

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's discussion and analysis of financial condition and results of operations is provided as a supplement to, and should be read in conjunction with, our consolidated financial statements and the related notes included elsewhere in this Annual Report on Form 10-K. Components of management's discussion and analysis of financial condition and results of operations include:

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Our fiscal year ends on the Sunday closest to January 31 of the following year, typically resulting in a 52-week year, but occasionally giving rise to an additional week, resulting in a 53-week year. Fiscal 2020 and 2019 were each 52-week years.

This discussion and analysis contains forward-looking statements based on current expectations that involve risks, uncertainties and assumptions, such as our plans, objectives, expectations, and intentions included in the "Special Note Regarding Forward-Looking Statements." Our actual results and the timing of events may differ materially from those anticipated in these forward-looking statements as a result of various factors, including those described in the "Item 1A. Risk Factors" section and elsewhere in this Annual Report on Form 10-K.

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

Overview

Fiscal 2020 was a year in which we had to adapt our priorities, and evolve our strategies, to navigate the challenges of the COVID-19 pandemic and begin to more impactfully address systemic inequities in our society.

We put three foundational principles in place to help guide us through the pandemic. These principles are: 1) protect our people to ensure their health, safety, and well-being, 2) make balanced decisions including investing in our digital and omni capabilities while tightly managing discretionary expenses, and 3) continue to invest in our future.

We completed our first acquisition in 2020, with our purchase of MIRROR. MIRROR bolsters our digital sweatlife offerings and brings immersive and personalized at-home sweat and mindfulness solutions to new and existing lululemon guests.

In addition, we established IDEA – our commitment to Inclusion, Diversity, Equity, and Action – to help drive lasting change both within our company and the communities in which we operate. In October 2020, we released our Impact Agenda detailing our strategies to become a more sustainable and equitable business, to minimize our environmental impact, and to accelerate positive change both internally and externally.

The Power of Three

Despite the global pandemic, we remain committed to our Power of Three growth plan and the targets contemplated by this plan which include a doubling of our men's business, a doubling of our e-commerce business, and a quadrupling of our international business by 2023 from levels realized in 2018. Due to a shift towards online shopping as a result of COVID-19, we exceeded our e-commerce goal this year.

In addition to the growth targets, the three strategic pillars of the plan also remain unchanged and include: product innovation, omni-guest experience, and market expansion.

Product Innovation

We continued to leverage our Science of Feel development platform and brought innovations to our guests including a relaunch of our Everlux fabric and an expansion of our Align franchise into tops. We also brought newness into our bra offering and expanded our On the Move assortment. We introduced more inclusive sizing into our core women's styles in 2020 with additional styles to be added in 2021. In men's, our guests responded well to shorts, sweats, hoodies, and joggers as they adapted their wardrobes to working and sweating from home.

Omni-Guest Experience

The COVID-19 pandemic impacted the way guests interacted with our brand in 2020. Temporary store closures, social distancing requirements, and other actions taken within our stores to keep our guests and employees safe, contributed to a decline in store traffic relative to 2019. Revenue in stores decreased 34%. However, this was offset by significant strength in our e-commerce business. We invested in IT infrastructure, fulfillment capacity, and increased the number of educators assisting guests in our Guest Education Center, including an online digital educator experience to provide a more personalized shopping experience. In addition, we used our social channels to engage with our guests by offering ambassador-led digital sweat sessions, meditation classes, and other recovery and well-being tools. Revenue in our e-commerce channel increased 101% in 2020.

In 2020, as it was safe to welcome guests back into our stores, we launched several initiatives to enhance the in-store experience. We adapted our Buy Online Pick-up In-store capability to allow guests to pick-up their purchases at the door of the store or at curbside, we implemented virtual waitlist capabilities so that guests did not have to physically wait in line to enter stores operating under strict capacity constraints, and we offered appointment shopping in-store.

Market Expansion

We continued to expand our presence both in North America and in our international markets. During the year, we opened 30 net new company-operated stores, including 18 stores in Asia Pacific, nine stores in North America, and three stores in Europe.

We also expanded our seasonal store strategy in 2020 with over 100 seasonal stores in operation for some period of time during the year. These stores allowed us to better cater to our guests in select markets, while also helping introduce new guests to our brand. In addition, in the fourth quarter, we opened 11 of these stores in close proximity to permanent lululemon stores. Having two stores in select locations, where locally mandated capacity constraints were contributing to long wait times, allowed guests quicker and easier access to our in-store shopping experience.

For 2020, our business in North America increased 8%, while total growth in our international markets was 31%.

