Lululemon (LULU) – BUY [8/13/25]
Market Cap: ~$23.9B
Sector: Consumer Discretionary | Apparel Retail
Description: Lululemon Athletica Inc. is the original and dominant global "athleisure" retailer and brand.

Thesis:

The market is overly pessimistic about Lulu's short-term prospects in the U.S. Lulu has built a brand with a loyal following that represents aspirational purchasing (more akin to a Nike or Patagonia vs. other brands). They have survived past issues (see 2013 sheer leggings) and if U.S. dynamics improve, Lulu has a clear path to being valued at $300/sh.

Over the next five years, Lulu's planned international growth is high probability / low variance. Even if U.S. growth does not re-accelerate, the stock is still priced at attractive levels. The market is extrapolating near term margin pressures (-160 bps in FY26E) caused by tariffs and brand investment as long term hurdles that cannot be overcome. Operating margins have a clear path to ~25% by end FY29, driven by pricing and sourcing actions, and amplified by SG&A leverage and structural margin opportunities in intl.

Lulu has a debt-free balance sheet (aside from ~$1.4B of capital leases) and ~$1.3B in cash with which management will likely continue to repurchase stock (>$2B repurchases L12M). At current prices and projected cash generation, Lulu can **easily** repurchase 20-30% of shares outstanding over a 5-year period and still invest in growing the store count.

Ultimately, a high-quality, durable brand in a secular growth market which can grow cash flow per share by ~10% p.a. under conservative assumptions should trade above ~13x trailing eps. For reference, NKE, RL, BIRK, and TPR, trade at ~30x LTM eps.

Conservative modelling gives fair value of ~$290/sh, representing ~45% upside and 19.8x FY2025 EPS.

Rationale / why opportunity exists:

Since 2015 performance across all key metrics has been outstanding (see below table).

USD, ($M)	2015	2024	CAGR
Revenue	$2,060	$10,588	19.9%
Gross Profit	$997	$6,271	22.7%
Operating Income	$357	$2,506	24.2%
Gross Margin	48.4%	59.2%	+10.8 ppts
Operating Margin	17.3%	23.7%	+6.4 ppts
Operating Cash Flow	$298	$2,273	25.3%
Shares Outstanding (M)	137	121	-1.4%
10 year average ROIC			36.00%

However, the market is now valuing Lululemon at 10-year low earnings multiples [~13x LTM EPS] due to growth slowdowns in the U.S.

What was a retail darling as of just a few years ago is now fully in the dumps. At current levels (~$200/sh) Lulu seems to represent a "heads I win, tails I lose very little" opportunity. The bears are focusing on two data points:

(1) NAM comparable sales slowdown caused by increased competition in the U.S.

North American comps are now negative. Within NAM, there is an interesting dichotomy between Canada (consistent mid to high single comp growth) and the U.S. (negative comp growth). What is driving this dichotomy? On the most recent earnings call management cited "…not seeing the same discerning consumer in Canada as we are seeing in the U.S." I would not take management here at their word. Rather below are some more interesting data points:

- Retail sales growth in both the U.S. and Canada has been a similar ~4-5% YoY
- Other retailers with key Canada / U.S. presences have not seen a similar bifurcation: (1) In Q1 Athleta saw U.S. rev decreases of 6% and Canadian rev decreases of 20% (2) In Q1 Canada Goose saw U.S. rev growth of 45% and Canadian rev growth of 11%. Clearly, the U.S. consumer is not universally weaker than the Canadian consumer.
- New Lululemon competitors Alo Yoga and Vuori have focused on the U.S. market, but not in Canada. For example, Vuori has 0 physical locations in Canada, and ~80 in the U.S.
    - Vuori and Alo are each believed to sales approaching $1B+

Given the above, I believe the bears are correct that the recent U.S. vs. Canada comps dichotomy is likely being caused by increasing competition in the U.S. that Lulu is not seeing in Canada. Extrapolated further, bears are pricing in a long term scenario in which Lululemon will never return to comp growth in the U.S., further fueling revenue and margin declines. However, my own survey work indicates that consumers believe Lululemon remains the premier brand in athleisure. ***Given this incremental data, I believe there is a reasonable likelihood that recent share shifts have been somewhat driven by consumer trial periods of Alo + Vuori, and long-term share could shift back to Lulu over time as trial periods end***. However, even if U.S. growth does not recover, I believe shares are still substantially undervalued.

(2) Operating margins declining in FY26 due to tariffs + investment

Lulu's operating margins are currently world class (23.7%), but management has guided to a decline to 22.1% in FY26E due to (1) tariffs, (2) slight increase in mark downs and (3) increased spending on SG&A to build brand awareness in international markets. While 100 bps of the guide down is due to tariffs alone, the street is extrapolating that Lulu's margins will be structurally lower and not recover in the coming years.

