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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

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**Form 10-Q**

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(Mark One)

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

**For the quarterly period ended August 2, 2020**

or

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 001-33608**

**lululemon athletica inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

*(State or other jurisdiction of incorporation or organization)*

**20-3842867**

*(I.R.S. Employer Identification No.)*

**1818 Cornwall Avenue, Vancouver, British Columbia V6J 1C7**

*(Address of principal executive offices)*

**Registrant's telephone number, including area code:  
604-732-6124**

**Former name, former address and former fiscal year, if changed since last report:  
N/A**

**Securities registered pursuant to Section 12(b) of the Act:**

<u>Title of each class</u>	<u>Trading symbol(s)</u>	<u>Name of each exchange on which registered</u>
Common Stock, par value \$0.005 per share	LULU	Nasdaq Global Select Market

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

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

Large Accelerated Filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
Emerging growth company	<input type="checkbox"/>		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

At September 1, 2020, there were 124,920,793 shares of the registrant's common stock, par value \$0.005 per share, outstanding.

*Exchangeable and Special Voting Shares:*

At September 1, 2020, there were outstanding 5,392,512 exchangeable shares of Lulu Canadian Holding, Inc., a wholly-owned subsidiary of the registrant. Exchangeable shares are exchangeable for an equal number of shares of the registrant's common stock.

In addition, at September 1, 2020, the registrant had outstanding 5,392,512 shares of special voting stock, through which the holders of exchangeable shares of Lulu Canadian Holding, Inc. may exercise their voting rights with respect to the registrant. The special voting stock and the registrant's common stock generally vote together as a single class on all matters on which the common stock is entitled to vote.

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**PART I  
FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**lululemon athletica inc.  
CONSOLIDATED BALANCE SHEETS**

*(Unaudited; Amounts in thousands, except per share amounts)*

	<u>August 2, 2020</u>	<u>February 2, 2020</u>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 522,998	\$ 1,093,505
Accounts receivable	48,922	40,219
Inventories	672,773	518,513
Prepaid and receivable income taxes	125,019	85,159
Prepaid expenses and other current assets	120,043	70,542
	1,489,755	1,807,938
Property and equipment, net	698,514	671,693
Right-of-use lease assets	725,805	689,664
Goodwill	386,593	24,182
Intangible assets, net	84,471	241
Deferred income tax assets	31,591	31,435
Other non-current assets	77,298	56,201
	\$ 3,494,027	\$ 3,281,354
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities		
Accounts payable	\$ 122,767	\$ 79,997
Accrued inventory liabilities	31,675	6,344
Other accrued liabilities	177,436	112,641
Accrued compensation and related expenses	84,102	133,688
Current lease liabilities	147,941	128,497
Current income taxes payable	75,153	26,436
Unredeemed gift card liability	106,425	120,413
Other current liabilities	17,810	12,402
	763,309	620,418
Non-current lease liabilities	632,646	611,464
Non-current income taxes payable	43,150	48,226
Deferred income tax liabilities	46,901	43,432
Other non-current liabilities	6,919	5,596
	1,492,925	1,329,136
Commitments and contingencies		
Stockholders' equity		
Undesignated preferred stock, \$0.01 par value: 5,000 shares authorized; none issued and outstanding	—	—
Exchangeable stock, no par value: 60,000 shares authorized; 5,393 and 6,227 issued and outstanding	—	—
Special voting stock, \$0.000005 par value: 60,000 shares authorized; 5,393 and 6,227 issued and outstanding	—	—
Common stock, \$0.005 par value: 400,000 shares authorized; 124,917 and 124,122 issued and outstanding	625	621
Additional paid-in capital	358,414	355,541
Retained earnings	1,872,948	1,820,637
Accumulated other comprehensive loss	(230,885)	(224,581)
	2,001,102	1,952,218
	\$ 3,494,027	\$ 3,281,354

See accompanying notes to the unaudited interim consolidated financial statements

**lululemon athletica inc.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME**

*(Unaudited; Amounts in thousands, except per share amounts)*

	Quarter Ended		Two Quarters Ended	
	August 2, 2020	August 4, 2019	August 2, 2020	August 4, 2019
Net revenue	\$ 902,942	\$ 883,352	\$ 1,554,904	\$ 1,665,667
Cost of goods sold	413,441	397,556	731,001	758,151
Gross profit	489,501	485,796	823,903	907,516
Selling, general and administrative expenses	352,904	317,814	652,510	610,722
Amortization of intangible assets	724	—	724	—
Acquisition-related expenses	11,464	—	13,509	—
Income from operations	124,409	167,982	157,160	296,794
Other income (expense), net	(344)	1,850	830	4,229
Income before income tax expense	124,065	169,832	157,990	301,023
Income tax expense	37,264	44,842	42,557	79,430
Net income	\$ 86,801	\$ 124,990	\$ 115,433	\$ 221,593
Other comprehensive income:				
Foreign currency translation adjustment	54,300	4,514	(6,304)	(11,209)
Comprehensive income	\$ 141,101	\$ 129,504	\$ 109,129	\$ 210,384
Basic earnings per share	\$ 0.67	\$ 0.96	\$ 0.89	\$ 1.70
Diluted earnings per share	\$ 0.66	\$ 0.96	\$ 0.88	\$ 1.69
Basic weighted-average number of shares outstanding	130,245	130,285	130,248	130,489
Diluted weighted-average number of shares outstanding	130,799	130,783	130,802	131,060

See accompanying notes to the unaudited interim consolidated financial statements

**lululemon athletica inc.**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
*(Unaudited; Amounts in thousands)*

**Quarter Ended August 2, 2020**

	Exchangeable Stock	Special Voting Stock		Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
	Shares	Shares	Par Value	Shares	Par Value				
Balance at May 3, 2020	5,482	5,482	\$ —	124,717	\$ 624	\$ 334,201	\$1,786,147	\$ (285,185)	\$1,835,787
Net income							86,801		86,801
Foreign currency translation adjustment								54,300	54,300
Common stock issued upon exchange of exchangeable shares	(89)	(89)	—	89	—	—			—
Stock-based compensation expense						15,784			15,784
Common stock issued upon settlement of stock-based compensation				114	—	9,328			9,328
Shares withheld related to net share settlement of stock-based compensation				(3)	1	(899)			(898)
Balance at August 2, 2020	5,393	5,393	\$ —	124,917	\$ 625	\$ 358,414	\$1,872,948	\$ (230,885)	\$2,001,102

**Quarter Ended August 4, 2019**

	Exchangeable Stock	Special Voting Stock		Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
	Shares	Shares	Par Value	Shares	Par Value				
Balance at May 5, 2019	7,381	7,381	\$ —	122,900	\$ 615	\$ 317,204	\$1,281,432	\$ (232,531)	\$1,366,720
Net income							124,990		124,990
Foreign currency translation adjustment								4,514	4,514
Stock-based compensation expense						11,848			11,848
Common stock issued upon settlement of stock-based compensation				33	1	1,336			1,337
Shares withheld related to net share settlement of stock-based compensation				(2)	—	(461)			(461)
Repurchase of common stock				(10)	(1)	(12)	(1,556)		(1,569)
Balance at August 4, 2019	7,381	7,381	\$ —	122,921	\$ 615	\$ 329,915	\$1,404,866	\$ (228,017)	\$1,507,379

Two Quarters Ended August 2, 2020

	Exchangeable Stock	Special Voting Stock		Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
	Shares	Shares	Par Value	Shares	Par Value				
Balance at February 2, 2020	6,227	6,227	\$ —	124,122	\$ 621	\$ 355,541	\$1,820,637	\$ (224,581)	\$1,952,218
Net income							115,433		115,433
Foreign currency translation adjustment								(6,304)	(6,304)
Common stock issued upon exchange of exchangeable shares	(834)	(834)	—	834	4	(4)			—
Stock-based compensation expense						21,912			21,912
Common stock issued upon settlement of stock-based compensation				485	2	12,461			12,463
Shares withheld related to net share settlement of stock-based compensation				(155)	—	(30,957)			(30,957)
Repurchase of common stock				(369)	(2)	(539)	(63,122)		(63,663)
Balance at August 2, 2020	5,393	5,393	\$ —	124,917	\$ 625	\$ 358,414	\$1,872,948	\$ (230,885)	\$2,001,102

Two Quarters Ended August 4, 2019

	Exchangeable Stock	Special Voting Stock		Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
	Shares	Shares	Par Value	Shares	Par Value				
Balance at February 3, 2019	9,332	9,332	\$ —	121,600	\$ 608	\$ 315,285	\$1,346,890	\$ (216,808)	\$1,445,975
Net income							221,593		221,593
Foreign currency translation adjustment								(11,209)	(11,209)
Common stock issued upon exchange of exchangeable shares	(1,951)	(1,951)	—	1,951	10	(10)			—
Stock-based compensation expense						22,005			22,005
Common stock issued upon settlement of stock-based compensation				497	3	13,511			13,514
Shares withheld related to net share settlement of stock-based compensation				(117)	(1)	(19,399)			(19,400)
Repurchase of common stock				(1,010)	(5)	(1,477)	(163,617)		(165,099)
Balance at August 4, 2019	7,381	7,381	\$ —	122,921	\$ 615	\$ 329,915	\$1,404,866	\$ (228,017)	\$1,507,379

See accompanying notes to the unaudited interim consolidated financial statements

**lululemon athletica inc.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
*(Unaudited; Amounts in thousands)*

	<b>Two Quarters Ended</b>	
	<b>August 2, 2020</b>	<b>August 4, 2019</b>
Cash flows from operating activities		
Net income	\$ 115,433	\$ 221,593
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	84,176	70,422
Stock-based compensation expense	21,912	22,005
Settlement of derivatives not designated in a hedging relationship	(13,538)	(5,430)
Changes in operating assets and liabilities:		
Inventories	(138,194)	(93,358)
Prepaid and receivable income taxes	(39,860)	(63,187)
Prepaid expenses and other current and non-current assets	(76,811)	(45,539)
Accounts payable	35,967	15,791
Accrued inventory liabilities	25,322	(7,069)
Other accrued liabilities	53,868	3,367
Accrued compensation and related expenses	(49,037)	(7,486)
Current and non-current income taxes payable	43,926	(55,508)
Unredeemed gift card liability	(13,848)	(19,413)
Right-of-use lease assets and current and non-current lease liabilities	7,388	9,625
Other current and non-current liabilities	3,358	4,229
Net cash provided by operating activities	<u>60,062</u>	<u>50,042</u>
Cash flows from investing activities		
Purchase of property and equipment	(104,723)	(135,764)
Settlement of net investment hedges	10,981	5,062
Acquisition, net of cash acquired	(452,581)	—
Other investing activities	1,000	(1,267)
Net cash used in investing activities	<u>(545,323)</u>	<u>(131,969)</u>
Cash flows from financing activities		
Proceeds from settlement of stock-based compensation	12,463	13,514
Taxes paid related to net share settlement of stock-based compensation	(30,957)	(19,400)
Repurchase of common stock	(63,663)	(165,099)
Net cash used in financing activities	<u>(82,157)</u>	<u>(170,985)</u>
Effect of exchange rate changes on cash and cash equivalents	<u>(3,089)</u>	<u>(4,670)</u>
Decrease in cash and cash equivalents	<u>(570,507)</u>	<u>(257,582)</u>
Cash and cash equivalents, beginning of period	<u>\$ 1,093,505</u>	<u>\$ 881,320</u>
Cash and cash equivalents, end of period	<u>\$ 522,998</u>	<u>\$ 623,738</u>

See accompanying notes to the unaudited interim consolidated financial statements

**lululemon athletica inc.**  
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**lululemon athletica inc.**  
**NOTES TO THE UNAUDITED INTERIM CONSOLIDATED FINANCIAL**  
**STATEMENTS**

**NOTE 1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION**

*Nature of operations*

lululemon athletica inc., a Delaware corporation ("lululemon" and, together with its subsidiaries unless the context otherwise requires, the "Company") is engaged in the design, distribution, and retail of healthy lifestyle inspired athletic apparel and accessories. The Company primarily conducts its business through company-operated stores and direct to consumer through e-commerce. It also generates net revenue from outlets, sales from temporary locations, sales to wholesale accounts, and license and supply arrangements. The Company operates stores in the United States, Canada, the People's Republic of China ("PRC"), Australia, the United Kingdom, Japan, Germany, New Zealand, South Korea, Singapore, France, Malaysia, Sweden, Ireland, the Netherlands, Norway, and Switzerland. There were 506 and 491 company-operated stores in operation as of August 2, 2020 and February 2, 2020, respectively.

On July 7, 2020, the Company acquired Curiouser Products Inc., dba MIRROR, ("MIRROR") which has been consolidated from the date of acquisition. MIRROR generates net revenue from the sale of in-home fitness equipment and associated content subscriptions. Please refer to Note 3 for further information.

*COVID-19 Pandemic*

The outbreak of a novel strain of coronavirus ("COVID-19") was declared a global pandemic by the World Health Organization in March 2020.

In line with recommendations by public health officials and in accordance with governmental authority orders, the Company took actions to temporarily close the majority of its retail locations and to reduce operating hours. In February 2020, the Company temporarily closed all of its retail locations in Mainland China, and in March 2020, the Company temporarily closed all of its retail locations in North America, Europe, and certain countries in Asia Pacific. The stores in Mainland China reopened during the first quarter of fiscal 2020, and stores in other markets began reopening in accordance with local government and public health authority guidelines during the second quarter of fiscal 2020. The Company's stores are operating with restrictive measures in place such as reduced operating hours and limited occupancy levels. As of August 2, 2020, 492 of its company-operated stores were open. The Company's distribution centers in Columbus, Ohio and Sumner, Washington were temporarily closed for one and two weeks, respectively, during the first quarter of fiscal 2020 due to COVID-19.

In response to COVID-19, various government programs have been announced to provide financial relief for affected businesses. The most significant relief measures which the Company qualifies for are the Employee Retention Credit under the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") in the United States, and the Canada Emergency Wage Subsidy ("CEWS") under the COVID-19 Economic Response Plan in Canada. During the first two quarters of fiscal 2020, the Company recognized payroll subsidies totaling \$35.5 million under these wage subsidy programs and similar plans in other jurisdictions. These subsidies were recorded as a reduction in the associated wage costs which the Company incurred, and were recognized in selling, general and administrative expenses.

The Company also qualifies for and has deferred certain corporate income tax payments and employer payroll tax payments. The most significant is the deferral of \$127.5 million of Canadian corporate income tax payments which would otherwise have been paid during the first and second quarters of fiscal 2020 to the third quarter of fiscal 2020.

The Financial Accounting Standards Board ("FASB") staff issued guidance in April 2020 in relation to accounting for lease concessions made in connection with the effects of COVID-19. In accordance with this guidance, the Company has elected to treat COVID-19-related lease concessions as variable lease payments. The Company is actively negotiating commercially reasonable lease concessions. No significant lease concessions were recognized in the first two quarters of fiscal 2020.

Temporary store closures as a result of COVID-19 and associated reduction in operating income during the first two quarters of fiscal 2020 are considered to be an indicator of impairment and the Company performed an assessment of recoverability for the long-lived assets and right-of-use assets associated with closed retail locations. In the first quarter of fiscal 2020, the Company recognized an insignificant impairment charge as a result of this analysis.

Revenue is presented net of an allowance for expected returns, which is estimated based on historic return rates, trends, considering shifts towards increased online shopping by guests, and future expectations. In light of the store closures, the

Company has extended its return policy. The increase in the sales return allowance reflects the higher proportion of direct to consumer net revenue and anticipated delays in returns as a result of reduced capacity at retail location and closures.

The COVID-19 pandemic has materially impacted the Company's operations. The extent to which COVID-19 continues to impact the Company's operations, and in turn, its operating results and financial position will depend on future developments, which are highly uncertain and cannot be predicted, including new information that may emerge concerning the severity of COVID-19 and the actions taken to contain it or treat its impact. Continued proliferation of the virus, or resurgence, may result in further or prolonged closures of its retail locations and distribution centers, reduce operating hours, interrupt the Company's supply chain, cause changes in guest behavior, and reduce discretionary spending. Such factors could result in the impairment of long-lived assets and right-of-use assets and the need for an increased provision against the carrying value of the Company's inventories.

### ***Basis of presentation***

The unaudited interim consolidated financial statements as of August 2, 2020 and for the quarters and two quarters ended August 2, 2020 and August 4, 2019 are presented in United States dollars and have been prepared by the Company under the rules and regulations of the Securities and Exchange Commission ("SEC"). The financial information is presented in accordance with United States generally accepted accounting principles ("GAAP") for interim financial information and, accordingly, does not include all of the information and footnotes required by GAAP for complete financial statements. The financial information as of February 2, 2020 is derived from the Company's audited consolidated financial statements and related notes for the fiscal year ended February 2, 2020, which are included in Item 8 in the Company's fiscal 2019 Annual Report on Form 10-K filed with the SEC on March 26, 2020. These unaudited interim consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary to a fair statement of the results for the interim periods presented. These unaudited interim consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and related notes included in Item 8 in the Company's fiscal 2019 Annual Report on Form 10-K. Changes in the significant accounting policies of the Company compared to those described in the Company's fiscal 2019 Annual Report on Form 10-K as a result of the acquisition of MIRROR are described below, and Note 2 sets out the impact of recent accounting pronouncements.

The Company's fiscal year ends on the Sunday closest to January 31 of the following year, typically resulting in a 52-week year, but occasionally giving rise to an additional week, resulting in a 53-week year. Fiscal 2020 will end on January 31, 2021 and will be a 52-week year. Fiscal 2019 was a 52-week year.

The Company's business is affected by the pattern of seasonality common to most retail apparel businesses. Historically, the Company has recognized a significant portion of its operating profit in the fourth fiscal quarter of each year as a result of increased net revenue during the holiday season.

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

### ***Accounting policies related to the acquisition of MIRROR***

#### ***Business combinations***

The purchase price of an acquisition is measured as the aggregate of the fair value of the consideration transferred including the acquisition-date fair value of the Company's previously held equity interests. The purchase price is allocated to the fair values of the tangible and intangible assets acquired and liabilities assumed, with any excess recorded as goodwill. These fair value determinations require judgment and may involve the use of significant estimates and assumptions. The purchase price allocation may be provisional during a measurement period of up to one year to provide reasonable time to obtain the information necessary to identify and measure the assets acquired and liabilities assumed. Any such measurement period adjustments are recognized in the period in which the adjustment amount is determined. Transaction costs associated with the acquisition are expensed as incurred.

