053**	**$ 1 384**	**$ 1 618**	**$ 1 461**	**$ 1 989**	**$ 2 459**	**$ 2 928**	**$ 3 373**	**$ 3 735**	**$ 3 828**	**$ 4 066**	**$ 4 332**	**$ 4 590**	**$ 4 858**	**$ 5 126**	**$ 5 397**
Current Lease Liabilities	$ -	$ -	$ -	$ -	$ 164	$ 157	$ 206	$ 245	$ 282	$ 312	$ 319	$ 339	$ 361	$ 382	$ 405	$ 427	$ 451
Non-current Lease Liabilitites	$ -	$ -	$ -	$ -	$ 531	$ 683	$ 899	$ 1 071	$ 1 232	$ 1 362	$ 1 393	$ 1 478	$ 1 575	$ 1 669	$ 1 767	$ 1 866	$ 1 967
Non Operating deferred taxes	$ (19)	$ (15)	$ (27)	$ (17)	$ (24)	$ (19)	$ (20)	$ (24)	$ (29)	$ (31)	$ (32)	$ (35)	$ (37)	$ (40)	$ (43)	$ (46)	$ (48)
Debt and Its Equivalents	**$ (19)**	**$ (15)**	**$ (27)**	**$ (17)**	**$ (24)**	**$ 821**	**$ 1 086**	**$ 1 292**	**$ 1 485**	**$ 1 643**	**$ 1 679**	**$ 1 782**	**$ 1 898**	**$ 2 011**	**$ 2 129**	**$ 2 248**	**$ 2 369**
Equity + Debt	**$1 086**	**$1 038**	**$ 1 357**	**$ 1 601**	**$ 1 436**	**$ 2 810**	**$ 3 544**	**$ 4 220**	**$ 4 857**	**$ 5 378**	**$ 5 507**	**$ 5 848**	**$ 6 230**	**$ 6 601**	**$ 6 988**	**$ 7 374**	**$ 7 766**

Disclosures and Disclaimers

Report Recommendations

Buy	Expected total return (including expected capital gains and expected dividend yield) of more than 10% over a 12-month period.
Hold	Expected total return (including expected capital gains and expected dividend yield) between 0% and 10% over a 12-month period.
Sell	Expected negative total return (including expected capital gains and expected dividend yield) over a 12-month period.

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