COVID-19 Pandemic

The outbreak of the COVID-19 coronavirus was declared a pandemic by the World Health Organization in March 2020 and it has caused governments and public health officials to impose restrictions and to recommend precautions to mitigate the spread of the virus.

Throughout the pandemic we have prioritized the safety of our employees and guests.

In February and March, we temporarily closed all of our retail locations in Mainland China, North America, Europe, and certain countries in Asia Pacific. Our retail locations in Mainland China reopened during the first quarter of 2020, and our retail locations in other markets began reopening during the second quarter of 2020. Almost all locations were open during the third quarter of 2020, and while most of our retail locations have remained open since then, certain locations have temporarily closed based on government and health authority guidance in those markets.

Our distribution centers and most of our open retail locations are operating with restrictive and precautionary measures in place such as reduced operating hours, physical distancing, enhanced cleaning and sanitation, and limited occupancy levels.

Prior to the COVID-19 pandemic, guest shopping preferences were shifting towards digital platforms and we had been investing in our websites, mobile apps, and omni-channel capabilities. We believe that the COVID-19 pandemic further shifted guest shopping behaviour and we saw significant increases in traffic to our websites and digital apps. This increased traffic contributed to the significant growth in our direct to consumer net revenue in 2020. While we expect our direct to consumer business to grow, we expect the year over year growth rate in direct to consumer net revenue to moderate in 2021.

The COVID-19 pandemic had a material adverse impact on our results of operations for 2020 and there remains significant uncertainty regarding the extent and duration of the impact that the COVID-19 pandemic will have on our operations. Continued proliferation of the virus, resurgence, or the emergence of new variants may result in further or prolonged closures of our retail locations and distribution centers, reduce operating hours, interrupt our supply chain, cause changes in guest behavior, and reduce discretionary spending. Such factors are beyond our control and could elicit further actions and recommendations from governments and public health authorities.

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 committed revolving credit facility, to meet our liquidity needs. As of January 31, 2021, we had cash and cash equivalents of \$1.2 billion and the capacity under our committed revolving credit facility was \$397.6 million.

Financial Highlights

The summary below compares 2020 to 2019:

- Net revenue increased 11% to \$4.4 billion. On a constant dollar basis, net revenue increased 10%.
- Company-operated stores net revenue decreased 34% to \$1.7 billion.
- Direct to consumer net revenue increased 101% to \$2.3 billion, or increased 101% on a constant dollar basis.
- Gross profit increased 11% to \$2.5 billion.
- Gross margin increased 10 basis points to 56.0%.
- Acquisition-related expenses of \$29.8 million were recognized.
- Income from operations decreased 8% to \$820.0 million.
- Operating margin decreased 370 basis points to 18.6%.
- Income tax expense decreased 8% to \$230.4 million. Our effective tax rate was 28.1% for each of 2020 and 2019.
- Diluted earnings per share were \$4.50 for 2020 compared to \$4.93 in 2019. This includes \$26.7 million of after-tax costs related to the MIRROR acquisition, which reduced diluted earnings per share by \$0.20 in 2020.

Refer to the non-GAAP reconciliation tables contained in the "Non-GAAP Financial Measures" section of this "Item 7. 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

The following table summarizes key components of our results of operations for the periods indicated:

	2020	2019	2020	2019
	<i>(In thousands)</i>		<i>(Percentage of revenue)</i>	
Net revenue	\$ 4,401,879	\$ 3,979,296	100.0 %	100.0 %
Cost of goods sold	1,937,888	1,755,910	44.0	44.1
Gross profit	2,463,991	2,223,386	56.0	55.9
Selling, general and administrative expenses	1,609,003	1,334,247	36.6	33.5
Amortization of intangible assets	5,160	29	0.1	—
Acquisition-related expenses	29,842	—	0.7	—
Income from operations	819,986	889,110	18.6	22.3
Other income (expense), net	(636)	8,283	—	0.2
Income before income tax expense	819,350	897,393	18.6	22.6
Income tax expense	230,437	251,797	5.2	6.3
Net income	\$ 588,913	\$ 645,596	13.4 %	16.2 %

Comparison of 2020 to 2019

Net Revenue

Net revenue increased \$422.6 million, or 11%, to \$4.4 billion in 2020 from \$4.0 billion in 2019. On a constant dollar basis, assuming the average exchange rates in 2020 remained constant with the average exchange rates in 2019, net revenue increased \$412.7 million, or 10%.