#### ***Goodwill and intangible assets***

Acquired finite-lived intangible assets are amortized on a straight-line basis over their estimated useful lives, and are reviewed for impairment when events or circumstances indicate that the asset group to which the intangible assets belong might be impaired. The Company revises the estimated remaining useful life of these assets when events or changes in circumstances warrant a revision. If the Company revises the useful life, the unamortized balance is amortized over the remaining useful life on a prospective basis.

Goodwill represents the excess of the aggregate of the consideration transferred over the net assets acquired and liabilities assumed and is tested annually for impairment, or more frequently if there are indicators of impairment.

### *Revenue recognition and cost of goods sold*

MIRROR generates net revenue from the sale of in-home fitness equipment and associated content subscriptions. Certain in-home fitness contracts contain multiple performance obligations, including hardware and a subscription service commitment. For customer contracts that contain multiple performance obligations the Company accounts for individual performance obligations if they are distinct. The transaction price is allocated to each performance obligation based on its standalone selling price.

The cost of digital content subscription services, including the costs of content creation, studio overhead, and related production departments is recorded in costs of goods sold.

## **NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS**

### ***Recently adopted accounting pronouncements***

In June 2016, the FASB issued guidance on ASC 326 *"Financial Instruments-Credit Losses: Measurement of Credit Losses on Financial Instruments"*. This guidance changes the impairment model for most financial assets and requires the use of a forward-looking expected loss model rather than incurred losses for instruments measured at amortized cost. Under this model, entities are required to estimate the lifetime expected credit loss on such instruments and record an allowance to offset the amortized cost basis of the financial asset, resulting in a net presentation of the amount expected to be collected on the financial asset. The Company adopted this update during the first quarter of fiscal 2020 and it did not have a material impact on the Company's consolidated financial statements.

### ***Recently issued accounting pronouncements***

In December 2019, the FASB issued guidance on ASC 740, *"Income Taxes"*. The amendments in this update simplify the accounting for income taxes by removing certain exceptions to the general principles in ASC 740. The amendments also improve consistent application and simplify GAAP for other areas of this topic by clarifying and amending existing guidance. This guidance is effective for the Company beginning in its first quarter of fiscal 2021 and early adoption is permitted. The Company is currently evaluating the impact that this new guidance may have on its consolidated financial statements but does not believe it will have a material impact.

In March 2020, the FASB released guidance on ASC 848, *"Reference Rate Reform: Facilitation of the Effects of Reference Rate Reform on Financial Reporting"*. This update provides optional expedients and exceptions to the current guidance on contracts, hedging relationships, and other transactions affected by reference rate reform if certain criteria are met. The amendments in this update apply only to contracts and hedging relationships that reference the London Interbank Offered Rate ("LIBOR") or another reference rate expected to be discontinued due to reference rate reform. The guidance was effective upon issuance and generally can be applied to applicable contract modifications through December 31, 2022. The Company is currently evaluating the impact that this new guidance may have on its consolidated financial statements but does not believe it will have a material impact.

## **NOTE 3. ACQUISITION**

On July 7, 2020, the Company acquired all of the outstanding shares of MIRROR, an in-home fitness company with an interactive workout platform that features live and on-demand classes. The results of operations, financial position, and cash flows of MIRROR have been included in the Company's consolidated financial statements since the date of acquisition.

The following table summarizes the fair value of the consideration transferred at the date of acquisition, as well as the calculation of goodwill based on the excess of consideration over the provisional fair value of net assets acquired. As part of the transaction, the Company assumed \$30.1 million of MIRROR's outstanding debt. This included \$15.1 million of external debt that was settled as part of the transaction and \$15.0 million of debt previously owed by MIRROR to the Company, which

represents the effective settlement of a preexisting relationship. The debt was determined to be at market terms and was recognized as a component of the consideration transferred, and no gain or loss was recorded on settlement.

	<b>July 7, 2020</b>
	<i>(in thousands)</i>
Fair value of consideration transferred:	
Cash paid to shareholders .....	\$ 428,261
Employee options attributed to pre-combination vesting .....	4,569
Acquired debt settled on acquisition .....	30,122
Fair value of existing lululemon investment .....	1,782
	<u>464,734</u>
Less cash and cash equivalents acquired .....	<u>(12,153)</u>
Fair value of consideration transferred, net of cash and cash equivalents acquired .....	\$ 452,581
Less net assets acquired:	
Assets acquired:	
Inventories .....	\$ 16,734
Prepaid expenses and other current assets .....	3,492
Intangible assets .....	85,000
Other non-current assets .....	5,648
	<u>\$ 110,874</u>
Liabilities assumed:	
Current liabilities .....	\$ (13,465)
Current and non-current lease liabilities .....	(3,246)
Net deferred income tax liability .....	(4,074)
	<u>\$ (20,785)</u>
Net assets acquired .....	<u>\$ 90,089</u>
Goodwill .....	<u>\$ 362,492</u>

The purchase price allocation remains provisional as the Company is still obtaining all information necessary to finalize the fair value of acquired intangibles, deferred taxes, certain contingencies, and resulting amount of goodwill as of the date of acquisition.

Goodwill relates to benefits expected as a result of the acquisition to MIRROR's business and has been allocated to the MIRROR reporting unit within the Company's other channels. None of the goodwill is expected to be deductible for income tax purposes.

The Company assigned a fair value to and estimated useful lives for the intangible assets acquired as part of the MIRROR business combination. The fair value of the separately identifiable intangible assets, and their estimated useful lives as of the acquisition date were as follows:

	<b>Estimated Fair Value</b>	<b>Estimated Useful Life</b>
	<i>(In thousands)</i>	
Intangible assets:		
Brand .....	\$ 26,500	20.0 years
Customer relationships .....	28,000	10.0 years
Technology .....	25,500	7.5 years
Content .....	5,000	5.0 years
	<u>\$ 85,000</u>	

Accounting for business combinations requires significant estimates and assumptions to derive the fair value of acquired assets and liabilities, and in the case of MIRROR, this is with specific reference to acquired intangible assets. The fair value of intangible assets was based upon widely-accepted valuation techniques, including discounted cash flows and relief from royalty and replacement cost methods, depending on the nature of the assets acquired or liabilities assumed. Inherent in each valuation technique are critical assumptions, including future revenue growth rates, gross margin, royalty rates, discount rates, and terminal value assumptions. The recognition of deferred tax assets in relation to the historic net operating losses of MIRROR relied on assumptions and estimates of the future profitability of the Company's US operations.

The Company has not disclosed pro forma information of the combined business as the transaction is not material to revenue or net earnings.

**Acquisition-related expenses**

In connection with the acquisition, the Company recognized certain acquisition-related expenses which are expensed as incurred. These expenses are recognized within acquisition-related expenses in the consolidated statements of operations include the following amounts:

- transaction and integration costs, including fees for advisory and professional services incurred as part of the acquisition and integration costs subsequent to the acquisition;
- acquisition-related compensation, including the partial acceleration of vesting of certain stock options, and amounts due to selling shareholders that are contingent upon continuing employment; and
- gain recognized on the Company's existing investment in the acquiree as of the acquisition date.

The following table summarizes the acquisition-related expenses recognized during fiscal 2020:

	<u>Quarter Ended</u> <u>August 2, 2020</u>	<u>Two Quarters</u> <u>Ended</u> <u>August 2, 2020</u>
	<i>(in thousands)</i>	
Acquisition-related expenses:		
Transaction and integration costs .....	\$ 7,201	\$ 9,246
Gain on existing investment .....	(782)	(782)
Acquisition-related compensation .....	<u>5,045</u>	<u>5,045</u>
	\$ 11,464	\$ 13,509
Income tax effects of acquisition-related expenses .....	\$ (1,967)	\$ (1,967)

In the first two quarters of fiscal 2020, the Company recognized an expense of \$2.9 million for the partial acceleration of vesting of certain stock options held by MIRROR employees, and recognized \$2.1 million related to deferred consideration.

The Company will recognize a total expense of \$57.1 million for deferred consideration which is due to certain continuing MIRROR employees, subject to the continued employment of those individuals through various vesting dates up to three years from the acquisition date. This acquisition-related compensation is expensed over the vesting periods as service is provided, and consists of cash payments, which are included within accrued compensation and related expenses until payments are made, and stock-based compensation awards that have been granted under the Company's 2014 Equity Incentive Plan to replace certain unvested options as of the acquisition date.

**NOTE 4. GOODWILL**

The Company's goodwill is assigned to its company-operated stores and other segments. The changes in the carrying amounts of goodwill were as follows:

	<b>Goodwill</b>
	<i>(In thousands)</i>
Balance as of February 2, 2020 .....	\$ 24,182
MIRROR acquisition .....	362,492
Effect of foreign currency translation .....	(81)
Balance as of August 2, 2020 .....	<u>\$ 386,593</u>

**NOTE 5. INTANGIBLE ASSETS, NET**

The carrying value of intangible assets, and their estimated remaining useful lives as of August 2, 2020 were as follows:

	<b>August 2, 2020</b>	<b>February 2, 2020</b>	<b>Remaining Useful Life</b>
	<i>(In thousands)</i>		
Intangible assets, net:			
Brand .....	\$ 26,390	\$ —	19.9 years
Customer relationships .....	27,758	—	9.9 years
Technology .....	25,211	—	7.4 years
Content .....	4,917	—	4.9 years
Other .....	195	241	2.2 years
	<u>\$ 84,471</u>	<u>\$ 241</u>	

**NOTE 6. CREDIT FACILITIES**

***North America revolving credit facility***

On June 6, 2018, the Company entered into Amendment No. 1 to its credit agreement. This amended the credit agreement to provide for (i) an increase in the aggregate commitments under the unsecured five-year revolving credit facility to \$400.0 million, with an increase of the sub-limits for the issuance of letters of credit and extensions of swing line loans to \$50.0 million for each, (ii) an increase in the option, subject to certain conditions as set forth in the credit agreement, to request increases in commitments under the revolving facility from \$400.0 million to \$600.0 million, and (iii) an extension in the maturity of the revolving facility from December 15, 2021 to June 6, 2023.

In addition, this amendment decreased the applicable margins for LIBOR loans from 1.00%-1.75% to 1.00%-1.50% and for alternate base rate loans from 0.00%-0.75% to 0.00%-0.50%, reduced the commitment fee on average daily unused amounts under the revolving facility from 0.125%-0.200% to 0.10%-0.20%, and reduced fees for unused letters of credit from 1.00%-1.75% to 1.00%-1.50%.

The Company is required to follow certain covenants. As of August 2, 2020, the Company was in compliance with these covenants.

The Company had no borrowings outstanding under this credit facility as of August 2, 2020 and February 2, 2020. As of August 2, 2020, the Company had letters of credit of \$2.3 million outstanding.

***Mainland China revolving credit facility***

In December 2019, the Company entered into an uncommitted and unsecured 130.0 million Chinese Yuan revolving credit facility. The terms are reviewed on an annual basis. The facility includes a revolving loan of up to 100.0 million Chinese Yuan as well as a financial bank guarantee facility of up to 30.0 million Chinese Yuan, or its equivalent in another currency. In U.S. dollars, the uncommitted and unsecured revolving credit facility is equivalent to \$18.6 million, the revolving loan is equivalent of up to \$14.3 million, and the financial bank guarantee facility is equivalent of up to \$4.3 million. Loans are available in Chinese Yuan for a period not to exceed 12 months, and interest accrues on them at a rate equal to 105% of the applicable PBOC Benchmark Lending Rate. Guarantees have a commission equal to 1% per annum of the outstanding amount.

The Company is required to follow certain covenants. As of August 2, 2020, the Company was in compliance with these covenants. As of August 2, 2020, there were no borrowings outstanding under this credit facility.

### ***364-Day revolving credit facility***

On June 29, 2020, the Company entered into a 364-day credit agreement providing for a \$300.0 million committed and unsecured revolving credit facility. The credit agreement matures on June 28, 2021. Bank of America, N.A., is administrative agent and swing line lender. Borrowings under the credit facility may be prepaid and commitments may be reduced or terminated without premium or penalty (other than customary breakage costs).

Borrowings made under the credit facility bear interest at a rate per annum equal to, at the Company's option, either (1) 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 (2) 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 1.50%-2.25% for LIBOR loans and 0.50%-1.25% for alternate base rate or Canadian prime rate loans. Additionally, a commitment fee of between 0.25%-0.55%, also determined by reference to the pricing grid, is payable on the average daily unused amounts under the credit facility.

The credit agreement contains negative covenants that, among other things and subject to certain exceptions, limit the ability of the Company's 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.

The Company is also required to maintain a consolidated rent-adjusted leverage ratio of not greater than 3.50:1.00 and the Company is 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 August 2, 2020, the Company was in compliance with the covenants. As of August 2, 2020, there were no borrowings outstanding under this credit facility.

## **NOTE 7. STOCK-BASED COMPENSATION AND BENEFIT PLANS**

### ***Stock-based compensation plans***

The Company's eligible employees participate in various stock-based compensation plans, which are provided by the Company directly.

Stock-based compensation expense charged to income for the plans was \$24.9 million and \$23.5 million for the two quarters ended August 2, 2020 and August 4, 2019, respectively. Total unrecognized compensation cost for all stock-based compensation plans was \$95.5 million at August 2, 2020, which is expected to be recognized over a weighted-average period of 2.2 years.

A summary of the balances of the Company's stock-based compensation plans as of August 2, 2020, and changes during the first two quarters then ended, is presented below:

	Stock Options		Performance-Based Restricted Stock Units		Restricted Shares		Restricted Stock Units		Restricted Stock Units (Liability Accounting)	
	Number	Weighted -Average Exercise Price	Number	Weighted -Average Grant Date Fair Value	Number	Weighted -Average Grant Date Fair Value	Number	Weighted -Average Grant Date Fair Value	Number	Weighted -Average Fair Value
<i>(In thousands, except per share amounts)</i>										
Balance at February 2, 2020	776	\$113.41	238	\$103.52	7	\$175.82	333	\$108.44	29	\$239.39
Granted	233	177.71	136	115.73	4	296.36	119	197.45	—	—
Exercised/released	145	85.80	171	63.03	7	175.82	165	86.93	—	—
Forfeited/expired	26	158.45	7	158.76	—	—	9	156.80	—	—
Balance at August 2, 2020	838	\$134.68	196	\$145.13	4	\$296.36	278	\$157.64	29	\$325.59
Exercisable at August 2, 2020	175	\$100.92								

The grant date fair value of each stock option granted is estimated on the date of grant using the Black-Scholes model. The assumptions used to calculate the fair value of the options granted are evaluated and revised, as necessary, to reflect market conditions and the Company's historical experience. The expected term of the options is based upon the historical experience of similar awards, giving consideration to expectations of future employee behavior. Expected volatility is based upon the historical volatility of the Company's common stock for the period corresponding with the expected term of the options. The risk-free interest rate is based on the U.S. Treasury yield curve for the period corresponding with the expected term of the options. The following are weighted averages of the assumptions that were used in calculating the fair value of stock options granted during the first two quarters of fiscal 2020:

	Two Quarters Ended August 2, 2020
Expected term	3.61 years
Expected volatility	40.03 %
Risk-free interest rate	0.32 %
Dividend yield	— %

The Company's performance-based restricted stock units are awarded to eligible employees and entitle the grantee to receive a maximum of two shares of common stock per performance-based restricted stock unit if the Company achieves specified performance goals and the grantee remains employed during the vesting period. The fair value of performance-based restricted stock units is based on the closing price of the Company's common stock on the award date. Expense for performance-based restricted stock units is recognized when it is probable that the performance goal will be achieved.

The grant date fair value of the restricted shares and restricted stock units is based on the closing price of the Company's common stock on the award date. Restricted stock units that are settled in cash or common stock at the election of the employee are remeasured to fair value at the end of each reporting period until settlement. This fair value is based on the closing price of the Company's common stock on the last business day before each period end.

### **Employee share purchase plan**

The Company's board of directors and stockholders approved the Company's Employee Share Purchase Plan ("ESPP") in September 2007. Contributions are made by eligible employees, subject to certain limits defined in the ESPP, and the Company matches one-third of the contribution. The maximum number of shares authorized to be purchased under the ESPP is 6.0 million shares. All shares purchased under the ESPP are purchased in the open market. During the quarter ended August 2, 2020, there were 14.9 thousand shares purchased.

### **Defined contribution pension plans**

The Company offers defined contribution pension plans to its eligible employees. Participating employees may elect to defer and contribute a portion of their eligible compensation to a plan up to limits stated in the plan documents, not to exceed

the dollar amounts set by applicable laws. The Company matches 50% to 75% of the contribution depending on the participant's length of service, and the contribution is subject to a two year vesting period. The Company's net expense for the defined contribution plans was \$4.5 million and \$4.3 million in the first two quarters of fiscal 2020 and fiscal 2019, respectively.

**NOTE 8. FAIR VALUE MEASUREMENT**

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements are made using a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value:

- Level 1 - defined as observable inputs such as quoted prices in active markets;
- Level 2 - defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and
- Level 3 - defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

***Assets and liabilities measured at fair value on a recurring basis***

The fair value measurement is categorized in its entirety by reference to its lowest level of significant input. As of August 2, 2020 and February 2, 2020, the Company held certain assets and liabilities that are required to be measured at fair value on a recurring basis:

	August 2, 2020	Level 1	Level 2	Level 3	Balance Sheet Classification
	<i>(In thousands)</i>				
Money market funds . . . . .	\$ 179,151	\$ 179,151	\$ —	\$ —	Cash and cash equivalents
Term deposits . . . . .	70,136	—	70,136	—	Cash and cash equivalents
Forward currency contract assets . . . . .	6,513	—	6,513	—	Prepaid expenses and other current assets
Forward currency contract liabilities . . . . .	6,559	—	6,559	—	Other current liabilities
	February 2, 2020	Level 1	Level 2	Level 3	Balance Sheet Classification
	<i>(In thousands)</i>				
Money market funds . . . . .	\$ 610,800	\$ 610,800	\$ —	\$ —	Cash and cash equivalents
Term deposits . . . . .	203,360	—	203,360	—	Cash and cash equivalents
Forward currency contract assets . . . . .	1,735	—	1,735	—	Prepaid expenses and other current assets
Forward currency contract liabilities . . . . .	1,920	—	1,920	—	Other current liabilities

The Company records accounts receivable, accounts payable, and accrued liabilities at cost. The carrying values of these instruments approximate their fair value due to their short-term maturities.

