

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Some of the statements contained in this Form 10-Q and any documents incorporated herein by reference constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, included or incorporated in this Form 10-Q are forward-looking statements, particularly statements which relate to expectations, beliefs, projections, future plans and strategies, anticipated events or trends and similar expressions concerning matters that are not historical facts, such as statements regarding our future financial condition or results of operations, our prospects and strategies for future growth, the development and introduction of new products, and the implementation of our marketing and branding strategies. In many cases, you can identify forward-looking statements by terms such as "may," "will," "should," "expects," "plans," "anticipates," "believes," "estimates," "intends," "predicts," "potential" or the negative of these terms or other comparable terminology.

The forward-looking statements contained in this Form 10-Q and any documents incorporated herein by reference reflect our current views about future events and are subject to risks, uncertainties, assumptions and changes in circumstances that may cause events or our actual activities or results to differ significantly from those expressed in any forward-looking statement. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future events, results, actions, levels of activity, performance or achievements. Readers are cautioned not to place undue reliance on these forward-looking statements. A number of important factors could cause actual results to differ materially from those indicated by the forward-looking statements, including, but not limited to, those factors described in "Risk Factors" and elsewhere in this report.

The forward-looking statements contained in this Form 10-Q reflect our views and assumptions only as of the date of this Form 10-Q and are expressly qualified in their entirety by the cautionary statements included in this Form 10-Q. Except as required by applicable securities law, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events.

This information should be read in conjunction with the unaudited interim consolidated financial statements and the notes included in Item 1 of Part I of this Quarterly Report on Form 10-Q and the audited consolidated financial statements and notes, and Management's Discussion and Analysis of Financial Condition and Results of Operations, contained in our Annual Report on Form 10-K.

We disclose material non-public information through one or more of the following channels: our investor relations website (<http://investor.lululemon.com/>), the social media channels identified on our investor relations website, press releases, SEC filings, public conference calls, and webcasts.

### ***Overview***

lululemon is a designer, distributor, and retailer of healthy lifestyle inspired athletic apparel. Since our inception, we have developed a distinctive corporate culture, and we have a mission to produce products which create transformational experiences for people to live happy, healthy, fun lives. We promote a set of core values in our business which include taking personal responsibility, nurturing entrepreneurial spirit, acting with honesty and courage, valuing connection, and choosing to have fun. These core values attract passionate and motivated employees who are driven to succeed and share our purpose of "elevating the world from mediocrity to greatness."

We offer a comprehensive line of apparel and accessories for women and men. We also offer activewear for girls under our ivivva brand name. Our apparel assortment includes items such as pants, shorts, tops and jackets designed for healthy lifestyle and athletic activities such as yoga, running, training, and many other sweaty pursuits. We also offer fitness-related accessories, including an array of items such as bags, socks, underwear, yoga mats, and water bottles.

On June 1, 2017, we announced that we plan to restructure our ivivva operations to a primarily e-commerce focused business, with a select number of stores remaining in key communities across North America. We plan to close approximately 40 of our 55 ivivva branded company-operated stores and to convert approximately half of the remaining stores to lululemon branded stores. We will also close all of our ivivva branded showrooms and other temporary locations and plan to streamline our corporate infrastructure. It is anticipated that the closures and restructuring will be substantially complete by the end of the third quarter of fiscal 2017.

### ***Financial Highlights***

The summary below provides both GAAP and adjusted non-GAAP financial measures. In connection with the restructuring of our ivivva operations, we recognized pre-tax costs totaling \$17.7 million in the first quarter of fiscal 2017. The

adjusted financial measures exclude these charges and their related tax effects, and also exclude certain discrete items related to the Company's transfer pricing arrangements and taxes on repatriation of foreign earnings which were recognized during the first quarter of fiscal 2016.

For the first quarter of fiscal 2017:

- Net revenue increased 5% to \$520.3 million, from \$495.5 million in the first quarter of fiscal 2016. On a constant dollar basis, net revenue increased 5%. The increase in net revenue was primarily due to the addition of 38 net new company-operated stores since the first quarter of fiscal 2016, partially offset by decreased comparable store sales.
- Total comparable sales, which includes comparable store sales and direct to consumer, decreased 1% compared to the first quarter of fiscal 2016. On a constant dollar basis, total comparable sales decreased by 1%.
  - Comparable store sales decreased 2% compared to the first quarter of fiscal 2016, or decreased by 1% on a constant dollar basis, primarily as a result of decreased traffic, partially offset by increased dollar value per transaction.
  - Direct to consumer net revenue was flat compared to the first quarter of fiscal 2016, and was flat on a constant dollar basis, primarily as a result of decreased conversion on our e-commerce websites, partially offset by increased traffic and dollar value per transaction.
- Gross profit increased 7% to \$256.9 million, from \$239.1 million in the first quarter of fiscal 2016. Adjusted gross profit increased 10% to \$262.3 million.
- Gross margin increased 110 basis points to 49.4% compared to 48.3% in the first quarter of fiscal 2016. Adjusted gross margin increased 210 basis points to 50.4%. The increase in gross margin was primarily due to an increase in product margin, primarily due to lower product costs and improved average retail prices.
- Income from operations decreased by 21% to \$45.4 million, from \$57.6 million in the first quarter of fiscal 2016. Adjusted income from operations increased by \$5.6 million, or 10%, to \$63.2 million.
- Operating margin decreased 290 basis points to 8.7% compared to 11.6% in the first quarter of fiscal 2016. Adjusted operating margin increased by 50 basis points to 12.1% compared to the first quarter of fiscal 2016.
- Income tax expense increased 28% to \$15.1 million, from \$11.8 million in the first quarter of fiscal 2016. Our effective tax rate for the first quarter of fiscal 2017 was 32.6% compared to 20.6% for the first quarter of fiscal 2016. The adjusted effective tax rate was 30.8% in the first quarter of fiscal 2017 compared to 29.8% in the first quarter of fiscal 2016.
- Diluted earnings per share were \$0.23 compared to \$0.33 in the first quarter of fiscal 2016. Adjusted diluted earnings per share were \$0.32 for the first quarter of fiscal 2017 compared to \$0.30 for the first quarter of fiscal 2016.