The increase in net revenue was primarily due to an increase in direct to consumer net revenue, partially due to a shift in the way guests are shopping due to COVID-19, as well as net revenue from MIRROR. This was partially offset by a decrease in company-operated store net revenue, as well as a decrease in net revenue from our other retail locations driven by temporary closures as a result of COVID-19 as well as reduced operating hours and restricted guest occupancy levels.

Net revenue for 2020 and 2019 is summarized below.

	2020		2019		Year over year change	
	<i>(In thousands)</i>		<i>(Percentage of revenue)</i>		<i>(In thousands)</i>	<i>(Percentage)</i>
Company-operated stores	\$ 1,658,807	\$ 2,501,067	37.7 %	62.9 %	\$ (842,260)	(33.7)%
Direct to consumer	2,284,068	1,137,822	51.9	28.6	1,146,246	100.7
Other	459,004	340,407	10.4	8.6	118,597	34.8
Net revenue	\$ 4,401,879	\$ 3,979,296	100.0 %	100.0 %	\$ 422,583	10.6 %

Company-Operated Stores. 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 2020. Certain stores experienced temporary re-closures during the last two quarters of 2020. COVID-19 restrictions, including reduced operating hours and occupancy limits, reduced net revenue from company-operated stores that have reopened.

During 2020, we opened 30 net new company-operated stores, including 18 stores in Asia Pacific, nine stores in North America, and three stores in Europe.

Direct to Consumer. Direct to consumer net revenue increased 101%, and increased 101% on a constant dollar basis. The increase in net revenue from our direct to consumer segment was primarily the result of increased traffic, and improved conversion rates, partially offset by a decrease in dollar value per transaction. The increase in traffic was partially due to COVID-19, with more guests shopping online instead of in-stores. During the second quarter of 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 2019.

Other. The increase in net revenue from our other operations was primarily the result of net revenue from MIRROR as well as an increased number of temporary locations, including seasonal stores, that were open during 2020 compared to 2019. The increase was partially offset by a decrease in outlet sales primarily due to the impact of COVID-19.

Gross Profit

	2020	2019	Year over year change	
	<i>(In thousands)</i>		<i>(In thousands)</i>	<i>(Percentage)</i>
Gross profit	\$ 2,463,991	\$ 2,223,386	\$ 240,605	10.8 %
Gross margin	56.0 %	55.9 %	10 basis points	

The increase in gross margin was primarily the result of:

- a decrease in occupancy and depreciation costs as a percentage of net revenue of 60 basis points, driven primarily by the increase in net revenue;
- a decrease in costs related to our product departments as a percentage of revenue of 50 basis points, driven by lower incentive compensation and travel costs, as well as the increase in net revenue; and
- a favorable impact of foreign exchange rates of 10 basis points.

The increase in gross margin was partially offset by an increase in costs as a percentage of net revenue related to our distribution centers of 80 basis points. This was primarily due to an increase in costs related to COVID-19 safety precautions, higher people costs related to the growth in our direct to consumer business, and increased usage of third-party warehouse and logistics providers. There was also a decrease in product margin of 30 basis points, which was primarily due to higher markdowns and air freight costs, partially offset by a favorable mix of higher margin product.

Selling, General and Administrative Expenses

	2020	2019	Year over year change	
	<i>(In thousands)</i>		<i>(In thousands)</i>	<i>(Percentage)</i>
Selling, general and administrative expenses	\$ 1,609,003	\$ 1,334,247	\$ 274,756	20.6 %

The increase in selling, general and administrative expenses was primarily due to:

- an increase in costs related to our operating channels of \$253.2 million, comprised of:
 - an increase in variable costs of \$144.1 million primarily due to an increase in distribution costs related to the growth in our direct to consumer net revenue, and an increase in credit card fees as a result of increased net revenue;
 - an increase in brand and community costs of \$116.4 million primarily due to an increase in digital marketing expenses;
 - an increase in other costs of \$14.2 million primarily due to increases in information technology costs; and
 - a decrease in employee costs of \$21.5 million primarily due to lower incentive compensation expenses in our company-operated stores and other channels. This was partially offset by an increase in salaries and wages as a result of increased headcount and labor hours in our direct to consumer and other operations;
- an increase in head office costs of \$56.5 million, comprised of:
 - an increase of \$63.0 million primarily due to increases in information technology costs, professional fees, depreciation, community giving, and other head office costs; and
 - a decrease in employee costs of \$6.5 million primarily due to lower incentive compensation and travel expenses, partially offset by increased salaries and wages expense as a result of headcount growth, and higher stock-based compensation expense; and
- an increase in net foreign exchange and derivative revaluation losses of \$1.6 million.