The Company has short-term, highly liquid investments classified as cash equivalents, which are invested in money market funds, Treasury bills, and term deposits. The Company records cash equivalents at their original purchase prices plus interest that has accrued at the stated rate.

The fair values of the forward currency contract assets and liabilities are determined using observable Level 2 inputs, including foreign currency spot exchange rates, forward pricing curves, and interest rates. The fair values consider the credit risk of the Company and its counterparties. The Company's Master International Swap Dealers Association, Inc., Agreements and other similar arrangements allow net settlements under certain conditions. However, the Company records all derivatives on its consolidated balance sheets at fair value and does not offset derivative assets and liabilities.

## **NOTE 9. DERIVATIVE FINANCIAL INSTRUMENTS**

### ***Foreign exchange risk***

The Company is exposed to risks associated with changes in foreign currency exchange rates and uses derivative financial instruments to manage its exposure to certain of these foreign currency exchange rate risks. The Company does not enter into derivative contracts for speculative or trading purposes.

The Company currently hedges against changes in the Canadian dollar to U.S. dollar exchange rate and changes in the Chinese Yuan to U.S. dollar exchange rate using forward currency contracts.

### ***Net investment hedges***

The Company is exposed to foreign exchange gains and losses which arise on translation of its foreign subsidiaries' balance sheets into U.S. dollars. These gains and losses are recorded as a foreign currency translation adjustment in accumulated other comprehensive income or loss within stockholders' equity.

The Company holds a significant portion of its assets in Canada and enters into forward currency contracts designed to hedge a portion of the foreign currency exposure that arises on translation of a Canadian subsidiary into U.S. dollars. These forward currency contracts are designated as net investment hedges. The effective portions of the hedges are reported in accumulated other comprehensive income or loss and will subsequently be reclassified to net earnings in the period in which the hedged investment is either sold or substantially liquidated. Hedge effectiveness is measured using a method based on changes in forward exchange rates. The Company recorded no ineffectiveness from net investment hedges during the first two quarters of fiscal 2020.

The Company classifies the cash flows at settlement of its net investment hedges within investing activities in the consolidated statements of cash flows.

### ***Derivatives not designated as hedging instruments***

The Company is exposed to gains and losses arising from changes in foreign exchange rates associated with transactions which are undertaken by its subsidiaries in currencies other than their functional currency. Such transactions include intercompany transactions and inventory purchases. These transactions result in the recognition of certain foreign currency denominated monetary assets and liabilities which are remeasured to the quarter-end or settlement date exchange rate. The resulting foreign currency gains and losses are recorded in selling, general and administrative expenses.

During the first two quarters of fiscal 2020, the Company entered into certain forward currency contracts designed to economically hedge the foreign exchange revaluation gains and losses that are recognized by its Canadian and Chinese subsidiaries on U.S. dollar denominated monetary assets and liabilities. The Company has not applied hedge accounting to these instruments and the change in fair value of these derivatives is recorded within selling, general and administrative expenses.

The Company classifies the cash flows at settlement of its forward currency contracts which are not designated in hedging relationships within operating activities in the consolidated statements of cash flows.

### ***Quantitative disclosures about derivative financial instruments***

The Company presents its derivative assets and derivative liabilities at their gross fair values within prepaid expenses and other current assets and other current liabilities on the consolidated balance sheets. However, the Company's Master International Swap Dealers Association, Inc., Agreements and other similar arrangements allow net settlements under certain conditions. As of August 2, 2020, there were derivative assets of \$6.5 million and derivative liabilities of \$6.6 million subject to enforceable netting arrangements.

The notional amounts and fair values of forward currency contracts were as follows:

	August 2, 2020			February 2, 2020		
	Gross Notional	Assets	Liabilities	Gross Notional	Assets	Liabilities
	<i>(In thousands)</i>					
Derivatives designated as net investment hedges:						
Forward currency contracts	\$ 721,000	\$ —	\$ 5,870	\$ 417,000	\$ 1,583	\$ —
Derivatives not designated in a hedging relationship:						
Forward currency contracts	726,000	6,513	689	460,000	152	1,920
Net derivatives recognized on consolidated balance sheets:						
Forward currency contracts		<u>\$ 6,513</u>	<u>\$ 6,559</u>		<u>\$ 1,735</u>	<u>\$ 1,920</u>

The forward currency contracts designated as net investment hedges outstanding as of August 2, 2020 mature on different dates between August 2020 and February 2021.

The forward currency contracts not designated in a hedging relationship outstanding as of August 2, 2020 mature on different dates between August 2020 and January 2021.

The pre-tax gains and losses on foreign exchange forward contracts recorded in accumulated other comprehensive income or loss were as follows:

	Quarter Ended		Two Quarters Ended	
	August 2, 2020	August 4, 2019	August 2, 2020	August 4, 2019
	<i>(In thousands)</i>			
Gains (losses) recognized in foreign currency translation adjustment:				
Derivatives designated as net investment hedges	\$ (24,728)	\$ (4,822)	\$ 3,528	\$ 1,941

No gains or losses have been reclassified from accumulated other comprehensive income or loss into net income for derivative financial instruments in a net investment hedging relationship, as the Company has not sold or liquidated (or substantially liquidated) its hedged subsidiary.

The pre-tax net foreign exchange and derivative gains and losses recorded in the consolidated statement of operations were as follows:

	Quarter Ended		Two Quarters Ended	
	August 2, 2020	August 4, 2019	August 2, 2020	August 4, 2019
	<i>(In thousands)</i>			
Gains (losses) recognized in selling, general and administrative expenses:				
Foreign exchange gains (losses)	\$ (23,867)	\$ (4,452)	\$ 3,874	\$ 1,245
Derivatives not designated in a hedging relationship	21,574	5,121	(5,946)	(1,510)
Net foreign exchange and derivative gains (losses)	<u>\$ (2,293)</u>	<u>\$ 669</u>	<u>\$ (2,072)</u>	<u>\$ (265)</u>

### **Credit risk**

The Company is exposed to credit-related losses in the event of nonperformance by the counterparties to the forward currency contracts. The credit risk amount is the Company's unrealized gains on its derivative instruments, based on foreign currency rates at the time of nonperformance.

The Company's forward currency contracts are entered into with large, reputable financial institutions that are monitored by the Company for counterparty risk.

The Company's derivative contracts contain certain credit risk-related contingent features. Under certain circumstances, including an event of default, bankruptcy, termination, and cross default under the Company's revolving credit facility, the Company may be required to make immediate payment for outstanding liabilities under its derivative contracts.

**NOTE 10. EARNINGS PER SHARE**

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

	Quarter Ended		Two Quarters Ended	
	August 2, 2020	August 4, 2019	August 2, 2020	August 4, 2019
	<i>(In thousands, except per share amounts)</i>			
Net income	\$ 86,801	\$ 124,990	\$ 115,433	\$ 221,593
Basic weighted-average number of shares outstanding	130,245	130,285	130,248	130,489
Assumed conversion of dilutive stock options and awards	554	498	554	571
Diluted weighted-average number of shares outstanding	130,799	130,783	130,802	131,060
Basic earnings per share	\$ 0.67	\$ 0.96	\$ 0.89	\$ 1.70
Diluted earnings per share	\$ 0.66	\$ 0.96	\$ 0.88	\$ 1.69

The Company's calculation of weighted-average shares includes the common stock of the Company as well as the exchangeable shares. Exchangeable shares are the equivalent of common shares in all material respects. All classes of stock have, in effect, the same rights and share equally in undistributed net income. For the two quarters ended August 2, 2020 and August 4, 2019, 58.2 thousand and 75.1 thousand stock options and awards, respectively, were anti-dilutive to earnings per share and therefore have been excluded from the computation of diluted earnings per share.

On January 31, 2019, the Company's board of directors approved a stock repurchase program for up to \$500.0 million of the Company's common shares on the open market or in privately negotiated transactions. Common shares repurchased on the open market are at prevailing market prices, including under plans complying with the provisions of Rule 10b5-1 and Rule 10b-18 of the Securities Exchange Act of 1934. The timing and actual number of common shares to be repurchased will depend upon market conditions, eligibility to trade, and other factors, in accordance with Securities and Exchange Commission requirements. As of March 31, 2020, the Company temporarily paused its share repurchase program. As of August 2, 2020, the remaining aggregate value of shares available to be repurchased under this program was \$263.6 million.

During the two quarters ended August 2, 2020 and August 4, 2019, 0.4 million and 1.0 million shares, respectively, were repurchased under the program at a total cost of \$63.7 million and \$165.1 million, respectively.

Subsequent to August 2, 2020, and up to September 1, 2020, no shares were repurchased.

**NOTE 11. SUPPLEMENTARY FINANCIAL INFORMATION**

A summary of certain consolidated balance sheet accounts is as follows:

	August 2, 2020	February 2, 2020
	<i>(In thousands)</i>	
Inventories:		
Finished goods	\$ 700,034	\$ 540,580
Provision to reduce inventories to net realizable value	(27,261)	(22,067)
	<u>\$ 672,773</u>	<u>\$ 518,513</u>

	August 2, 2020	February 2, 2020
	<i>(In thousands)</i>	
Prepaid expenses and other current assets:		
Prepaid expenses	\$ 70,753	\$ 64,568
Forward currency contract assets	6,513	1,735
Government payroll subsidy receivables	32,700	—
Other current assets	10,077	4,239
	<u>\$ 120,043</u>	<u>\$ 70,542</u>
Property and equipment, net:		
Land	\$ 70,843	\$ 71,829
Buildings	29,910	30,187
Leasehold improvements	535,033	489,202
Furniture and fixtures	111,565	109,533
Computer hardware	102,263	95,399
Computer software	368,195	336,768
Equipment and vehicles	15,137	19,521
Work in progress	58,429	40,930
Property and equipment, gross	1,291,375	1,193,369
Accumulated depreciation	(592,861)	(521,676)
	<u>\$ 698,514</u>	<u>\$ 671,693</u>
Other non-current assets:		
Cloud computing arrangement implementation costs	\$ 45,999	\$ 24,648
Security deposits	21,858	19,901
Other	9,441	11,652
	<u>\$ 77,298</u>	<u>\$ 56,201</u>
Other accrued liabilities		
Accrued duty, freight, and other operating expenses	\$ 93,658	\$ 59,403
Sales return allowances	30,093	12,897
Sales tax collected	19,301	17,370
Accrued capital expenditures	13,624	5,457
Forward currency contract liabilities	6,559	1,920
Accrued rent	6,117	8,356
Other	8,084	7,238
	<u>\$ 177,436</u>	<u>\$ 112,641</u>

**NOTE 12. SEGMENTED INFORMATION AND DISAGGREGATED NET REVENUE**

The Company applies ASC Topic 280, *Segment Reporting* ("ASC 280"), in determining reportable segments for its financial statement disclosure. The Company reports segments based on the financial information it uses in managing its business. The Company's reportable segments are comprised of company-operated stores and direct to consumer. Direct to consumer represents sales from the Company's e-commerce websites and mobile apps. Other net revenue includes revenue from outlets, temporary locations, sales to wholesale accounts, license and supply arrangements, and the sale of in-home fitness equipment and associated content subscriptions. During the first quarter of fiscal 2020, the Company reviewed its segment and general corporate expenses and determined certain costs that are more appropriately classified in different categories. Accordingly, comparative figures have been reclassified to conform to the financial presentation adopted for the current year.

	Quarter Ended		Two Quarters Ended	
	August 2, 2020	August 4, 2019	August 2, 2020	August 4, 2019
	<i>(In thousands)</i>			
Net revenue:				
Company-operated stores	\$ 287,201	\$ 583,756	\$ 547,171	\$ 1,090,178
Direct to consumer	554,302	217,636	906,341	427,480
Other	61,439	81,960	101,392	148,009
	<u>\$ 902,942</u>	<u>\$ 883,352</u>	<u>\$ 1,554,904</u>	<u>\$ 1,665,667</u>
Segmented income (loss) from operations:				
Company-operated stores	\$ (5,293)	\$ 154,316	\$ (35,447)	\$ 275,227
Direct to consumer	237,595	86,618	394,542	165,955
Other	2,587	16,418	2,318	29,041
	<u>234,889</u>	<u>257,352</u>	<u>361,413</u>	<u>470,223</u>
General corporate expense	98,292	89,370	190,020	173,429
Amortization of intangible assets	724	—	724	—
Acquisition-related expenses	11,464	—	13,509	—
Income from operations	<u>124,409</u>	<u>167,982</u>	<u>157,160</u>	<u>296,794</u>
Other income (expense), net	(344)	1,850	830	4,229
Income before income tax expense	<u>\$ 124,065</u>	<u>\$ 169,832</u>	<u>\$ 157,990</u>	<u>\$ 301,023</u>
Capital expenditures:				
Company-operated stores	\$ 27,316	\$ 42,026	\$ 61,135	\$ 80,736
Direct to consumer	9,781	7,584	12,079	13,810
Corporate and other	15,525	17,720	31,509	41,218
	<u>\$ 52,622</u>	<u>\$ 67,330</u>	<u>\$ 104,723</u>	<u>\$ 135,764</u>
Depreciation and amortization:				
Company-operated stores	\$ 21,963	\$ 23,712	\$ 47,591	\$ 44,772
Direct to consumer	2,928	2,970	5,612	5,432
Corporate and other	15,753	10,917	30,973	20,218
	<u>\$ 40,644</u>	<u>\$ 37,599</u>	<u>\$ 84,176</u>	<u>\$ 70,422</u>

The following table disaggregates the Company's net revenue by geographic area.

	Quarter Ended		Two Quarters Ended	
	August 2, 2020	August 4, 2019	August 2, 2020	August 4, 2019
	<i>(In thousands)</i>			
United States .....	\$ 595,918	\$ 621,843	\$ 1,055,270	\$ 1,175,490
Canada .....	147,658	145,605	247,155	269,250
Outside of North America .....	159,366	115,904	252,479	220,927
	<u>\$ 902,942</u>	<u>\$ 883,352</u>	<u>\$ 1,554,904</u>	<u>\$ 1,665,667</u>

The following table disaggregates the Company's net revenue by category.

	Quarter Ended		Two Quarters Ended	
	August 2, 2020	August 4, 2019	August 2, 2020	August 4, 2019
	<i>(In thousands)</i>			
Women's product .....	\$ 649,310	\$ 616,197	\$ 1,129,623	\$ 1,179,180
Men's product .....	191,019	212,727	320,148	382,946
Other categories .....	62,613	54,428	105,133	103,541
	<u>\$ 902,942</u>	<u>\$ 883,352</u>	<u>\$ 1,554,904</u>	<u>\$ 1,665,667</u>

**NOTE 13. LEGAL PROCEEDINGS AND OTHER CONTINGENCIES**

In addition to the legal proceedings described below, the Company is, from time to time, involved in routine legal matters, and audits and inspections by governmental agencies and other third parties which are incidental to the conduct of its business. This includes legal matters such as initiation and defense of proceedings to protect intellectual property rights, personal injury claims, product liability claims, employment claims, and similar matters. The Company believes the ultimate resolution of any such legal proceedings, audits, and inspections will not have a material adverse effect on its consolidated balance sheets, results of operations or cash flows.

On October 9, 2015, certain current and former hourly employees of the Company filed a class action lawsuit in the Supreme Court of New York entitled *Rebecca Gathmann-Landini et al v. lululemon USA inc.* On December 2, 2015, the case was moved to the United States District Court for the Eastern District of New York. The lawsuit alleges that the Company violated various New York labor codes by failing to pay all earned wages, including overtime compensation. The plaintiffs are seeking an unspecified amount of damages. The Company intends to vigorously defend this matter.

On March 23, 2020, a former retail employee filed a representative action in the Los Angeles Superior Court alleging violation of the Private Attorney General Act ("PAGA") based on purported California labor code violations including failure to pay wages, failure to pay overtime, failure to provide accurate itemized statements, and failure to provide meal and rest periods. The plaintiff is seeking to recover civil penalties under PAGA. The Company intends to vigorously defend this matter.

On April 9, 2020, Align Activation Wear, LLC filed a lawsuit in the United States District Court for the Central District of California alleging federal trademark infringement, false designation of origin and unfair competition. The plaintiff is seeking injunctive relief, monetary damages and declaratory relief. The Company intends to vigorously defend this matter.

**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 the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. 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, the impact of the COVID-19 pandemic on our business and results of operations, expectations related to our acquisition of MIRROR, 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 fiscal 2019 Annual Report on Form 10-K filed with the SEC on March 26, 2020.

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 athletica inc. is principally a designer, distributor, and retailer of healthy lifestyle inspired athletic apparel and accessories. We have a vision to be the experiential brand that ignites a community of people through sweat, grow, and connect, which we call "living the sweatlife." Since our inception, we have fostered a distinctive corporate culture; 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 achieve personal and professional goals, and share our purpose "to elevate the world by unleashing the full potential within every one of us."

Our healthy lifestyle inspired athletic apparel and accessories are marketed under the lululemon brand. We offer a comprehensive line of apparel and accessories for women and men. Our apparel assortment includes items such as pants, shorts, tops, and jackets designed for a healthy lifestyle including athletic activities such as yoga, running, training, and most other sweaty pursuits. We also offer fitness-related accessories.

During the second quarter of fiscal 2020, we acquired Curiouser Products Inc., dba MIRROR, for a purchase price of approximately \$500.0 million, of which approximately \$57.1 million is due to certain continuing employees subject to their continued employment through various vesting dates up to three years after the closing date of the transaction. MIRROR is a leading in-home fitness company with an interactive workout platform that features live and on-demand classes. The acquisition of MIRROR will bolster our digital sweatlife offerings and bring immersive and personalized in-home sweat, and mindfulness solutions to new and existing lululemon guests.

## **COVID-19 Pandemic**

The outbreak of a novel strain of coronavirus ("COVID-19") was declared a global pandemic by the World Health Organization in March 2020. The spread of COVID-19 has caused public health officials to impose restrictions and to recommend precautions to mitigate the spread of the virus, especially when congregating in heavily populated areas, such as malls and lifestyle centers.

We have taken actions to temporarily close retail locations and to reduce operating hours, and we continue to monitor the situation and work closely with local authorities to prioritize the safety of our people and guests. In February 2020, we temporarily closed all of our retail locations in Mainland China. In March 2020, we temporarily closed all of our retail locations in North America, Europe, and certain countries in Asia Pacific. The stores in Mainland China reopened during the first quarter of fiscal 2020, and stores in other markets began reopening in accordance with local government and public health authority guidelines during the second quarter of fiscal 2020. As of August 2, 2020, 492 of our company-operated stores were open. Our distribution centers in Columbus, Ohio and Sumner, Washington were temporarily closed for one and two weeks, respectively, during the first quarter of fiscal 2020 due to COVID-19. As of August 2, 2020, all of our distribution centers were open.