Refer to the non-GAAP reconciliation tables contained in the "Results of Operations" section of this "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" for reconciliations between constant dollar changes in net revenue, total comparable sales, comparable store sales, and direct to consumer net revenue, and adjusted gross profit, gross margin, income from operations, operating margin, effective tax rates, and diluted earnings per share, and the most directly comparable measures calculated in accordance with GAAP.

## Results of Operations

### First Quarter Results

The following table summarizes key components of our results of operations for the quarters ended April 30, 2017 and May 1, 2016. The percentages are presented as a percentage of net revenue.

	Quarter Ended			
	April 30, 2017	May 1, 2016	April 30, 2017	May 1, 2016
	<i>(In thousands)</i>		<i>(Percentages)</i>	
Net revenue	\$ 520,307	\$ 495,516	100.0%	100.0%
Cost of goods sold	263,412	256,385	50.6	51.7
Gross profit	256,895	239,131	49.4	48.3
Selling, general and administrative expenses	199,141	181,542	38.3	36.6
Asset impairment and restructuring costs	12,331	—	2.4	—
Income from operations	45,423	57,589	8.7	11.6
Other income (expense), net	907	(486)	0.2	(0.1)
Income before income tax expense	46,330	57,103	8.9	11.5
Income tax expense	15,084	11,767	2.9	2.5
Net income	\$ 31,246	\$ 45,336	6.0%	9.0%

### Net Revenue

Net revenue increased \$24.8 million, or 5%, to \$520.3 million for the first quarter of fiscal 2017 from \$495.5 million for the first quarter of fiscal 2016. On a constant dollar basis, assuming the average exchange rates for the first quarter of fiscal 2017 remained constant with the average exchange rates for the first quarter of fiscal 2016, net revenue increased \$26.3 million, or 5%.

The increase in net revenue was primarily due to net revenue generated by new company-operated stores. Total comparable sales, which includes comparable store sales and direct to consumer, decreased 1% in the first quarter of fiscal 2017 compared to the first quarter of fiscal 2016. Total comparable sales decreased 1% on a constant dollar basis.

Net revenue on a segment basis for the quarters ended April 30, 2017 and May 1, 2016 is summarized below. The percentages are presented as a percentage of total net revenue.

	Quarter Ended			
	April 30, 2017	May 1, 2016	April 30, 2017	May 1, 2016
	<i>(In thousands)</i>		<i>(Percentages)</i>	
Company-operated stores	\$ 379,099	\$ 358,704	72.9%	72.4%
Direct to consumer	97,223	97,566	18.7	19.7
Other	43,985	39,246	8.4	7.9
Net revenue	\$ 520,307	\$ 495,516	100.0%	100.0%

*Company-Operated Stores.* Net revenue from our company-operated stores segment increased \$20.4 million, or 6%, to \$379.1 million in the first quarter of fiscal 2017 from \$358.7 million in the first quarter of fiscal 2016. Net revenue from company-operated stores we opened or significantly expanded subsequent to May 1, 2016, and therefore not included in comparable store sales, contributed \$26.6 million to the increase. We have opened 38 net new company-operated stores since the first quarter of fiscal 2016, including 22 stores in the United States, four stores in China, three stores in each of Canada and the United Kingdom, two stores in South Korea, and one store in each of Hong Kong, Ireland, Japan, and Switzerland. The increase in net revenue from our company-operated stores segment was partially offset by a comparable store sales decrease of 2% in the first quarter of fiscal 2017 which resulted in a \$6.2 million decrease to net revenue. Comparable store sales decreased 1%, or \$5.6 million on a constant dollar basis. The decrease in comparable store sales was primarily as a result of decreased traffic, partially offset by increased dollar value per transaction.

*Direct to Consumer.* Net revenue from our direct to consumer segment decreased \$0.3 million, or 0%, to \$97.2 million in the first quarter of fiscal 2017 from \$97.6 million in the first quarter of fiscal 2016. Direct to consumer net revenue decreased

0% on a constant dollar basis. This was primarily the result of decreased conversion on our e-commerce websites, partially offset by increased traffic and dollar value per transaction.

*Other:* Net revenue from our other segment increased \$4.7 million, or 12%, to \$44.0 million in the first quarter of fiscal 2017 from \$39.2 million in the first quarter of fiscal 2016. This increase was primarily the result of increased net revenue at existing outlets, and an increased number of temporary locations and outlets during the first quarter of fiscal 2017 compared to the first quarter of fiscal 2016. The increase in net revenue from our other segment was partially offset by a decreased number of showrooms during the first quarter of fiscal 2017 compared to the first quarter of fiscal 2016.