The increase in selling, general and administrative expenses was partially offset by \$36.5 million of government payroll subsidies. These payroll subsidies partially offset the wages paid to employees while our retail locations were temporarily closed due to the COVID-19 pandemic.

Amortization of Intangible Assets

	2020	2019	Year over year change	
	<i>(In thousands)</i>		<i>(In thousands)</i>	<i>(Percentage)</i>
Amortization of intangible assets	\$ 5,160	\$ 29	\$ 5,131	n/a

The increase in the amortization of intangible assets was the result of the intangible assets recognized upon the acquisition of MIRROR during the second quarter of 2020.

Acquisition-Related Expenses

	2020	2019	Year over year change	
	<i>(In thousands)</i>		<i>(In thousands)</i>	<i>(Percentage)</i>
Acquisition-related expenses	\$ 29,842	\$ —	\$ 29,842	n/a

As a result of our acquisition of MIRROR in the second quarter of 2020, we recognized acquisition-related compensation of \$20.1 million for deferred consideration for certain continuing MIRROR employees. We also recognized transaction and integration related costs of \$10.5 million for advisory and professional services, and integration costs subsequent to the acquisition. 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 2019. Please refer to Note 6. Acquisition included in Item 8 of Part II of this report for further information.

Income from Operations

On a segment basis, we determine income from operations without taking into account our general corporate expenses. During the first quarter of 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 from operations before general corporate expenses is summarized below.

Income from operations	2020	2019	2020	2019	Year over year change	
	<i>(In thousands)</i>		<i>(Percentage of net revenue of respective operating segment)</i>		<i>(In thousands)</i>	<i>(Percentage)</i>
Segment income from operations:						
Company-operated stores	\$ 212,592	\$ 689,339	12.8 %	27.6 %	\$ (476,747)	(69.2)%
Direct to consumer	1,029,102	484,146	45.1	42.6	544,956	112.6 %
Other	10,502	72,013	2.3	21.2	(61,511)	(85.4)%
	\$ 1,252,196	\$ 1,245,498			\$ 6,698	0.5 %
General corporate expenses	397,208	356,359			40,849	11.5 %
Amortization of intangibles	5,160	29			5,131	n/a
Acquisition-related expenses	29,842	—			29,842	n/a
Income from operations	\$ 819,986	\$ 889,110			\$ (69,124)	(7.8)%
Operating margin	18.6 %	22.3 %			(370) basis points	

Company-Operated Stores. The decrease in income from operations from company-operated stores was primarily the result of decreased gross profit of \$591.8 million which was primarily due to lower net revenue as well as lower gross margin. The decrease in gross margin was primarily due to deleverage on occupancy and depreciation costs as a result of lower net revenue. The decrease in gross profit was partially offset by a decrease in selling, general and administrative expenses, primarily due to lower people costs and lower operating costs. People costs decreased primarily due to lower incentive compensation. Store operating costs decreased primarily due to lower credit card fees, packaging and supplies, and distribution costs as a result of lower net revenue, as well as lower community, security, and repairs and maintenance costs. The recognition of certain government payroll subsidies also reduced selling, general, and administrative expenses. 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. The increase in income from operations from our direct to consumer segment was primarily the result of increased gross profit of \$773.7 million which was primarily due to increased net revenue and due to higher gross margin. The increase in gross profit 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 and supplies costs as a result of higher net revenue, as well as higher digital marketing expenses, employee costs and information technology costs. Income from operations as a percentage of direct to consumer net revenue has increased primarily due to leverage on selling, general and administrative expenses and an increase in gross margin.

Other. The decrease in income from operations was primarily the result of increased selling, general and administrative expenses, driven primarily by MIRROR digital marketing expenses, as well as increased distribution costs and credit card fees

as a result of revenue generated by MIRROR. The increase in selling, general and administrative expenses was partially offset by an increase in gross profit related to MIRROR, driven by increased 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 Expenses. The increase in general corporate expenses was primarily the result of increases in information technology costs, salaries and wages as a result of headcount growth, professional fees, depreciation, community giving, and an increase in net foreign exchange and derivative losses of \$1.6 million. The increase in general corporate expense was partially offset by a decrease in travel and incentive compensation costs, as well as the recognition of certain government payroll subsidies. We expect general corporate expenses to continue to increase in future years as we grow our overall business and require increased efforts at our head office to support our operations.