Here, the market is not appreciating that Lulu has multiple proven levers to improve operating margins over time. I believe there is a clear path towards ~25% and beyond in the next 5+ years.

First, management has called out sourcing mitigation strategies that will extend into 2026. Second, Lulu has a plan to raise pricing on specific items that are price inelastic. Unlike other brands with less premium positions, Lulu has a higher probability of success when raising prices given its premium positioning, aspirational quality, and brand loyalty. Third, recent investments, such as the multiyear distribution project to support future growth, will generate improved fixed cost leverage in the coming years. Lastly, as Lululemon expands internationally and China becomes a larger portion of sales, product margins will naturally increase + SG&A leverage will increase. While it was previously believed that margins in China would only meet those of the U.S., it now appears China has structurally higher longer term product margins (lower discounting) and still has substantial runway on which to leverage previous SG&A investments.

Putting it all together, from an expected FY2026 operating margin of ~22% I believe the path to 25%+ operating margins at end FY2029 will be driven by (a) near term sticky price increases and sourcing optimization (100 bps) (b) greater fixed cost leverage from new distribution centers (100 bps), (c) reduction in SG&A as a % of revenue in international locations as new stores openings become a less important growth driver and brand awareness improves, requiring less incremental marketing (75 bps) (d) International mix shift driving structurally higher product margins from China (25-50 bps).

Catalysts:

- **U.S. Comps Re-accelerate**: A return to positive comparable sales growth in the U.S. as consumers who trialed competing brands return to Lululemon
- **Margin Improvement**: Sourcing optimization, pricing actions, realizing leverage on fixed costs, and country mix shifts leading to operating margins recovering and expanding toward 25%
- **Continued International Growth:** Sustained high-growth performance in international markets, particularly in China. Whitespace further propelled by entry into and success in India
- **Aggressive Share Repurchases**: Management's continued use of its strong cash flow generation to aggressively buy back shares, which could total 20-30% of shares outstanding over five years

Company overview:

Founded in Vancouver in 1998 by Chip Wilson, Lululemon pioneered the creation of dedicated apparel for the growing yoga market. What began as a design and yoga studio evolved into a global brand, pioneering the "athleisure" market. The global athleisure market is projected to grow 8-10% over the next 5 years. In the past, the market has grown by (a) expanding the athletic clothing category to more use cases (casual wear outside of the gym / sports) as well as by (b) taking share from traditional athletic clothing brands, such as Nike, due to better materials, high quality designs, and premium positioning / branding.

Today, Lulu operates at the high end of the athleisure market, selling premium apparel, footwear, and accessories. While it outsources manufacturing, Lululemon does have key competitive advantages in its proprietary, in-house designed fabrics, innovative styling, and powerful brand identity built over nearly 3 decades. This has allowed the company to command premium prices and sustain / grow margins over time.

Lululemon maintains tight control over its brand and profitability by selling primarily through company-owned channels, with retail stores accounting for about half of sales and e-commerce making up roughly 40%. This direct-to-consumer model fosters strong customer relationships and provides valuable data. The brand has successfully expanded beyond its initial female customer base, with the men's category now representing ~25% of revenue, and growing.

In addition to growth through expansion to men's and accessories, Lululemon has grown by adding stores in international (outside of NAM) markets, with China being a major growth driver. As a first-mover in the athleisure / yoga space, Lululemon has built a loyal following, which is reinforced by a membership program of over 20 million people that drives repeat purchases and deepens customer engagement. This has created a flywheel which allows Lulu to invest more than competitors to create the best fabrics, designs, and customer experiences which further deepens the Lulu brand appeal.

Valuation:

Taking a longer term view than the market is today, Lulu has an asymmetric risk/reward. ***My base case reflects fair value for Lulu of ~$290/sh, ~45% upside and ~19.8x FY2025 EPS***.

On valuation, I use a 5-year DCF to model a bear, base, and bull case scenario (detailed below).

Valuation cases	***At 10% WACC***	***Probability of occuring***	***Explanation***
Bear Case (terminal decline)	$171	15.00%	(1) NAM comps negative in perpetuity (2) China + RoW comps decline to single digit growth in FY27, then decrease to 2% over forecast period (2) Operating margins decline to 20% over time, driven by tariffs, increased discounting as merchandising becomes too difuse, RoW margins not scaling (3) Company uses only ~25% of fcf to repurchase shares (~7% of outstanding) over forecast period (4) Terminal growth (-1)%, reflecting decreasing brand strength and inability to penetrate new categories
Base Case (no recovery in NAM)	$290	55.00%	(1) NAM comps increase to flat through forecast (2) China + RoW comps consistently fall to mid single digits (well below historical) (2) Operating margins improve to 24.7% through forecast driven by pricing, sourcing, fixed cost leverage, and mix shifts (3) Company uses ~50% of fcf to repurchase shares (~25% of outstanding) over forecast period - slower than current pace of 100%+ of fcf. (4) Terminal growth 3% (vs. 4.3% 10 year treasury) representing slowdown of growth in international segments and reduced margin potentia
Bull Case (recovery in NAM)	$366	30.00%	(1) NAM comps improve to 2% due to product assortment improvements and end of trial period of Alo + Vuori (2) China + RoW comps exhibit longer runway and stay high single digits by end of forecast (well below historical) (2) Operating margins improve to ~26% as tariffs lifted, in addition to actions on pricing, sourcing, fixed cost leverage, and mix shifts (3) Company uses ~75% of fcf to repurchase shares (~30% of outstanding) over forecast period - slower than current pace of 100%+ of fcf. (4) Terminal growth 4% (vs. 4.3% 10 year treasury) representing larger whitespace in China, and India becoming robust growth market (larger entry in FY27/28)