Our retail locations and distribution centers are operating with restrictive and precautionary measures in place such as reduced operating hours, physical distancing, enhanced cleaning and sanitation, and limited occupancy levels. This pandemic has also impacted the operations of our third party logistics providers and our manufacturing and supply partners, including through the closure or reduced capacity of facilities, and operational changes to accommodate physical distancing. As the pandemic continues, we may face further disruptions or increased operational and logistics costs throughout our supply chain.

There is significant uncertainty regarding the extent and duration of the impact that the COVID-19 pandemic will have on our store operations, the demand for our products, and on our supply chain. It had a material adverse impact on our results of operations for the first two quarters of fiscal 2020, and we expect it to continue to impact our results of operations, financial position, and liquidity. The extent to which COVID-19 impacts our results will depend on future developments, which are highly uncertain and cannot be predicted, including new information that may emerge concerning the severity of COVID-19 and the actions taken to contain it or treat its impact.

We remain confident in the long-term growth opportunities and our Power of Three growth plan and believe that we have sufficient cash and cash equivalents, and available capacity under our revolving credit facilities, to meet our liquidity needs. As of August 2, 2020, we had cash and cash equivalents of \$523.0 million and the capacity under our committed revolving credit facilities was \$697.7 million.

### ***Financial Highlights***

For the second quarter of fiscal 2020, compared to the second quarter of fiscal 2019:

- Net revenue increased 2% to \$902.9 million. On a constant dollar basis, net revenue increased 3%.
- Company-operated stores net revenue decreased 51% to \$287.2 million.
- Direct to consumer net revenue increased 155% to \$554.3 million, or increased 157% on a constant dollar basis. We held an online warehouse sale during the second quarter of fiscal 2020 which generated net revenue of \$43.3 million.
- Gross profit increased 1% to \$489.5 million.
- Gross margin decreased 80 basis points to 54.2%.
- Acquisition-related expenses of \$11.5 million were recognized.
- Income from operations decreased 26% to \$124.4 million.
- Operating margin decreased 520 basis points to 13.8%.
- Income tax expense decreased 17% to \$37.3 million. Our effective tax rate for the second quarter of fiscal 2020 was 30.0% compared to 26.4% for the second quarter of fiscal 2019.
- Diluted earnings per share were \$0.66 compared to \$0.96 in the second quarter of fiscal 2019. This includes \$9.5 million of after-tax costs related to the MIRROR acquisition, which reduced diluted earnings per share by \$0.08 for the second quarter of fiscal 2020.

As the temporary store closures from COVID-19 have resulted in a significant number of stores being removed from our comparable store base, total comparable sales and comparable store sales are not currently representative of the underlying trends of our business. We do not believe these metrics are currently useful to investors in understanding performance, therefore we have not included these metrics in our discussion and analysis of results of operations.

Refer to the non-GAAP reconciliation tables contained in the "Non-GAAP Financial Measures" 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 and direct to consumer net revenue and the most directly comparable measures calculated in accordance with GAAP.

## Results of Operations

### Second Quarter Results

The following table summarizes key components of our results of operations for the quarters ended August 2, 2020 and August 4, 2019. The percentages are presented as a percentage of net revenue.

	Quarter Ended			
	August 2, 2020	August 4, 2019	August 2, 2020	August 4, 2019
	<i>(In thousands)</i>		<i>(Percentages)</i>	
Net revenue	\$ 902,942	\$ 883,352	100.0 %	100.0 %
Cost of goods sold	413,441	397,556	45.8	45.0
Gross profit	489,501	485,796	54.2	55.0
Selling, general and administrative expenses	352,904	317,814	39.1	36.0
Amortization of intangible assets	724	—	0.1	—
Acquisition-related expenses	11,464	—	1.3	—
Income from operations	124,409	167,982	13.8	19.0
Other income (expense), net	(344)	1,850	—	0.2
Income before income tax expense	124,065	169,832	13.7	19.2
Income tax expense	37,264	44,842	4.1	5.1
Net income	\$ 86,801	\$ 124,990	9.6 %	14.1 %

### Net Revenue

Net revenue increased \$19.6 million, or 2%, to \$902.9 million for the second quarter of fiscal 2020 from \$883.4 million for the second quarter of fiscal 2019. On a constant dollar basis, assuming the average exchange rates for the second quarter of fiscal 2020 remained constant with the average exchange rates for the second quarter of fiscal 2019, net revenue increased \$26.6 million, or 3%.

The increase in net revenue was primarily due to increased direct to consumer net revenue. This was partially offset by a decrease in company-operated store revenue, as well as a decrease in net revenue from our other channels driven by temporary retail location closures as well as reduced operating hours and limited guest occupancy levels as a result of COVID-19.

Net revenue on a segment basis for the quarters ended August 2, 2020 and August 4, 2019 is summarized below. The percentages are presented as a percentage of total net revenue.

	Quarter Ended			
	August 2, 2020	August 4, 2019	August 2, 2020	August 4, 2019
	<i>(In thousands)</i>		<i>(Percentages)</i>	
Company-operated stores	\$ 287,201	\$ 583,756	31.8 %	66.1 %
Direct to consumer	554,302	217,636	61.4	24.6
Other	61,439	81,960	6.8	9.3
Net revenue	\$ 902,942	\$ 883,352	100.0 %	100.0 %

*Company-Operated Stores.* Net revenue from our company-operated stores segment decreased \$296.6 million, or 51%, to \$287.2 million in the second quarter of fiscal 2020 from \$583.8 million in the second quarter of fiscal 2019. The decrease in net revenue from our company-operated stores segment was primarily due to the impact of COVID-19, including temporary store closures, reduced operating hours, and occupancy restrictions.

*Direct to Consumer.* Net revenue from our direct to consumer segment increased \$336.7 million, or 155%, to \$554.3 million in the second quarter of fiscal 2020 from \$217.6 million in the second quarter of fiscal 2019. Direct to consumer net revenue increased 157% on a constant dollar basis. The increase in net revenue from our direct to consumer segment was primarily a result of increased website traffic and improved conversion rates. This was partially offset by a decrease in dollar value per transaction. The shift in the way guests are shopping continued in the second quarter of fiscal 2020 as a result of COVID-19, with more guests shopping online instead of in-store. During the second quarter of fiscal 2020, we held an online warehouse sale in the United States and Canada which generated net revenue of \$43.3 million. We did not hold any warehouse sales during the second quarter of fiscal 2019.

*Other.* Net revenue from our other segment decreased \$20.5 million, or 25%, to \$61.4 million in the second quarter of fiscal 2020 from \$82.0 million in the second quarter of fiscal 2019. This decrease was primarily the result of COVID-19, including temporary location closures, reduced operating hours, and occupancy restrictions.

### **Gross Profit**

Gross profit increased \$3.7 million, or less than 1%, to \$489.5 million for the second quarter of fiscal 2020 from \$485.8 million for the second quarter of fiscal 2019.

Gross profit as a percentage of net revenue, or gross margin, decreased 80 basis points to 54.2% in the second quarter of fiscal 2020 from 55.0% in the second quarter of fiscal 2019. The decrease in gross margin was primarily the result of:

- an increase in costs as a percentage of revenue related to our distribution centers of 130 basis points; and
- an unfavorable impact of foreign exchange rates of 20 basis points.

This was partially offset by a decrease in costs related to our product departments as a percentage of revenue of 40 basis points, and a decrease in depreciation and occupancy costs as a percentage of revenue of 30 basis points. Product margin was consistent with the second quarter of fiscal 2019 primarily due to lower product costs and product mix, offset by higher markdowns.

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

Selling, general and administrative expenses increased \$35.1 million, or 11%, to \$352.9 million in the second quarter of fiscal 2020 from \$317.8 million in the second quarter of fiscal 2019. The increase in selling, general and administrative expenses was primarily due to:

- an increase in costs related to our operating channels of \$38.7 million, comprised of:
  - an increase in variable costs of \$36.9 million primarily due to an increase in distribution costs as a result of increased direct to consumer net revenue;
  - an increase in other costs of \$19.2 million primarily due to increased digital marketing expenses; and
  - a decrease in employee costs of \$17.4 million primarily due to lower incentive compensation expenses in our company-operated store and other channels;
- an increase in head office costs of \$14.3 million, comprised of:
  - an increase of \$15.8 million primarily due to increases in information technology costs, professional fees, and depreciation; and
  - a decrease in employee costs of \$1.5 million primarily due to decreased travel and decreased incentive compensation expense, partially offset by increased salaries and wages expense as a result of headcount growth, and stock-based compensation expense; and
- an increase in net foreign exchange and derivative revaluation losses of \$3.0 million.

The increase in selling, general and administrative expenses was partially offset by \$20.9 million of government payroll subsidies which were recognized during the second quarter of fiscal 2020.

As a percentage of net revenue, selling, general and administrative expenses increased 310 basis points, to 39.1% in the second quarter of fiscal 2020 from 36.0% in the second quarter of fiscal 2019.

### **Amortization of intangible assets**

Amortization of intangible assets was \$0.7 million in the second quarter of fiscal 2020. This was primarily the result of the recognition of intangible assets of \$85.0 million in the second quarter of fiscal 2020 as a result of our acquisition of MIRROR. We did not recognize an expense for the amortization of intangible assets in the second quarter of fiscal 2019.

### **Acquisition-related expenses**

As a result of our acquisition of MIRROR in the second quarter of fiscal 2020, we recognized acquisition-related expenses of \$11.5 million in the second quarter of fiscal 2020. This included transaction and integration related costs of \$7.2 million for advisory and professional services, and integration costs subsequent to the acquisition. This also included acquisition-related compensation of \$5.0 million for the partial acceleration of vesting of certain options and deferred

consideration due to certain continuing MIRROR employees. Acquisition-related expenses were partially offset by a \$0.8 million gain recognized on our existing investment. We did not have acquisition-related expenses in the second quarter of fiscal 2019. Please refer to Note 3 to the unaudited interim consolidated financial statements included in Item 1 of Part I of this report for further information.

### Income from Operations

Income from operations decreased \$43.6 million, or 26%, to \$124.4 million in the second quarter of fiscal 2020 from \$168.0 million in the second quarter of fiscal 2019. Operating margin decreased 520 basis points to 13.8% compared to 19.0% in the second quarter of fiscal 2019.

On a segment basis, we determine income from operations without taking into account our general corporate expenses. During the first quarter of fiscal 2020, we reviewed our segment and general corporate expenses and determined certain costs that are more appropriately classified in different categories. Accordingly, comparative figures have been reclassified to conform to the financial presentation adopted for the current year.

Segmented income (loss) from operations for the quarters ended August 2, 2020 and August 4, 2019 is summarized below. The percentages are presented as a percentage of net revenue of the respective operating segments.

	Quarter Ended			
	August 2, 2020	August 4, 2019	August 2, 2020	August 4, 2019
	<i>(In thousands)</i>		<i>(Percentage of segment revenue)</i>	
Segmented income (loss) from operations:				
Company-operated stores	\$ (5,293)	\$ 154,316	(1.8)%	26.4 %
Direct to consumer	237,595	86,618	42.9	39.8
Other	2,587	16,418	4.2	20.0
	<u>234,889</u>	<u>257,352</u>		
General corporate expense	98,292	89,370		
Amortization of intangible assets	724	—		
Acquisition-related expenses	11,464	—		
Income from operations	<u>\$ 124,409</u>	<u>\$ 167,982</u>		

*Company-Operated Stores.* Income from operations from our company-operated stores segment decreased \$159.6 million, or 103%, to a loss of \$5.3 million for the second quarter of fiscal 2020 from income of \$154.3 million for the second quarter of fiscal 2019. The decrease was primarily the result of decreased gross profit of \$209.3 million which was primarily due to lower net revenue as a result of the impact of COVID-19 restrictions, and lower gross margin, which was primarily due to deleverage on occupancy and depreciation costs as a result of lower net revenue. This was partially offset by a decrease in selling, general and administrative expenses, primarily due to decreased store operating expenses including lower incentive compensation, credit card fees, packaging costs, and distribution costs primarily as a result of lower net revenue, and due to the recognition of government payroll subsidies and lower community costs. Income from operations as a percentage of company-operated stores net revenue decreased primarily due to lower gross margin and deleverage on selling, general and administrative expenses.

*Direct to Consumer.* Income from operations from our direct to consumer segment increased \$151.0 million, or 174%, to \$237.6 million for the second quarter of fiscal 2020 from \$86.6 million for the second quarter of fiscal 2019. The increase was primarily the result of increased gross profit of \$222.2 million which was primarily due to increased net revenue and higher gross margin. This was partially offset by an increase in selling, general and administrative expenses primarily due to higher variable costs including distribution costs, credit card fees, and packaging as a result of higher net revenue, as well as higher digital marketing expenses. Income from operations as a percentage of direct to consumer net revenue increased 310 basis points primarily due to leverage on selling, general and administrative expenses and higher gross margin.

*Other.* Income from operations from our other channels decreased \$13.8 million, or 84%, to \$2.6 million for the second quarter of fiscal 2020 from \$16.4 million for the second quarter of fiscal 2019. The decrease was primarily the result of decreased gross profit of \$9.2 million which was primarily due to decreased net revenue. This was partially offset by an increase in selling, general and administrative expenses primarily due to an increase in marketing costs, partially offset by decreased operating expenses including lower incentive compensation, credit card fees, packaging costs, and distribution costs primarily as a result of lower net revenue. Income from operations as a percentage of other net revenue decreased primarily due to deleverage on selling, general and administrative expenses.

**General Corporate Expense.** General corporate expense increased \$8.9 million, or 10%, to \$98.3 million for the second quarter of fiscal 2020 from \$89.4 million for the second quarter of fiscal 2019. This increase was primarily due to increases in depreciation, information technology costs, and professional fees, and an increase in net foreign exchange and derivative revaluation losses of \$3.0 million. The increase in general corporate expense was partially offset by a decrease in incentive compensation and the recognition of government payroll subsidies.

**Other Income (Expense), Net**

Other income, net decreased \$2.2 million, or 119%, to an expense of \$0.3 million for the second quarter of fiscal 2020 from income of \$1.9 million for the second quarter of fiscal 2019. The decrease was primarily due to a decrease in net interest income.

**Income Tax Expense**

Income tax expense decreased \$7.6 million, or 17%, to \$37.3 million for the second quarter of fiscal 2020 from \$44.8 million for the second quarter of fiscal 2019. The effective tax rate for the second quarter of fiscal 2020 was 30.0% compared to 26.4% for the second quarter of fiscal 2019.

The increase in the effective tax rate was due to certain non-deductible expenses related to the MIRROR acquisition which increased the effective tax rate by 110 basis points, and due to new regulations which resulted in additional foreign tax credits being recognized in the second quarter of fiscal 2019.

**Net Income**

Net income decreased \$38.2 million, or 31%, to \$86.8 million for the second quarter of fiscal 2020 from \$125.0 million for the second quarter of fiscal 2019. This was primarily due to an increase in selling, general and administrative expenses of \$35.1 million, acquisition-related expenses of \$11.5 million, amortization of intangible assets of \$0.7 million, and a decrease in other income (expense), net of \$2.2 million, partially offset by an increase in gross profit of \$3.7 million, and a decrease in income tax expense of \$7.6 million.

**First Two Quarters Results**

The following table summarizes key components of our results of operations for the first two quarters ended August 2, 2020 and August 4, 2019. The percentages are presented as a percentage of net revenue.

	Two Quarters Ended			
	August 2, 2020	August 4, 2019	August 2, 2020	August 4, 2019
	<i>(In thousands)</i>		<i>(Percentages)</i>	
Net revenue	\$ 1,554,904	\$ 1,665,667	100.0 %	100.0 %
Cost of goods sold	731,001	758,151	47.0	45.5
Gross profit	823,903	907,516	53.0	54.5
Selling, general and administrative expenses	652,510	610,722	42.0	36.7
Amortization of intangible assets	724	—	—	—
Acquisition-related expenses	13,509	—	0.9	—
Income from operations	157,160	296,794	10.1	17.8
Other income (expense), net	830	4,229	0.1	0.3
Income before income tax expense	157,990	301,023	10.2	18.1
Income tax expense	42,557	79,430	2.7	4.8
Net income	<u>\$ 115,433</u>	<u>\$ 221,593</u>	<u>7.4 %</u>	<u>13.3 %</u>

**Net Revenue**

Net revenue decreased \$110.8 million, or 7%, to \$1.555 billion for the first two quarters of fiscal 2020 from \$1.666 billion for the first two quarters of fiscal 2019. On a constant dollar basis, assuming the average exchange rates for the first two quarters of fiscal 2020 remained constant with the average exchange rates for the first two quarters of fiscal 2019, net revenue decreased \$96.1 million, or 6%.

The decrease in net revenue was primarily due to a decrease in company-operated store net revenue as well as a decrease in net revenue from our other locations driven by temporary retail location closures as well as reduced operating hours and

limited guest occupancy levels as a result of COVID-19. This was partially offset by an increase in direct to consumer net revenue.

Net revenue on a segment basis for the first two quarters ended August 2, 2020 and August 4, 2019 is summarized below. The percentages are presented as a percentage of total net revenue.

	Two Quarters Ended			
	August 2, 2020	August 4, 2019	August 2, 2020	August 4, 2019
	<i>(In thousands)</i>		<i>(Percentages)</i>	
Company-operated stores .....	\$ 547,171	\$ 1,090,178	35.2 %	65.4 %
Direct to consumer .....	906,341	427,480	58.3	25.7
Other .....	101,392	148,009	6.5	8.9
Net revenue .....	<u>\$ 1,554,904</u>	<u>\$ 1,665,667</u>	<u>100.0 %</u>	<u>100.0 %</u>

*Company-Operated Stores.* Net revenue from our company-operated stores segment decreased \$543.0 million, or 50%, to \$547.2 million in the first two quarters of fiscal 2020 from \$1.090 billion in the first two quarters of fiscal 2019. The decrease in net revenue from our company-operated stores segment was primarily due to the impact of COVID-19. All of our stores in North America, Europe, and certain countries in Asia Pacific were temporarily closed for a significant portion of the first two quarters of fiscal 2020. Since re-opening our company-operated store net revenues have been impacted by COVID-19 restrictions including reduced operating hours and occupancy limits.