### **Gross Profit**

Gross profit increased \$17.8 million, or 7%, to \$256.9 million for the first quarter of fiscal 2017 from \$239.1 million for the first quarter of fiscal 2016. Gross profit as a percentage of net revenue, or gross margin, was 49.4% in the first quarter of fiscal 2017 compared to 48.3% in the first quarter of fiscal 2016.

During the first quarter of fiscal 2017, as a result of the plan to restructure the ivivva operations, we recognized an expense of \$1.9 million to reduce the carrying value of certain ivivva branded inventories to their estimated net realizable value. In addition, we recognized an expense of \$3.5 million for the net loss we expect to realize on certain committed inventory and raw material purchases, as outlined in Notes 5 and 9 to the unaudited interim consolidated financial statements included in Item 1 of Part I of this report. Excluding these charges, adjusted gross profit increased 10% to \$262.3 million and adjusted gross margin increased 210 basis points to 50.4% compared to the first quarter of fiscal 2016.

Gross margin increased by 110 basis points, to 49.4% in the first quarter of fiscal 2017 from 48.3% in the first quarter of fiscal 2016. The increase in gross margin was primarily the result of:

- an increase in product margin of 380 basis points primarily due to lower product costs and improved average retail prices; and
- a favorable impact of foreign exchange rates of 30 basis points.

This was partially offset by an increase in inventory provision expense and anticipated losses related to firm purchase commitments for ivivva branded products of 100 basis points, an increase in occupancy and depreciation costs of 100 basis points, and an increase in costs related to our product and supply chain departments of 100 basis points.

### **Selling, General and Administrative Expenses**

Selling, general and administrative expenses increased \$17.6 million, or 10%, to \$199.1 million in the first quarter of fiscal 2017 from \$181.5 million in the first quarter of fiscal 2016. The increase in selling, general and administrative expenses was primarily due to:

- an increase in head office costs other than employee costs of \$13.5 million primarily due to increased professional fees, increased brand and community costs, and increased depreciation;
- an increase in employee costs for our operating locations of \$10.8 million primarily from a growth in labor hours and benefits, mainly associated with new company-operated stores and other new operating locations;
- an increase in other costs of \$6.9 million for our operating channels including digital marketing expenses, depreciation, repairs and maintenance costs, and software support and licensing costs; and
- an increase in head office employee costs of \$6.3 million primarily due to additional employees to support the growth in our business.

The increase in selling, general and administrative expenses was partially offset by an increase in net foreign exchange gains of \$19.3 million, primarily related to the revaluation of U.S. dollar cash and receivables held in Canadian subsidiaries. There were net foreign exchange gains of \$5.8 million in the first quarter of fiscal 2017 compared to net foreign exchange losses of \$13.5 million in the first quarter of fiscal 2016. The increase in selling, general and administrative expenses was also partially offset by a decrease in variable costs of \$0.6 million for our operating channels, primarily due to a decrease in packaging and distribution costs, partially offset by an increase in credit card fees.

As a percentage of net revenue, selling, general and administrative expenses increased 170 basis points, to 38.3% in the first quarter of fiscal 2017 from 36.6% in the first quarter of fiscal 2016.

## Asset Impairment and Restructuring Costs

As a result of the plan to restructure our ivivva operations, we recognized asset impairment and restructuring costs of \$12.3 million in the first quarter of fiscal 2017. This includes long-lived asset impairment charges of \$11.6 million and severance costs of \$0.7 million. We did not have asset impairment and restructuring costs in the first quarter of fiscal 2016. Please refer to Note 9 to the unaudited interim consolidated financial statements included in Item 1 of Part I of this report.

## Income from Operations

Income from operations decreased \$12.2 million, or 21%, to \$45.4 million in the first quarter of fiscal 2017 from \$57.6 million in the first quarter of fiscal 2016. Operating margin decreased 290 basis points to 8.7% compared to 11.6% in the first quarter of fiscal 2016.

In connection with the restructuring of our ivivva operations, we recognized pre-tax costs totaling \$17.7 million in the first quarter of fiscal 2017. This includes long-lived asset impairment and restructuring costs of \$12.3 million, inventory write downs of \$1.9 million, and anticipated losses related to firm inventory purchase commitments of \$3.5 million. Excluding these charges, adjusted income from operations increased by 10% to \$63.2 million and adjusted operating margin increased by 50 basis points to 12.1%.

On a segment basis, we determine income from operations without taking into account our general corporate expenses, and the costs we incur in connection with the planned restructuring of our ivivva operations. This includes long-lived asset impairment and restructuring charges, the expense recognized to reduce the carrying value of certain ivivva branded inventories to their estimated net realizable value, and the cost recognized for the net loss we expect to realize on certain firm ivivva branded inventory and raw material purchase commitments.

Segmented income from operations for the quarters ended April 30, 2017 and May 1, 2016 is summarized below. The percentages are presented as a percentage of net revenue of the respective operating segments.