A few things to note: the bear case shown above assumes ***extremely punitive modelling (growth erosion over short and long term across geographies, margin erosion over time)*** *and the bull case is* ***relatively likely***. In each case I model Lulu as having decreasing capital expenditure rates over the long term to reflect a maturing business, so the terminal value reflects that step down over time (as a % of operating cash flow, capex falls to 25% vs. ~10% for Nike recently)**.**

Base Case	*FY26E* **2025**	*FY27E* **2026**	*FY28E* **2027**	*FY29E* **2028**	*FY30E* **2029**	*terminal*
Revenue	$ 11,382,775	$12,131,350	$ 12,811,213	$ 13,399,499	$ 13,874,551	
YoY growth %		*6.58%*	*5.60%*	*4.59%*	*3.55%*	
Operating Margin	*22.10%*	*22.75%*	*23.40%*	*24.05%*	*24.70%*	
Operating Income (EBIT)	$ 2,515,593	$ 2,759,882	$ 2,997,824	$ 3,222,579	$ 3,427,014	
Net income	$ 1,760,915	$ 1,931,918	$ 2,098,477	$ 2,255,806	$ 2,398,910	
D&A	$ 437,484	$ 466,254	$ 492,384	$ 514,994	$ 533,252	
WC	$ 2,791,149	$ 2,974,706	$ 3,141,414	$ 3,285,667	$ 3,402,153	
Change NWC	$ 144,168	$ 183,557	$ 166,708	$ 144,252	$ 116,487	
Operating cash flow	$ 2,054,231	$ 2,214,615	$ 2,424,153	$ 2,626,547	$ 2,815,675	
Capex	$ (750,000)	$ (831,790)	$ (892,598)	$ (950,739)	$ (1,005,265)	
FCF	$ 1,304,231	$ 1,382,825	$ 1,531,555	$ 1,675,809	$ 1,810,410	$31,072,988
Assumed lulu price for buyback	$ 199.96	$ 199.96	$ 199.96	$ 199.96	$ 199.96	
Assumed buyback amount (75% cash generated to buyback)	2.84%	3.01%	3.34%	3.65%	3.95%	
Cash added	$ 652,115	$ 691,413	$ 765,777	$ 837,904	$ 905,205	
Cash build	$ 652,115	$ 1,343,528	$ 2,109,305	$ 2,947,210	$ 3,852,415	
PV of cash flow	**$ 1,185,665**	**$ 1,142,831**	**$ 1,150,680**	**$ 1,144,600**	**$ 1,124,122**	**$19,293,881**

EV	$	25,041,778
Add cash	$	5,177,685
Subtract debt (estimated capital leases)	$	2,500,000
Equity value	$	27,719,463
Shares outstanding (after repurchases)		95,463,072
Price / Share ($)	$	290.37
Current Lululemon Share Price ($)	$	199.96

Appendix:

Survey:

I ran a survey of 200 female past Lululemon purchasers to better understand brand preference and purchasing habits compared with Vuori and Alo Yoga, Lululemon's two strong competitors in the premium athleisure space. Findings indicate that Lululemon is still perceived as having the best value and best brand, with Vuori being a worthy 2nd competitor and Alo holding strong style and trend appeal but ultimately being viewed as a weaker brand / product overall. Qualitative feedback suggests that Lululemon purchasers have been interested in trialing both Vuori and Alo Yoga products but may switch back to buying Lululemon in larger quantities as they realize Lululemon offers the best mix of style, product quality, functionality, and durability. If this were to happen, I would expect U.S. comps to reaccelerate to low single digits %, highlighted in the bull case.

Female Lulu purchasers	**Brand perception**		
	Lululemon	*Vuori*	*Alo Yoga*
No opinion	0%	12%	12%
Good style	73%	63%	75%
High quality	81%	70%	49%
Differentiated materials	39%	46%	7%
Innovative	24%	20%	11%
Durable	57%	36%	20%
Overpriced	58%	37%	74%
Good value	12%	14%	2%
Versatile	49%	37%	20%
Trendy	43%	50%	88%
Comfortable	79%	82%	41%
Positive brand image	66%	58%	45%