Other Income (Expense), Net

	2020	2019	Year over year change	
	<i>(In thousands)</i>		<i>(In thousands)</i>	<i>(Percentage)</i>
Other income (expense), net	\$ (636)	\$ 8,283	\$ (8,919)	(107.7)%

The decrease in other income, net was primarily due to a decrease in net interest income as a result of lower cash balances and lower interest rates during the majority of 2020 compared to 2019. We did not have any borrowings on our revolving credit facilities during 2020 or 2019.

Income Tax Expense

	2020	2019	Year over year change	
	<i>(In thousands)</i>		<i>(In thousands)</i>	<i>(Percentage)</i>
Income tax expense	\$ 230,437	\$ 251,797	\$ (21,360)	(8.4)%
Effective tax rate	28.1 %	28.1 %	— basis points	

Our effective tax rate for 2020 was consistent with 2019. This included an increase in the effective tax rate due to certain non-deductible expenses related to the MIRROR acquisition which increased the effective tax rate by 60 basis points. This was offset by adjustments upon filing of certain income tax returns and an increase in tax deductions related to stock-based compensation.

Net Income

	2020	2019	Year over year change	
	<i>(In thousands)</i>		<i>(In thousands)</i>	<i>(Percentage)</i>
Net income	\$ 588,913	\$ 645,596	\$ (56,683)	(8.8)%

The decrease in net income in 2020 was primarily due to an increase in selling, general and administrative expenses of \$274.8 million, the recognition of acquisition-related expenses of \$29.8 million, an increase in amortization of intangible assets of \$5.1 million, and a decrease in other income (expense), net of \$8.9 million. This was partially offset by an increase in gross profit of \$240.6 million, and a decrease in income tax expense of \$21.4 million.

Comparable Store Sales and Total Comparable Sales

We 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 use total comparable sales to evaluate the performance of our business from an omni-channel perspective. We therefore 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 resulted in a significant number of stores being removed from our comparable store calculations during the first two quarters of 2020, we believe total comparable sales and comparable store sales on a full year basis are not currently representative of the underlying trends of our business. We do not believe these full year 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. We did not provide comparable sales metrics that included the first two quarters during 2020, and expect to do the same for 2021.

Comparable store sales 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. Comparable store sales also exclude sales from direct to consumer and our other operations, as well as sales from company-operated stores that have closed.

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

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.

Opening new stores and expanding existing stores is an important part of our growth strategy. Accordingly, total comparable sales is just one way of assessing the success of our growth strategy insofar as comparable sales do not reflect the performance of stores opened, or significantly expanded, within the last 12 full fiscal months. The comparable sales measures we report may not be equivalent to similarly titled measures reported by other companies.

Non-GAAP Financial Measures

Constant dollar changes in net revenue 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.

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

	2020		
	Net Revenue	Direct to Consumer Net Revenue	
	<i>(In thousands)</i>	<i>(Percentages)</i>	<i>(Percentages)</i>
Change	\$ 422,583	11 %	101 %
Adjustments due to foreign exchange rate changes	(9,898)	(1)	—
Change in constant dollars	\$ 412,685	10 %	101 %

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 committed revolving credit facility. Our primary cash needs are capital expenditures for opening new stores and remodeling or relocating existing stores, investing in information technology and making system enhancements, funding working capital requirements, and making other strategic capital investments both in North America and internationally. We may also use cash to repurchase shares of our common stock. Cash and cash equivalents in excess of our needs are held in interest bearing accounts with financial institutions, as well as in money market funds, treasury bills, and term deposits.

We believe that our cash and cash equivalent balances, cash generated from operations, and borrowings available to us under our committed revolving credit facility will be adequate to meet our liquidity needs and capital expenditure requirements for at least the next 12 months. Our cash from operations may be negatively impacted by a decrease in demand for our products as well as the other factors described in "Item 1A. Risk Factors". In addition, we may make discretionary capital improvements with respect to our stores, distribution facilities, headquarters, or systems, or we may repurchase shares under an approved stock repurchase program, 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.

Capital expenditures are expected to range between \$335.0 million and \$345.0 million in fiscal 2021.

As of January 31, 2021, our working capital (excluding cash and cash equivalents) was \$90.7 million, our cash and cash equivalents were \$1.2 billion and our capacity under our committed revolving credit facility was \$397.6 million.