	Quarter Ended			
	April 30, 2017	May 1, 2016	April 30, 2017	May 1, 2016
	<i>(In thousands)</i>		<i>(Percentages)</i>	
Company-operated stores . . . . .	\$ 77,499	\$ 73,259	20.4%	20.4%
Direct to consumer . . . . .	35,442	38,551	36.5	39.5
Other . . . . .	2,836	2,069	6.4	5.3
Segmented income from operations . . . . .	<u>115,777</u>	<u>113,879</u>		
General corporate expense . . . . .	52,604	56,290		
ivivva inventory write downs, and losses on purchase commitments . . . . .	5,419	—		
Asset impairment and restructuring costs . . . . .	12,331	—		
Income from operations . . . . .	<u>\$ 45,423</u>	<u>\$ 57,589</u>		

*Company-Operated Stores.* Income from operations from our company-operated stores segment increased \$4.2 million, or 6%, to \$77.5 million for the first quarter of fiscal 2017 from \$73.3 million for the first quarter of fiscal 2016. The increase was primarily the result of increased gross profit of \$17.3 million which was primarily due to increased net revenue from new stores, and higher gross margin. The increase in gross margin was primarily due to lower product costs and improved average retail prices. The increase in gross profit was partially offset by an increase in selling, general and administrative expenses, including increased store employee costs and increased operating expenses associated with new stores. Income from operations as a percentage of company-operated stores net revenue was 20.4% for both the first quarter of fiscal 2017 and fiscal 2016. The increase in gross margin was offset by deleverage of selling, general and administrative expenses.

*Direct to Consumer.* Income from operations from our direct to consumer segment decreased \$3.1 million, or 8%, to \$35.4 million for the first quarter of fiscal 2017 from \$38.6 million for the first quarter of fiscal 2016. The decrease was primarily due to an increase in selling, general and administrative expenses, including higher digital marketing expenses, and higher head office costs to support the business. Income from operations as a percentage of direct to consumer net revenue decreased by 300 basis points primarily due to deleverage of selling, general and administrative expenses, partially offset by increased gross margin.

*Other.* Other income from operations increased \$0.8 million, or 37%, to \$2.8 million for the first quarter of fiscal 2017 from \$2.1 million for the first quarter of fiscal 2016. The increase was primarily the result of increased gross profit of \$3.3

million which was primarily due to increased net revenue at existing outlets, an increased number of outlets and temporary locations, and higher gross margin. The increase in gross profit was partially offset by an increase in selling, general and administrative expenses, including increased employee costs, and increased operating expenses associated with new locations. Income from operations as a percentage of other net revenue increased by 110 basis points primarily due to an increase in gross margin partially offset by deleverage of selling, general and administrative expenses as a percentage of other net revenue.

*General Corporate Expense.* General corporate expense decreased \$3.7 million, or 7%, to \$52.6 million for the first quarter of fiscal 2017 from \$56.3 million for the first quarter of fiscal 2016. The decrease was primarily due to an increase in net foreign exchange gains of \$19.3 million, primarily related to the revaluation of U.S. dollar cash and receivables held in Canadian subsidiaries. There were net foreign exchange gains of \$5.8 million in the first quarter of fiscal 2017 compared to net foreign exchange losses of \$13.5 million in the first quarter of fiscal 2016. This was partially offset by increased employee costs, professional fees, marketing expenses, and depreciation to support the growth of our business.

### **Other Income (Expense), Net**

Other income (expense), net increased \$1.4 million, or 287%, to income of \$0.9 million for the first quarter of fiscal 2017 from an expense of \$0.5 million for the first quarter of fiscal 2016. The increase was primarily due to net interest expense of \$1.2 million which was recorded in the first quarter of fiscal 2016 in relation to certain tax adjustments that are outlined in Note 7 to the unaudited interim consolidated financial statements included in Item 1 of Part I of this report.

### **Income Tax Expense**

Income tax expense increased \$3.3 million, or 28%, to \$15.1 million for the first quarter of fiscal 2017 from \$11.8 million for the first quarter of fiscal 2016.

The first quarters of fiscal 2017 and fiscal 2016 included certain adjustments which resulted in net income tax recoveries of \$4.7 million and \$5.6 million, respectively. As outlined in Notes 7 and 9 to the unaudited interim consolidated financial statements included in Item 1 of Part I of this report, these tax recoveries relate to the tax effect of the costs recognized in connection with the ivivva restructuring, and to the Company's transfer pricing arrangements and taxes on repatriation of foreign earnings.

The effective tax rate for the first quarter of fiscal 2017 was 32.6% compared to 20.6% for the first quarter of fiscal 2016. The adjusted effective tax rate, was 30.8% for the first quarter of fiscal 2017 compared to 29.8% for the first quarter of fiscal 2016.

### **Net Income**

Net income decreased \$14.1 million, or 31%, to \$31.2 million for the first quarter of fiscal 2017 from \$45.3 million for the first quarter of fiscal 2016. This was primarily due to an increase in selling, general and administrative expenses of \$17.6 million, long-lived asset impairment and restructuring costs of \$12.3 million, and an increase in income tax expense of \$3.3 million, partially offset by an increase in gross profit of \$17.8 million, and an increase in other income (expense), net of \$1.4 million.