*Direct to Consumer.* Net revenue from our direct to consumer segment increased \$478.9 million, or 112%, to \$906.3 million in the first two quarters of fiscal 2020 from \$427.5 million in the first two quarters of fiscal 2019. Direct to consumer net revenue increased 114% on a constant dollar basis. The increase in net revenue from our direct to consumer segment was primarily a result of increased website traffic and improved conversion rates. This was partially offset by a decrease in dollar value per transaction. There was a shift in the way guests shopped in the first two quarters of fiscal 2020 as a result of COVID-19, with more guests shopping online instead of in-store. During the second quarter of fiscal 2020, we held an online warehouse sale in the United States and Canada which generated net revenue of \$43.3 million. We did not hold any warehouse sales during the first two quarters of fiscal 2019.

*Other.* Net revenue from our other segment decreased \$46.6 million, or 31%, to \$101.4 million in the first two quarters of fiscal 2020 from \$148.0 million in the first two quarters of fiscal 2019. This decrease was primarily the result of COVID-19, including temporary location closures, reduced operating hours, and occupancy restrictions.

### Gross Profit

Gross profit decreased \$83.6 million, or 9%, to \$823.9 million for the first two quarters of fiscal 2020 from \$907.5 million for the first two quarters of fiscal 2019.

Gross profit as a percentage of net revenue, or gross margin, decreased 150 basis points, to 53.0% in the first two quarters of fiscal 2020 from 54.5% in the first two quarters of fiscal 2019. The decrease in gross margin was primarily the result of:

- an increase in occupancy and depreciation costs as a percentage of revenue of 120 basis points;
- an increase in costs as a percentage of revenue related to our distribution centers of 110 basis points; and
- an unfavorable impact of foreign exchange rates of 20 basis points.

This was partially offset by an increase in product margin of 80 basis points primarily due to lower product costs, and a favorable mix of higher margin product, partially offset by higher markdowns, and a decrease in costs related to our product departments as a percentage of revenue of 20 basis points.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses increased \$41.8 million, or 7%, to \$652.5 million in the first two quarters of fiscal 2020 from \$610.7 million in the first two quarters of fiscal 2019. The increase in selling, general and administrative expenses was primarily due to:

- an increase in costs related to our operating channels of \$55.2 million, comprised of:
  - an increase in variable costs of \$47.3 million primarily due to an increase in distribution costs as a result of increased direct to consumer net revenue;

- an increase in other costs of \$30.6 million primarily due to increased digital marketing expenses; and
- a decrease in employee costs of \$22.7 million primarily due to lower incentive compensation expenses in our company-operated store and other channels;
- an increase in head office costs of \$20.0 million, comprised of:
  - an increase of \$32.1 million primarily due to increases in information technology costs, depreciation, and brand and community costs; and
  - a decrease in employee costs of \$12.1 million primarily due to decreased incentive compensation expense and decreased travel, partially offset by increased salaries and wages expense as a result of headcount growth; and
- an increase in net foreign exchange and derivative revaluation losses of \$1.8 million.

The increase in selling, general and administrative expenses was partially offset by \$35.2 million of government payroll subsidies which were recognized during the first two quarters of fiscal 2020.

As a percentage of net revenue, selling, general and administrative expenses increased 530 basis points, to 42.0% in the first two quarters of fiscal 2020 from 36.7% in the first two quarters of fiscal 2019.

### **Amortization of intangible assets**

Amortization of intangible assets was \$0.7 million in the first two quarters of fiscal 2020. This was primarily the result of the recognition of intangible assets of \$85.0 million in the second quarter of fiscal 2020 as a result of our acquisition of MIRROR. We did not recognize an expense for the amortization intangible assets in the first two quarters of fiscal 2019.

### **Acquisition-related expenses**

As a result of our acquisition of MIRROR in the second quarter of fiscal 2020, we recognized acquisition-related expenses of \$13.5 million in the first two quarters of fiscal 2020. This included transaction and integration related costs of \$9.2 million for advisory and professional services, and integration costs subsequent to the acquisition. This also included acquisition-related compensation of \$5.0 million for the partial acceleration of vesting of certain options and deferred consideration to certain continuing MIRROR employees. Acquisition-related expenses were partially offset by a \$0.8 million gain recognized on our existing investment. We did not have acquisition-related expenses in the first two quarters of fiscal 2019. Please refer to Note 3 to the unaudited interim consolidated financial statements included in Item 1 of Part I of this report for further information.

### **Income from Operations**

Income from operations decreased \$139.6 million, or 47%, to \$157.2 million in the first two quarters of fiscal 2020 from \$296.8 million in the first two quarters of fiscal 2019. Operating margin decreased 770 basis points to 10.1% compared to 17.8% in the first two quarters of fiscal 2019.

On a segment basis, we determine income from operations without taking into account our general corporate expenses. During the first quarter of fiscal 2020, we reviewed our segment and general corporate expenses and determined certain costs that are more appropriately classified in different categories. Accordingly, comparative figures have been reclassified to conform to the financial presentation adopted for the current year.

Segmented income (loss) from operations for the first two quarters ended August 2, 2020 and August 4, 2019 is summarized below. The percentages are presented as a percentage of net revenue of the respective operating segments.

	Two Quarters Ended			
	August 2, 2020	August 4, 2019	August 2, 2020	August 4, 2019
	<i>(In thousands)</i>		<i>(Percentage of segment revenue)</i>	
Segmented income (loss) from operations:				
Company-operated stores	\$ (35,447)	\$ 275,227	(6.5)%	25.2 %
Direct to consumer	394,542	165,955	43.5	38.8
Other	2,318	29,041	2.3	19.6
	<u>361,413</u>	<u>470,223</u>		
General corporate expense	190,020	173,429		
Amortization of intangible assets	724	—		
Acquisition-related expenses	13,509	—		
Income from operations	<u>\$ 157,160</u>	<u>\$ 296,794</u>		

*Company-Operated Stores.* Income from operations from our company-operated stores segment decrease \$310.7 million, or 113%, to a loss of \$35.4 million for the first two quarters of fiscal 2020 from income of \$275.2 million for the first two quarters of fiscal 2019. The decrease was primarily the result of decreased gross profit of \$386.8 million which was primarily due to lower net revenue as a result of the impact of COVID-19 restrictions, and lower gross margin, which was primarily due to deleverage on occupancy and depreciation costs as a result of lower net revenue. This was partially offset by a decrease in selling, general and administrative expenses, primarily due to decreased store operating expenses including lower incentive compensation, credit card fees, packaging costs, and distribution costs primarily as a result of lower net revenue, as well as decreases in security and repairs and maintenance costs, and due to the recognition of government payroll subsidies. Income from operations as a percentage of company-operated stores net revenue decreased, primarily due to lower gross margin and deleverage on selling, general and administrative expenses.

*Direct to Consumer.* Income from operations from our direct to consumer segment increased \$228.6 million, or 138%, to \$394.5 million for the first two quarters of fiscal 2020 from \$166.0 million for the first two quarters of fiscal 2019. The increase was primarily the result of increased gross profit of \$325.3 million which was primarily due to increased net revenue and higher gross margin. This was partially offset by an increase in selling, general and administrative expenses primarily due to higher variable costs including distribution costs and credit card fees as a result of higher net revenue, as well as higher digital marketing expenses and employee costs. Income from operations as a percentage of direct to consumer net revenue increased 470 basis points, primarily due to leverage on selling, general and administrative expenses and higher gross margin.

*Other.* Income from operations from our other channels decreased \$26.7 million, or 92%, to \$2.3 million for the first two quarters of fiscal 2020 from \$29.0 million for the first two quarters of fiscal 2019. The decrease was primarily the result of decreased gross profit of \$22.2 million which was primarily due to decreased net revenue, and an increase in selling, general and administrative expenses primarily due to an increase in marketing costs, partially offset by decreased operating expenses including lower incentive compensation, credit card fees, and packaging costs primarily as a result of lower net revenue. Income from operations as a percentage of other net revenue decreased primarily due to deleverage on selling, general and administrative expenses, partially offset by an increase in gross margin.

*General Corporate Expense.* General corporate expense increased \$16.6 million, or 10%, to \$190.0 million for the first two quarters of fiscal 2020 from \$173.4 million for the first two quarters of fiscal 2019. This increase was primarily due to increases in information technology costs, depreciation, professional fees, and brand and community costs, and an increase in net foreign exchange and derivative revaluation losses of \$1.8 million. The increase in general corporate expense was partially offset by a decrease in incentive compensation and the recognition of government payroll subsidies.

### Other Income (Expense), Net

Other income, net decreased \$3.4 million, or 80%, to \$0.8 million for the first two quarters of fiscal 2020 from \$4.2 million for the first two quarters of fiscal 2019. The decrease was primarily due to a decrease in net interest income.

### Income Tax Expense

Income tax expense decreased \$36.9 million, or 46%, to \$42.6 million for the first two quarters of fiscal 2020 from \$79.4 million for the first two quarters of fiscal 2019. The effective tax rate for the first two quarters of fiscal 2020 was 26.9% compared to 26.4% for the first two quarters of fiscal 2019.

The increase in the effective tax rate was due to certain non-deductible expenses related to the MIRROR acquisition which increased the effective tax rate by 90 basis points and due to new regulations which resulted in additional foreign tax credits being recognized in the first two quarters of fiscal 2019. This was partially offset by an increase in tax deductions related to stock-based compensation.

## **Net Income**

Net income decreased \$106.2 million, or 48%, to \$115.4 million for the first two quarters of fiscal 2020 from \$221.6 million for the first two quarters of fiscal 2019. This was primarily due to a decrease in gross profit of \$83.6 million, an increase in selling, general and administrative expenses of \$41.8 million, acquisition-related expenses of \$13.5 million, amortization of intangible assets of \$0.7 million, and a decrease in other income (expense), net of \$3.4 million, partially offset by a decrease in income tax expense of \$36.9 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, or open after being significantly expanded, for at least 12 full fiscal months. Net revenue from a store is included in comparable store sales beginning with the first fiscal month for which the store has a full fiscal month of sales in the prior year. Comparable store sales exclude sales from new stores that have not been open for at least 12 full fiscal months, from stores which have not been in their significantly expanded space for at least 12 full fiscal months, and from stores which have been temporarily relocated for renovations or temporarily closed for at least 30 days. Comparable store sales also exclude sales from direct to consumer and other segments, as well as sales from company-operated stores that we have closed.

Total comparable sales combines comparable store sales and direct to consumer sales. We are evolving towards an omni-channel approach to support the shopping behavior of our guests. This involves country and region specific websites, mobile apps, including mobile apps on in-store devices that allow demand to be fulfilled via our distribution centers, social media, product notification emails, and online order fulfillment through stores.

In fiscal years with 53 weeks, the 53rd week of net revenue is excluded from the calculation of comparable sales. In the year following a 53 week year, the prior year period is shifted by one week to compare similar calendar weeks.

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

We typically use comparable store sales to assess the performance of our existing stores as it allows us to monitor the performance of our business without the impact of recently opened or expanded stores. We typically use total comparable sales to evaluate the performance of our business from an omni-channel perspective. We therefore typically believe that investors would similarly find these metrics useful in assessing the performance of our business. However, as the temporary store closures from COVID-19 have resulted in a significant number of stores being removed from our comparable store base, we believe total comparable sales and comparable store sales are not currently representative of the underlying trends of our business. We do not believe these metrics are currently useful to investors in understanding performance, therefore we have not included these metrics in our discussion and analysis of results of operations.

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

Constant dollar changes in net revenue and direct to consumer net revenue 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 our results to help investors understand the underlying growth rate of net revenue excluding the impact of changes in foreign exchange rates.

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.

**Constant dollar changes in net revenue and direct to consumer net revenue**

The below changes in net revenue show the change compared to the corresponding period in the prior year.

	<b>Quarter Ended August 2, 2020</b>		
	<b>Net Revenue</b>		<b>Direct to Consumer Net Revenue</b>
	<i>(In thousands)</i>	<i>(Percentages)</i>	<i>(Percentages)</i>
Change .....	\$ 19,590	2 %	155 %
Adjustments due to foreign exchange rate changes .....	6,976	1	2
Change in constant dollars .....	<u>\$ 26,566</u>	<u>3 %</u>	<u>157 %</u>

  

	<b>Two Quarters Ended August 2, 2020</b>		
	<b>Net Revenue</b>		<b>Direct to Consumer Net Revenue</b>
	<i>(In thousands)</i>	<i>(Percentages)</i>	<i>(Percentages)</i>
Change .....	\$ (110,763)	(7)%	112 %
Adjustments due to foreign exchange rate changes .....	14,650	1	2 %
Change in constant dollars .....	<u>\$ (96,113)</u>	<u>(6)%</u>	<u>114 %</u>

**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% of our full year operating profit during each of the fourth quarters of fiscal 2019 and fiscal 2018.

**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 facilities. Our primary cash needs are capital expenditures for opening new stores and remodeling or relocating existing stores, making information technology system investments and enhancements, funding working capital requirements, and making other strategic 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 well as in money market funds, treasury bills, and term deposits.

As of August 2, 2020, our working capital, excluding cash and cash equivalents, was \$203.4 million, our cash and cash equivalents were \$523.0 million, and our capacity under our committed revolving credit facilities was \$697.7 million.

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

	<b>Two Quarters Ended</b>	
	<b>August 2, 2020</b>	<b>August 4, 2019</b>
	<i>(In thousands)</i>	
Total cash provided by (used in):		
Operating activities .....	\$ 60,062	\$ 50,042
Investing activities .....	(545,323)	(131,969)
Financing activities .....	(82,157)	(170,985)
Effect of exchange rate changes on cash .....	(3,089)	(4,670)
Decrease in cash and cash equivalents .....	<u>\$ (570,507)</u>	<u>\$ (257,582)</u>

## Operating Activities

Cash flows provided by operating activities consist primarily of net income adjusted for certain items including depreciation and amortization, stock-based compensation expense, and the effect of changes in operating assets and liabilities.

Cash provided by operating activities increased \$10.0 million, to \$60.1 million for the first two quarters of fiscal 2020 compared to \$50.0 million for the first two quarters of fiscal 2019, primarily as a result of the following:

- an increase of \$110.6 million in changes in operating assets and liabilities, primarily due to the following:
  - an increase of \$122.8 million related to income taxes, primarily due to the deferral of Canadian income tax payments to the third quarter of fiscal 2020 as well as payments for withholding taxes on repatriated foreign earnings in the first quarter of fiscal 2019;
  - an increase of \$50.5 million related to other accrued liabilities, primarily due to increases in accrued duty, freight, and other operating expenses as well as an increase in the sales return allowance as a result of COVID-19 reducing in-period returns; and
  - an increase of \$20.2 million related to accounts payable.

The increase in changes in operating assets and liabilities was partially offset by the following:

- a decrease of \$41.6 million related to accrued compensation related expenses;
  - a decrease of \$31.3 million related to prepaid expenses and other current and non-current assets, primarily due to government payroll subsidy receivables related to COVID-19; and
  - a decrease of \$12.4 million related to inventories, primarily due to lower than expected net revenue as a result of temporary store closures and other COVID-19 restrictions.
- an increase of \$5.6 million from adjustments to reconcile net income to net cash provided by operating activities other than changes in operating assets and liabilities, primarily related to an increase in depreciation and amortization, partially offset by a decrease in the settlement of derivatives not designated in a hedging relationship.

The increase in cash provided by operating activities was partially offset by a decrease of \$106.2 million in net income, primarily due temporary retail location closures as well as reduced operating hours and limited guest occupancy levels as a result of COVID-19.

## Investing Activities

Cash flows used in investing activities relate to the acquisition of MIRROR, capital expenditures, the settlement of net investment hedges, and other investing activities. Capital expenditures primarily relate to 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 increased \$413.4 million to \$545.3 million for the first two quarters of fiscal 2020 from \$132.0 million for the first two quarters of fiscal 2019. The increase was primarily the result of the acquisition of MIRROR, partially offset by a decrease in capital expenditures for our company-operated stores.

## Financing Activities

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

Cash used in financing activities decreased \$88.8 million to \$82.2 million for the first two quarters of fiscal 2020 compared to \$171.0 million for the first two quarters of fiscal 2019. The decrease was primarily the result of a decrease in stock repurchases.

Cash used in financing activities for the first two quarters of fiscal 2020 included \$63.7 million to repurchase 0.4 million shares of our common stock compared to \$165.1 million to repurchase 1.0 million shares for the first two quarters of fiscal 2019. During the first two quarters of fiscal 2019, 1.0 million shares were repurchased in a private transaction. We did not purchase any shares in a private transaction during the first two quarters of fiscal 2020. The other common stock was repurchased in the open market at prevailing market prices, including under plans complying with the provisions of Rule 10b5-1 and Rule 10b-18 of the Securities Exchange Act of 1934, with the timing and actual number of shares repurchased depending upon market conditions, eligibility to trade, and other factors. The share repurchase program was temporarily paused as of March 31, 2020.

We believe the cash and cash equivalent balances, cash flows from operations, and borrowings available under the revolving credit facilities are adequate to meet our liquidity needs and capital expenditure requirements for at least the next 12 months. The cash from operations may be negatively impacted by a decrease in demand for our products, the continuing impact of COVID-19, as well as the other factors described in Item 1 of Part II of this Quarterly Report on Form 10-Q. In addition, discretionary capital improvements may be made with respect to the stores, distribution facilities, headquarters, or systems. Strategic investments or repurchase of shares under an approved stock repurchase program may be made, 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 Facilities***

#### **North America revolving credit facility**

On December 15, 2016, we entered into a credit agreement for \$150.0 million under a committed and 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, if any, 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 August 2, 2020, we were in compliance with the covenants of the credit facility.

On June 6, 2018, we entered into Amendment No. 1 to the credit agreement. The Amendment amended the credit agreement to provide for (i) an increase in the aggregate commitments under the unsecured five-year revolving credit facility to \$400.0 million, with an increase of the sub-limits for the issuance of letters of credit and extensions of swing line loans to \$50.0 million for each, (ii) an increase in the option, subject to certain conditions as set forth in the credit agreement, to request increases in commitments under the revolving facility from \$400.0 million to \$600.0 million and (iii) an extension in the maturity of the revolving facility from December 15, 2021 to June 6, 2023.

In addition, the Amendment decreased the applicable margins for LIBOR loans from 1.00%-1.75% to 1.00%-1.50% and for alternate base rate loans from 0.00%-0.75% to 0.00%-0.50%, reduced the commitment fee on average daily unused amounts under the revolving facility from 0.125%-0.200% to 0.10%-0.20%, and reduced fees for unused letters of credit from 1.00%-1.75% to 1.00%-1.50%.