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

	2020	2019
	<i>(In thousands)</i>	
Total cash provided by (used in):		
Operating activities	\$ 803,336	\$ 669,316
Investing activities	(695,532)	(278,408)
Financing activities	(80,788)	(177,173)
Effect of exchange rate changes on cash	29,996	(1,550)
Increase in cash and cash equivalents	\$ 57,012	\$ 212,185

Operating Activities

Net cash provided by operating activities increased \$134.0 million to \$803.3 million in 2020 from \$669.3 million in 2019, primarily as a result of the following:

- an increase from changes in operating assets and liabilities of \$146.5 million, primarily due to the following:
 - \$97.5 million related to accounts payable, partially due to a change in payment terms with our non-product vendors;
 - \$76.8 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;
 - \$38.7 million related to inventories; and
 - \$12.1 million related to other current and non-current liabilities.

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

- \$38.4 million related to prepaid expenses and other current and non-current assets, including increases in cloud computing implementation costs;
- \$32.0 million related to accrued compensation and related expenses due to lower accrued incentive compensation, partially offset by acquisition-related compensation accruals; and
- \$8.2 million related to income taxes.
- an increase of \$44.2 million in 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, deferred income taxes, the settlement of derivatives not designated in a hedging relationship, and stock-based compensation.

The increase in cash provided by operating activities was partially offset by a decrease of \$56.7 million in net income.

Investing Activities

Cash used in investing activities increased \$417.1 million, to \$695.5 million in 2020 from \$278.4 million in 2019. The increase was primarily due to the acquisition of MIRROR, net of cash acquired for \$452.6 million during 2020. This was partially offset by a decrease in capital expenditures.

Capital expenditures for our company-operated stores segment were \$134.2 million and \$171.5 million in 2020 and 2019, respectively. The capital expenditures for our company-operated stores segment in each period were primarily for the remodeling or relocation of certain stores, for opening new company-operated stores, and ongoing store refurbishment. The decrease in capital expenditures for our company-operated stores segment was primarily due to fewer store renovations during 2020 in comparison with 2019. The capital expenditures for our company-operated stores segment also included \$41.0 million to open 40 company-operated stores and \$44.3 million to open 57 company-operated stores, in 2020 and 2019

respectively. As a result of the COVID-19 pandemic we delayed certain store renovations and new store openings. We expect to open between 40 and 50 company-operated stores in 2021.

Capital expenditures for our direct to consumer segment were \$37.2 million and \$15.8 million in 2020 and 2019, respectively. We accelerated our investments in our e-commerce websites and mobile apps during 2020 in response to the COVID-19 pandemic and the impact it had on guest shopping behavior. The capital expenditures in 2020 were primarily related to enhancing the functionality and capacity of our websites, and in 2019 were primarily related to our then new distribution center in Toronto, Canada as well as other information technology infrastructure and system initiatives.

Capital expenditures related to corporate activities and other were \$57.8 million and \$95.7 million in 2020 and 2019, respectively. The capital expenditures in each fiscal year were primarily related to investments in information technology and business systems, and for capital expenditures related to opening retail locations other than company-operated stores. The decrease in capital expenditures for our corporate activities and other was partially due to more larger scale projects in the prior year in comparison to the current year as well as a shift to cloud computing. Implementation costs related to cloud service arrangements are capitalized within other non-current assets in the consolidated balance sheets and the associated cash flows are included in operating activities. We anticipate that we will continue to shift towards more cloud-based technology services in the future.

Financing Activities

Cash used in financing activities decreased \$96.4 million, to \$80.8 million in 2020 from \$177.2 million in 2019. The decrease was primarily the result of a decrease in our stock repurchases.

During 2020, 0.4 million shares were repurchased at a cost of \$63.7 million. During 2019, 1.1 million shares, were repurchased at a cost of \$173.4 million. In the first quarter of 2019, we repurchased 1.0 million shares in a private transaction. We did not purchase any shares in private transactions during 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.

Revolving Credit Facilities

North America revolving credit facility

During 2016, we obtained a \$150.0 million committed and unsecured five-year revolving credit facility with major financial institutions. On June 6, 2018, we amended the credit agreement to provide for (i) an increase in the aggregate commitments under the 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, to request increases in commitments from \$400.0 million to \$600.0 million and (iii) an extension in the maturity of the facility from December 15, 2021 to June 6, 2023. Borrowings under the facility may be made in U.S. Dollars, Euros, Canadian Dollars, and in other currencies, subject to the lenders' approval.

As of January 31, 2021, aside from letters of credit of \$2.4 million, we had no other borrowings outstanding under this credit facility.

Borrowings under the facility bear interest at a rate equal to, at our option, either (a) 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, an applicable margin 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%-1.50% for LIBOR loans and 0.00%-0.50% for alternate base rate loans. Additionally, a commitment fee of between 0.10%-0.20% is payable on the average unused amounts under the revolving credit facility, and fees of 1.00%-1.50% are payable on unused letters of credit.