### ***Comparable Store Sales and Total Comparable Sales***

We separately track comparable store sales, which reflect net revenue from company-operated stores that have been open for at least 12 months, or open for at least 12 months after being significantly expanded. Net revenue from a store is included in comparable store sales beginning with the first month for which the store has a full month of sales in the prior year. Comparable store sales exclude sales from new stores that have not been open for at least 12 months, from stores which have not been in their significantly expanded space for at least 12 months, and from stores which have been temporarily relocated for renovations. Comparable store sales also exclude sales from direct to consumer, outlets, showrooms, wholesale accounts, temporary locations, warehouse sales, license and supply arrangements, and sales from company-operated stores that we have closed.

Total comparable sales combines comparable store sales and direct to consumer sales.

The comparable sales measures we report may not be equivalent to similarly titled measures reported by other companies.

### ***Non-GAAP Financial Measures***

Constant dollar changes in net revenue, total comparable sales, comparable store sales, and direct to consumer net revenue, and the adjusted financial results are non-GAAP financial measures.

A constant dollar basis assumes the average foreign exchange rates for the period remained constant with the average foreign exchange rates for the same period of the prior year. We provide constant dollar changes in net revenue, total comparable sales, comparable store sales, and changes in direct to consumer net revenue because we use these measures to understand the underlying growth rate of net revenue excluding the impact of changes in foreign exchange rates. We believe that disclosing these measures on a constant dollar basis is useful to investors because it enables them to better understand the level of growth of our business.

Adjusted gross profit, gross margin, income from operations, operating margin, effective tax rates, and diluted earnings per share exclude the costs recognized in connection with the plan to restructure the ivivva operations, its related tax effects, and certain discrete items related to the Company's transfer pricing arrangements and taxes on repatriation of foreign earnings. We believe these adjusted financial results and measures provide useful information because these items do not directly relate to our ongoing business operations and therefore do not contribute to a meaningful evaluation of the Company's future operating performance. Furthermore, we believe these adjusted financial results and metrics are useful to investors because of their comparability to our historical information.

The presentation of this financial information is not intended to be considered in isolation or as a substitute for, or with greater prominence to, the financial information prepared and presented in accordance with GAAP. A reconciliation of the non-GAAP financial measures follows, which includes more detail on the GAAP financial measure that is most directly comparable to each non-GAAP financial measure, and the related reconciliations between these financial measures.

The below changes in net revenue, total comparable sales, comparable store sales, and direct to consumer net revenue show the change compared to the corresponding period in the prior year.

**Constant dollar changes in net revenue, total comparable sales, comparable store sales, and direct to consumer net revenue**

	<b>Quarter Ended April 30, 2017</b>	
	<i>(In thousands)</i>	<i>(Percentages)</i>
Change in net revenue . . . . .	\$ 24,791	5%
Adjustments due to foreign exchange rate changes . . . . .	1,480	—
Change in net revenue in constant dollars . . . . .	<u>\$ 26,271</u>	<u>5%</u>
		<b>Quarter Ended April 30, 2017</b>
Change in total comparable sales <sup>1,2</sup> . . . . .		(1)%
Adjustments due to foreign exchange rate changes . . . . .		—
Change in total comparable sales in constant dollars <sup>1,2</sup> . . . . .		<u>(1)%</u>
		<b>Quarter Ended April 30, 2017</b>
	<i>(In thousands)</i>	<i>(Percentages)</i>
Change in comparable store sales <sup>2</sup> . . . . .	\$ (6,176)	(2)%
Adjustments due to foreign exchange rate changes . . . . .	527	1
Change in comparable store sales in constant dollars <sup>2</sup> . . . . .	<u>\$ (5,649)</u>	<u>(1)%</u>
		<b>Quarter Ended April 30, 2017</b>
		<i>(Percentages)</i>
Change in direct to consumer net revenue . . . . .		— %
Adjustments due to foreign exchange rate changes . . . . .		—
Change in direct to consumer net revenue in constant dollars . . . . .		<u>— %</u>

<sup>1</sup>Total comparable sales includes comparable store sales and direct to consumer sales.

<sup>2</sup>Comparable store sales reflects net revenue from company-operated stores that have been open for at least 12 months, or open for at least 12 months after being significantly expanded.

## Adjusted financial measures

The following table reconciles adjusted financial measures with the most directly comparable measures calculated in accordance with GAAP. The amounts are in thousands, except for the per share amounts.

	Quarter Ended April 30, 2017			Quarter Ended May 1, 2016		
	GAAP Results	Adjustments	Adjusted Results (Non-GAAP)	GAAP Results	Adjustments	Adjusted Results (Non-GAAP)
Net revenue	\$ 520,307	\$ —	\$ 520,307	\$ 495,516	\$ —	\$ 495,516
Costs of goods sold <sup>1</sup>	263,412	(5,419)	257,993	256,385	—	256,385
Gross profit <sup>1</sup>	256,895	5,419	262,314	239,131	—	239,131
<i>As a percent of net revenue<sup>1</sup></i>	49.4%	1.0 %	50.4%	48.3%	—%	48.3%
Selling, general and administrative expenses	199,141	—	199,141	181,542	—	181,542
<i>As a percent of net revenue</i>	38.3%	—%	38.3%	36.6%	—%	36.6%
Impairment and restructuring costs <sup>2</sup>	12,331	(12,331)	—	—	—	—
<i>As a percent of net revenue<sup>2</sup></i>	2.4%	(2.4)%	—%	—%	—%	—%
Income from operations <sup>1,2</sup>	45,423	17,750	63,173	57,589	—	57,589
<i>As a percent of net revenue<sup>1,2</sup></i>	8.7%	3.4 %	12.1%	11.6%	—%	11.6%
Other income (expense), net <sup>3</sup>	907	—	907	(486)	1,240	754
Income before income tax expense <sup>1,2,3</sup>	46,330	17,750	64,080	57,103	1,240	58,343
Income tax expense <sup>3,4</sup>	15,084	4,684	19,768	11,767	5,644	17,411
<i>Effective tax rate<sup>3,4</sup></i>	32.6%		30.8%	20.6%		29.8%
Net income <sup>1,2,3,4</sup>	\$ 31,246	\$ 13,066	\$ 44,312	\$ 45,336	\$ (4,404)	\$ 40,932
Diluted earnings per share <sup>1,2,3,4</sup>	\$ 0.23	\$ 0.09	\$ 0.32	\$ 0.33	\$ (0.03)	\$ 0.30