As of August 2, 2020, aside from letters of credit of \$2.3 million, we had no other borrowings outstanding under this credit facility.

### **Mainland China revolving credit facility**

In December 2019, we entered into an uncommitted and unsecured 130.0 million Chinese Yuan revolving credit facility. The terms are reviewed on an annual basis. The facility includes a revolving loan of up to 100.0 million Chinese Yuan as well as a financial bank guarantee facility of up to 30.0 million Chinese Yuan, or its equivalent in another currency. In U.S. dollars, the uncommitted and unsecured revolving credit facility is equivalent to \$18.6 million, the revolving loan is equivalent of up to \$14.3 million, and the financial bank guarantee facility is equivalent of up to \$4.3 million. Loans are available in Chinese Yuan for a period not to exceed 12 months, and interest accrues on them at a rate equal to 105% of the applicable PBOC Benchmark Lending Rate. Guarantees have a commission equal to 1% per annum of the outstanding amount. We are required to follow certain covenants. As of August 2, 2020, we were in compliance with the covenants. As of August 2, 2020, there were no borrowings outstanding under this credit facility.

### **364-Day revolving credit facility**

On June 29, 2020, we entered into a 364-day credit agreement providing for a \$300.0 million committed and unsecured revolving credit facility. The credit agreement matures on June 28, 2021. Bank of America, N.A., is administrative agent and swing line lender. Borrowings under the credit facility may be prepaid and commitments may be reduced or terminated without premium or penalty (other than customary breakage costs).

Borrowings made under the credit facility bear interest at a rate per annum equal to, at our option, either (1) 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 (2) 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 1.50%-2.25% for LIBOR loans and 0.50%-1.25% for alternate base rate or Canadian prime rate loans. Additionally, a commitment fee of between 0.25%-0.55%, also determined by reference to the pricing grid, is payable on the average daily unused amounts under the 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 August 2, 2020, we were in compliance with the covenants. As of August 2, 2020, there were no 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 August 2, 2020, letters of credit and letters of guarantee totaling \$2.3 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 fiscal 2019 Annual Report

on Form 10-K filed with the SEC on March 26, 2020, and in Notes 1, 2, 3, 8, and 9, included in Item 1 of Part I of this Quarterly Report on Form 10-Q.

**Operating Locations**

Our company-operated stores by country as of August 2, 2020 and February 2, 2020 are summarized in the table below.

	August 2, 2020	February 2, 2020
United States	309	305
Canada	61	63
People's Republic of China <sup>(1)</sup>	46	38
Australia	31	31
United Kingdom	15	14
Japan	8	7
Germany	7	6
New Zealand	7	7
South Korea	7	5
Singapore	4	4
France	3	3
Malaysia	2	2
Sweden	2	2
Ireland	1	1
Netherlands	1	1
Norway	1	1
Switzerland	1	1
Total company-operated stores	506	491

<sup>(1)</sup> Included within PRC as of August 2, 2020, were seven company-operated stores in the Hong Kong Special Administrative Region, two company-operated stores in the Macao Special Administration Region, and two company-operated store in Taiwan, PRC. As of February 2, 2020, there were six company-operated stores in the Hong Kong Special Administrative Region, two company-operated stores in the Macao Special Administration Region, and one company-operated store in Taiwan, PRC.

Our retail locations have experienced temporary closures during the first two quarters of fiscal 2020 as a result of COVID-19. As of August 2, 2020, 492 of our company-operated stores were open.

Retail locations operated by third parties under license and supply arrangements are not included in the above table. As of August 2, 2020, there were eight licensed locations, including four in Mexico, three in the United Arab Emirates, and one in Qatar.

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

*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.

As of August 2, 2020, we had certain forward currency contracts outstanding in order to hedge a portion of the foreign currency exposure that arises on translation of a Canadian subsidiary into U.S. dollars. We also had certain forward currency

contracts outstanding in an effort to reduce our exposure to the foreign exchange revaluation gains and losses that are recognized by our Canadian and Chinese subsidiaries on U.S. dollar denominated monetary assets and liabilities. Please refer to Note 9 to the unaudited interim consolidated financial statements included in Item 1 of Part I of this report for further information, including details of the notional amounts outstanding.

In the future, in an effort to reduce foreign exchange risks, we may enter into further derivative financial instruments including hedging additional currency pairs. We do not, and do not intend to, engage in the practice of trading derivative securities for profit.

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:

- the following impacts to the consolidated statements of operations:
  - 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;
  - foreign exchange revaluation gains by our Canadian subsidiaries on U.S. dollar denominated monetary assets and liabilities; and
  - derivative valuation losses on forward currency contracts not designated in a hedging relationship;
- the following impacts to the consolidated balance sheets:
  - a decrease in the foreign currency translation adjustment which arises on the translation of our Canadian subsidiaries' balance sheets into U.S. dollars; and
  - an increase in the foreign currency translation adjustment from derivative valuation losses on forward currency contracts, entered into as net investment hedges of a Canadian subsidiary.

During the first two quarters of fiscal 2020, the change in the relative value of the U.S. dollar against the Canadian dollar resulted in a \$14.6 million increase in accumulated other comprehensive loss within stockholders' equity. During the first two quarters of fiscal 2019, the change in the relative value of the U.S. dollar against the Canadian dollar resulted in a \$4.7 million increase 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 two quarters of fiscal 2020 would have resulted in additional income from operations of approximately \$0.1 million in the first two quarters of fiscal 2020. This assumes a consistent 10% appreciation in the U.S. dollar against the Canadian dollar over the first two quarters of fiscal 2020. 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.

*Interest Rate Risk.* Our committed revolving credit facilities provide us with available borrowings in an amount up to \$700.0 million in the aggregate. Because our revolving credit facilities bear 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 August 2, 2020, aside from letters of credit of \$2.3 million, there were no borrowings outstanding under these credit facilities. 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.

Our cash and cash equivalent balances are held in the form of cash on hand, bank balances, short-term deposits and treasury bills with original maturities of three months or less, and in money market funds. We do not believe these balances are subject to material interest rate risk.

*Credit Risk.* We have cash on deposit with various large, reputable financial institutions and have invested in U.S. and Canadian Treasury Bills, and in AAA-rated money market funds. The amount of cash and cash equivalents held with certain financial institutions exceeds government-insured limits. We are also exposed to credit-related losses in the event of nonperformance by the financial institutions that are counterparties to our forward currency contracts. The credit risk amount is

our unrealized gains on our derivative instruments, based on foreign currency rates at the time of nonperformance. We have not experienced any losses related to these items, and we believe credit risk to be minimal. We seek to minimize our credit risk by entering into transactions with credit worthy and reputable financial institutions and by monitoring the credit standing of the financial institutions with whom we transact. We seek to limit the amount of exposure with any one counterparty.

### ***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 principal executive officer and principal financial and 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 principal executive officer and principal financial and accounting 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 August 2, 2020. Based on that evaluation, our principal executive officer and principal financial and accounting officer concluded that, at August 2, 2020, our disclosure controls and procedures were effective.

There were no changes in our internal control over financial reporting during the quarter ended August 2, 2020 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

In addition to the legal matters described in Note 13 to the unaudited interim consolidated financial statements included in Item 1 of Part I of this report and in our fiscal 2019 Annual Report on Form 10-K, we are, from time to time, involved in routine legal matters incidental to the conduct of our business, including legal matters such as initiation and defense of proceedings to protect intellectual property rights, personal injury claims, product liability claims, employment claims, and similar matters. We believe the ultimate resolution of any such current proceeding will not have a material adverse effect on our continued financial position, results of operations or cash flows.

### ITEM 1A. RISK FACTORS

*In addition to the other information contained in this Form 10-Q and in our Annual Report on Form 10-K for our 2019 fiscal year, the following risk factors should be considered carefully in evaluating our business. Our business, financial condition, or results of operations could be materially adversely affected by any of these risks. Please note that additional risks not presently known to us or that we currently deem immaterial could also impair our business and operations.*

***Our success depends on our ability to maintain the value and reputation of our brand.***

Our success depends on the value and reputation of the lululemon brand. The lululemon name is integral to our business as well as to the implementation of our strategies for expanding our business. Maintaining, promoting, and positioning our brand will depend largely on the success of our marketing and merchandising efforts and our ability to provide a consistent, high quality product, and guest experience. We rely on social media, as one of our marketing strategies, to have a positive impact on both our brand value and reputation. Our brand and reputation could be adversely affected if we fail to achieve these objectives, if our public image was to be tarnished by negative publicity, which could be amplified by social media, if we fail to deliver innovative and high quality products acceptable to our guests, or if we face or mishandle a product recall. Additionally, while we devote considerable efforts and resources to protecting our intellectual property, if these efforts are not successful the value of our brand may be harmed. Any harm to our brand and reputation could have a material adverse effect on our financial condition.

***The current COVID-19 coronavirus pandemic and related government, private sector, and individual consumer responsive actions have and will continue to adversely affect our business operations, store traffic, employee availability, financial condition, liquidity, and cash flow.***

The outbreak of the COVID-19 coronavirus disease has been declared a pandemic by the World Health Organization and has spread across the United States, Canada, and many other countries globally. Related government and private sector responsive actions have significantly affected our business operations and will likely continue to do so for the foreseeable future.

The spread of COVID-19 has caused public health officials to impose restrictions and recommend precautions to mitigate the spread of the virus, especially when congregating in heavily populated areas, such as malls and lifestyle centers. In February 2020, we temporarily closed the majority of our stores, and we have implemented precautionary measures in line with guidance from local authorities in the stores we have reopened. These measures include restrictions such as limitations on the number of guests allowed in our stores at any single time, minimum physical distancing requirements, and limited operating hours. We do not know how the measures recommended by local authorities or implemented by us may change over time or what the duration of these restrictions will be. There is significant uncertainty regarding what the results of operations of reopened stores will be.

A resurgence in COVID-19 cases could cause additional restrictions, including temporarily closing all or some of our stores again. An outbreak at one of our locations, even if we follow appropriate precautionary measures, could negatively impact our employees, guests, and brand. There is uncertainty over the impact of COVID-19 on the U.S., Canadian, and global economies, consumer willingness to visit stores, malls, and lifestyle centers, and employee willingness to staff our stores once they reopen. There is also uncertainty regarding potential long-term changes to consumer shopping behavior and preferences and whether consumer demand will recover when restrictions are lifted.

We may be impacted by other business disruptions related to COVID-19, including disruptions to our sourcing and manufacturing or to our distribution facilities. Both of our distribution centers in the United States have experienced temporary closures due to COVID-19.

The temporary closure of the majority of our retail locations as well as other impacts of COVID-19 have negatively impacted our cash flows from operations and our liquidity. The length and severity of the pandemic, as well as the pace of recovery could negatively impact our liquidity for the foreseeable future. The availability of federal, state, and foreign funding programs is uncertain.

The COVID-19 situation is changing rapidly and the extent to which COVID-19 impacts our results will depend on future developments, which are highly uncertain and cannot be predicted, including new information that may emerge concerning the severity of COVID-19 and the actions taken to contain it or treat its impact.

***If any of our products are unacceptable to us or our guests, our business could be harmed.***

We have occasionally received, and may in the future receive, shipments of products that fail to comply with our technical specifications or that fail to conform to our quality control standards. We have also received, and may in the future receive, products that are otherwise unacceptable to us or our guests. Under these circumstances, unless we are able to obtain replacement products in a timely manner, we risk the loss of net revenue resulting from the inability to sell those products and related increased administrative and shipping costs. Additionally, if the unacceptability of our products is not discovered until after such products are purchased by our guests, our guests could lose confidence in our products or we could face a product recall and our results of operations could suffer and our business, reputation, and brand could be harmed.

***We operate in a highly competitive market and the size and resources of some of our competitors may allow them to compete more effectively than we can, resulting in a loss of our market share and a decrease in our net revenue and profitability.***

The market for technical athletic apparel is highly competitive. Competition may result in pricing pressures, reduced profit margins or lost market share, or a failure to grow or maintain our market share, any of which could substantially harm our business and results of operations. We compete directly against wholesalers and direct retailers of athletic apparel, including large, diversified apparel companies with substantial market share and established companies expanding their production and marketing of technical athletic apparel, as well as against retailers specifically focused on women's athletic apparel. We also face competition from wholesalers and direct retailers of traditional commodity athletic apparel, such as cotton T-shirts and sweatshirts. Many of our competitors are large apparel and sporting goods companies with strong worldwide brand recognition. Because of the fragmented nature of the industry, we also compete with other apparel sellers, including those specializing in yoga apparel and other activewear. Many of our competitors have significant competitive advantages, including longer operating histories, larger and broader customer bases, more established relationships with a broader set of suppliers, greater brand recognition and greater financial, research and development, store development, marketing, distribution, and other resources than we do.

Our competitors may be able to achieve and maintain brand awareness and market share more quickly and effectively than we can. In contrast to our grassroots community-based marketing approach, many of our competitors promote their brands through traditional forms of advertising, such as print media and television commercials, and through celebrity endorsements, and have substantial resources to devote to such efforts. Our competitors may also create and maintain brand awareness using traditional forms of advertising more quickly than we can. Our competitors may also be able to increase sales in their new and existing markets faster than we do by emphasizing different distribution channels than we do, such as catalog sales or an extensive franchise network.

In addition, because we hold limited patents and exclusive intellectual property rights in the technology, fabrics or processes underlying our products, our current and future competitors are able to manufacture and sell products with performance characteristics, fabrication techniques, and styling similar to our products.

***Our reliance on suppliers to provide fabrics for and to produce our products could cause problems in our supply chain.***

We do not manufacture our products or the raw materials for them and rely instead on suppliers. Many of the specialty fabrics used in our products are technically advanced textile products developed and manufactured by third parties and may be available, in the short-term, from only one or a very limited number of sources. We have no long-term contracts with any of our suppliers or manufacturers for the production and supply of our raw materials and products, and we compete with other companies for fabrics, other raw materials, and production. The following statistics are based on cost.

We work with a group of approximately 39 vendors that manufacture our products, five of which produced approximately 56% of our products in fiscal 2019. During fiscal 2019, the largest single manufacturer produced approximately 17% of our products. During fiscal 2019, approximately 33% of our products were manufactured in Vietnam, 16% in Cambodia, 15% in Sri Lanka, and 11% in the PRC, including 2% in Taiwan, PRC.

We work with a group of approximately 76 suppliers to provide the fabrics for our products. In fiscal 2019, approximately 59% of our fabrics were produced by our top five fabric suppliers, and the largest single manufacturer produced approximately 32% of fabric used. During fiscal 2019, approximately 46% of our fabrics originated from Taiwan, PRC, 14% from the rest of the PRC, 19% from Sri Lanka, and the remainder from other regions.

We also source other raw materials which are used in our products, including items such as content labels, elastics, buttons, clasps, and drawcords from suppliers located predominantly in the Asia Pacific region.

We have experienced, and may in the future experience, a significant disruption in the supply of fabrics or raw materials from current sources and we may be unable to locate alternative materials suppliers of comparable quality at an acceptable price, or at all. In addition, if we experience significant increased demand, or if we need to replace an existing supplier or manufacturer, we may be unable to locate additional supplies of fabrics or raw materials or additional manufacturing capacity on terms that are acceptable to us, or at all, or we may be unable to locate any supplier or manufacturer with sufficient capacity to meet our requirements or to fill our orders in a timely manner. Identifying a suitable supplier is an involved process that requires us to become satisfied with its quality control, responsiveness and service, financial stability, and labor and other ethical practices. Even if we are able to expand existing or find new manufacturing or fabric sources, we may encounter delays in production and added costs as a result of the time it takes to train our suppliers and manufacturers in our methods, products, and quality control standards. Our supply of fabric or the manufacturing of our products could be disrupted or delayed by the impact of global health pandemics, including the current COVID-19 coronavirus pandemic, and the related government and private sector responsive actions such as border closures, restrictions on product shipments, and travel restrictions. Delays related to supplier changes could also arise due to an increase in shipping times if new suppliers are located farther away from our markets or from other participants in our supply chain. Any delays, interruption, or increased costs in the supply of fabric or manufacture of our products could have an adverse effect on our ability to meet guest demand for our products and result in lower net revenue and income from operations both in the short and long term.

***The operations of many of our suppliers are subject to additional risks that are beyond our control and that could harm our business, financial condition, and results of operations.***

Almost all of our suppliers are located outside of North America, and as a result, we are subject to risks associated with doing business abroad, including:

- the impact of health conditions, including the current COVID-19 coronavirus pandemic, and related government and private sector responsive actions, and other changes in local economic conditions in countries where our manufacturers, suppliers, or guests are located;
- political unrest, terrorism, labor disputes, and economic instability resulting in the disruption of trade from foreign countries in which our products are manufactured;
- the imposition of new laws and regulations, including those relating to labor conditions, quality and safety standards, imports, duties, taxes and other charges on imports, as well as trade restrictions and restrictions on currency exchange or the transfer of funds;
- reduced protection for intellectual property rights, including trademark protection, in some countries, particularly in the PRC; and
- disruptions or delays in shipments whether due to port congestion, labor disputes, product regulations and/or inspections or other factors, natural disasters or health pandemics, or other transportation disruptions.

These and other factors beyond our control could interrupt our suppliers' production in offshore facilities, influence the ability of our suppliers to export our products cost-effectively or at all and inhibit our suppliers' ability to procure certain materials, any of which could harm our business, financial condition, and results of operations.

***Our business could be harmed if our suppliers and manufacturers do not comply with our Vendor Code of Ethics or applicable laws.***

While we require our suppliers and manufacturers to comply with our Vendor Code of Ethics, which includes labor, health and safety, and environment standards, we do not control their practices. If suppliers or contractors do not comply with these standards or applicable laws or there is negative publicity regarding the production methods of any of our suppliers or manufacturers, even if unfounded or not material to our supply chain, our reputation and sales could be adversely affected, we could be subject to legal liability, or we could be forced to locate alternative suppliers or manufacturing sources.