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 3.5:1 and to maintain the ratio of consolidated EBITDAR to consolidated interest charges (plus rent) below 2:1. 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). As of January 31, 2021, we were in compliance with the covenants of the 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 with terms that are reviewed on an annual basis. The credit facility was increased to 230.0 million Chinese Yuan during 2020. It comprises of a revolving loan of up to 200.0 million Chinese Yuan and a financial guarantee facility of up to 30.0 million Chinese Yuan, or its equivalent in another currency. Loans are available for a period not to exceed 12 months, at an interest rate equal to the loan prime rate plus a spread of 0.5175%. We are required to follow certain covenants. As of January 31, 2021, we were in compliance with the covenant and there were no borrowings or guarantees outstanding under this credit facility.

364-Day revolving credit facility

In June 2020, we obtained a 364-day \$300.0 million committed and unsecured revolving credit facility. In December 2020, we elected to terminate this credit facility.

Contractual Obligations and Commitments

Leases. We lease certain store and other retail locations, distribution centers, offices, and equipment under non-cancellable operating leases. Our leases generally have initial terms of between five and 15 years, and generally can be extended in five-year increments, if at all. The following table details our future minimum lease payments. Minimum lease commitments exclude variable lease expenses including contingent rent payments, common area maintenance, property taxes, and landlord's insurance.

Purchase obligations. The amounts listed for purchase obligations in the table below represent agreements (including open purchase orders) to purchase products and for other expenditures in the ordinary course of business that are enforceable and legally binding and that specify all significant terms. In some cases, values are subject to change, such as for product purchases throughout the production process. The reported amounts exclude liabilities included in our consolidated balance sheets as of January 31, 2021.

One-time transition tax. As outlined in Note 17. Income Taxes included in Item 8 of Part II of this report, U.S. tax reform imposed a mandatory transition tax on accumulated foreign subsidiary earnings which have not previously been subject to U.S. income tax. The one-time transition tax is payable over eight years beginning in fiscal 2018. The table below outlines the expected payments due by fiscal year.

Deferred consideration. The amounts listed for deferred consideration in the table below represent expected future cash payments for certain continuing MIRROR employees, subject to the continued employment of those individuals up to three years from the acquisition date as outlined in Note 6. Acquisition included in Item 8 of Part II of this report.

The following table summarizes our contractual arrangements due by fiscal year as of January 31, 2021, and the timing and effect that such commitments are expected to have on our liquidity and cash flows in future periods:

	Total	2021	2022	2023	2024	2025	Thereafter
	<i>(In thousands)</i>						
Operating leases (minimum rent)	\$ 874,517	\$ 189,907	\$ 177,819	\$ 151,668	\$ 127,834	\$ 71,670	\$ 155,619
Purchase obligations	567,864	522,467	4,696	4,696	15,654	2,348	18,003
One-time transition tax payable	48,226	5,076	5,076	9,518	12,691	15,865	—
Deferred consideration	49,544	25,194	24,341	9	—	—	—

Off-Balance Sheet Arrangements

We enter into standby letters of credit to secure certain of our obligations, including leases, taxes, and duties. As of January 31, 2021, letters of credit and letters of guarantee totaling \$2.8 million had been issued, including \$2.4 million under our committed revolving credit facility.

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, estimates, and judgements are as follows, and see Note 2. Summary of Significant Account Policies included in Item 8 of Part II for additional information:

Inventory provisions

Inventory is valued at the lower of cost and net realizable value. We periodically review our inventories and make a provision for obsolescence and goods that have quality issues or that are damaged. We record a provision at an amount that is equal to the difference between the inventory cost and its net realizable value. As at January 31, 2021 the net carrying value of our inventories was \$647.2 million, which included provisions for obsolete and damaged inventory of \$30.0 million. The provision is determined based upon assumptions about product quality, damages, future demand, selling prices, and market conditions. If changes in market conditions result in reductions in the estimated net realizable value of our inventory below our previous estimate, we would increase our reserve in the period in which we made such a determination.

Goodwill impairment assessment

Goodwill is tested annually for impairment on the first day of the fourth quarter each fiscal year, or more frequently if there are indicators of impairment. Goodwill is allocated to the reporting unit which is expected to receive the benefit from the synergies of the combination.