<sup>1</sup> During the first quarter of fiscal 2017, we recognized costs totaling \$5.4 million to reduce the carrying value of certain ivivva branded inventories to their estimated net realizable value and to record the expected net loss on certain committed inventory purchases.

<sup>2</sup> During the first quarter of fiscal 2017, we recognized long-lived asset impairment charges of \$11.6 million and severance costs of \$0.7 million related to our plan to restructure our ivivva operations.

<sup>3</sup> The adjustments in the first quarter of fiscal 2016 relate to our transfer pricing arrangements and the associated repatriation of foreign earnings.

<sup>4</sup> The adjustment to income tax expense for the first quarter of fiscal 2017 represents the tax effect of the ivivva related restructuring adjustments, calculated based on the expected annual tax rate of the applicable tax jurisdictions.

Please refer to Notes 7 and 9 to the unaudited interim consolidated financial statements included in Item 1 of Part I of this report for further information on these adjustments.

## Seasonality

Our business is affected by the general seasonal trends common to the retail apparel industry. Our annual net revenue is weighted more heavily toward our fourth fiscal quarter, reflecting our historical strength in sales during the holiday season, while our operating expenses are more equally distributed throughout the year. As a result, a substantial portion of our operating profits are generated in the fourth quarter of our fiscal year. For example, we generated approximately 47%, 45%, and 42% of our full year operating profit during the fourth quarters of fiscal 2016, fiscal 2015, and fiscal 2014, respectively.

### **Liquidity and Capital Resources**

Our primary sources of liquidity are our current balances of cash and cash equivalents, cash flows from operations, and capacity under our revolving credit facility. Our primary cash needs are capital expenditures for opening new stores and remodeling or relocating existing stores, making information technology system enhancements, funding working capital requirements, and making other strategic capital investments both in North America and internationally. We may also use cash to repurchase shares of our common stock. Cash and cash equivalents in excess of our needs are held in interest bearing accounts with financial institutions.

As of April 30, 2017, our working capital (excluding cash and cash equivalents) was \$228.4 million, our cash and cash equivalents were \$698.3 million and our capacity under our revolving facility was \$149.2 million.

The following table summarizes our net cash flows provided by and used in operating, investing and financing activities for the periods indicated:

	<b>Quarter Ended</b>	
	<b>April 30, 2017</b>	<b>May 1, 2016</b>
	<i>(In thousands)</i>	
Total cash provided by (used in):		
Operating activities . . . . .	\$ 19,400	\$ 40,027
Investing activities . . . . .	(19,879)	(26,644)
Financing activities . . . . .	(14,487)	(13,622)
Effect of exchange rate changes on cash. . . . .	(21,591)	48,803
(Decrease) increase in cash and cash equivalents. . . . .	<u>\$ (36,557)</u>	<u>\$ 48,564</u>

### **Operating Activities**

Cash flows provided by operating activities consist primarily of net income adjusted for certain items not affecting cash and the effect of changes in operating assets and liabilities.

Cash provided by operating activities decreased \$20.6 million, to \$19.4 million for the first quarter of fiscal 2017 compared to \$40.0 million for the first quarter of fiscal 2016. The decrease was primarily the result of increased inventory purchases, partially offset by changes in accounts payable and accrued liabilities.

### **Investing Activities**

Cash flows used in investing activities relate entirely to capital expenditures. The capital expenditures were primarily for opening new company-operated stores, remodeling or relocating certain stores, and ongoing store refurbishment. We also had capital expenditures related to information technology and business systems, related to corporate buildings, and for opening retail locations other than company-operated stores.

Cash used in investing activities decreased \$6.8 million to \$19.9 million for the first quarter of fiscal 2017 from \$26.6 million for the first quarter of fiscal 2016. The decrease was primarily the result of reduced capital expenditures related to our company-operated stores, primarily as a result of opening fewer company-operated stores in the first quarter of fiscal 2017 compared to the first quarter of fiscal 2016.

### **Financing Activities**

Cash flows used in or provided by financing activities consist primarily of cash used to repurchase shares of our common stock and certain cash flows related to stock-based compensation.

Cash used in financing activities increased \$0.9 million, to \$14.5 million for the first quarter of fiscal 2017 compared to \$13.6 million for the first quarter of fiscal 2016.