***An economic recession, depression, downturn or economic uncertainty in our key markets may adversely affect consumer discretionary spending and demand for our products.***

Many of our products may be considered discretionary items for consumers. Some of the factors that may influence consumer spending on discretionary items include general economic conditions (particularly those in North America), high levels of unemployment, health pandemics (such as the impact of the current COVID-19 coronavirus pandemic, including reduced store traffic and widespread temporary store closures), higher consumer debt levels, reductions in net worth based on market declines and uncertainty, home foreclosures and reductions in home values, fluctuating interest and foreign currency rates and credit availability, government austerity measures, fluctuating fuel and other energy costs, fluctuating commodity prices, tax rates and general uncertainty regarding the overall future economic environment. To date, COVID-19 and related restrictions and mitigation measures have negatively impacted the global economy and created significant volatility and disruption of financial markets. While the duration and severity of the economic impact of COVID-19 is unknown, any recession, depression or general downturn in the global economy will negatively affect consumer confidence and discretionary spending. As global economic conditions continue to be volatile or economic uncertainty remains, trends in consumer discretionary spending also remain unpredictable and subject to reductions due to credit constraints and uncertainties about the future. Unfavorable economic conditions may lead consumers to delay or reduce purchases of our products. Consumer demand for our products may not reach our targets, or may decline, when there is an economic downturn or economic uncertainty in our key markets, particularly in North America. Our sensitivity to economic cycles and any related fluctuation in consumer demand may have a material adverse effect on our financial condition.

***Our sales and profitability may decline as a result of increasing product costs and decreasing selling prices.***

Our business is subject to significant pressure on costs and pricing caused by many factors, including intense competition, constrained sourcing capacity and related inflationary pressure, pressure from consumers to reduce the prices we charge for our products, and changes in consumer demand. These factors may cause us to experience increased costs, reduce our prices to consumers or experience reduced sales in response to increased prices, any of which could cause our operating margin to decline if we are unable to offset these factors with reductions in operating costs and could have a material adverse effect on our financial condition, operating results, and cash flows.

***If we are unable to anticipate consumer preferences and successfully develop and introduce new, innovative, and updated products, we may not be able to maintain or increase our sales and profitability.***

Our success depends on our ability to identify and originate product trends as well as to anticipate and react to changing consumer demands in a timely manner. All of our products are subject to changing consumer preferences that cannot be predicted with certainty. If we are unable to introduce new products or novel technologies in a timely manner or our new products or technologies are not accepted by our guests, our competitors may introduce similar products in a more timely fashion, which could hurt our goal to be viewed as a leader in technical athletic apparel innovation. Our new products may not receive consumer acceptance as consumer preferences could shift rapidly to different types of athletic apparel or away from these types of products altogether, and our future success depends in part on our ability to anticipate and respond to these changes. Our failure to anticipate and respond in a timely manner to changing consumer preferences could lead to, among other things, lower sales and excess inventory levels. Even if we are successful in anticipating consumer preferences, our ability to adequately react to and address those preferences will in part depend upon our continued ability to develop and introduce innovative, high-quality products. Our failure to effectively introduce new products that are accepted by consumers could result in a decrease in net revenue and excess inventory levels, which could have a material adverse effect on our financial condition.

***Our results of operations could be materially harmed if we are unable to accurately forecast guest demand for our products.***

To ensure adequate inventory supply, we must forecast inventory needs and place orders with our manufacturers based on our estimates of future demand for particular products. Our ability to accurately forecast demand for our products could be affected by many factors, including an increase or decrease in guest demand for our products or for products of our competitors, our failure to accurately forecast guest acceptance of new products, product introductions by competitors, unanticipated changes in general market conditions (for example, because of unexpected effects on inventory supply and consumer demand caused by the current COVID-19 coronavirus pandemic), and weakening of economic conditions or consumer confidence in future economic conditions. If we fail to accurately forecast guest demand, we may experience excess inventory levels or a shortage of products available for sale in our stores or for delivery to guests.

Inventory levels in excess of guest demand may result in inventory write-downs or write-offs and the sale of excess inventory at discounted prices, which would cause our gross margin to suffer and could impair the strength and exclusivity of

our brand. Conversely, if we underestimate guest demand for our products, our manufacturers may not be able to deliver products to meet our requirements, and this could result in damage to our reputation and guest relationships.

***Our inability to safeguard against security breaches or our failure to comply with data privacy laws could damage our customer relationships and result in significant legal and financial exposure.***

As part of our normal operations, we receive confidential, proprietary, and personally identifiable information, including credit card information, and information about our customers, our employees, job applicants, and other third parties. Our business employs systems and websites that allow for the storage and transmission of this information. However, despite our safeguards and security processes and protections, security breaches could expose us to a risk of theft or misuse of this information, and could result in litigation and potential liability. The retail industry, in particular, has been the target of many recent cyber-attacks. We may not have the resources or technical sophistication to be able to anticipate or prevent rapidly evolving types of cyber-attacks. Attacks may be targeted at us, our vendors or customers, or others who have entrusted us with information. In addition, despite taking measures to safeguard our information security and privacy environment from security breaches, our customers and our business could still be exposed to risk. Actual or anticipated attacks may cause us to incur increasing costs including costs to deploy additional personnel and protection technologies, train employees and engage third party experts and consultants. Advances in computer capabilities, new technological discoveries or other developments may result in the technology used by us to protect transaction or other data being breached or compromised. Measures we implement to protect against cyber-attacks may also have the potential to impact our customers' shopping experience or decrease activity on our websites by making them more difficult to use. Data and security breaches can also occur as a result of non-technical issues including intentional or inadvertent breach by employees or persons with whom we have commercial relationships that result in the unauthorized release of personal or confidential information. Any compromise or breach of our security could result in a violation of applicable privacy and other laws, significant legal and financial exposure, and damage to our brand and reputation or other harm to our business.

Additionally, we are subject to laws and regulations such as the European Union's General Data Privacy Regulation ("GDPR") and the California Consumer Privacy Act ("CCPA"). These regulations require companies to satisfy new requirements regarding the handling of personal and sensitive data, including its use, protection, and the ability of persons whose data is stored to correct or delete such data about themselves. Failure to comply with GDPR requirements could result in penalties of up to four percent of worldwide revenue. The GDPR, CCPA, and other similar laws and regulations, as well as any associated inquiries or investigations or any other government actions, may be costly to comply with, increase our operating costs, require significant management time and attention, and subject us to remedies that may harm our business, including fines, negative publicity, or demands or orders that we modify or cease existing business practices.

***Any material disruption of our information technology systems or unexpected network interruption could disrupt our business and reduce our sales.***

We are increasingly dependent on information technology systems and third-parties to operate our e-commerce websites, process transactions, respond to guest inquiries, manage inventory, purchase, sell and ship goods on a timely basis, and maintain cost-efficient operations. The failure of our information technology systems to operate properly or effectively, problems with transitioning to upgraded or replacement systems, or difficulty in integrating new systems, could adversely affect our business. In addition, we have e-commerce websites in the United States, Canada, and internationally. Our information technology systems, websites, and operations of third parties on whom we rely, may encounter damage or disruption or slowdown caused by a failure to successfully upgrade systems, system failures, viruses, computer "hackers", natural disasters, or other causes. These could cause information, including data related to guest orders, to be lost or delayed which could, especially if the disruption or slowdown occurred during the holiday season, result in delays in the delivery of products to our stores and guests or lost sales, which could reduce demand for our products and cause our sales to decline. The concentration of our primary offices, two of our distribution centers, and a number of our stores along the west coast of North America could amplify the impact of a natural disaster occurring in that area to our business, including to our information technology systems. In addition, if changes in technology cause our information systems to become obsolete, or if our information systems are inadequate to handle our growth, we could lose guests. We have limited back-up systems and redundancies, and our information technology systems and websites have experienced system failures and electrical outages in the past which have disrupted our operations. Any significant disruption in our information technology systems or websites could harm our reputation and credibility, and could have a material adverse effect on our business, financial condition, and results of operations.

***If the technology-based systems that give our customers the ability to shop with us online do not function effectively, our operating results, as well as our ability to grow our e-commerce business globally, could be materially adversely affected.***

Many of our customers shop with us through our e-commerce websites and mobile apps. Increasingly, customers are using tablets and smart phones to shop online with us and with our competitors and to do comparison shopping. We are increasingly using social media and proprietary mobile apps to interact with our customers and as a means to enhance their shopping experience. Any failure on our part to provide attractive, effective, reliable, user-friendly e-commerce platforms that offer a wide assortment of merchandise with rapid delivery options and that continually meet the changing expectations of online shoppers could place us at a competitive disadvantage, result in the loss of e-commerce and other sales, harm our reputation with customers, have a material adverse impact on the growth of our e-commerce business globally and could have a material adverse impact on our business and results of operations.

***Temporary store closures due to COVID-19, changes in consumer shopping preferences, and shifts in distribution channels could materially impact our results of operations.***

We sell our products through a variety of trade channels, with a significant portion through traditional brick-and-mortar retail channels. Many of our stores remain temporarily closed due to the impacts of COVID-19, and we are unable to predict the breadth and duration of these store closures and the restrictions that will be in place once they do reopen. As strong e-commerce channels emerge and develop, we are evolving towards an omni-channel approach to support the shopping behavior of our guests. This involves country and region specific websites, social media, product notification emails, mobile apps, including mobile apps on in-store devices that allow demand to be fulfilled via our distribution centers, and online order fulfillment through stores. The diversion of sales from our company-operated stores could adversely impact our return on investment and could lead to store closures and impairment charges. We could have difficulty in recreating the in-store experience through direct channels. We could also be exposed to liability for online content. Our failure to successfully integrate our digital and physical channels and respond to these risks might adversely impact our business and results of operations, as well as damage our reputation and brands.

***The fluctuating cost of raw materials could increase our cost of goods sold and cause our results of operations and financial condition to suffer.***

The fabrics used by our suppliers and manufacturers include synthetic fabrics whose raw materials include petroleum-based products. Our products also include silver and natural fibers, including cotton. Our costs for raw materials are affected by, among other things, weather, consumer demand, speculation on the commodities market, the relative valuations and fluctuations of the currencies of producer versus consumer countries, and other factors that are generally unpredictable and beyond our control. Increases in the cost of raw materials, including petroleum or the prices we pay for silver and our cotton yarn and cotton-based textiles, could have a material adverse effect on our cost of goods sold, results of operations, financial condition, and cash flows.

***Our limited operating experience and limited brand recognition in new international markets may limit our expansion and cause our business and growth to suffer.***

Our future growth depends in part on our expansion efforts outside of North America. We have limited experience with regulatory environments and market practices internationally, and we may not be able to penetrate or successfully operate in any new market. In connection with our expansion efforts we may encounter obstacles we did not face in North America, including cultural and linguistic differences, differences in regulatory environments, labor practices and market practices, difficulties in keeping abreast of market, business and technical developments, and foreign guests' tastes and preferences. We may also encounter difficulty expanding into new international markets because of limited brand recognition leading to delayed acceptance of our technical athletic apparel by guests in these new international markets. Our failure to develop our business in new international markets or disappointing growth outside of existing markets could harm our business and results of operations.

***Global economic and political conditions and global events such as health pandemics could adversely impact our results of operations.***

Uncertain or challenging global economic and political conditions could impact our performance, including our ability to successfully expand internationally. Global economic conditions could impact levels of consumer spending in the markets in which we operate, which could impact our sales and profitability. Political unrest could negatively impact our guests and employees, reduce consumer spending, and adversely impact our business and results of operations. Health pandemics, such as the current COVID-19 coronavirus pandemic, and the related governmental, private sector and individual consumer responsive actions could contribute to a recession, depression, or global economic downturn, reduce store traffic and consumer spending, result in temporary or permanent closures of stores, offices, and factories, and could negatively impact the flow of goods.

***If we encounter problems with our distribution system, our ability to deliver our products to the market and to meet guest expectations could be harmed.***

We rely on our distribution facilities for substantially all of our product distribution. Our distribution facilities include computer controlled and automated equipment, which means their operations may be subject to a number of risks related to security or computer viruses, the proper operation of software and hardware, electronic or power interruptions, or other system failures. In addition, our operations could also be interrupted by labor difficulties, extreme or severe weather conditions or by floods, fires, or other natural disasters near our distribution centers. If we encounter problems with our distribution system, our ability to meet guest expectations, manage inventory, complete sales, and achieve objectives for operating efficiencies could be harmed.

***Our fabrics and manufacturing technology generally are not patented and can be imitated by our competitors.***

The intellectual property rights in the technology, fabrics, and processes used to manufacture our products generally are owned or controlled by our suppliers and are generally not unique to us. Our ability to obtain intellectual property protection for our products is therefore limited and we do not generally own patents or hold exclusive intellectual property rights in the technology, fabrics or processes underlying our products. As a result, our current and future competitors are able to manufacture and sell products with performance characteristics, fabrics and styling similar to our products. Because many of our competitors have significantly greater financial, distribution, marketing, and other resources than we do, they may be able to manufacture and sell products based on our fabrics and manufacturing technology at lower prices than we can. If our competitors do sell similar products to ours at lower prices, our net revenue and profitability could suffer.

***Our failure or inability to protect our intellectual property rights could diminish the value of our brand and weaken our competitive position.***

We currently rely on a combination of copyright, trademark, trade dress, and unfair competition laws, as well as confidentiality procedures and licensing arrangements, to establish and protect our intellectual property rights. The steps we take to protect our intellectual property rights may not be adequate to prevent infringement of these rights by others, including imitation of our products and misappropriation of our brand. In addition, intellectual property protection may be unavailable or limited in some foreign countries where laws or law enforcement practices may not protect our intellectual property rights as fully as in the United States or Canada, and it may be more difficult for us to successfully challenge the use of our intellectual property rights by other parties in these countries. If we fail to protect and maintain our intellectual property rights, the value of our brand could be diminished, and our competitive position may suffer.

***Our ability to source and sell our merchandise profitably or at all could be hurt if new trade restrictions are imposed or existing trade restrictions become more burdensome.***

The United States and the countries in which our products are produced or sold internationally have imposed and may impose additional quotas, duties, tariffs, or other restrictions or regulations, or may adversely adjust prevailing quota, duty, or tariff levels. The results of any audits or related disputes regarding these restrictions or regulations could have an adverse effect on our financial statements for the period or periods for which the applicable final determinations are made. Countries impose, modify, and remove tariffs and other trade restrictions in response to a diverse array of factors, including global and national economic and political conditions, which make it impossible for us to predict future developments regarding tariffs and other trade restrictions. Trade restrictions, including tariffs, quotas, embargoes, safeguards, and customs restrictions, could increase the cost or reduce the supply of products available to us, could increase shipping times, or may require us to modify our supply chain organization or other current business practices, any of which could harm our business, financial condition, and results of operations.

We are dependent on international trade agreements and regulations. The countries in which we produce and sell our products could impose or increase tariffs, duties, or other similar charges that could negatively affect our results of operations, financial position, or cash flows.

Adverse changes in, or withdrawal from, trade agreements or political relationships between the United States and the PRC, Canada, or other countries where we sell or source our products, could negatively impact our results of operations or cash flows. The current political administrations in the United States and the PRC have proposed tariffs which increase the costs of our products. General geopolitical instability and the responses to it, such as the possibility of sanctions, trade restrictions, and changes in tariffs, including recent sanctions against the PRC, tariffs imposed by the United States and the PRC, and the possibility of additional tariffs or other trade restrictions between the United States and Mexico, could adversely impact our business. It is possible that further tariffs may be introduced, or increased. Such changes could adversely impact our business and could increase the costs of sourcing our products from the PRC, or could require us to source our products from other countries.

On January 31, 2020, the United Kingdom ("UK") withdrew from the European Union ("EU"), commonly referred to as "Brexit". There is significant uncertainty related to how the UK's trade, duties, and customs arrangements with the EU will be impacted by Brexit after the transition period, as well as the impact on the movement of goods, people, and capital between the UK and the EU. There could be changes in economic conditions in the UK or EU, including foreign exchange rates and consumer markets. Our business could be adversely affected by these changes, including by additional duties on the importation of our products into the UK from the EU and as a result of shipping delays or congestion.

***The potential benefits and synergies sought with the acquisition of MIRROR might not be fully realized, if at all.***

On July 7, 2020, we completed the acquisition of MIRROR as part of our growth plan, which includes driving business through omni guest experiences. The potential benefits of enhancing our digital and interactive capabilities and deepening our roots in the sweatlife might not be realized fully, if at all. The expected synergies between lululemon and MIRROR, such as those related to our connections with our guests and communities as well as our store and direct to consumer infrastructure, may not materialize. A significant portion of the purchase price was allocated to goodwill and if our acquisition does not yield expected returns, we may be required to record impairment charges, which would adversely affect our results of operations.

Management has limited experience in addressing the challenges of integrating management teams, strategies, cultures, and organizations of two companies. This integration may divert the attention of management and cause additional expenses. Management also has limited experience outside of the retail industry, including with the specialized hardware and software sold and licensed by MIRROR. If MIRROR has inadequate or ineffective controls and procedures, our internal control over financial reporting could be adversely impacted. The acquisition may not be well received by the customers or employees of either company, and this could hurt our brand and result in the loss of key employees. If we are unable to successfully integrate MIRROR, including its people and technologies, we may not be able to manage operations efficiently, which could adversely affect our results of operations.

In addition, we may, from time to time, evaluate and pursue other strategic investments or acquisitions. These involve various inherent risks and the benefits sought may not be realized. The acquisition of MIRROR or other strategic investments or acquisitions may not create value and may harm our brand and adversely affect our business, financial condition, and results of operations.

***The significant costs incurred in connection with the acquisition of MIRROR could limit our operating flexibility.***

The acquisition of MIRROR had a significant impact on our cash flows. We have incurred and expect to continue to incur costs in connection with the acquisition including fees for financial and legal advisors as well as expenses incurred in integrating MIRROR. These costs could limit our operating flexibility and ability to take responsive actions to current and future economic uncertainty, including the ongoing impact of COVID-19. While we expanded our available borrowings under our credit facilities to provide extra liquidity, we will incur additional interest expenses if we draw from these facilities.

***We may not be able to grow the MIRROR business and have it achieve profitability.***

We may be unable to attract and retain subscribers to MIRROR. If we do not provide the delivery and installation service that our guests expect, offer engaging and innovative classes, and support and continue to improve the technology used, we may not be able to maintain and grow the number of subscribers. This could adversely impact our results of operations.

We are dependent on information technology systems to provide live and recorded classes to our customers with MIRROR subscriptions, to maintain its software, and to manage subscriptions. If we experience issues such as cybersecurity threats or actions, or interruptions or delays in our information technology systems, the data privacy and overall experience of subscribers could be negatively impacted and could therefore damage our brand and adversely affect our results of operations.

Competition, including from other in-home fitness solutions as well as in-person fitness studios, and trends of consumer preferences, could also impact the level of subscriptions and therefore our results of operations.