The Company has allocated \$362.5 million of goodwill to the MIRROR reporting unit. As at November 2, 2020, we performed a qualitative assessment and concluded that it was more likely than not that the fair value of the MIRROR reporting unit exceeded its carrying value, and therefore, no further impairment testing was required.

In concluding that it was more likely than not that the fair value of the MIRROR reporting unit exceeded its fair value we considered if there had been any negative changes to the key valuation inputs; including future revenue growth rates, future gross and operating margin, discount rates, and terminal value assumptions since the date of acquisition.

In future periods a full impairment test may be required depending on changes to market conditions, performance of the MIRROR reporting unit, or changes in the Company's strategy.

Deferred taxes on undistributed net investment of foreign subsidiaries.

We have not recognized U.S. state income taxes and foreign withholding taxes on the net investment in our subsidiaries which we have determined to be indefinitely reinvested. This determination is based on the cash flow projections and operational and fiscal objectives of each of our foreign subsidiaries. Such estimates are inherently imprecise since many assumptions utilized in the projections are subject to revision in the future.

For the portion of our net investment in our Canadian subsidiaries that are not indefinitely reinvested, we have recorded a deferred tax liability for the taxes which would be due upon repatriation. For distributions made by our Canadian subsidiaries, the amount of tax payable is partially dependent on how the repatriation transactions are made. The deferred tax liability has been recorded on the basis that we would choose to make the repatriation transactions in the most tax efficient manner. Specifically, to the extent that the Canadian subsidiaries have sufficient paid-up-capital, any such distributions would be characterized for Canadian tax purposes as a return of capital, rather than as a dividend, and would not be subject to Canadian withholding tax.

As of January 31, 2021, the paid-up-capital balance of the Canadian subsidiaries for tax purposes was \$2.0 billion. The net investment in our Canadian subsidiaries was \$1.8 billion, of which \$0.8 billion was determined to be indefinitely reinvested. The Canadian subsidiaries have sufficient paid-up-capital such that we could choose to repatriate the portion of our net investment that is not indefinitely reinvested without paying Canadian withholding tax.

Deferred income tax liabilities of \$3.0 million have been recognized in relation to the portion of our net investment in our Canadian subsidiaries that is not indefinitely reinvested, principally representing the U.S. state income taxes which would

be due upon repatriation. The unrecognized deferred tax liability on the indefinitely reinvested amount is approximately \$2.4 million.

In future periods, if the net investment in our Canadian subsidiaries exceeds their paid-up-capital balance, whether due to a change in the amount that is indefinitely reinvested or as a result of accumulation of profits by these subsidiaries, we will record additional deferred tax liabilities for Canadian withholding taxes and our effective tax rate will increase.

Contingencies

We are involved in legal proceedings regarding contractual and employment relationships and a variety of other matters. We record contingent liabilities, when a loss is assessed to be probable and its amount is reasonably estimable. If it is reasonably possible that a material loss could occur through ongoing litigation, we provide disclosure in the footnotes to our financial statements. Assessing probability of loss and estimating the amount of probable losses requires analysis of multiple factors, including in some cases judgments about the potential actions of third-party claimants and courts. Should we experience adverse court judgments or should negotiated outcomes differ to our expectations with respect to such ongoing litigation it could have a material adverse effect on our results of operations, financial position, and cash flows.

ITEM 7A. 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 January 31, 2021, 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 15. Derivative Financial Instruments included in Item 8 of Part II 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 weakening of the U.S. dollar against the Canadian dollar results in:

- the following impacts to the consolidated statements of operations:
 - an increase in our net revenue upon translation of the sales made by our Canadian operations into U.S. dollars for the purposes of consolidation;
 - an increase 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 losses by our Canadian subsidiaries on U.S. dollar denominated monetary assets and liabilities; and
 - derivative valuation gains on forward currency contracts not designated in a hedging relationship;
- the following impacts to the consolidated balance sheets:

- an increase in the foreign currency translation adjustment which arises on the translation of our Canadian subsidiaries' balance sheets into U.S. dollars; and
- a decrease 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 2020, the change in the relative value of the U.S. dollar against the Canadian dollar resulted in a \$57.0 million reduction in accumulated other comprehensive loss within stockholders' equity. During 2019, the change in the relative value of the U.S. dollar against the Canadian dollar resulted in a \$4.6 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 2020 would have resulted in lower income from operations of approximately \$22.0 million in 2020. This assumes a consistent 10% appreciation in the U.S. dollar against the Canadian dollar throughout the fiscal year. 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 facility provides us with available borrowings in an amount up to \$400.0 million. 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 January 31, 2021, aside from letters of credit of \$2.4 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.