On June 11, 2014, our board of directors approved a program to repurchase shares of our common stock up to an aggregate value of \$450.0 million. This stock repurchase program was completed during the second quarter of fiscal 2016. On December 1, 2016, our board of directors approved a program to repurchase shares of our common stock up to an aggregate value of \$100.0 million over a period of up to two years.

Our cash used in financing activities for the first quarter of fiscal 2017 included \$12.8 million to repurchase 0.2 million shares of our common stock compared to \$15.8 million to repurchase 0.2 million shares for the first quarter of fiscal 2016.

We believe that our cash and cash equivalent balances, cash generated from operations, and borrowings available to us under our revolving credit facility will be adequate to meet our liquidity needs and capital expenditure requirements for at least the next 12 months. Our cash from operations may be negatively impacted by a decrease in demand for our products as well as the other factors described in Item 1 of Part II of this Quarterly Report on Form 10-Q. In addition, we may make discretionary capital improvements with respect to our stores, distribution facilities, headquarters, or systems, which we would expect to fund through the use of cash, issuance of debt or equity securities or other external financing sources to the extent we were unable to fund such capital expenditures out of our cash and cash equivalents and cash generated from operations.

### ***Revolving Credit Facility***

On December 15, 2016, we entered into a credit agreement for \$150.0 million under an unsecured five-year revolving credit facility. Bank of America, N.A., is administrative agent and HSBC Bank Canada is the syndication agent and letter of credit issuer, and the lenders party thereto. Borrowings under the revolving credit facility may be made, in U.S. Dollars, Euros, Canadian Dollars, and in other currencies, subject to the approval of the administrative agent and the lenders. Up to \$35.0 million of the revolving credit facility is available for the issuance of letters of credit and up to \$25.0 million is available for the issuance of swing line loans. Commitments under the revolving credit facility may be increased by up to \$200.0 million, subject to certain conditions, including the approval of the lenders. Borrowings under the agreement may be prepaid and commitments may be reduced or terminated without premium or penalty (other than customary breakage costs). The principal amount outstanding under the credit agreement will be due and payable in full on December 15, 2021, subject to provisions that permit us to request a limited number of one year extensions annually.

Borrowings made under the revolving credit facility bear interest at a rate per annum equal to, at our option, either (a) a rate based on the rates applicable for deposits on the interbank market for U.S. Dollars or the applicable currency in which the borrowings are made ("LIBOR") or (b) an alternate base rate, plus, in each case, an applicable margin. The applicable margin is determined by reference to a pricing grid, based on the ratio of indebtedness to earnings before interest, tax depreciation, amortization and rent ("EBITDAR") and ranges between 1.00%-1.75% for LIBOR loans and 0.00%-0.75% for alternate base rate loans. Additionally, a commitment fee of between 0.125%-0.200%, also determined by reference to the pricing grid, is payable on the average daily unused amounts under the revolving credit facility.

The credit agreement contains negative covenants that, among other things and subject to certain exceptions, limit the ability of our subsidiaries to incur indebtedness, incur liens, undergo fundamental changes, make dispositions of all or substantially all of their assets, alter their businesses and enter into agreements limiting subsidiary dividends and distributions.

We are also required to maintain a consolidated rent-adjusted leverage ratio of not greater than 3.50:1.00 and we are not permitted to allow the ratio of consolidated EBITDAR to consolidated interest charges (plus rent) to be less than 2.00:1.00. The credit agreement also contains certain customary representations, warranties, affirmative covenants, and events of default (including, among others, an event of default upon the occurrence of a change of control). If an event of default occurs, the credit agreement may be terminated and the maturity of any outstanding amounts may be accelerated.

As of April 30, 2017, aside from letters of credit of \$0.8 million, we had no other borrowings outstanding under this credit facility.

### ***Off-Balance Sheet Arrangements***

We enter into standby letters of credit to secure certain of our obligations, including leases, taxes and duties. As of April 30, 2017, letters of credit and letters of guarantee totaling \$0.8 million had been issued.

We have not entered into any transactions, agreements or other contractual arrangements to which an entity unconsolidated with us is a party and under which we have (i) any obligation under a guarantee, (ii) any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity, (iii) any obligation under derivative instruments that are indexed to our shares and classified as equity in our consolidated balance sheets, or (iv) any obligation arising out of a variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with us.

### ***Critical Accounting Policies and Estimates***

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions. Predicting future events is inherently an imprecise activity and, as such, requires the use of judgment. Actual results may vary from our estimates in amounts that may be material to the financial statements. An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used or changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact our consolidated financial statements. Our critical accounting policies and estimates are discussed in our Annual Report on

Form 10-K for our 2016 fiscal year end filed with the SEC on March 29, 2017 and in Note 2 included in Item 1 of Part I of this Quarterly Report on Form 10-Q.

### **Operating Locations**

Our company-operated stores by brand and by country as of April 30, 2017 and January 29, 2017, are summarized in the table below.

	<u>April 30, 2017</u>	<u>January 29, 2017</u>
<b>lululemon</b>		
United States .....	247	245
Canada .....	51	51
Australia .....	27	27
United Kingdom .....	9	9
New Zealand .....	5	5
China .....	4	3
Hong Kong .....	3	3
Singapore .....	3	3
South Korea .....	2	2
Germany .....	1	1
Ireland .....	1	—
Japan .....	1	—
Puerto Rico .....	1	1
Switzerland .....	1	1
	<u>356</u>	<u>351</u>
<b>ivivva</b>		
United States .....	42	42
Canada .....	13	13
	<u>55</u>	<u>55</u>
<b>Total</b> .....	<u>411</u>	<u>406</u>

Retail locations operated by third parties under license and supply arrangements are not included in the above table. As of April 30, 2017, there were five licensed stores, including three in the United Arab Emirates, one in Mexico, and one in Qatar.