***Changes in tax laws or unanticipated tax liabilities could adversely affect our effective income tax rate and profitability.***

We are subject to the income tax laws of the United States, Canada, and several other foreign jurisdictions. Our effective income tax rates could be unfavorably impacted by a number of factors, including changes in the mix of earnings amongst countries with differing statutory tax rates, changes in the valuation of deferred tax assets and liabilities, changes in tax laws, new tax interpretations and guidance, the outcome of income tax audits in various jurisdictions around the world, and any repatriation of unremitted earnings for which we have not previously accrued applicable U.S. income taxes and foreign withholding taxes. We may face unanticipated tax liabilities in connection with our acquisition of MIRROR.

Repatriations from our Canadian subsidiaries are not subject to Canadian withholding taxes if such distributions are made as a return of capital. We have not accrued for any Canadian withholding taxes that could be payable on future repatriations from our Canadian subsidiaries because we believe the current net investment in our Canadian subsidiaries can either be repatriated free of withholding tax or is expected to be indefinitely reinvested. The extent to which future increases in the net assets of our Canadian subsidiaries can be repatriated free of withholding tax is dependent on, among other things, the amount of paid-up-capital in our Canadian subsidiaries and transactions undertaken by our exchangeable shareholders. We are unable to determine the timing and extent to which such transactions may occur. Accordingly, increases in our Canadian net assets may result in an increase to our effective tax rate.

We and our subsidiaries engage in a number of intercompany transactions across multiple tax jurisdictions. Although we believe that these transactions reflect the accurate economic allocation of profit and that proper transfer pricing documentation is in place, the profit allocation and transfer pricing terms and conditions may be scrutinized by local tax authorities during an audit and any resulting changes may impact our mix of earnings in countries with differing statutory tax rates.

Current economic and political conditions make tax rules in any jurisdiction, including the United States and Canada, subject to significant change. Changes in applicable U.S., Canadian, or other foreign tax laws and regulations, or their interpretation and application, including the possibility of retroactive effect, could affect our income tax expense and profitability, as they did in fiscal 2017 and fiscal 2018 upon passage of the U.S. Tax Cuts and Jobs Act.

***If we continue to grow at a rapid pace, we may not be able to effectively manage our growth and the increased complexity of our business and as a result our brand image and financial performance may suffer.***

We have expanded our operations rapidly since our inception in 1998 and our net revenue has increased from \$40.7 million in fiscal 2004 to \$4.0 billion in fiscal 2019. If our operations continue to grow at a rapid pace, we may experience difficulties in obtaining sufficient raw materials and manufacturing capacity to produce our products, as well as delays in production and shipments, as our products are subject to risks associated with overseas sourcing and manufacturing. We could be required to continue to expand our sales and marketing, product development and distribution functions, to upgrade our management information systems and other processes and technology, and to obtain more space for our expanding workforce. This expansion could increase the strain on our resources, and we could experience operating difficulties, including difficulties in hiring, training, and managing an increasing number of employees. These difficulties could result in the erosion of our brand image which could have a material adverse effect on our financial condition.

***We are subject to risks associated with leasing retail and distribution space subject to long-term and non-cancelable leases.***

We lease the majority of our stores under operating leases and our inability to secure appropriate real estate or lease terms could impact our ability to grow. Our leases generally have initial terms of between five and 15 years, and generally can be extended in five-year increments if at all. We generally cannot cancel these leases at our option. If an existing or new store is not profitable, and we decide to close it, as we have done in the past and may do in the future, we may nonetheless be committed to perform our obligations under the applicable lease including, among other things, paying the base rent for the balance of the lease term. Similarly, we may be committed to perform our obligations under the applicable leases even if current locations of our stores become unattractive as demographic patterns change. In addition, as each of our leases expire, we may fail to negotiate renewals, either on commercially acceptable terms or at all, which could require us to close stores in desirable locations.

We also lease the majority of our distribution centers and our inability to secure appropriate real estate or lease terms could impact our ability to deliver our products to the market.

***Increasing labor costs and other factors associated with the production of our products in South and South East Asia could increase the costs to produce our products.***

A significant portion of our products are produced in South and South East Asia and increases in the costs of labor and other costs of doing business in the countries in this area could significantly increase our costs to produce our products and could have a negative impact on our operations and earnings. Factors that could negatively affect our business include a potential significant revaluation of the currencies used in these countries, which may result in an increase in the cost of producing products, labor shortage and increases in labor costs, and difficulties and additional costs in transporting products manufactured from these countries to our distribution centers. Also, the imposition of trade sanctions or other regulations against products imported by us from, or the loss of "normal trade relations" status with any country in which our products are manufactured, could significantly increase our cost of products and harm our business.

***We may not be able to successfully open new store locations in a timely manner, if at all, which could harm our results of operations.***

Our growth will largely depend on our ability to successfully open and operate new stores, which depends on many factors, including, among others, our ability to:

- identify suitable store locations, the availability of which is outside of our control;
- gain brand recognition and acceptance, particularly in markets that are new to us;
- negotiate acceptable lease terms, including desired tenant improvement allowances;
- hire, train and retain store personnel and field management;
- immerse new store personnel and field management into our corporate culture;
- source sufficient inventory levels; and
- successfully integrate new stores into our existing operations and information technology systems.

We may be unsuccessful in identifying new markets where our technical athletic apparel and other products and brand image will be accepted. In addition, we may not be able to open or profitably operate new stores in existing, adjacent, or new markets due to the impact of COVID-19, which could have a material adverse effect on us.

***Our failure to comply with trade and other regulations could lead to investigations or actions by government regulators and negative publicity.***

The labeling, distribution, importation, marketing, and sale of our products are subject to extensive regulation by various federal agencies, including the Federal Trade Commission, Consumer Product Safety Commission and state attorneys general in the United States, the Competition Bureau and Health Canada in Canada, as well as by various other federal, state, provincial, local, and international regulatory authorities in the countries in which our products are distributed or sold. If we fail to comply with any of these regulations, we could become subject to enforcement actions or the imposition of significant penalties or claims, which could harm our results of operations or our ability to conduct our business. In addition, any audits and inspections by governmental agencies related to these matters could result in significant settlement amounts, damages, fines, or other penalties, divert financial and management resources, and result in significant legal fees. An unfavorable outcome of any particular proceeding could have an adverse impact on our business, financial condition, and results of operations. In addition, the adoption of new regulations or changes in the interpretation of existing regulations may result in significant compliance costs or discontinuation of product sales and could impair the marketing of our products, resulting in significant loss of net revenue.

Our international operations are also subject to compliance with the U.S. Foreign Corrupt Practices Act, or FCPA, and other anti-bribery laws applicable to our operations. In many foreign countries, particularly in those with developing economies, it may be a local custom that businesses operating in such countries engage in business practices that are prohibited by the FCPA or other U.S. and foreign laws and regulations applicable to us. Although we have implemented procedures designed to ensure compliance with the FCPA and similar laws, some of our employees, agents, or other channel partners, as well as those companies to which we outsource certain of our business operations, could take actions in violation of our policies. Any such violation could have a material and adverse effect on our business.

***Our future success is substantially dependent on the service of our senior management and other key employees.***

In the last few years, we have had changes to our senior management team including new hires, departures, and role and responsibility changes. The performance of our senior management team and other key employees may not meet our needs and expectations. Also, the loss of services of any of these key employees, or any negative public perception with respect to these individuals, may be disruptive to, or cause uncertainty in, our business and could have a negative impact on our ability to manage and grow our business effectively. Such disruption could have a material adverse impact on our financial performance, financial condition, and the market price of our stock.

We do not maintain a key person life insurance policy on any of the members of our senior management team. As a result, we would have no way to cover the financial loss if we were to lose the services of members of our senior management team.

***Our business is affected by seasonality.***

Our business is affected by the general seasonal trends common to the retail apparel industry. This seasonality may adversely affect our business and cause our results of operations to fluctuate, and, as a result, we believe that comparisons of

our operating results between different quarters within a single fiscal year are not necessarily meaningful and that results of operations in any period should not be considered indicative of the results to be expected for any future period.

***Because a significant portion of our net revenue and expenses are generated in countries other than the United States, fluctuations in foreign currency exchange rates have affected our results of operations and may continue to do so in the future.***

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 have, and may continue to, enter into forward currency contracts, or other derivative instruments, in an effort to mitigate the foreign exchange risks which we are exposed to. This may include entering into forward currency contracts to hedge against the foreign exchange gains and losses which arise on translation of our foreign subsidiaries' balance sheets into U.S. dollars, or entering into forward currency contracts in an effort to reduce our exposure to foreign exchange revaluation gains and losses that arise on monetary assets and liabilities held by our subsidiaries in a currency other than their functional currency.

Although we use financial instruments to hedge certain foreign currency risks, these measures may not succeed in fully offsetting the negative impact of foreign currency rate movements.

We are exposed to credit-related losses in the event of nonperformance by the counterparties to the forward currency contracts.

***Our trademarks and other proprietary rights could potentially conflict with the rights of others and we may be prevented from selling some of our products.***

Our success depends in large part on our brand image. We believe that our trademarks and other proprietary rights have significant value and are important to identifying and differentiating our products from those of our competitors and creating and sustaining demand for our products. We have applied for and obtained some United States, Canada, and foreign trademark registrations, and will continue to evaluate the registration of additional trademarks as appropriate. However, some or all of these pending trademark applications may not be approved by the applicable governmental authorities. Moreover, even if the applications are approved, third parties may seek to oppose or otherwise challenge these registrations. Additionally, we may face obstacles as we expand our product line and the geographic scope of our sales and marketing. Third parties may assert intellectual property claims against us, particularly as we expand our business and the number of products we offer. Our defense of any claim, regardless of its merit, could be expensive and time consuming and could divert management resources. Successful infringement claims against us could result in significant monetary liability or prevent us from selling some of our products. In addition, resolution of claims may require us to redesign our products, license rights from third parties, or cease using those rights altogether. Any of these events could harm our business and cause our results of operations, liquidity, and financial condition to suffer.

***We are subject to periodic claims and litigation that could result in unexpected expenses and could ultimately be resolved against us.***

From time to time, we are involved in litigation and other proceedings, including matters related to product liability claims, stockholder class action and derivative claims, commercial disputes and intellectual property, as well as trade, regulatory, employment, and other claims related to our business. Any of these proceedings could result in significant settlement amounts, damages, fines, or other penalties, divert financial and management resources, and result in significant legal fees. An unfavorable outcome of any particular proceeding could exceed the limits of our insurance policies or the carriers may decline to fund such final settlements and/or judgments and could have an adverse impact on our business, financial condition, and results of operations. In addition, any proceeding could negatively impact our reputation among our guests and our brand image.

***Our business could be negatively affected as a result of actions of activist stockholders or others.***

We may be subject to actions or proposals from stockholders or others that may not align with our business strategies or the interests of our other stockholders. Responding to such actions can be costly and time-consuming, disrupt our business and operations, and divert the attention of our board of directors, management, and employees from the pursuit of our business strategies. Such activities could interfere with our ability to execute our strategic plan. Activist stockholders or others may create perceived uncertainties as to the future direction of our business or strategy which may be exploited by our competitors and may make it more difficult to attract and retain qualified personnel and potential guests, and may affect our relationships with current guests, vendors, investors, and other third parties. In addition, a proxy contest for the election of directors at our annual meeting would require us to incur significant legal fees and proxy solicitation expenses and require significant time and attention by management and our board of directors. The perceived uncertainties as to our future direction also could affect the market price and volatility of our securities.

***Anti-takeover provisions of Delaware law and our certificate of incorporation and bylaws could delay and discourage takeover attempts that stockholders may consider to be favorable.***

Certain provisions of our certificate of incorporation and bylaws and applicable provisions of the Delaware General Corporation Law may make it more difficult or impossible for a third-party to acquire control of us or effect a change in our board of directors and management. These provisions include:

- the classification of our board of directors into three classes, with one class elected each year;
- prohibiting cumulative voting in the election of directors;
- the ability of our board of directors to issue preferred stock without stockholder approval;
- the ability to remove a director only for cause and only with the vote of the holders of at least 66 2/3% of our voting stock;
- a special meeting of stockholders may only be called by our chairman or Chief Executive Officer, or upon a resolution adopted by an affirmative vote of a majority of the board of directors, and not by our stockholders;
- prohibiting stockholder action by written consent; and
- our stockholders must comply with advance notice procedures in order to nominate candidates for election to our board of directors or to place stockholder proposals on the agenda for consideration at any meeting of our stockholders.

In addition, we are governed by Section 203 of the Delaware General Corporation Law which, subject to some specified exceptions, prohibits "business combinations" between a Delaware corporation and an "interested stockholder," which is generally defined as a stockholder who becomes a beneficial owner of 15% or more of a Delaware corporation's voting stock, for a three-year period following the date that the stockholder became an interested stockholder. Section 203 could have the effect of delaying, deferring, or preventing a change in control that our stockholders might consider to be in their best interests.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The following table provides information regarding our purchases of shares of our common stock during the quarter ended August 2, 2020 related to our stock repurchase program:

<u>Period<sup>(1)</sup></u>	<u>Total Number of Shares Purchased<sup>(2)</sup></u>	<u>Average Price Paid per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs<sup>(2)</sup></u>	<u>Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs<sup>(2)</sup></u>
May 4, 2020 - May 31, 2020 .....	—	—	—	\$ 263,646,016
June 1, 2020 - July 5, 2020 .....	—	—	—	263,646,016
July 6, 2020 - August 2, 2020 .....	—	—	—	263,646,016
Total .....	—	—	—	

<sup>(1)</sup> Monthly information is presented by reference to our fiscal periods during our second quarter of fiscal 2020.

<sup>(2)</sup> On January 31, 2019, our board of directors approved a stock repurchase program of up to \$500 million of our common shares on the open market or in privately negotiated transactions. Common shares repurchased on the open market are at prevailing market prices, including under plans complying with the provisions of Rule 10b5-1 and Rule 10b-18 of the Securities Exchange Act of 1934. The timing and actual number of common shares to be repurchased will depend upon market conditions, eligibility to trade, and other factors. As of March 31, 2020, we temporarily paused our share repurchase program.

The following table provides information regarding our purchases of shares of our common stock during the quarter ended August 2, 2020 related to our Employee Share Purchase Plan:

<u>Period<sup>(1)</sup></u>	<u>Total Number of Shares Purchased<sup>(2)</sup></u>	<u>Average Price Paid per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs<sup>(2)</sup></u>	<u>Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs<sup>(2)</sup></u>
May 4, 2020 - May 31, 2020 .....	5,263	\$ 266.78	5,263	4,699,286
June 1, 2020 - July 5, 2020 .....	4,937	292.66	4,937	4,694,349
July 6, 2020 - August 2, 2020 .....	4,712	316.22	4,712	4,689,637
<b>Total .....</b>	<b>14,912</b>		<b>14,912</b>	

<sup>(1)</sup> Monthly information is presented by reference to our fiscal periods during our second quarter of fiscal 2020.

<sup>(2)</sup> Our Employee Share Purchase Plan (ESPP) was approved by our board of directors and stockholders in September 2007. All shares purchased under the ESPP are purchased on the Nasdaq Global Select Market (or such other stock exchange as we may designate from time to time). Unless our board of directors terminates the ESPP earlier, the ESPP will continue until all shares authorized for purchase under the ESPP have been purchased. The maximum number of shares authorized to be purchased under the ESPP is 6,000,000.

Excluded from this disclosure are shares withheld to settle statutory employee tax withholding related to the vesting of stock-based compensation awards.

**ITEM 6. EXHIBITS**

Exhibit No.	Exhibit Title	Filed Herewith	Incorporated by Reference			
			Form	Exhibit No.	File No.	Filing Date
10.1	<a href="#">364-Day Credit Agreement, dated June 29, 2020, among lululemon athletica inc., a Delaware corporation; lululemon athletica canada inc., a corporation organized under the laws of British Columbia; Lulu Canadian Holding, Inc., a corporation organized under the laws of British Columbia; lululemon usa inc., a Nevada corporation; each lender from time to time a party to the credit agreement; and Bank of America, N.A., as administrative agent and swing line lender</a>		8-K	10.1	001-33608	7/1/2020
31.1	<a href="#">Certification of principal executive officer Pursuant to Exchange Act Rule 13a-14(a)</a>	X				
31.2	<a href="#">Certification of principal financial and accounting officer Pursuant to Exchange Act Rule 13a-14(a)</a>	X				
32.1*	<a href="#">Certification of principal executive officer and principal financial and accounting officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</a>					
101	The following unaudited interim consolidated financial statements from the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended August 2, 2020, formatted in iXBRL: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations and Comprehensive Income, (iii) Consolidated Statements of Stockholders' Equity, (iv) Consolidated Statements of Cash Flows (v) Notes to the Unaudited Interim Consolidated Financial Statements	X				

\* Furnished herewith.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

lululemon athletica inc.

By: /s/ CALVIN MCDONALD

Calvin McDonald

Chief Executive Officer

(principal financial and accounting officer)

Dated: September 8, 2020

**Exhibit Index**

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31.1	Certification of principal executive officer Pursuant to Exchange Act Rule 13a-14(a)	X				
31.2	Certification of principal financial and accounting officer Pursuant to Exchange Act Rule 13a-14(a)	X				
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\* Furnished herewith.

I, Calvin McDonald, certify that:

1. I have reviewed this quarterly report on Form 10-Q of lululemon athletica inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

By: /s/ CALVIN McDONALD

\_\_\_\_\_  
Calvin McDonald

Chief Executive Officer and Director  
(principal executive officer)

Date: September 8, 2020

I, Calvin McDonald, certify that:

1. I have reviewed this quarterly report on Form 10-Q of lululemon athletica inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

By: /s/ CALVIN McDONALD

\_\_\_\_\_  
Calvin McDonald

Chief Executive Officer and Director

(principal financial and accounting officer)

Date: September 8, 2020

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO SECTION 906 OF  
THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of lululemon athletica inc. (the "Company") on Form 10-Q for the second quarter of fiscal 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), each of the undersigned officers of the Company certifies, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to such officer's knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ CALVIN McDONALD  
Calvin McDonald  
Chief Executive Officer and Director  
(principal executive officer)

Date: September 8, 2020

By: /s/ CALVIN McDONALD  
Calvin McDonald  
Chief Executive Officer and Director  
(principal financial and accounting officer)

Date: September 8, 2020

The foregoing certification is being furnished solely pursuant to 18 U.S.C. § 1350 and is not being filed as part of the Report or as a separate disclosure document.