As part of the plan to restructure our ivivva operations, we plan to close approximately 40 of our 55 ivivva branded company-operated stores and to convert approximately half of the remaining stores to lululemon branded stores.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk represents the risk of loss that may impact our financial position due to adverse changes in financial market prices and rates. Our market risk exposure is primarily a result of fluctuations in interest rates and foreign currency exchange rates. We do not hold or issue financial instruments for trading purposes.

*Foreign Currency Exchange Risk.* The functional currency of our foreign subsidiaries is generally the applicable local currency. Our consolidated financial statements are presented in U.S. dollars. Therefore, the net revenue, expenses, assets, and liabilities of our foreign subsidiaries are translated from their functional currencies into U.S. dollars. Fluctuations in the value of the U.S. dollar affect the reported amounts of net revenue, expenses, assets, and liabilities. Foreign exchange differences which arise on translation of our foreign subsidiaries' balance sheets into U.S. dollars are recorded as a foreign currency translation adjustment in accumulated other comprehensive income or loss within stockholders' equity.

We also have exposure to changes in foreign exchange rates associated with transactions which are undertaken by our subsidiaries in currencies other than their functional currency. Such transactions include intercompany transactions and inventory purchases denominated in currencies other than the functional currency of the purchasing entity. As a result, we have

been impacted by changes in exchange rates and may be impacted for the foreseeable future. The potential impact of currency fluctuation increases as our international expansion increases.

We currently generate a significant portion of our net revenue and incur a significant portion of our expenses in Canada. We also hold a significant portion of our net assets in Canada. The reporting currency for our consolidated financial statements is the U.S. dollar. A strengthening of the U.S. dollar against the Canadian dollar results in:

- a decrease in our net revenue upon translation of the sales made by our Canadian operations into U.S. dollars for the purposes of consolidation;
- a decrease in our selling, general and administrative expenses incurred by our Canadian operations upon translation into U.S. dollars for the purposes of consolidation; and
- foreign exchange revaluation gains by our Canadian subsidiaries on U.S. dollar cash and receivables denominated in U.S. dollars.

During the first quarter of fiscal 2017, the change in the relative value of the U.S. dollar against the Canadian dollar resulted in a \$32.7 million increase in accumulated other comprehensive loss within stockholders' equity. During the first quarter of fiscal 2016, the change in the relative value of the U.S. dollar against the Canadian dollar resulted in a \$68.1 million reduction in accumulated other comprehensive loss within stockholders' equity.

A 10% appreciation in the relative value of the U.S. dollar against the Canadian dollar compared to the exchange rates in effect for the first quarter of fiscal 2017 would have resulted in additional income from operations of approximately \$3.5 million in the first quarter of fiscal 2017. This assumes a consistent 10% appreciation in the U.S. dollar against the Canadian dollar throughout the first quarter of fiscal 2017. The timing of changes in the relative value of the U.S. dollar combined with the seasonal nature of our business, can affect the magnitude of the impact that fluctuations in foreign exchange rates have on our income from operations.

We have not historically hedged foreign currency fluctuations. However, in the future, in an effort to mitigate these risks, we may enter into derivative financial instruments. We do not, and do not intend to, engage in the practice of trading derivative securities for profit.

*Interest Rate Risk.* Our revolving credit facility provides us with available borrowings in an amount up to \$150.0 million in the aggregate. Because our revolving credit facility bears interest at a variable rate, we will be exposed to market risks relating to changes in interest rates, if we have a meaningful outstanding balance. As of April 30, 2017, aside from letters of credit of \$0.8 million, we had no other borrowings outstanding under this credit facility. We currently do not engage in any interest rate hedging activity and currently have no intention to do so. However, in the future, if we have a meaningful outstanding balance under our revolving facility, in an effort to mitigate losses associated with these risks, we may at times enter into derivative financial instruments, although we have not historically done so. These may take the form of forward contracts, option contracts, or interest rate swaps. We do not, and do not intend to, engage in the practice of trading derivative securities for profit.

### ***Inflation***

Inflationary factors such as increases in the cost of our product and overhead costs may adversely affect our operating results. Although we do not believe that inflation has had a material impact on our financial position or results of operations to date, a high rate of inflation in the future may have an adverse effect on our ability to maintain current levels of gross margin and selling, general and administrative expenses as a percentage of net revenue if the selling prices of our products do not increase with these increased costs.

### **ITEM 4. CONTROLS AND PROCEDURES**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934, or the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer (principal executive officer) and Chief Financial Officer (principal financial officer and principal accounting officer), to allow timely decisions to be made regarding required disclosure. We have established a Disclosure Committee, consisting of certain members of management, to assist in this evaluation. The Disclosure Committee meets on a quarterly basis, and as needed.

Our management, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Exchange Act), at

April 30, 2017. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, at April 30, 2017, our disclosure controls and procedures were effective.

There were no changes in our internal control over financial reporting during the quarter ended April 30, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.